

Mr. Charlie McCreevy

European Commissioner for Internal Market and
Services

European Commission

nr ref.: ZAR/1127/06 /MJ

Warsaw, September 18th, 2006

Re: Reports of Expert Groups on Investment Fund Market Efficiency and Alternative
Investments

Dear Mr. McCreevy,

Being a licensed UCITS III management company, KBC Towarzystwo Funduszy Inwestycyjnych S.A. welcomes the initiative of the European Commission to further improve the European investment fund regulatory environment and at the same time is grateful for the opportunity it had been given to comment on the reports of the three independent experts groups.

The investment fund industry is a fast-growing sector of the financial market. The assets under management grow, investment funds play more and more important role in our financial system, the investors have more confidence in this type of investments and better choice of diverse and well-designed products. However, there are few drawbacks which prevent the industry from further development – regulatory barriers and lack of consistent approach towards the industry by regulators from different Member States.

Thus, we have welcomed the Green Paper soon to be followed by the White Paper, expert groups' reports, survey on investment funds' costs in which we participated as well as all CESR's initiatives. All carried out in dialog with the industry. And all aimed to identify regulatory failures and gaps impeding the development of the efficient and competitive investment fund market.

The first step has been made; now there should be time to redesign the regulatory framework so it could keep pace with the changing and demanding environment and help to create a truly harmonized single market. Although the proposals may require not only changes to the UCITS law but also to corporate and civil law of local jurisdictions, we believe the time has come to undertake such endeavor. This is quite a challenge for the European Commission and the regulators from 25 Member States but at the same time an initiative the industry has been waiting for.

Below you can find our comments regarding the three reports. However, we would like to indicate that due to the scope and nature of our activity we concentrate on the report on investment fund market efficiency.

Report of the Expert Group on Investment Fund Market Efficiency

The report truly represents the industry views and expectations. As well as its call for a quick action in the areas that require immediate attention so to enable investment funds to compete with other products. Obviously, none of this improvements can be made without significant amendments to the existing legislation. But these amendments should be regarded as the natural after-effect of the industry development. Moreover, it is important to point to the fact that while proposing their innovations and solutions the Expert Group managed not to tamper the core features of the UCITS Directive.

In our comments we raise the issues which we believe are crucial to further advancement of the industry and at the same time react to the propositions of changes to the regulatory framework.

1. Authorization and notification of UCITS

The lengthy authorization and notification procedures are one of the most important issues raised in the report. They are an efficient hold-back to the development process and may result not only in higher cost which must be borne by the fund operator but also in missed opportunities. It should be recognized by the regulators that a new product is always an inseparable part of the management company's overall strategy, or even the cross border group's strategy. Hence, long-lasting licensing procedure forces fund operators to plan and design their products much ahead what is not easy in changing markets.

Along with the lengthy authorization come very complex and detailed documents which must be filed with the regulator. These documents are often overloaded with information which is of no value to investor. And, what is most important, their contents still vary significantly from country to country, thus, the investors are unable to compare different products.

We do agree that there is a desperate call for a change in this area. However, we do not support the proposal of the Expert Group regarding shortening the authorization process to 20 working days basing on the Prospectus Directive.

It must be borne in mind that until now UCITS have been perceived as investment products providing a high level investors' protection. This confidence in UCITS products has been built in years and we must not forget that the regulators played an important role in the entire process. It should be our priority to maintain this quality of UCITS.

Therefore, we propose the following actions to be taken in order to facilitate the authorization of UCITS by Home Member States:

- UCITS Directive should provide for the maximum authorization time for the Home Member State. This time should allow the local authority to review the file and comment on its contents. We do believe that the two-month period should suffice for that purpose. Explicit regulatory approval should close the process.
- The subsequent approval of modifications to UCITS offering documents should also fit in within the reasonable time limits and should be required only when such changes have significant impact on investors (e.g. costs, management fee, entrance/exit fees).
- At the same time we would like to stress that once the Directive sets the time limits for authorization process it is very important that all CESR Members adopt the same approach towards managing those time limits.
- The new rules regarding the simplified prospectus should be worked out and they should aim at improving the quality and transparency of this document while ensuring reasonable size. As a result, the simplified prospectus should be replaced by the summary prospectus, as proposed by the Expert Group.

