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Committee of European Securities Regulators (CESR)
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75008 Paris

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AFG response to CESR's consultation paper Technical advice at level 2 on the Management Company Passport

The Association Française de la Gestion financière (AFG)[1] welcomes CESR's consultation on Technical advice at level 2 on the Management Company Passport. We are very grateful to CESR for having accepted to change the final deadline for responding to this consultation (however, we may have some additional remarks at a later stage if needed, considering the short period of time for consultation).

It is worth noting that our working group dedicated to this matter counts over fifteen French investment management companies and is representative of the industry. It is made of entities that are varied in size (small or large), structure (entrepreneurial or belonging to French or foreign banking or insurance groups) and product range (plain vanilla funds, structured funds or both). Given that the French fund industry is the first one in the EU for the financial management of EU funds (wherever they are domiciled in the EU), the following comments are meaningful from a European perspective.

General comments

AFG supports the general approach proposed by CESR of seeking, whenever possible, alignment with the MiFID rules, as it will be convenient for management companies and it will ensure a level playing field. However, the extension of MiFID rules to management companies should take into account the specificities of such companies.

Besides, CESR should ensure that the requirements imposed on management companies are proportionate to the activity of collective portfolio management.

Moreover, we are of the opinion that there is no reason to treat investment companies differently from management companies: both should fulfil the same requirements.

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[1] The Association Française de la Gestion financière (AFG)[1] represents the France-based investment management industry, both for collective and discretionary individual portfolio managements.

Our members include 409 management companies. They are entrepreneurial or belong to French or foreign banking or insurance groups.

AFG members are managing 2300 billion euros in the field of investment management, making in particular the French industry *the leader in Europe in terms of financial management location* for collective investments (with nearly 1300 billion euros managed from France, i.e. 23% of all EU investment funds assets under management), wherever the funds are domiciled in the EU, *and second at worldwide level after the US*. In the field of collective investment, our industry includes – beside UCITS – the employee savings schemes and products such as regulated hedge funds/funds of hedge funds as well as a significant part of private equity funds and real estate funds. AFG is of course an active member of the European Fund and Investment Management Association (EFAMA) and of the European Federation for Retirement Provision (EFRP). AFG is also an active member of the International Investment Funds Association (IIFA).

In addition, AFG calls for a clarification of the definition of 'clients'. Indeed, it would be impossible for management companies to manage a UCITS depending on the individual interests of its investors (a UCITS is a community of clients) or manage conflicts of interest between two individual investors in a UCITS (this would not be in accordance with the principle of collective investment). Furthermore, very often management companies do not know the individual investors in their funds (as the funds are distributed by third parties). The conflicts of interest must be managed between the collective interests of the UCITS and the other accounts of the relevant management company.

We feel that aligning the requirements for UCITS management companies with the MiFID requirements, if done in a non-simplistic and realistic way, would not entail significant additional costs to the extent that in general French management companies already comply with MiFID requirements and have already supported such costs. However, the requirements relating to risk management might imply considerable costs. In particular, the notion of best execution / best selection is still unclear and it is difficult to assess the potential costs it would entail. In addition, the drafting by CESR on risk management is too wide and therefore too far reaching, thus potentially putting risk management teams at legal risk as they obviously cannot guarantee that they can identify ex ante *all potential* risks related to a relevant fund for instance.

In addition, AFG wishes to recall that delegation and outsourcing activities such as accounting, internal audit, and compliance are allowed. AFG wishes CESR to elaborate more on this issue and develop rules on delegation and outsourcing modelled on MiFID rules.

Regarding the Section on the depositary and its written agreement relationship with the Management Company, please note that our comments are made on the basis of the existing UCITS Directive and do not take into account the potential modifications that will stem from the current Commission consultation on the UCITS depositary function.

In this area, AFG fully agrees with the provisions proposed by CESR on the measures to be taken by a depositary of a UCITS managed by a management company situated in another Member State, including the particulars that need to be included in the standard agreements to be used by the depositary and the management companies.

In particular, we support the requirement that the agreement between the management company and the depositary must be harmonised on the key points identified rightly by CESR in its paper. If agreements between management companies and depositaries were fully left at contractual discretion or national discretion, it would obviously harm the smooth functioning of the Management Company Passport.

In addition, we think that such written agreements should be governed by the national law of the UCITS' domicile (Box 3), in order to ensure a single legal approach throughout Europe.

Last, we also share CESR's view that domestic written agreements between Management Companies and depositaries should comply with the same standards, once again in order to ensure an equality of treatment between domestic relationships and cross-border relationships within the Single Market.

