REPORT

EUROPEAN PARLIAMENT

Policy Department
Economic and Scientific Policy

WORKSHOP
UCITS

Presentations and Briefing notes

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Table of Contents

PARLAMENTO EUROPEO EVROPSKÝ PARLAMENT EUROPA-PARLAMENTET
EUROPÄISCHES PARLAMENT EUROOPA PARLAMENT ΕΥΡΩΠΑΪΚΟ ΚΟΙΝΟΒΟΥΛΙΟ EUROPEAN PARLIAMENT
PARLEMENT EUROPÉEN PARLAMENTO EUROPEO EIROPAS PARLAMENTS
EUROPOS PARLAMENTAS EURÓPAI PARLAMENT IL-PARLAMENT EWROPEW EUROPEES PARLEMENT
PARLAMENT EUROPEJSKI PARLAMENTO EUROPEU EURÓPSKY PARLAMENT
EVROPSKI PARLAMENT EUROOPAN PARLAMENTTI EUROPAPARLAMENTET

DIRECTORATE-GENERAL INTERNAL POLICIES OF THE UNION
- DIRECTORATE A -
ECONOMIC AND SCIENTIFIC POLICIES

Workshop: UCITS

Programme

15 September 2008
European Parliament, Brussels, Room: **ASP 5G2 15.00-18.30**
(Interpretation DE, EN, FR)

15.00-15.10 **Introduction by MEP Wolf Klinz, Rapporteur (ALDE)**

15.10-17.00 **Session 1: UCITS IV**

- Notification issues, including advertising and marketing and translation of documents.
- Is the Key Investor Information (KII) an improvement on the prospectus, what could be the legal liability?
- Are the provisions for mergers covered adequately? How can any tax implications be addressed?
- The management company passport is not part of the revision proposal but it is explicitly mentioned in the explanatory memorandum and CESR has been given a technical mandate to address some remaining supervisory issues. What are the main issues and challenges in the application of this passport? What would be the benefits of such a passport?

Guest speakers:
- Mr Carlo Comporti, Secretary General of CESR
- Dr Wolfgang Mansfeld, President, Bundesverband Investment und Asset Management, Germany
- Mr Claude Kremer, Chairman, Association of the Luxembourg Fund Industry (ALFI), Luxembourg
- Mr Alain Leclair, President, Association Française de la Gestion Financière (AFG), France

17.00-18.30 **Session 2: How to prevent UCITS from becoming a museum piece?**

- UCITS is a trademark for European asset management. How can this be maintained effectively? It is estimated that 90% of cross border UCITS sales come from Asia and that this trend will continue. How can this affect UCITS? Should anything be changed?
- The role of supervisors is complex in an ever sophisticated financial market. How can they keep control and at the same time give flexibility?
- What are the main differences and advantages and disadvantages between harmonised and non harmonised funds? Risk management, liquidity risk, and marketing.
- Is there a need to rethink the product-based nature of UCITS in order to remain attractive in the long run?

Guest speakers:

- Mr Paul Freeman, Managing Director, Black Rock, UK
- Mr Heinz Macher, Head of Legal, Taxes and Compliance, Raiffeissen Kapitalanlge-Gesellschaft m.b.h., Austria
- Mr Dario Frigerio, Chief Executive Officer, Pioneer Investments, Italy
- Mr Jean- Pierrre Paelinck, Secretary General, Euroshareholders, Belgium

Referent:

Prof. Dr Raimond Maurer, Chair of Investments, Portfolio Management and Pension Finance, Goethe University, Frankfurt, Germany

Curricula Vitae

Session I - Speakers

Carlo Comporti

Carlo Comporti has been CESR's Secretary General since January 2008.

Prior to this, Mr Comporti was the Deputy to the Secretary General of CESR and Director for Markets and Intermediaries in the CESR Secretariat.

He joined the CONSOB in 1994, firstly in the Intermediaries Enforcement Division and subsequently in the International Relations Office. He has been a member of expert groups in the field of securities regulation at the EU Council, Commission, OECD, and rapporteur of the FESCO Expert Group on Investor Protection and then the CESR MiFID Expert Group. Carlo Comporti spent six months at the ECB working on a joint project with CESR in securities clearing and settlement, and one year at the European Commission as a national expert working on the revision of the Investment Services Directive.

He graduated from the University of Siena with a Degree in Economics and Banking and holds a Doctorate in Banking and Securities Law.

He is a visiting professor of Commercial Law at the University of Siena and he has published numerous publications in the fields of securities and company law.

Wolfgang Mansfeld

Wolfgang Mansfeld began working in the asset management industry in 1986, joining Union Investment in 1990 and moving to his current position as Member of the Board in 1999. In 2007 he was elected President of the German Fund Industry Association BVI, where he served as a Board Member since 2002.