As for the notification procedure, we do support proposal of the Expert Group, however, we are able to accept a bit longer time limits e.g. up to 20 working days. The key issues in this area are:

- According to CESR's proposal, all regulators should adopt a model frame for attestation and notification letter (see: CESR's guidelines for supervisors regarding the notification procedure according to Section VIII of the UCITS Directive).
- The notification should be limited to the analysis of UCITS passport and marketing documents (see: next indent) as all other documents have already been approved by the Home Member State.
- The approach to marketing requirements, as requested by the UCITS Directive, should be standardized across the European Union. The current situation where some Member States accept certain solutions as the main distribution model while other rule them out (e.g. nominee accounts) should be eliminated.
- English language should be allowed and recognized as the language "*customary in the sphere of international finance*". Above all, it should be the commercial decision of the UCITS operator to prepare offering documents in the language of the Host Member State where the UCITS is distributed.

2. UCITS mergers

The report rightly points to fund mergers as an area where there is still a gap. The UCITS Directive does not provide for a possibility of such operations, thus, the respective regulatory requirements in Member States – if any – are not based on any objective criteria.

Without doubt the European investment fund industry needs merger possibilities. European funds are smaller than those operating in the US what leads to relatively high costs in proportion to funds' sizes and prevents fund operators from fully exploiting economies of scale.

With the European Union expanding its borders companies more frequently operate on transnational basis. Mergers or acquisitions of financial institutions are common. As a result one group can find itself operating many funds of similar investment policy in several jurisdictions.

Thus, many UCITS operators try to employ alternative techniques which are not only costly and time-consuming but also, given the lack of reasonable legal framework, very complicated from the legal perspective (different legal forms of funds, voting rights of shareholders, taxation issues, necessity to deal with regulators from different jurisdictions, etc).

Therefore, we do support initiative of the Expert Group to implement UCITS merger framework allowing for both domestic and cross-border mergers. Below, we discuss a few issues which in our opinion should be given particular attention.

- Due to different legal forms of UCITS launched under different jurisdictions (SICAV, FCP, unit trust, Polish open-end investment fund) it is clear that it may often be impossible to merge funds of one operator in two Member States. Thus, the proposal of new legislation should provide remedy to this problem. We do support the Group's proposal to provide definitions of several types of fund mergers applicable throughout the European Union, however, legal approval of those definitions by all Members States must be sought.
- The protection of investors should be maintained at the high level during the entire merger process what should include providing necessary information, possibility to drop out of the fund without extra costs and approval of the merger through voting if required due to certain legal form of merging fund. Obviously, some of the above issues can be included in the legal framework but in our opinion they should be adopted as industry practice developed under leadership of EFAMA, to avoid overregulation.
- In case merging funds have different investment policy, information to investors should provide comparison of investment policy, indicate what will be the

investment policy after the merger and provide reasonable time for investors to drop out of the fund if they dislike planned changes in this respect.

- As far as taxation of fund mergers is concerned no one doubts that the necessary pan-European framework should be built up. We would, however, prefer to avoid overregulation in that respect or introduction of a regulatory system at the level of directive (Taxation of Fund Mergers Directive) which would be differently interpreted or implemented by Member States. Thus, bearing in mind the formal requirements of the Lamfalussy process, it should be considered to cover this issue in the European Commission Regulation rather than in the directive.
- Moreover, application of the EU Savings Directive should be discussed in case when shareholders in funds subject to merger come from different jurisdictions.
- In case of cross-border merger, administrative proceeding should take place before one regulator only, preferably before the regulator of the fund which takes over. The regulators should communicate and cooperate particularly in the area of investors protection.
- The valuation issues must not be forgotten and practical solutions should be worked out, preferably under EFAMA leadership. The common approach should include rules regarding i) one independent auditor to check the valuation methods and the exchange ratio; ii) role of the depositary as an entity responsible for the assets transfer and their valuation.

3. Pooling techniques

We truly believe that “master feeder” structures should be allowed under UCITS Directive, hence, we welcome the Group’s initiative in that respect. However, at the current stage it is realistic to allow such a “feeder UCITS” to invest in another UCITS.

The above-mentioned approach does not require any extra regulatory framework neither on a directive nor national level except for the obligation to disclose the name of the “master UCITS”, its investment policy and risks connected with thereof in the prospectus (or statute depending on the jurisdiction) of a “feeder UCITS”.

Please note that our opinion regarding the possibility to launch UCITS of hedge funds shall be discussed under separate point further in this correspondence.

4. Management company passport

Regarding where we stand now on the Management Company passport and how little has been done in order to fully use the possibilities provided by the Directive 2001/07/EC, there is undeniably a need to review the relevant regulation as well as analyze the expectations of the industry.

Using the opportunity of discussion about the UCITS management company, we would like to raise an issue which the report is not concerned with. It regards **granting the management company the ability to provide management services to pension funds**. We truly believe that both UCITS and pension funds regulatory framework should be amended in that respect.

As the discretionary asset management services of management companies do not differ as such from those offered by asset management companies (investment firms) there are no reasonable arguments why a management company duly licensed to provide discretionary asset management services could not manage pension funds.

