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Director, Financial Services Policy and Financial Markets
Directorate General Internal Market and Services
European Commission
107 Avenue de Cortenbergh
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AFG RESPONSE TO EXPERT GROUP REPORTS ON FUNDS (MARKET EFFICIENCY, HEDGE FUNDS AND PRIVATE EQUITY)

Dear David,

AFG[1] wants to thank all the experts who provided their expertise, inputs and time to the European Commission. We also want to congratulate the European Commission itself, in particular Niall Bohan and his team, for its excellent work of setting up and coordinating expert groups during such a short period with such positive results.

AFG welcomes the three reports, namely the Investment Fund Market Efficiency Report, the Hedge Fund Report and the Private Equity Report and, and acknowledges the high quality of

[1] The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. Our 1159 members include in particular 365 management companies and 772 investment companies. Some are entrepreneurial ones while others are part of French or foreign banking, insurance or asset management groups. AFG members manage over 2200 billion euros in the field of investment management - making the French industry the leader in Europe for collective investment in terms of financial management location - i.e. wherever the funds are domiciled in Europe (with more than 20% of EU investment funds assets under management) and the second at global level after the US. Our industry includes – beside UCITS – products such as hedge funds, real estate funds and private equity funds. We are also a member of the European Fund and Asset Management Association, EFAMA), of whom we obviously support the separate response.

the work done and takes the opportunity of the consultation to clearly state the position of the French asset management industry on several topics.

Before expressing our main comments on the three reports we would like to make *four major remarks*:

- First of all, we deeply regret the absence of translations of the groups of experts' reports in the official languages of the European Union, or at least in the three working languages of the European Commission. The single use of English for official Reports under the auspices of the Commission does not encourage non-English speaking countries market participants to answer consultations. The spectrum of answers - and the analysis to be done of these answers by Commission services – is inevitably therefore based on a strong bias. This strong bias might afterwards lead to policies which would not necessarily fit with the needs of market participants in the majority of Member States. We positively took note that for the Open Hearing of 19 July 2006, several languages were available to the speakers and the public. We would have appreciated the same action for the reports themselves. Having said that, we have, however, decided to answer in English to be coherent with the language used by the experts themselves;

- Regarding the working mandate of the groups of experts, we would have appreciated that this mandate requests those groups (or another, dedicated, group) to express their thoughts and views on real estate funds – which constitute a growing part of the investment funds in many Member States. We therefore ask the European Commission to incorporate the topic in the White Paper in order to build the appropriate European framework for the investment funds as a whole. It would be consistent with the scope which was defined by the Commission in its July 2005 Green Paper on investment funds and its Annex, which had defined alternative investment as being composed of hedge funds/funds of hedge funds, private equity funds and real estate funds;

- More widely, we would have wished the expert groups to tackle issues which lead to reforming (or not) the UCITS Directive under a Lamfalussy format. For instance, adapting for the future the scope of eligible assets beyond what is authorised today at Level 1, or adapting for the future the scope of management techniques beyond what is authorised today at Level 1, are topics which would have benefited from the input of the experts;

- Last, we request the European Commission to urgently clarify the link between the MiFID and the UCITS Directive, as well as the impacts of the MiFID in terms of distribution of funds. European asset managers have currently doubts on what this link means both legally and in practice; and they cannot stand facing such an uncertainty for long.

Turning now to the three expert Reports, we generally support the conclusions drawn by the experts, in particular in the Market Efficiency Report (notification/authorisation of funds; fund mergers; pooling; management company passport; depositary passport). For the two other Reports, we fully share the analysis provided by the experts but have strong doubts on the operational means proposed by the experts to reach the goals they have identified.

In particular, we would like to emphasize the few crucial issues which remain for us following the release of the three Reports and that we hope will be taken into account by the European Commission while drafting its White Paper for future European legislative actions.

