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Mr Philippe Richard
IOSCO Secretary General
Oquendo 12
28006 Madrid
Espagne

Paris, 15 October 2006

AFG RESPONSE TO IOSCO CONSULTATION ON EXAMINATION OF GOVERNANCE FOR COLLECTIVE INVESTMENT SCHEMES (PART II)

Dear Mr Richard,

The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. Our members include 365 management companies. Some are entrepreneurial ones; others belong to French or foreign banking, insurance or asset management groups. AFG members are responsible for the management of over 2200 billion euros in the field of investment management. In terms of financial management of collective investment schemes domiciled wherever in Europe (i.e. in France, Luxemburg or elsewhere), the French industry is the leader in the EU (with more than 20% of EU investment funds assets under management) and the second one at global level. Our collective investment industry includes – beside UCITS – a significant part of products such as hedge funds, real estate funds and private equity funds. Globally, the French asset management industry manages more than 800 investment companies and 6000 mutual funds. We are a member of European Fund and Asset Management Association (FEFSI/EFAMA) and of the International Investment Fund Association (IIFA) and contribute actively to the work carried out by these two trade associations.

Therefore, we hope that AFG (through the size and diversity of its membership) can provide with a helpful contribution to IOSCO, based on our members' experience.

We appreciate the opportunity to comment on IOSCO's consultation report on "*Examination of Governance for Collective Investment Schemes – Part II*".

In addition to supporting the remarks expressed by EFAMA, to which we contributed actively, we would like to express some general comments complemented by some more specific ones.

I. General comments

The work carried out by IOSCO SC5 and its members can be lauded as delivering a global mapping of the way the governance of funds is currently carried out among various jurisdictions. Such a general overview of the topic had never been done before and is very useful for getting a wider view of the CIS industry and its organisation depending of the countries concerned.

a) How to tackle the concept of governance when applied to CIS?

As already expressed in answering your previous consultation document last year, *we agree with IOSCO that, although the definition of CIS" governance" can make some use of the concept of corporate governance, a definition of CIS governance must recognize the differences between the nature and purposes of CIS and the operating companies in which they invest.* Following the first consultation paper issued by IOSCO last year, some public events like the "*Entretiens de l'AMF*" on 29 November 2005 made clear that such a difference had to be kept, in particular because the collective management industry has already to comply with a very comprehensive set of rules as compared to those applied by competitor products. At the end of the day, CIS are efficient saving vehicles, not corporations; therefore, the notion of "oversight" seems more appropriate than the one of "governance".

We agree that CIS must be organized and operated efficiently and exclusively in the interests of CIS investors, and not in the interest of CIS insiders. We consider that in the EU, thanks to the UCITS Directive and the MiFID, such a condition is already met. For UCITS, the two decades following the adoption of the 1985 Directive did not bring any significant market failure. The French regulator is even stricter. For instance, the role and responsibilities of depositaries is wider and much more detailed than they are in the directives.

Thus, we fully share IOSCO's approach which makes clear that CIS are structured and regulated differently among the jurisdictions of SC5 members. For instance, the way in which potential conflicts of interest in the operation of funds are addressed reflects differences in law, policy, and business structures.

Therefore, we are ready to help regulators to find improvements in the way the CIS are managed in the best interest of the investors – as it is already a requirement for the whole EU thanks to both the UCITS and MiFID Directives. Considering that regulation has already reached a very deep level of requirements, we consider that the remaining space for taking action, if any, must be left to industry or cross-industry *self-regulation*.

Between the different types of IOEs identified in the Report, we know that some outsiders would like to favour the approach of independent Boards of Directors. However, it appears that Boards of Directors, in practice, are too far from the day-to-day activities of CIS and CIS Operators. Our members consider that in addition to the proper organisation of the CIS management company, depositaries, auditors and an effective supervision by the CIS Regulator are more able to fulfil the functions dedicated to IOEs.

b) The work already carried out by EFAMA and AFG

EFAMA already made public a comprehensive set of conduct of business rules last year (with the contribution of AFG in particular), to be applied by the European industry.

On its own, *AFG* itself released (and updated) codes of ethics to be complied with by the French management companies. Those AFG codes were approved by the French regulator and are used by AMF staff when investigating French management companies:

- AFG professional code of conduct for managers of UCITS (1st one issued in 1990);
- AFG professional code of conduct for specially-tailored, individual management mandates (1997);
- AFG specific provisions for the manager of employee saving funds (in addition to the code of conduct for UCITS managers) (1999);
- AFG specific code of conduct for venture capital management companies (2001).

For your convenience, *you will find attached an English version of the compendium of codes of ethics which were issued by AFG* during the last decade. Some parts have been updated and the English version will be available soon.

c) What should be tackled beyond the topics already dealt by regulation and self-regulation today?