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Detailed comments

Section I: Organisational requirements and conflicts of interest

AFG agrees with CESR's proposal of extending the organisational rules set for UCITS management companies to Alternative Investment Fund Managers ("AIFM") and asks for the alignment of the provisions of the AIFM Directive with those of the UCITS Directive.

Chapter 1: Organisational requirements – Implementation of Article 12(1)(a) of UCITS Directive

Box 1 - General organisational procedures and arrangements for management companies

Point (e) provides that management companies should establish, implement and maintain effective information flows with distributors. This is an additional requirement that is not included in MiFID. AFG would prefer if the organisational procedures and arrangements for management companies were aligned with the MiFID rules and therefore suggests rewording this provision. In particular, we wish to stress that all distributors are not always known from the management companies and therefore such information flows should be set up at the initiative of distributors.

Point (d) does not explicitly provide for the possibility of delegation or outsourcing. AFG wishes to clarify that delegation and outsourcing activities such as accounting, internal audit, and compliance are still allowed. AFG wishes CESR to elaborate on this issue and develop rules on delegation and outsourcing modelled on MiFID rules.

Box 2 – Responsibility of Senior Management

AFG is of the opinion that the requirements relating to the responsibility of Senior Management do not need to be extended to cover all employees of UCITS management companies.

Box 8 – Record keeping requirements

AFG believes that the list presented by CESR regarding the record of information sufficient to reconstruct details on the order and the executed transactions should be exhaustive rather than indicative.

We think that the wording of point (1) on the ability to process data electronically should not be as restrictive: management companies should be required to make the relevant arrangements to keep record of the information but not to have the relevant IT systems to do so.

Finally, we believe that point (2)(ii) on the recording of subscription and redemption orders will not be possible to implement, as in practice management companies are not always aware of the identity of the persons receiving the order from the unit holder.

Box 9 – UCITS accounting principles

Regarding para 2, we would suggest to shift and/or to amend the last part of the sentence (i.e. '*and that the orders … can be executed at that NAV*') for two reasons. First, as already mentioned in our comments on Box 8 right above, management companies usually do not know the individual subscriptions and redemptions; therefore this obligation can be only of a general nature. Second, we think that as such this requirement – that we do not contest in principle – is not a 'accounting principle' and should be put elsewhere in CESR requirements' structure.

Box 10 - Implementation of the general investment policy

Point 1 - AFG wants to clarify that the responsibility for the implementation of the general investment policy that rests with the senior management of management companies is a legal responsibility that can be delegated.

Point 2 - We are of the opinion that in practice the senior management of the management company will not be able to perform these tasks. Rather, the management company (legal entity) should be responsible for the implementation of the general investment policy. Furthermore, we believe that management companies should be allowed to delegate the execution of these tasks to third parties for the purpose of a more efficient conduct of their business (under the conditions set by Article 13 of the UCITS Directive).

Box 11- Implementation of strategies for the exercise of voting rights

AFG wishes management companies to have the possibility to justify their choice not to exercise the voting rights attached to the instruments held in the managed portfolios. For votes effectively cast, we think that it would be counterproductive to force to make them public as it could lead to non-voting in

order to avoid being caught in a public debate. Of course any investor should have the right to know what were the votes cast by asking it to the management company.

Chapter 2: Conflicts of interest – Implementation of Article 12(1)(b) of UCITS Directive

AFG calls for a clarification of the definition of 'clients'. Indeed, we strongly believe that it is impossible for management companies to manage a UCITS depending on the individual interests of each of its investors (a UCITS is a community of clients) or manage conflicts of interest between two individual investors in a UCITS (this would not be in accordance with the principle of collective investment). A UCITS is managed in the best interest of all unit-holders; therefore unit-holders have to all be treated equally.

Box 12 - Conflicts of interest potentially detrimental to a client of a management company or to an investor

AFG calls for an alignment with the MiFID rules. Besides, we believe that requirements applying to companies managing discretionary mandates and investment funds should be identical (in our view, differences are not justified).

Box 16 - Management of non-neutralised conflicts

AFG believes that the requirements regarding the management of non-neutralised conflicts should be aligned with those set by MiFID.

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Section II: Rules of conduct

Box 1 – Duty to act in the best interests of the UCITS and its unit holders and to ensure market integrity

Point 3 - We wish to remove any reference to national laws in order to ensure a better harmonisation among Member States.

Box 3 – Direct sales

AFG believes that there is no reason why the requirements presented in box 7 & 8 should apply to direct sales.

Box 4 - Appropriateness test and execution only

MiFID provides that appropriateness tests only apply to retail investors. Following this principle, we believe that such tests should not be required for professional investors.

