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By e mail

Response to Alternative Investment Group Report

Schroders is an independent asset management house. We are a global provider of investment services with over €170 billion under management and offices in 30 countries. We use the European Passport available under the UCITS Directive to provide products to investors across Europe and globally. We also provide a range of hedge funds and fund of hedge funds and have a thriving private equity business. We welcome the opportunity to comment on the Alternative Investment Group Report.

Managing, Servicing and Marketing Hedge Funds in Europe

We support the findings of the hedge funds expert group. We fully support the Expert Groups suggestions that:

- ◆ product regulation is not the solution to harmonising alternative fund access to cross-border investors; and
- ◆ the Commission should look towards the way products are sold to produce an appropriate regime that reflects the need to adequately protect consumers, meaning building on the MiFID framework.

We note that there has been a growing debate about interpreting MiFID so as to allow access to the retail market for alternative products. We accept that such an interpretation could mean the result that UCITS products will be at a disadvantage. But we would argue that currently the main disadvantage to UCITS is the unnecessarily bureaucratic process that UCITS have to go through in terms of product authorisation/notification. Solving time to market concerns would level the playing field whilst retaining the UCITS 'badge' of approval.

We would oppose suggestions that the suitability and appropriateness tests in MiFID will somehow lessen investor protection as some commentators have said. These tests are appropriate for an investment firm providing advice when selling financial instruments, be they collective investment schemes or otherwise. It is as a result of the way that regulators have developed their fund regimes that UCITS-style authorisation and/or notification is the norm for non-UCITS products. The result is over regulation of fund providers – because both the product and the service are regulated. If this was the most appropriate form of regulation then why are other service providers' products not regulated in this way?

In addition we would question whether the raising of artificial registration requirements, meaning an investment firm advising a customer would be barred from selling certain products that might be most suitable (because they have not been registered), is truly compatible with the objective of creating a single market in financial services.

We set out below a possible three step solution to the issue which will not require changes to the EU legislative framework set up by the Financial Services Action Plan other than the changes identified by the Expert Group on Investment Fund Market Efficiency.

(1) Improve UCITS time to market.

We suggest that the Commission need to urgently legislate to allow UCITS products to get to market quickly. This means implementing the proposals contained in the Expert Group Report on Investment

Fund Market Efficiency with regard to faster Prospectus Directive notification and authorisation times, as well as repositioning the simplified prospectus as a summary prospectus that would switch off host State marketing rules if that document was used for marketing purposes.

A fast-tracked change to the UCITS Directive would mean that, going forward, the UCITS product would not be subject to the perverse effect that the most regulated product takes the longest time to get to market. In one sense, these changes would make the UCITS product a “26th regime” product. The cost of abiding by the product rules and summary prospectus requirements would lead to a simpler cross-border marketing regime and the benefit of being classed a ‘non complex’ product under MiFID.

Regulators need to authorise UCITS on the basis that they accept the operators of UCITS are fit and proper people and that when an operator produces documentation for a new fund which includes a statement that the fund is a UCITS, then this is accepted. Why do regulators need to spend so much time checking legal documentation whereas non-fund product providers can produce products without any such administrative burdens?

(2) Clearly define the ‘non complex’ product boundary

UCITS is a ‘non complex’ product under MiFID. No other fund product will automatically be a ‘non complex’ product, though there is no MiFID barrier to producing a non-UCITS, non complex product.

The four principles within Article 38 of the level 2 implementing Commission Directive should be considered further by CESR. Hedge funds are highly unlikely to meet these principles not least because of the long redemption periods, meaning they are likely to be classified as complex products and so be subject to the additional safeguards built into MiFID. It may also be the case that funds of hedge funds may also be deemed complex, but this will depend of how regulators interpret ‘frequent opportunities’ for redemption as set out in Article 38.

By providing a clear demarcation between funds that are complex and non-complex, this will assist fund providers in their choice of fund structure. This choice will be either a UCITS product, a non-UCITS non-complex product, or a complex product.

Producing a UCITS product will have the advantages of the UCITS brand and the simple marketing route proposed by the summary prospectus. As a non-complex product it can either be sold direct to customers without suitability or appropriateness tests, or under advice.

Producing a non-UCITS non complex fund might mean a higher ‘cost’ since there will undoubtedly be closer co-operation between the product provider and distributor in terms of explaining the product features and training of staff. However it can be sold direct via a MiFID investment firm without suitability or appropriateness tests and, if sold on a cross-border basis, home State marketing rules apply.

Producing a complex product would need to be sold through MiFID investment firms on suitability requirements and where necessary appropriateness tests. The fund will clearly be less marketable.

Over time, if the UCITS product is still a useful brand as commentators claim, it will continue to thrive. If not, then further legislative action to the UCITS Directive should be considered. Simply put, if UCITS can get to market as fast as other competing fund products (and importantly they already have to compete against non-fund products that are not individually authorised by regulators) then the market will decide if the current brand is indeed up-to-date or should be expanded further in terms of eligible assets.

(3) Clarify what form of notification needs to take place for investment funds willing to sell alternative products.

Whilst individual product authorisation is not foreseen by MiFID, it is reasonable that member States' Competent Authorities should be informed if MiFID investment firms are intent on providing a service allowing alternative fund products to be sold. There appear three mechanisms under MiFID where CESR could specify what is required before selling alternative products.

- ◆ the authorisation of the investment firm could specifically refer to this type of activity in its scope;
- ◆ the notification to the host State Competent Authority could include, within the programme of operations, details of the how the investment firm will be selling alternative products, and
- ◆ marketing communication guidelines under the 'fair, clear and not misleading' requirement could be produced to ensure appropriate messages are included (building upon the level 2 implementing Commission Directive requirements set out in Article 32) – perhaps including references to minimum wealth requirements as suggested by the Alternative Expert Group Report.

We hope the Commission can consider our solution further.

Developing European Private Equity

We welcome the Expert Group's report which calls for the harmonisation of a private placement regime. At the very least, such a regime should be put in place for sales of all fund products to institutional investors.

Yours sincerely

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