Main remaining concerns of AFG on the three Reports:

- *Investment Fund Market Efficiency Report: 5 main requests by AFG:*

    - *A fully harmonised and truly simplified summary Prospectus instead of the current non –harmonised simplified prospectuses;*
    - *A full Management Company Passport, including the deletion of the 'Head Office' principle and the ability from country A to manage funds domiciled in country B (including for administrative management – and not only financial management) without having to set up a legal entity in the country of domiciliation of the fund. In order to answer regulators' concerns on monitoring, we think the Management Company Passport will be accepted more easily by regulators in the short term if the depositary remains in the country of the fund (before achieving a real Depositary Passport in the longer term);*
    - *Envisaging a regulatory framework for domestic and cross-border Master-feeders for UCITS in parallel with a European approach on virtual pooling;*
    - *We are opposed to the possible future ability of MiFID investment firms to manage UCITS on the basis of their MiFID authorisation as long as this approach is not further clarified;*
    - *In any case, the series of issues raised by the experts should <u>not</u> be given a priority order among them, as we consider both that all these issues are crucial and are also connected very often the ones with the others.*

- *Hedge Fund Report: major concerns by AFG Members:*

    - *AFG members, which include many managers dedicated to alternative investment (either to hedge funds or funds of hedge funds), consider that developing cross-border activity of hedge funds and funds of hedge funds in Europe requires an appropriate European regulatory framework;*
    - *We do not consider that the current MiFID provisions as such would allow for a sound cross-border marketing of non-coordinated funds;*
    - *The mere principle of mutual recognition has been rather unsuccessful until now and would be a very uncertain process to reach a real Single Market for Hedge funds/funds of hedge funds;*
    - *We therefore ask for:*
        - *A 'private placement' regime for hedge funds and funds of hedge funds oriented towards institutional investors, through a European definition of what 'private placement' is and of a minimum regulatory framework for those who could provide for such a private placement, complemented by a very light definition of the funds to be placed (i.e. including off-shore funds)*
        - *In addition, a European legislative framework for regulated hedge funds and funds of hedge funds, for a wider distribution than just 'private placement', either through their inclusion within the UCITS Directive or as a chapter separate from UCITS, in order to develop a European label for 'non-UCITS', complemented by a light definition of the product (i.e. limited to on-shore funds)*

- *The inclusion of derivatives on hedge fund indices within the scope of eligible assets of the UCITS Directive (as similar indices are currently under inclusion).*

- *Private Equity Report: close concern to the one AFG members have for Hedge Funds:*

  - *The development of Private Equity funds in the European Union is currently harmed by the difficulties in selling such funds on a cross-border basis. It seems for AFG members that just relying on a mutual recognition approach will not solve the issue*
  - *We therefore suggest providing for a common definition of private placement at European level in addition to a definition of who could manage and provide for such a private placement and possibly to launch a reflexion on a framework for a European private equity vehicle which could be passported for a wider distribution.*

You will find below our detailed comments on the different reports.

1. Investment Fund Market Efficiency

AFG is largely satisfied with the proposals of the experts' group. The group made operational recommendations to the European Commission with legislative changes requiring immediate actions in targeted areas (in line with the European Parliament's Report to a large extent).

We fully support the recommendations of the Report, apart from four fundamental issues for our industry that would need *more attention* from the European Commission: a fully harmonised and really simplified prospectus, an effective management company passport, the equal treatment between master-feeders and virtual pooling, avoiding the possible introduction of a collective investment management passport for MiFID investment firms as long as this topic is not further clarified.

Notification and authorisation:
The conclusions of the experts' group on the notification and authorisation are deemed satisfactory and would be very efficient if put in place, to the exception of the 'summary prospectus' concept.

i. Authorisation and notification periods:

The experts' group recommends to reduce administrative timeframes regarding the cross-border authorisation and notification of funds and to align the regime of the UCITS Directive with the regime of the Prospectus Directive. Therefore, they suggest a twenty working days period for the authorisation of the funds and a three working days period for the cross-border notification of the funds. This recommendation implies an amendment of the UCITS Directive on the notification and authorisation periods.

