



Nymphenburger Strasse 112-116
80636 München
GERMANY

20 September 2006

By email to: mark-consult-july-2006expertgroups@ec.europa.eu

Commission of the European Communities
Brussels

Dear Sirs,

**FEAM¹ COMMENTS TO COMMISSION SERVICES
ON EXPERT GROUP REPORTS
ABOUT
(1) INVESTMENT FUND MARKET EFFICIENCY
AND
(2) HEDGE FUNDS**

In our response to the “Green Paper on the Enhancement of the EU Framework for Investment Funds” dated 31 October 2005 we outlined in detail our view on what improvements are needed to realise the benefits of a single market in asset management for both our clients and our firms.

Given that the agenda has been debated for quite some time, we would like to underline the final conclusion of the Market Efficiency Report: It is now time to act.

¹ This response is made by the Forum of European Asset Managers, a lobby group of fourteen Pan-European asset management companies who collectively manage over 5 trillion Euros worldwide, of which over 1.6 trillion Euros is managed in Europe. Our outlook is European rather than domestic. We want to realise the benefits of a single market both for our clients and for our companies. The members of FEAM are: Aberdeen Asset Management, Allianz Global Investors, AXA Investment Managers, ABN Amro Asset Management, Capital International, Fidelity International, Fortis Investment Management, Invesco, JP Morgan Fleming Asset Management, Merrill Lynch Investment Management, Pioneer Global Asset Management, State Street Global Advisors, Threadneedle Investments and UBS Global Asset Management

It might look appealing for the asset management industry to create a completely modernised regulatory framework, which corrects all shortcomings the industry currently faces in the regulatory regime. However, this is an unrealistic project for many reasons:

- There is agreement that no regulatory change should be contemplated or proposed until a rigorous cost/benefit case has been established. This has not been done in support of radical change and we are of the opinion that, were it done, then the business case would be at best unproven because of certain costs (direct and opportunity), disruptions and very uncertain benefits.
- The real value of the UCITS brand as existing is tangible in sales within and beyond Europe.
- The track record of introducing complex, far reaching European legislation that achieves its intended effects without unintentional consequences is questionable. It is hard to see why this should be different for asset management. In fact the history even of UCITS evolution has included failures and there are also major problems with other financial services regulation. The many different opinions on hedge funds, to take an important example, suggest that any attempt to regulate these products would be subject to intense, competitive lobbying, which could seriously jeopardise the current successes if it is somehow included in the UCITS-Directive.
- Any new Asset Management Directive will take significant time to develop and agree, even if assuming it can be agreed without compromises and trade offs that will weaken its effect.
- Meanwhile, other competing savings and pensions products will not be subject to the same degree of massive investment in regulation. This will be a diversion for the industry at a time it can ill afford to be distracted from the supply of quality savings and investment solutions to European consumers.
- Part of the motivation for radical change is a belief that untapped potential for asset management solutions can be realised, in particular if recognised as a pension vehicle across Europe. But past experience is that other interest groups have been extremely effective in preventing such logical and consumer benefiting developments. While we broadly support any position to strengthen the asset management role in pensions provision, we strongly believe that there will be other opportunities of pursuing this rather than through a UCITS-Directive re-write.
- There is no justification for radical change from a consumer protection perspective, indeed the consistent demand from the consumer groups has been for simplification (e.g. the simplified prospectus) and fair regulation across products.

Hence we fully agree with the Market Efficiency Report about the need for a focused short-term agenda to be implemented at Member State level within the next three years.

The greatest benefit the Market Efficiency Report contributes to the debate should be its impressive level of detail. The report does not only identify key obstacles. It also provides clear and strong proposals how to remove them. On that basis the tight timeframe for implementation should be achievable. As with financial products, “time to market” is crucial for any legal regime identified as appropriate. Therefore we generally support the Lamfalussy procedure not only under the Markets in Financial Instruments Directive (“MiFID”) but also for the UCITS-Directive. Because we understand that a rewriting of the UCITS-Directive to become Lamfalussy compliant would mean a complete legal overhaul it should be the right approach to concentrate such procedural renovation to those focus areas that require anyhow some amendments of the UCITS-Directive.