In our opinion this is an issue which requires an immediate action.

Furthermore, we would like to comment on two issues raised in the report which regard compliance and supervision:

- As far as compliance and risk control are concerned we stand in a position that those functions should be performed in a jurisdiction where an investment fund is located (has its head office). Compliance and risk control tasks require excellent knowledge not only of legislation but also of domestic environment, regulator, market and competition. Therefore, it is not feasible at all to run them from one geographical location.

Nowadays financial institutions are usually part of an international or national financial group which often operates in different sectors of financial market, e.g. banking, insurance, life insurance, pensions, investment funds, asset management and brokerage, hedge funds. Therefore, as long as a number of companies operate in the same Member State within one group it should be possible to locate the compliance and risk control function at the national cross-sector level so it could cover all above-mentioned operations.

Such solution would be beneficial not only from the costs' perspective but it could also allow for more efficient and objective control mechanism.

- "Dual" supervision

We share the opinion of the Group that the regulators should use all possibilities provided by the directives to ensure alignment of the supervision and regulatory requirements. On our way to building harmonized single market, regulators as well as market participants should be open to cooperation on issues regarding legal framework and adopting of common industry standards.

CESR and EFAMA should respectively serve as such cooperation platforms. We would like to use the opportunity to express our appreciation of the

initiatives taken by CESR and EFAMA which are extremely beneficial to the sector's further development.

We believe that the main goal of such endeavors should be directed towards creating coherent approach and not preserving national diversities.

5. Depositary

As set forth in the Article 8 of the UCITS Directive "A depositary must either have its registered office in the same Member State as that of the management company or be established in that Member State if its registered office is in an other Member State."

We support the view of the Expert Group that the depositary passport may be created only after full harmonization of the status, role and responsibilities of depositaries across the European Union. The two-stage approach suggested by the Group provides reasonable solution, however, while discussing possibilities to enable branches of EU established banks to act as depositaries or to enable depositary to delegate certain functions abroad, the specific function of UCITS' depositary and its responsibilities towards unit-holders should be always taken into consideration.

Although the report is not directly concerned with the **VAT issue on services carried out on behalf of investment funds**, we would like to use the opportunity to emphasize the importance of that issue.

According to the judgment of the European Court of Justice (ECJ) as of 4 May 2006 in the Abbey National Case, depositary services for investment funds are subject to VAT as they are not specified as functions included in the activity of the collective portfolio management in Annex II to the UCITS Directive. Nevertheless, according to the UCITS Directive safe-keeping services carried out by the depositary are a required part of the governance structure of the fund. Therefore "*there should be no doubt both that the depositary is a required part of the governance structure of the fund and that the activities of safe-keeping and oversight are management. So the **depositary functions must be exempt too. This should be clarified in legislation.***" (see: EFAMA Comments on the Consultation Paper on modernizing VAT obligations for financial services and insurances)

We truly support the above-mentioned position expressed on behalf of the industry and do look forward to immediate action in this area.

Report of the Expert Group on Hedge Funds

UCITS of Hedge Funds

As already indicated earlier in this report, we would like to comment on the proposal to launch hedge funds as UCITS or create UCITS of hedge funds.

We would not support such initiative at this stage. As it has been said earlier in this correspondence, we have created a product (UCITS) perceived as safe investment option providing high level protection to investors. UCITS of hedge funds or UCITS as hedge funds, due to the specific risks connected to hedge funds operations, could not be regarded as the safe investment.

However, we believe it might be considered to allow investments by UCITS in hedge funds within reasonable limits which would guarantee preserving the high level of investors' protection and limited investment risk.

Reports of the Expert Group on Hedge Funds and Private Equity

Hedge funds and private equity are important part of the capital market. There should be no surprise that the investors are more often attracted to those vehicles as they are interesting alternative investment. However, we must bear in mind that offering any investment products to retail investor must entail certain regulatory framework. Otherwise, it could imperil the retail investors who do not have adequate knowledge to properly assess risks as well as impair the competing industries like collective investments schemes (UCITS), closed-end funds, unit-links, etc. which are subject to quite heavy regulatory obligations.

Nevertheless, as the markets are developing it is not possible to impede development and expansion of hedge funds and private equity any further. Thus, we would support the possibility to create some framework of distribution for these products, e.g. through licensed investment firms which could advice the investor on specific issues connected to hedge funds and private equity vehicles.

The definition of "eligible investor" should be definitely developed but not in the proposed form where it bases only on the initial payment amount. Especially that the amount indicated by the Group is too low to make sure that the access to those investment vehicles is in fact limited to truly "eligible investors".

Yours sincerely,



Philippe De Brouwer

Chief Executive Officer