AFG fully supports this recommendation, since it would simplify the administrative procedure and increase the volume of cross-border transactions. This alignment of time

periods will ensure more consistency between the UCITS and Prospectus Directive products (in a way to ensure a better level playing field) and consequently benefit to investors.

However these new periods can only be implemented safely, both for the regulators and the industry, if the simplified prospectus has been harmonised beforehand. As mentioned by Carlo Biancheri during the Open Hearing on 19 July, although it is true that CESR was commissioned to work on the simplification of the procedural rules for the UCITS cross-border notification, its action cannot be sufficient by itself. In particular CESR only delivers recommendations and does not take any regulatory binding decisions. Therefore an amendment of the UCITS Directive on this issue, in line with the Prospectus Directive, is the solution, as recommended by the experts.

ii. Review of the Simplified Prospectus:

AFG strongly supports the implementation of a *single fully harmonised and really simplified summary prospectus* across Europe, both in terms of format and of main features of the fund. As previously said by many stakeholders in the Member States, the main issue relating to the Simplified Prospectus is the lack of harmonisation of the simplified prospectus and the way Member States inconsistently implemented the UCITS Directive into their national law[2].
On this very specific point, the wording of the expert group report seems rather ambiguous. The recommendation box on the prospectus[3] refers to a 'summary prospectus' as the one of the Prospectus Directive, stating that the '*simplified prospectus is repositioned as a summary prospectus (…) (that) should, in brief technical language convey the essential characteristics of the fund structure and each relevant sub-fund if the structure is an umbrella fund. It should have a flexible format (…).*" On the contrary, the executive summary refers to the revision of the '*simplified prospectus so that it becomes a fully and automatically recognised document containing key disclosures for investors*'[4].

In the event the experts support the notion they call 'summary prospectus', without having first defined its format and the main features of the fund, we cannot agree with this proposal. The format and content of the 'summary' prospectus, as described in the Prospectus Directive and to which experts refer in their report, are too flexible to be satisfactory (non-limitative list of items, no mandatory limitation in its number of words for instance). As long as the prospectus, whether 'simplified' or 'summarised', is not harmonised in its format and main features on the fund, cross-border distribution of UCITS will not be solved. Investors and industry are looking for a brief document setting out standardised, understandable and comparable information of two to three pages in their own language.

Our position is in line with the one expressed by the European Parliament in its report on asset management (on the basis of MEP Klinz Report) where it reminded the differences of

[2] Feedback Statement on the Commission Green Paper, 'Enhancing the European Framework for Investment Funds', February 2006, page 8: "*One of the main problems cited was the inconsistent implementation of the UCITS III rules (as clarified by Commission Recommendation 2004/384/EC) across Member States (…) Some respondents furthermore underlined that the simplified prospectus was too long and was not understood by its readers (the "average retail investor") and that in certain specific situations (e.g. umbrella funds) the simplified prospectus became longer than the full prospectus*".

[3] Investment Fund Market Efficiency Report, page 9

[4] Investment Fund Market Efficiency Report, Executive Summary

implementation of the simplified prospectus in the different Member States[5] and supported a modification of the UCITS Directive on the Simplified Prospectus in order to achieve a single Simplified Prospectus in the EU[6].

We therefore call on the European Commission to be careful with the notion of summary prospectus, as it is currently described in the Prospectus Directive, and to take all the necessary steps to ensure that the 'summary' Prospectus we need is fully harmonised, through an amendment of the UCITS Directive or at least a Level 2 measure. On the contrary the European Commission should not start working again on a mere Recommendation – which would have no binding effect on Member States: this non-binding approach was the reason for the failure of common implementation of the current so-called Simplified Prospectus.

Mergers of funds:

The experts have identified two issues relating to mergers of funds: the absence of European legislative framework regulating mergers of funds and the existence of taxation barriers preventing cross-border mergers of funds.