To summarize our starting remarks, we believe it is time to implement core improvements rather quickly even if this would not tackle 100% of all issues that might be regulated better. Should the further assessment reveal that any of the focus proposals might need more time to implement than the three years it should be put on the mid-term agenda and not hold back implementation of the “quick-wins”.

As the Market Efficiency Report contains a comprehensive list of all issues that deserve priority action, we would like to concentrate our comments mainly to that report. The second part of this response will deal in a more abstract way with key Single Market issues put forward by the Hedge Funds Report. Consistent with our position against any radical change of the UCITS-Directive we do not support any attempt to dilute the UCITS brand by including not sufficiently correlated asset management market segments in the UCITS-Directive. While recognising that there are limitations in the UCITS-Directive, that some legislative change will be needed to modernise it and that focused modernisation will not address at EU level the issue of non-regulated/non-harmonised products, again we consider that there are other routes to delivery of these products to the European market (e.g. harmonised private placement rules and sophisticated investor regime). In particular with regard to Hedge Funds we concur with the Expert Group that this should not be focused on product regulation. The Hedge Fund industry should be the best example why product regulation for technically complex products does not work. Such product oriented attempt should be confronted with materially different starting points for regulators that are difficult to harmonise and more importantly the outcome should only limit the pace of innovation in the market.

A.) Report of the Expert Group on Investment Fund Market Efficiency

The report starts with exactly the right analysis. UCITS have become a successful product in Europe and globally. This success had been achieved due to its core regulatory concept with protections build into the UCITS-Directive, namely on investment limits, strong home country authorization / regulation and oversight by an independent depository.

At the same time this success should be the best indicator for the failure to reach a truly Single Market. While the UCITS product became a “de facto international gold standard”, its cross-border distribution within Europe still is lacking behind. Simply there are too many too small UCITS operated and sold in a fragmented European market.

The report addresses the right priority actions to also achieve the original goal of the UCITS-Directive: the Single Market for UCITS. It is important to note that none of the proposals affects regulatory or investor protection principles that constitute a UCITS.

We fully support the five focus areas identified in the report:

- Notification for cross-border sales (including Simplified Prospectus)
- Pooling techniques
- Management Company Passport
- Depository Flexibility
- Cross-Border Mergers of Funds

The slightly revised order of the focus areas is based on our understanding that Cross-Border Mergers of Funds will not get meaningful attention by the industry without the proposed Taxation of Fund Mergers Directive. Though we agree with the Expert Group that the existing Taxation of Mergers Directive (90/434/EC) can be used to address most key tax issues of fund mergers, we see the risk that these discussions might hold back implementation of the other priority actions. If that turns out to be the case, cross-border fund mergers should be put on the mid-term agenda. Up to now we are confident that this will not become necessary, but it should be better keep some procedural flexibility in this regard.

The fact that with this comment we do not go into detail neither on the creation of a level playing field with competing other investment products nor on the positioning of investment funds for pensions accumulation and decumulation should not be interpreted as deviation from what we had said in our response to the Green Paper. As we do not want to repeat previous statements, this comment shall be a focused feedback on the concrete legislative

proposals made by the Expert Group. Furthermore we completely agree with the Expert Group that successful competition with substitute products first and foremost requires improved market efficiency for investment funds. This will also be crucial to deliver sustainable pension products.

1.) Notification for cross-border sales

In order to avoid any recapitulation of our comprehensive responses to the two CESR consultations on its guidelines to simplify the notification procedure of UCITS, only a few basic remarks seem necessary to keep a consistent understanding.

The proposal of the Expert Group to codify the notification procedure along the lines of the Prospectus Directive timescales should remedy all obstacle that currently hinder the efficiency of the product passport.

In our first response to the CESR consultation we even went one step further by outlining how an optimal notification regime could look like, e.g. similar to the EDGAR model practised among the US States since years. For example we still believe that a direct authority-to-authority notification procedure is less efficient than a direct notification by the UCITS to the host-country authority if it can be reduced to the simple notification letter as described in our earlier statement. But on the other hand both ways should not really make a difference, provided the three days period (or even one day if combined with the authorisation request) as proposed by the Expert Group can be achieved.