AFG has not concluded yet what should be deepened in the field of oversight of funds. The extreme variety of situations (remarkably reflected through IOSCO's work) prevents from following very detailed and cumbersome routes.

We suggest regulators, in the context of IOSCO or in other contexts, to apply therefore cost-benefit analysis in order to identify the areas in which fund oversight improvements should be brought.

In the meantime, the main improvement could be, based on existing legislations, to reinforce in practice the disclosure of the rules to be applied by CIS and CIS operators: already today, management companies have to comply with the rules of funds and must act in the best interests of their clients. For instance, management companies have to tackle any conflict of interest which might harm investors' interests: the policy and procedures related to conflicts of interest should be identified, disclosed and enforced/controlled afterwards.

Regarding the existing French system, in addition to the codes of conduct to be applied by them, our members consider that this system has worked well until now thanks to the crucial roles of depositaries and auditors as external Independent Oversight entities. However, the responsibilities of those two external entities could be clarified (as well as their respective roles). In any case, the fact for a depositary to be a 'related party' to the CIS or to the CIS Operator should not be considered as harming investors' protection, as what is crucial are the

duties to be fulfilled by the depositary (which are defined for UCITS through the UCITS Directive).

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II. Specific comments

a)The concept of independence: definition and key features

We agree with the various forms presented in page 6. We also agree with the definition of the concept of independence – as it is in any case required both by the French law and by the UCITS Directive - though we have some doubts around the specific notion of 'related parties' which might be clarified.

We agree with Principle II.1 and the fact that this Principle can be reached by various means, in particular the fact that Independent Oversight Entities (IOEs) could be designated in such a *transparent* way as to help ensure that the IOEs or their members do not face any conflicts of interests with the CIS Operator.

We do share IOSCO's view that entities such as trustees or depositaries can be considered, among others, as *Independent Entities* for the purpose of independent review – as long as (as stated by IOSCO) these entities are *"legally and economically independent from the CIS operator*". Instead of adopting a 'one size fits all' approach which might harm many regional industries, IOSCO is right when accepting that such various independent entities can ensure CIS are operated exclusively in the interest of CIS investors.

We agree that in the case of depositaries or trustees, the organization and the functioning of the Oversight Entities should be clearly segregated from any CIS Operator activity through contractual arrangements. However, *we think that prohibiting direct or cross shareholdings would be very costly to be set up in the jurisdictions which do not have such a requirement today - without harm for investors - and should therefore be strictly limited to the jurisdictions which have it in place already*.

In addition, we agree that the prohibition for IOEs to be entities (or to be composed of a majority of individuals) that have direct or indirect relationships with the CIS Operator or an entity related to the CIS Operator is *limited to the cases* where it creates conflicts of interest or situations impeding the independence of their assessment. *However, we strongly disagree on the fact that having directors shared with or affiliated to the CIS Operator automatically implies a conflict of interest.*

Regarding Principle II. 2, we agree that if independence is likely to be endangered, the IOEs can be controlled by the management of the CIS Operator. Until now in France, the CIS Operator has to put in place the means and procedures in order to monitor not only its own activities but also those of its depositaries and intermediaries. *However, as mentioned above, we disagree on the two stances given for endangering the independence, i.e. common directors and cross shareholdings.*

Regarding Principle II. 3, we support in particular the prohibition for the IOEs to receive any remuneration or incentives from the CIS Operator which may bias the independence of its assessment in such a way that it could be detrimental to the interests of CIS investors, and that this prohibition is compatible with the exception where compensation from the CIS Operator to the members of the IOE is done in terms determined by the IOE and disclosed to unitholders.

b) The powers of the IOEs

We support Principles III. 1, III.2 and III.3. However, we consider that the examples of rules which are given can also be provided through industry or cross-industry self-regulation.

In addition, we have some doubt on the need to debate about proxy voting in the context of this paper strictly dedicated to the oversight of funds.

c) Functions to be performed by the IOEs

We agree with Principle IV.1. Depending on the functions quoted, the most appropriate IOEs might be either the CIS auditor (functions 2 to 5) and/or the CIS depositary (functions 3 to 6).

On Principle IV.2, we support as well as it is required for depositaries through the EU UCITS Directive. Regarding the list of functions, the first one should probably be introduced in the national law; the 2nd, 3rd, 4th and 5th would be best fulfilled by auditors and depositaries. The last one is already done today by the depositary regarding subscriptions and redemptions.

Regarding Principle IV.3, we agree on it.

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We are now looking forward to reading your next paper on the subject and ready to share our experience with IOSCO if you find it helpful.

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

Yours sincerely,

(signed)

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