More generally, we agree that sales should be handled in the same way whether they are made through a distributor or directly by the management company. Consequently, we support the establishment of a level playing field and the use of the same wording as MiFID.

Box 6 - Reporting obligations in respect of execution of subscription and redemption orders

Point (1) – We believe that both points (a) and (b) should not apply where the confirmation notice would contain the same information as a confirmation that is to be otherwise promptly dispatched to the investor by another person.

Point (3) – We would like CESR to clarify what venue this requirement relates to.

Box 7 - Duties of management companies to act in the best interests of the UCITS when executing the decisions to deal on behalf of the managed UCITS in the context of the management of their portfolios

AFG would like CESR to make sure that the wording used to describe these duties is identical to the wording used in MiFID.

Box 8 - Duties of management companies in the context of the management of UCITS portfolios to act in the best interests of the UCITS when placing orders to deal on behalf of the UCITS with other entities for execution

AFG would like CESR to make sure that the wording used to describe these duties is identical to the wording used in MiFID.

Point 3 – AFG believes that management companies should not be required to make available appropriate information to the unit holders on any material changes to their policy, as such a requirement is not provided for by MiFID.

Box 11 - Inducements

AFG is of the opinion that this requirement should be extended beyond the 'quality of collective management portfolio activity' and that it should cover the 'quality of service provided to investors'.

More generally, AFG would like CESR to make sure that the wording used to describe these duties is identical to the wording used in MiFID.

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Section III: Measures to be taken by a depositary of a UCITS managed by a management company situated in another Member State

Please note that our comments on this section are made on the basis of the existing UCITS Directive and do not take into account the potential modifications that will stem from the current Commission consultation on the UCITS depositary function.

AFG fully agrees with the provisions proposed by CESR on the measures to be taken by a depositary of a UCITS managed by a management company situated in another Member State, including the particulars that need to be included in the standard agreements to be used by the depositary and the management companies.

In particular, we support the requirement that the agreement between the management company and the depositary must be harmonised on the key points identified rightly by CESR in its paper. If agreements between management companies and depositaries were fully left at contractual discretion or national discretion, it would obviously harm the smooth functioning of the Management Company Passport.

In addition, we think that such written agreements should be always governed by the national law of the UCITS' home Member State (Box 3), in order to ensure the same legal approach throughout Europe.

Last, we also share CESR's view that domestic written agreements between Management Companies and depositaries should comply with the same standards, once again in order to ensure an equality of treatment between domestic relationships and cross-border relationships within the Single Market.

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Section IV: Risk management

AFG supports largely the provisions proposed by CESR in this section; however, we would like to make general comments on risk management relating to the principle of proportionality and delegation.

- We believe that the requirements set by CESR on risk management should be proportionate to the activity of collective portfolio management. For instance, in small sized management companies, an independent risk management function may not be compulsory. In addition, we think that management companies should be allowed to delegate this function to third parties.

- More widely, we are concerned that in practice some CESR proposals might lead to very high costs if they have to be set up – or even some requirements might appear as impossible to put in place. E.g.:

    - Box 2 para 1 p. 104: there might be some technical difficulties for the risk management function to get access to *all* relevant information. This wording is obviously too wide open and should be more focused in order not to put unduly the risk function teams at legal risk;

    - Box 4 para 1 p. 108: the wordings '*at any time*' and '*might be* exposed' are too wide. In practice, it is not possible to "measure and manage at any time the risks the UCITS theu manage … might be exposed to". The principle of proportionality should also apply to this temporal element as in some cases it is not possible to fully measure and manage the risks on a pre-trade basis or even on an intraday basis;

    - Definitions: the definition of '*liquidity risk*' p. 102 requires to be amended, as it would not fit all types of eligible assets: even liquid instruments may be sold at a high cost even if the relevant market is considered as liquid, as soon as the volume sold is high as compared to the relevant market liquidity: the liquidity risk has not to be based on the types of assets, but more on the volumes sold as compared to the relevant market depth at the moment of the order.

- We are of the opinion that the risk management function may be delegated to service providers. Management companies should not be required to fulfil this task themselves; however, they should be able to monitor this delegation (they should have both the expertise and the resources to do so) and ensure that such a delegation does not create conflicts of interest and that it preserves Chinese walls.

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Section V: Supervisory co-operation

AFG agrees on the proposals made by CESR in this Section.

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If you need any further information, please don't hesitate to contact myself at +33 1 44 94 94 29 (p.bollon@afg.asso.fr) or our Head of International Affairs Division, Stéphane Janin, at +33 1 44 94 94 04 (s.janin@afg.asso.fr) .

Sincerely Yours,

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