On the necessary modifications of the UCITS Directive to allow mergers of funds, AFG fully supports the proposal and notes that discussions on the topic have been going one step further on the technical side since the Green Paper. AFG agrees with these measures since they emphasize the protection of the investor, which is a key issue for many regulators in the context of cross-border mergers.

On the need for a Taxation of Fund Mergers Directive to limit the adverse tax implications for UCITS-to-UCITS mergers, AFG fully agrees with the proposal.

[5] ECON, PE.367.703v03.00, 27.03.2006.
See for example sections 5 and 6 of the report where the European Parliament identifies the issues linked to the lack of harmonisation of the simplified prospectus and states its support to the EFAMA's model for a simplified prospectus across Europe.
Section 5: "*Notes that, within the current legislative framework, Member States have implemented the simplified prospectus in different ways and have, in some instances, established additional stringent national requirements in spite of Commission Recommendation 2004/384/EC on some contents of the simplified prospectus*".
Section 6: "*Proposes that the simplified prospectus- in the spirit of the FEFSI proposal of October 2003- should take the form of a fact sheet to give investors transparency and provide them with a harmonised pan-European document setting out brief, standardised, understandable and comparable information of two to three pages in length in their own language, including information on the nature and risk of the financial instruments used and a quotation of the total expense ratio based on a standardised calculation and of load fees, an understandable description of the asset management (investment) strategy and references to the relevant sections of the full prospectus from which detailed information can be obtained; believes that this document must be offered to the investor before conclusion of the contract*".

[6] ECON, PE.367.703v03.00, 27.03.2006
Section 4 : " *(…) believes however there is a need to go further and to modify in some areas the Directive 1985/611/EC as amended by UCITS III I order to achieve the objectives set out in paragraph 3 of this report; these modifications concern the following: a simplified prospectus (…)*"
Section 3: "*Notes that the objectives of investor protection and product diversity, ensuring fair conditions of competition and improving performance and competitiveness at global level have not yet all been achieved to a satisfactory degree despite existing EU regulations*".

However, AFG asks the European Commission to treat both topics, i.e. the modifications to the UCITS Directive as well as the taxation issue, separately to avoid one issue to block progress on the other.

Pooling techniques:

AFG agrees with the Report on the principle of tackling both virtual pooling and entity pooling.

We first would like to remind the European Commission that there is a wish from the industry to develop cross-border pooling based on existing successful national experiences such as "*domestic master-feeder structures in France, Spain and Luxembourg*" as identified by the European Parliament in its report on investment funds[7].

Regarding virtual pooling, we clearly understand that regulators would need to discuss among them to understand its mechanisms and functioning. We would support discussions on the topic at the level of CESR.

However, starting discussions among regulators on virtual pooling should not prevent the Commission from launching in parallel an in-depth work on entity pooling:

- the Commission should try to act towards each Member State to allow an effective implementation of cross-border master-feeders – taking into consideration the various successful domestic experiences mentioned right above;

- but we also urge the European Commission to amend the UCITS Directive to allow domestic and cross-border master-feeders for UCITS. On this issue, we wish to remind the European Commission that ten years ago, European institutions had already been considering modifying the UCITS Directive to include 'master-feeder' funds as an instrument because of their similarities with UCITS[8]. More recently, the European Parliament in its report on investment funds also supported a modification of the UCITS Directive to allow master-feeder structures[9].This political support has to be taken into account by the Commission in our view.

Finally, we are surprised to see that the experts included in the scope of their analysis the barriers to pension pooling. We do think this is a different issue that should be addressed at a

[7] ECON, PE.367.703v03.00, 27.03.2006, Section 29.

