



ABI POSITION ON  
THE REPORTS OF THE EXPERT GROUPS ON  
THE EFFICIENCY OF THE INVESTMENT FUND MARKET AND  
ALTERNATIVE INVESTMENTS IN THE EU

## **General assessment**

The Italian Banking System, with more than 800 member banks, represents the entire Italian banking industry. We attach great importance to the discussion initiated with the publication of the reports of the Commission's expert groups on the efficiency of the investment fund market and on alternative investments within the European Union. The discussion is certainly an advance over last year's debate following the release of the Green paper on the enhancement of the EU framework for investment funds. The proposals set out in the reports, in fact, offer a more detailed set of proposals for regulatory action to foster the growth of the European asset management industry.

The experts' suggestions now need to be supplemented with the comments of all stakeholders and comparative studies of costs and benefits in order to set priorities and determine the substance of initiatives to be undertaken. What follows is ABI's own assessment of the reports on the efficiency of UCITS, hedge funds and private equity funds, drafted after consultation with the main bank-controlled intermediaries active in these sectors in Italy.

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### **Report of the expert group on the efficiency of the investment fund market**

We share the basic analysis of the Report and concur on the need to supplement the UCITS directive as indicated. However, some of the proposals, in our view, require further elaboration, as we indicate below.

#### **1. Simplification of authorization to market fund units both in the home country and in other EU countries**

We agree with the proposed amendments to the UCITS directive:

- Article 4, to bring the time frame of the authorization process for UCITS (both initial and for subsequent product modifications) to that of the prospectus directive;
- Article 46, to simplify the procedure for notification to the host country supervisory authorities by electronic transmission of documentation by the home country authority;
- Article 47, to speed up the translation of the simplified prospectus;
- Annex C, to harmonize and simplify the simplified prospectus, focusing the data on the product's risk and yield characteristics.

However, the proposals do not tackle one of the most significant factors slowing the procedure for cross-border marketing of UCITS units, namely the fact that the UCITS directive does not establish the administrative and organizational requirements needed to protect the rights

(method of payment upon subscription, procedure for receiving amounts due upon redemption, etc.) of investors in the other countries where the funds are marketed; instead (Article 45), this is left to regulations of the individual Member States.

The true cause of the difficulty and slowness of the notification procedure is the absence of uniform administrative and organizational requirements for marketing, and therefore the lack of mutual recognition between supervisory authorities.

The same reasoning applies to the subsequent proposal for redefining the simplified prospectus. In itself, in fact, the proposal is reasonable, but it leaves unresolved the problems relating to the production of documentation, in addition to the simplified prospectus (approved by the home country authority), concerning administrative and organization requirements for investors of the host country.

The best way to overcome this lack of uniformity would be to bring these administrative and organizational requirements for cross-border marketing in the sphere of application of the directive. If this should prove difficult, then in our view, to overcome the difficulties of verification of the marketing requirements of the host country, in addition to the proposals made in the Report amendment of Article 46 of the directive is needed to set new, more stringent time limits for the verification (shorter than the two months now envisaged), worded in such a way as to limit as severely as possible the delays stemming from possible requests for additional information on the part of the host country authorities.

The new deadlines should be consistent with the shortening of the deadlines referred to in articles 4, 46 and 47. The time needed for host-country verifications must not nullify the benefits of shorter limits for the initial authorization and for notification.

## **2. Proposals to facilitate fund mergers**

The proposal to add to the UCITS directive specific provisions on mergers both domestic and cross-border is of great importance for the efficiency of the funds market within the EU. The Report's proposal is properly couched, with identification of the issues to take up and the main provisions necessary for each issue. Nevertheless, in our view the portion of the Report on the valuation of the assets of merged funds and the calculation of the exchange ratio needs to put greater emphasis on the necessity that the verification of the correct exchange ratio:

- must be performed by an independent third party;
- must be totally removed from the sphere of the depositaries of the merging funds, to prevent conflicts of interest.

## **3. Proposals to permit pooling techniques**

The proposals designed to favour the use of pooling techniques are of interest because they seek to foster scale economies for UCITS, but they also elicit serious doubts. They could result in a single management of a number of funds, which could have significant effects relating

to the role and responsibilities of the depositary of each fund, the investment limits on each, the criteria for evaluating fund assets and performance, and responsibility for investment decisions.

To avoid these risks, amendments to the UCITS directive are needed, not just clarifications from the CESR as the Report suggests, clearly governing the rules applying to the various entities taking part in the virtual pooling. In our view, these techniques need to be weighed carefully and permitted to UCITS only on the basis of specific, additional provisions of the UCITS directive. The same goes for the proposals to favour pooling techniques by pension funds.