Claude Kremer

Claude Kremer is chairman of the Association of the Luxembourg Fund Industry ("ALFI"). Claude Kremer is a partner of the Luxembourg law firm Arendt & Medernach. A member of the Luxembourg Bar since 1982, he holds various positions in legal and industry working groups.

In 2006, following the publication by the European Commission of the Green Paper on investment funds, Claude Kremer was appointed to the expert group set up to report on ways to improve the efficiency of the EU investment fund market.

Claude Kremer is a lecturer at the University of Luxembourg. He is co-author of a book entitled O*rganismes de placement collectif et véhicules d'investissement apparentés en droit luxembourgeois* (Undertakings for Collective Investment and related investment vehicles under Luxembourg Law, Larcier, Brussels, 2nd edition, 2007).

Alain Leclair

Alain Leclair is the Chairman of **AFG** (French Asset Management Association), and was elected to that position in 1997.

Alain Leclair also chaired from 1999 to 2000 **FEFSI** (European Federation of Investment Funds and Companies), which has become the European Federation of Asset Management (**EFAMA**).

Alain Leclair has been Vice-Chairman of the European Savings Institute (**OEE**) since 1999.
He is member of the executive board of **Paris Europlace** and the "**Pôle de Compétitivité Finance Innovation**".

He is a member of the "**Investment Banking Committee**" of the French Banks Association (**FBF**) and member of the advisory board of the **FRR**, the French Public Retirement Pension Fund.

Alain Leclair has held several positions with the investment banking division at **Paribas** and headed its stockmarket division.

He is the founder and chairman of **Paribas Asset Management SA**.

Today he is founder-Vice Chairman of the asset management company "**La Française des Placements**" and Chairman of **Financière de la Cité Asset Management Company**.
Alain Leclair is a graduate of « Ecole des Hautes Etudes Commerciales » (**HEC**, 1962) and also « **Institut d'Etudes Politiques** » de Paris (1964).

Referent

Prof. Dr. Raimond Maurer

Prof. Dr. Raimond Maurer currently holds the endowed Chair of Investment, Portfolio Management and Pension Finance at the Finance Department of the Goethe University. His main research interests focus on asset management, insurance, and pension. He received his habilitation, PhD, as well as Diplom in business&economics from Mannheim University and has previous working experience in the areas of banking, asset management, , and policy consulting. Dr. Maurer holds several professional positions like at the Society of Actuaries, the Association of Certified International Investment Analysts, and the Pension Research Council at the Wharton School of the University of Pennsylvania.

Session II - Speakers

Paul Freeman

Paul Freeman is the Head of the International Product Development at BlackRock, with responsibility for the development of funds domiciled or distributed internationally. He has worked in the investment funds industry for 30 years and has held senior management positions at Schroders, Rothschild Asset Management, Henderson Investors and GT Management (now part of Invesco).

Heinz Macher

Heinz Macher is head of Legal, Taxes and Compliance at Raiffeisen Capital Management in Vienna, Austria. Since 2006 Macher has been a University Lecturer at the Department of Finance & Accounting at Vienna University of Economics and Business Administration. Macher received the Scientific Prize of the International Fiscal Association for his doctoral thesis on “VAT Law in the Single Market” (1995). He has published widely on EU VAT law, investment fund law and corporate governance in asset management.

Dario Frigerio

Dario Frigerio was born in Italy in 1962. He graduated in economics from Bocconi University, Milan, with first class honours and distinction.

After two years spent in university, his professional career started in 1988, when he joined Credito Italiano as a financial analyst.

In 1989, he worked in International and Domestic Treasury Management and, in 1991, moved to Proprietary and Asset and Liability Management, becoming Head of Fixed Income & Currency in 1995 within Asset Management.

In 1997, he became Chief Investment Officer, CreditRolo Gestioni SpA, and held the same post at EuroPlus Research & Management (Ireland) from 1998 onwards, and then that of Chief Executive Officer, Pioneer Investment Management Limited (Ireland) from 2000 onwards.

Dario Frigerio moved to Boston in 2001 when he became Chief Executive Officer of Pioneer Global Asset Management.

In 2004, he was appointed Group Deputy General Manager of UniCredit and Chief Executive Officer of UniCredit Private Banking.

In 2007 he was appointed Deputy Chairman of UniCredit Private Banking S.p.A., the Group's bank serving private customers in Italy.

He is currently holding office as Head of Asset Management Division.

Jean-Pierre Paelinck

Born in Ghent (Belgium) on 9th February 1939 and is married to Hedwine GHUYS (who studied “romance languages” at the University of Ghent).

In1976: doctorate degree in Economic Sciences also from the University of Ghent with a dissertation on "Banking Concentration in Europe".