[8] OJ C 242, 30/08/1994, p.5, recital 2: "*Whereas money market funds, cash funds, funds of Ucits and* ***master-feeder funds****, [. . .] given their operational features and investment objectives,* ***may be regarded as very close to Ucits;*** *whereas it is desirable to bring these funds within the scope of Directive 85/611/EEC since [. . .] this [. . .] would facilitate the removal of the restrictions on the free circulation of the units of these funds in the [. . .] European Union and such coordination is necessary to bring about a European capital market (…)*".
Article 26b:*Notwithstanding Article 24 (2), Article 24 (3), first subparagraph and Article 25 (2) third indent, Member States may authorize a Ucits ("a feeder fund") to invest its assets in units issued by one single Ucits ("a master fund"), whose units would therefore be distributed indirectly through one or more feeder funds (…)*

[9] ECON, PE.367.703v03.00, 27.03.2006, Section 31: "*Points out that an amendment to Directive 85/611/EC is necessary to allow master-feeder structures*".

later stage and that the European Commission should mandate experts in that field in case it is interested in the topic.

Management Company Passport:

The Management Company Passport is a key issue for the asset management industry. We consider as an urgency to set up a full management company and follow the European Parliament's position which called on the Commission '*to develop its works for achieving a real management company passport (…) [through] harmonised rules for management companies*'[10].

i. registered office and head office

The discussions in the experts' report went around the ambiguity of the UCITS Directive and the procedural or wording barriers which might prevent a full management company passport.

It seems that experts could not express a clear and common position on the topic. As stated in the recommendation box[11], they all agree on the principle of the management company passport but disagree on the *scope of the activities* to be covered by the management company passport. They built an analysis on the confusing meaning of 'registered office' and 'head office' in Article 3 of the UCITS Directive as last amended[12]read together with Article 6 of the same Directive that set up the rule of the management company passport[13]. Although Article 6 (1) of the UCITS Directive grants freedom to authorized management companies in one Member State to carry business in another Member State (either through a branch or through the 'freedom to provide services'), Article 3 of the same Directive seems to restrict this freedom by imposing that the 'head office' of the UCITS should be situated in the same Member State. This limit could lead to a limitation of the activities a management company could provide on cross-border.

AFG requests to amend the UCITS Directive by deleting Article 3, in order that 'registered office' and 'head office' may be located in other countries than the one where the fund is domiciled, and that the existing Article 6 becomes a reality.

To answer concerns expressed by regulators during the Open Hearing, AFG wants to remind that setting up a management company passport will not harm the protection of the investor as long as regulators cooperate between them to be able to supervise funds managed in another Member State. It might be proposed that there is a 'joint supervision' between the regulator of

[10] Report of the European Parliament on asset management, PE.367.703v03-00, Sections 18 to 21, Management company and depositary passports.

[11] Investment Fund Market Efficiency Report, pages 24-25

[12] References of the UCITS Directive
Article 3 provides the following :
'For the purpose of this Directive, a UCITS shall be deemed to be situated in the Member State in which the investment company or the management company of the unit trust has its registered office; the Member States must require that the head office be situated in the same Member State as the registered office'.

[13] Article 6 provides the following :
'Member States shall ensure that a management company, authorized in accordance with this Directive by the competent authorities of another Member State, may carry on within their territories the activity for which its has been authorized, either by the establishment of a branch or under the freedom to provide services'.

the country where the UCITS is domiciled and the one of the country where the management company is registered. The UCITS Directive might, if necessary, be amended in that sense.

In addition, postponing a full Depositary Passport (see below the Section on the Depositary Passport) would help answering regulators' concerns as the depositary would stay in the country of domiciliation of the fund for the years to come.

ii. activities included in the 'collective portfolio management'

The experts ask for clarity around the definition of the 'collective portfolio management' (CPM) activities that are passportable. We see in this argument a way to delay a full implementation of the Management Company Passport and do not deem satisfactory to distinguish passportable activities of the CPM since it will limit /circumscribe the activities that are passportable. As previously said, relying on the principles set up by Article 6 of the UCITS Directive, activities that an authorized management company should be allowed to passport should cover all the activities defined in the Annex II of the UCITS Directive, i.e. Investment management, Administration and Marketing.

iii. MiFID activities available to management companies

AFG is strongly opposed to allowing MiFID investment firms to manage UCITS on the basis of their MiFID authorisation as long as the conditions for such a management of UCITS are not clarified. As apparently mentioned by some members of the expert group, it is our view that authorisation under MiFID would be insufficient to ensure the existence of the appropriate technical and human resources necessary to operate a UCITS. In addition,allowing MiFID investment firms to manage UCITS might raise issues regarding conflicts of interest.
Last, the MiFID Directive clearly excludes such a faculty and its recent but difficult adoption should not be reopened right now through such a discussion.