The (limited) success of the CESR consultation should not be used as an argument against the need for further legislative improvements of the notification regime. First it should be noted that CESR made more than clear that its consultation does not cover any ideas to modernise the notification regime beyond the limits of the current text of the UCITS-Directive. And even within those limits CESR could not reach consensus to fully exploit its existing potential. There is no doubt that the CESR guidelines are an important improvement to the current situation. But they only redress the most obvious aberrations of the hitherto existing practise in Member States. The CESR guidelines are to be followed without any further delay, the new notification regime should be available within the proposed three years timeframe.

The proposed orientation on the Prospectus Directive has been criticised for disregarding the differences between a prospectus for primarily shares in a company and fund units. While it

is correct that the prospectus for fund units to a large extent shapes the characteristics of the product this is similar for other securities sold under the Prospectus Directive. Moreover we are indeed of the opinion that for the retail investor both prospectuses serve the same information needs and are comparable in other relevant aspects as well. Very often products sold under the Prospectus Directive are even more complex than fund units.

A key component under the notification regime that urgently needs appropriate attention should be a clear and uniform definition of what constitutes “marketing”. The Expert Group is right to complain that host Member States have overstepped their residual powers under Article 44 of the UCITS-Directive. To fix the limits of these residual powers should also give comfort to host-country authorities observing their supervisory responsibilities as expected.

One of the great benefits of using the Prospectus Directive as a model should be the evident transfer of its summary prospectus component to also solve the obvious failure of the Simplified Prospectus. We concur with all proposals made by the Expert Group in this respect and would solely like to add that the goal should be a comparable model among Member States. Such comparability would not only enable retail investors to better chose between foreign and local products. It should also support the groundbreaking idea of the Expert Group to use the Simplified Prospectus as a marketing document that switches off host State marketing rules.

We would like to conclude our comment on the notification regime with one final issue that seems to have been overlooked due to its less pressing but nevertheless unnecessary outdated existence: the requirement to have a local paying agent. Many Member States that do not require a local paying agent should be sufficient proof that its need is just a bureaucratic formality. Even in Member States that require local paying agents investors hardly ever transact via such person. In order to be capable of handling unexpected client transactions providers of pure paying agent services in Europe offer pricing schedules with extraordinary high fees to cope with the manual workload should this ever become actuality. We do not see why such relic needs to survive.

2.) Pooling techniques

The Expert Group report contains a concise presentation of pooling techniques and explains convincingly why their introduction for cross-border situations should be a priority action. Compared to fund mergers pooling does not raise similar tax issues, which means it should be available for all types of UCITS with modification to the UCITS-Directive only.

In particular the introduction of Master Feeder structures should be of major importance. As Master Feeder structures enable the integration of varying local market characteristics in one single European product it should be the prototype of a Single Market fund product.

Since the technical aspects of virtual pooling are indeed sophisticated we are cautious about the idea to assign to CESR a far reaching role in clarification and education re virtual pooling. Such role might require a level of detail (e.g. on accounting and valuation principles), which goes beyond what can be reasonably expected from CESR. If pooling was introduced in a Lamfalussy like form to the UCITS-Directive, the technical investor protection principles should be dealt with on level 2. We agree that this should lead to a need for convergent interpretation at level 3 among CESR members but we expect this process to evolve over time from bilateral to multilateral coordination among affected supervisory authorities rather than among all CESR Members from the very beginning.

3.) Management Company Passport

Even if it could be debated if UCITS III introduced the management company passport in order to grant management companies the right to passport their collective portfolio management or solely with respect to the new bolt-on MiFID services, an all-embracing management company passport should be significant to achieve the advantages correctly outlined by the Expert Group. In addition it is hard to understand how the current prohibition for management companies to establish UCITS in other Member States even via local branches harmonises with the concept of a Single Market.

We agree with the concept proposed by the Expert Group to determine the domicile of the fund by the domicile of the regulator responsible for its authorisation and ongoing supervision. Provided that the domicile of a depository can also be determined at branch level, this could be an additional requirement.

The discussion about perceived contradictions with tax codes of some Member States to determine the domicile of a fund should not drive the conceptual design of the UCITS-Directive. Anyhow the so-called head-office concept seems to stem from an analogy of corporate tax principles first to corporate type funds and than to all funds. The fact that the UCITS-Directive does not define what constitutes a head office simply shows the irrelevance of any such category for the UCITS product itself. A clear product oriented definition of the

fund domicile in the UCITS-Directive – as needed with the proposed management company passport – should remove the basis for this misleading analogy.