#### **4. Proposals to make the passport for management companies effective**

The Italian banking industry concurs that it is important to make the passport for management companies effective, in view of the cost reductions this could produce for UCITS, and further that the proposals as drafted take proper account of the obstacles that have impeded the attainment of this objective to date.

As to the solutions proposed:

- we agree with the expert group members who do not believe authorization to provide investment services under MIFID is sufficient to be able to perform collective asset management services as well;
- we believe that the UCITS directive needs to be supplemented to provide more explicit rules to ensure correct interaction between the management company and supervisory authorities in the States where the investment funds will be instituted.

#### **5. Proposals to broaden the conditions for providing some depositary services**

The Report's discussion of the rules governing UCITS depositaries correctly describes the reasons why the European passport for depositaries is an important objective but a longer-term one. It can be attained only if the requisites for performing the depositary function, duties and responsibilities, are harmonized.

The proposals to broaden the conditions for performing depositary services, pending the harmonization of this role, are reasonable, as long as it is kept clearly in mind that in any event it is the individual Member States that must establish the conditions under which to allow:

- Community bank branches to serve as depositary bank for the funds authorized in that country, so as to safeguard in this case too observance of local rules on depositary banks. From this standpoint, for a good time now Italian regulations expressly allow the branches of Community banks to act as UCITS depositaries, providing that they directly perform the functions of depositary bank;
- sub-deposits of the assets of investment funds with Community depositaries. From this standpoint, for some time now Italian law allows this, while requiring: i) prior consent on the part of the management company; ii) specific obligations for the depositary bank to ensure

separation of the fund's assets also with the sub-depositary; iii) continuation of the depositary bank's liability also in the case of sub-deposits.

## **Report of the Expert Group on Alternative Investments**

### **Comments on the recommendations concerning hedge funds**

The Italian banking industry shares the basic aim of the Report, namely broadening the access of investors, retail and institutional alike, to hedge funds, and consequently the call on national regulators to lower the minimum participation thresholds and ease any other restrictions. However, given the significant differences in the various Member States, we think the analysis traced out in the document requires further study to design requests for opening in favour of hedge funds that can actually be effective in overcoming regulators' resistance.

Similar considerations apply to the proposals for liberalizing custody and prime brokerage services. It must be borne in mind that especially in a situation of complete freedom of investment, such as hedge funds enjoy, in some countries the depositary plays a fundamental role in protecting investors' rights, which entails daily controls on the activities of the prime broker and on the composition of the funds' portfolio, even if these are entrusted to the prime broker himself as sub-depositary.

The Report's analysis, in any event, is an invaluable base for further reflection, especially as regards identification of the most appropriate type of action (at national and not Community level) and of the relevant issues in fostering the expansion and efficiency of the hedge fund market.

### **Comments on the recommendations concerning private equity investment**

We agree with the fundamental analysis presented in the Report, but we consider that it needs to be supplemented with some observations on the treatment, under European regulations, of the capital charges on private equity investment by banks. This matter is not treated as thoroughly as others in the Report. With regard to exposures to very high-risk collective investment undertakings such as venture capital and private equity instruments, European regulations establish a risk weighting of 150%.

However, it must be considered that investment in a fund generally means less risk than direct investment in a firm's equity, for which Community rules provide the same risk weighting. The fact is that investing via a fund:

- permits satisfactory diversification, investing in a portfolio of companies in various sectors;
- complies with the prudential limits on risk concentration, which set a ceiling of between 15 and 20 percent of the total on any single equity holding;
- is managed by a specialized asset management firm, with a team of investment specialists, often with a good track record in the field.

In addition, private equity funds (which invest in more mature companies) are generally less risky than venture capital funds (investing in start-ups). We should therefore propose to modify the Community capital requirements to reflect these different levels of risk.

Finally, let us note another problem with the capital requirement rules, namely the determination of an average risk weight for investments in collective investment undertakings. The average risk weight enables banks that subscribe fund units to make capital provision according to the different classes of risk asset weights in which the collective investment undertaking invests. But the average risk weight factor is hard to apply to banks' investments in funds that themselves invest in private equity instruments, as the investee firms, generally small or medium-sized, lack ratings on which to assign risk weights; and the capital requirement directive itself requires such ratings. It would be useful for us to specify a standard for determining the average risk weighting factor for banks' investments in collective investment undertakings in line with the characteristics of private equity investment.