Depositary passport:

On the subject-matter of the depositary passport, experts have reached the conclusion that the approach should be a progressive one with two steps, first setting up preliminary conditions heading to a passport later on.
In the short-term, experts ask Member States to allow branches of EU established banks to act as local depositaries and to allow depositaries to be free to delegate asset-safekeeping to custodians. AFG agrees with this proposal.
In the long term, experts recommend the European Commission to take the necessary steps in order to harmonise the capital requirements for depositaries and to analyse at a later stage existing barriers relating to the role and responsibilities of the depositary. AFG agrees with this recommendation but would welcome the European Commission to launch as soon as today the work on such a harmonisation in order to get, at a later stage, a depositary passport.

2.Hedge Fund Report

Contrary to some national associations in other Member States, AFG represents both the UCITS industry and the alternative investment industry in France. According to a recent IOSCO Report on the topic of hedge funds at worldwide level, the French regime for

regulated hedge funds is currently the second one after the US[14]. Many AFG members being part of the hedge fund industry usually manage both on-shore hedge funds and off-shore hedge funds, or manage funds of hedge funds. We therefore think our position might be helpful for the analysis of the Hedge Fund Report.

Overall, the report provides for very deep and thoughtful analysis of the current Hedge Fund industry in Europe. We share the underlying aim of the expert group which seems to have been: how to keep innovation and flexibility of hedge funds and at the same time develop cross-border activity through the European Union, with the lightest European regulatory regime? Indeed if a very cumbersome European regime for hedge funds appeared, it would just push off-shore or abroad a wide part of the industry.

The second main issue regards the type of investor targeted: are the products to be sold only to institutional investors or also to retail investors? This difference has consequences both on the type of placement/distribution and also on the type of fund to be sold.

This issue has served as an underlying guide for AFG following comments.

a) 1st recommendation

AFG fully agrees with the first recommendation that Member States should recognise the broadening appetite for hedge funds and related products, by developing a regulatory approach that is compatible with these needs and the organisation of the hedge fund business.

However, we do not agree with the interpretation that MiFID - by just regulating the general principles of distribution of such funds by investment firms - would suffice to deal with such products at European level, without having flanking European legislation on the manager and other players in the value chain (and possibly a very light definition of the product, i.e. a product domiciled off-shore or on-shore only, depending on the case).

AFG considers that the MiFID was never intended nor discussed by the European Parliament, the Council of the European Commission before its adoption in 2004, for tackling the issue of European distribution of non-UCITS funds without any possible addition on the fund, its manager or the relevant investors.

Otherwise, it would mean that the most risky products, unregulated hedge funds, would be just caught at European level by the MiFID, when substitute products are covered by the Prospectus Directive and when the less risky products, UCITS, are covered by the UCITS Directive.

Such an interpretation might even lead to a paradox: it would then potentially allow a regime for unregulated hedge funds potentially to any investor (including retail ones) more easily than UCITS.

We therefore refuse for European legal and practical reasons such an interpretation which might harm, if applied, both the pan-European development of hedge funds as well as investor protection.

[14] See IOSCO Report on Hedge Funds

On the contrary, we consider that investors (including institutional ones) need to know that all the players they are facing in the value chain are regulated - and MiFID would not be enough for that.

It means that *a light level of European legislation should be envisaged in order to ensure:*

- *a regulation and supervision of the players of the value chain*
- *as well as a common definition of 'private placement'*
- *and a definition of which hedge funds can be subject to 'private placement' (i.e. including off-shore funds, as soon as they are managed and distributed by players registered in the European Union), in addition to whom this may apply to and how one may qualify for such a treatment.*

This three-fold approach should also be offered for funds of hedge funds when distributed through private placement.