A key concern raised against the effective management company passport refers to the dual supervision of funds. As the Expert Group convincingly points out this should not lead to insurmountable problems. For all practical purposes it should not make any difference if the core activity of investment management is delegated to an asset manager in another jurisdiction or if such asset manager was acting directly for a UCITS on the basis of its management company passport. While it is correct that the home-country regulator should be restricted to impose direct sanctions against foreign asset managers this does not mean that effective UCITS supervision will be hampered. It should be highly unlikely that the host-country regulator responsible for the asset manager will ignore reported problems of the home-country regulator.

Even if our assessment of the practicability of dual-supervision was not shared, this should not eliminate the feasibility of an effective management company passport. For example it should be possible to address potentially remaining concerns by explicitly granting the home-country regulator in the UCITS-Directive the right to not authorise or to revoke the authorisation for the management of a local UCITS if reason exists to question the sound compliance with local UCITS-regulation.

There is only one aspect in the Expert Group Report where we completely disagree, despite any limited information given by regulators, which might have led to the views of the Expert Group. Based on experience from within our membership it is not correct that the take-up of the new UCITS III authority to provide some investment services listed in MiFID has been extremely low. Furthermore none of the assumed reasons for the perceived insignificance can be confirmed. On the contrary as with the management company passport there is still a compelling business need to have the ability of offering asset management services throughout Europe from as few legal entities as possible. The fact that many Asset Management Groups still have a MiFID investment firm in addition to a management company is mainly based on the divergent scope of services possible under MiFID and the UCITS-Directive. Typically individual portfolio management is accompanied by those investment services and activities listed in Annex 1 Section A (1), (2) and (4) of MiFID, i.e. various distribution activities and investment advise. As long as the UCITS-Directive falls short of this MiFID scope the need for an additional MiFID investment firm within the group will remain. To illustrate one bizarre consequence of this mismatch we would like to mention the German interpretation that a management company can be authorised to manage individual client portfolios without prior approval of the client for each trade but not if the

contract was constructed in each case to require prior client consent as the latter would constitute a MiFID service not covered by the UCITS-Directive.

4.) Depository Flexibility

In our response to the Green Paper we had indicated that the depository passport is not a high priority for us as fund managers and unlike the management company passport does not seem to offer particular benefits to investors.

Based on the profound analysis of the Expert Group we are prepared to align our views with the position taken in the Expert Group report. Of particular importance should be the proposed option for the depository to appoint a custodian in the EU under its responsibility with respect to cross-border pooling techniques. We also agree to the Expert Group that the ability for EU banks to operate as local depository via branches should be a short-term action as well. This should allow depositories to be organised much more efficiently without any material investor protection concern. In addition the Banking Directive (2000/12/EC) contains a general branch passport, which makes it hard to understand why this passport should not exist for UCITS depositories.

5.) Cross-Border Mergers of Funds

Maybe the most complex short-term proposal of the Expert Group concerns the key tool to counteract against the evolved European landscape of too many too small UCITS. This is indeed a huge problem, which therefore deserves all attention regardless of its complexity to be solved short-term.

Some critics have expressed their concern that Fund Mergers will not rectify this undisputed situation since market forces are expected to keep the pressure high for the production of new funds. While we agree with the expectation of an ongoing need for innovative products, the Expert Group is absolutely right to point out that this only exacerbates the problem and different from the view of some critics only underlines why cross-border product consolidation already is a top priority.

The Expert Group raises the issue of redomiciliation of UCITS as preparatory step for domestic mergers. It should be added to the analysis of redomiciliations as expensive, complex and time consuming, that in most cases a redomiciliation simply is not an available

alternative. The UCITS-Directive is silent on potential redomicilations. To create an efficient management company passport the questions of a UCITS` domicile as well as its redomicilation will need (new) answers. This might even include some technical provisions on the potential cross-border transfer of the management company function, comparable to existing regulation in Member States for domestic cases.

We fully concur with the basic principles of a mergers regime as proposed by the Expert Group, in particular with the innovative idea of the final decision by the regulator of the “merging fund”. This should indeed be the best way to achieve the highest degree of investor protection.