Apart from the mere private placement approach, we consider that there is a need to set up a regulatory framework regarding the players and information on the product in order to ensure the enlargement of distribution of alternative investments.

For instance in France, the successful experience of regulated alternative investments afforded distribution to "affluent retail investors".

This regulatory framework for a wider distribution would facilitate cross-border marketing of regulated products.

It would also greatly help in solving the crucial issue of the current investment barriers applied to many institutional investors (e.g. insurance companies, pension funds).

On a more specific point, we agree with the Report on setting *a threshold at 50 000 €* for hedge funds but we contest that it must be left to the decision of regulators. In order to ensure that this minimum threshold will be shared across Europe, it must be introduced in a *European legislation*. Regarding funds of hedge funds, this threshold might be lower.

b) 2nd, 3rd and 4th recommendation

Regarding the third recommendation on the eligibility of derivatives based on *hedge fund indices* within the scope of eligible assets for UCITS under the UCITS Directive, AFG considers that such derivatives *should be eligible in the near future*, as derivatives based other but similar indices were recently accepted by the European Commission in the context of the draft Regulation on eligible assets (Level 2 of the UCITS Directive). The risks on the reliability of hedge fund indices are not necessarily higher than for other types of indices which are going to be elected by the European Commission, the European Securities Committee and the European Parliament.

Regarding the inclusion of funds of hedge funds as UCITS compliant funds, AFG considers that as mentioned above *there is an urgent need for a European legislative framework for alternative investments should include also such funds of hedge funds.* As made clear in Table 1 of the Annex of the Report, funds of hedge funds are now regulated at national level in *all* the Member States having a significant investment fund industry (i.e. more than 80% of the whole European investment fund industry): the development of this segment of investment

funds is now an important driver for new investments at national level. Now this market is constrained by the difficulty to sell such products on a cross-border basis because of the lack of a common regime across Europe. Moreover, if we wish to develop a strong European industry in this segment in order to be able to compete at global level with non-European countries, we obviously need a European legislative framework for such products as well as for regulated alternative investments.

At least two different approaches would be possible: Either to include funds of hedge funds within the scope of the UCITS Directive. It would be our preference as it would be the easiest approach from a legislative process perspective. Carlo Comporti, Deputy Secretary-General of CESR, also supported such a view. But we also understand that managers of existing UCITS in many countries are reluctant for such an extension of the UCITS label to funds of hedge funds, as they are afraid it might 'pollute' the existing worldwide UCITS label. Then, the other approach would be *to add a new section in European legislation, on non-UCITS, **separate from** UCITS*. It would offer the advantage of not creating confusion with the existing UCITS though allowing a pan-European framework for such products. And for the future, beside the existing UCITS label, it would favour the development of a 'non-UCITS' label at worldwide level. The same approach could also be applied for regulated alternative investments.

Regarding retail-oriented or 'affluent retail-oriented' hedge fund products, AFG is more than skeptical on the approach proposed in the Report to develop such products on a cross-border basis. The Report suggests following a mutual recognition approach. In our view, this approach has rather failed in the European Union; it will be particularly the case here as many regulators might raise the principle of investor protection (which is one of their official missions) to refuse such a mutual recognition. The failure of mutual recognition was explicitly mentioned during the Open Hearing on 19 July: Carlo Biancheri representing the Consob, as well as Ilkka Harju, representing the EU Finnish Presidency, mentioned that mutual recognition was not efficient and could not be enough by itself. They recommended regulatory actions at EU level instead. We consider that *helping developing such a retail-oriented hedge fund market will require here again a European legislative framework, mainly based on the players with a light definition of the product (which would be here a limitation of the scope of distributed funds to **on-shore** products, in order to ensure a higher degree of investor protection as compared to hedge funds sold through a private placement - which could be domiciled off-shore).*