In some details we would even be prepared to accept a more stringent regime in order to prevent investors from the decision to end with an investment in a completely different fund after the merger or to exit their investment. While voting requirements are an efficient tool to mitigate this risk, pure client information requirements about some key characteristics like charges and valuation methodologies might not be suitable where an approval by the regulator has to compensate for non-existing voting procedures. In order to give some guidelines to the regulators in such non-voting Member States, it should be acceptable to require that the investment objectives of both funds do not differ significantly and that charges are in comparable ranges.

Different from the situation under Company Law we do not see which domestic grounds could justify to disapprove a merger of two UCITS products. Moreover, as a general principle, residual powers should only be introduced where absolutely necessary and only with a clear definition of their scope.

As regards appropriate information to regulators concerned by a proposed merger, it should be acceptable to give both regulators the same information and not only for the fund in their jurisdiction that is subject to merge.

Finally we would like to reiterate one additional aspect afore said in our response to the Green Paper: a codification of principles for the valuation of in-specie asset transfers and their subsequent availability for subscriptions and redemptions in all Member States should be a quick interim solution to achieve some level of product consolidation already in advance of the final mergers regime.

B.) Report of the Alternative Investment Expert Group – Managing, Servicing and Marketing Hedge Funds in Europe

The Hedge Fund Report gives a good explanation of the hedge fund industry and their importance in Europe. We understand and support the demand for a regulatory regime of European Hedge Funds that fits to the particular characteristics of this growing segment of our asset management industry.

At the same time it should be key to not dilute or otherwise damage the UCITS product by introducing a hedge fund regime, which completely ignores the basic parameters of existing European regulation. For that reason we can not support any ideas to include an unregulated hedge fund product within the UCITS-Directive, neither directly nor indirectly via an extension of the eligible assets for UCITS.

We share the view of the Expert Group that it should be the appropriate approach to address the obstacles for European sales of Hedge Funds on the basis of MiFID rather than by imposing additional regulation at the level of the product, its manager or other participants in the value chain.

There should be no doubt about the MiFID responsibility of the distributor vis-à-vis the end-investor, but this must not intensify the anomaly pointed out very clearly by the other Expert Group on Market Efficiency that the product with the most investor protection characteristics takes longest to reach the market. We have no reservations to adopt the modernised UCITS passport to other retail type of fund products such as Hedge-Fund-of-Funds as long as this will not happen under the UCITS-brand. Even if it is correct that traditional investment funds and Hedge Funds already have and increasingly will have comparable investment techniques, the investment and risk characteristics of any type of Hedge Fund should not coincide with core characteristics of a UCITS.

In order to avoid distribution of Hedge Funds to investors to whom such investments are not suitable minimum investment thresholds are not unusual. At the end the appropriateness of any minimum level is a political decision, which has to be balanced against practical realities. Therefore we do not want to question if the proposed 50.000,- Euro threshold should be increased. Everyone who fights against this level should first answer the question if regulation really has to protect a retail investor who understands whichever threshold as a challenge to overcome. Moreover we are not among those critics who dislike the proposed model for its perceived inconsistency with the UCITS product regulation. The Expert Group is completely right by pointing out that any such kind of product regulation would only produce

regulation on paper as it would prevent Hedge Funds from being established but not from being sold in Europe. Furthermore both ways – i.e. product regulation and minimum investments – should be regarded as distinct means to achieve appropriate investor protection. The regulation of UCITS singles out this product and forms the basis for sound regulatory and investor confidence as valued by the UCITS brand. But we should not transpose this international gold standard to all kinds of investment products. Such attempt would either destroy the value of the UCITS brand or lead to regulation without any practical meaning.

Unfortunately the Expert Group does not go into detail about which “enlightened steps” should be taken to remove the inefficiencies associated with the “legal minefield” of national private placement regimes. As outlined in more detail in our response to the Green Paper, a harmonised set of private placement rules across all Member States should have important benefits for investors as well as for asset managers. Again the model provided by the Prospectus Directive could be a good starting point for one single European private placement regime in addition to existing domestic systems across Member States.

Yours faithfully,

Elizabeth Corley
Chairman of the Management Committee, FEAM
Chief Executive Officer, Allianz Global Investors Europe