c) 5th recommendation and following

Regarding restrictions on investment by institutional investors (e.g. pension funds, insurance companies), we fully agree that those restrictions should be removed. For instance during the Open Hearing on 19 July, Robert Coomans, from APB pension fund, noted the discriminations existing between the EU Member States legislations and regulations, restricting institutional investors from investing in hedge funds in many Member States.
However, the mere pressure on Member States or regulators might not have a major impact in the short term, particularly as hedge funds (especially from other Member States) are not well known by national authorities. We think that setting up as a first step a European legislative framework for regulated hedge funds would significantly help persuading authorities afterwards that such pan-European hedge funds (because they are regulated) can be invested by those types of institutional investors.

Regarding urging the European Union and national authorities to enter into negotiation with the US SEC and other relevant parties with a view to securing exemption from the US registration requirements for European hedge fund managers who are already registered with a Member State authority and are doing business with US qualified investors, AFG fully support the position of the experts' group. We are rather confident on the current move towards such a direction but *the 'leverage effect' on the US authorities that might constitute the European Commission, the Finnish Presidency of the Council, the European Parliament and CESR in this matter - through the so-called 'transatlantic dialogue' - would be more than very helpful*. In particular, concerning the future regime of non-US hedge funds with US investors, we ask the European bodies to monitor this issue very carefully to avoid a requirement for dual registration of European managers (i.e. both in the European Union and in the United States).

Regarding the role of depositaries, we wish to stress that those depositaries have a crucial role to play in monitoring the funds. This *monitoring role* must be kept in any case. We have therefore strong doubt with the statement of the experts Reports mentioning that "*Given the level of regulation under which most established investment managers operate within the European Union, the benefits of additional oversight by a local custodian or prime broker are questionable when weighted against the additional costs.*"

In addition, it must be recalled that the cornerstone of the safety in the hedge fund industry remains in the *correct valuation of assets*: main accidents or frauds out of Europe were linked to mis-valuation (with intent or not). However, in order to deal with this crucial issue, we are not sure that regulation of the correct valuation itself is the best way to tackle it: it would be *better to identify who would be responsible* (and in which way) in case of mis-valuation. Otherwise, a detailed regulation on asset valuation might dangerously miss its goal: mis-valuation may occur even when following the rules of valuation. We therefore fully support the 11th Recommendation.

3. Private Equity Report

Contrary to some national associations in other Member States, AFG represents both the UCITS industry and – along with the dedicated French private equity association, AFIC - the private equity industry in France. AFG has among its members global investment companies managing UCITS as well as private equity funds and specialised firms managing private equity funds only. The French private equity industry is the first one in continental Europe with highly performing products such as the FCPR (Venture Capital Funds) and the FCPI (Innovation Funds).

Overall, AFG considers that the report is very informative and well drafted.

Among the different recommendations addressed by the group to the European Commission, our members support a higher transparency on taxation issues (and ideally would like a harmonisation on tax issues at EU level) and are strongly in favour of a common definition of criteria of private placement in Europe to help cross-border private placement.

They are also keen on having a common definition at EU level of notions such as 'qualified investors ' as well as the concept of 'management' in the private equity context.

AFG members consider that getting this set of common definitions or common criteria of definitions (private placement, qualified investor, and management) should require a European legislative action: just relying on mutual recognition or even agreements between regulators would have very uncertain effects in terms of common implementations. Such a legislative approach should allow for a passport for the management company or even for a European harmonised private equity vehicle – coexisting with still nationally designed vehicles - at a later stage.

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If you wish to discuss the content of this answer with us, please contact myself at 00 33 1 44 94 94 14 (e-mail: p.bollon@afg.asso.fr), our Head of International Affairs Stéphane Janin at 00 33 1 44 94 94 04 (e-mail: s.janin@afg.asso.fr) or his deputy Catherine Jasserand at 00 33 1 44 94 96 58 (e-mail: c.jasserand@afg.asso.fr).

Yours sincerely,

(signed)

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