Currently Secretary General of "Euroshareholders" and Financial consultant accredited by the Centre of Management of the Brussels Chamber of Commerce and Industry

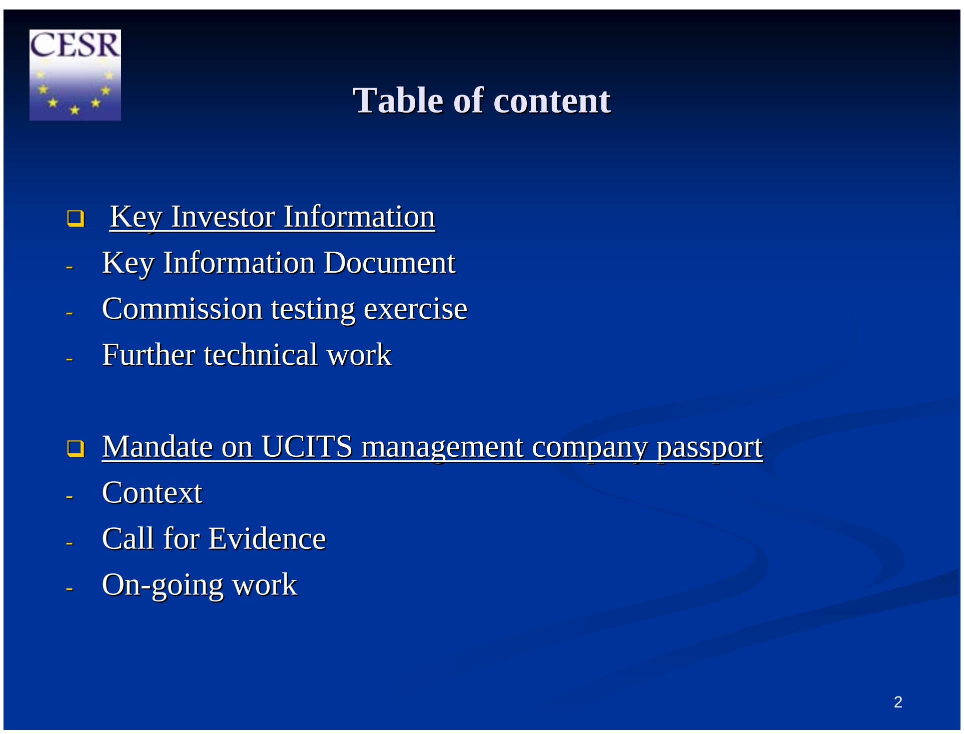
Board member of: Institut de Références des Marchés S.A (Président), Europrivec S.A (Managing Director), Compagnie Financière du Lombard S.A., DUBUS Management S.A. (Lille) and N.V. Immoganda (real estate company).

Honorary Consul of Guatemala in Ghent

Slides

Session I - UCITS IV

Presentation by
Carlo Comporti
Secretary General of CESR



KID: Key Information Document

- Following two-month consultation, advice delivered to the Commission in February
- Key recommendations:
  - Limit length of document to 2 sides of A4 for all funds
  - Test two options for risk/reward disclosure: synthetic risk/reward indicator and improved narrative
  - Use 10 years of past performance information where available; bar charts and percentages preferred
  - Test two options for charges disclosure: improvement of existing approach, or addition of ‘summary’ figure; latter approach requires certain assumptions e.g. investment period

3

KID: Commission testing exercise

- Testing of KID with investors
- Testing based on CESR’s advice of February 2008
- Two phases involving quantitative and qualitative testing
- Ongoing CESR input on questionnaires, variants and analysis of results
- Individual disclosure elements tested at Phase 1, full mock-ups of KID at Phase 2
- Results to feed into CESR’s final advice for delivery in mid-2009

4

CESR

KID: Further technical work

- <u>Further technical work following advice to Commission</u>
- Risk/reward
  - Calculation methodology for synthetic risk/reward indicator
- Past performance
  - Calculation methodology, handling of benchmarks, material changes, simulated performance
- Charges
  - Calculation methodologies for TER, use of ex-ante vs ex-post data, handling of performance fees & transaction costs, ‘summary’ figure
- Structured/formula funds
  - Specific risk/reward profile; past performance not relevant so consideration of prospective and historical simulations
- Consultation early 2009

5

CESR

Mandate on UCITS management company passport

- <u>16 July 2008:</u>
  - European Commission’s proposal to amend the UCITS Directive
  - Request for assistance from the European Commission to CESR on UCITS management company passport
- <u>UCITS Management company passport in the Directive proposal:</u> no provisions due to concerns on the effectiveness of the supervision, but an explanatory text asking CESR to address them with a view to introducing amendments
- <u>1st November:</u> advice to the European Commission on:
  - Structure and principles that should guide potential future amendment to the Level 1 UCITS Directive
  - Fields that could be addressed through Level 2 measures.

6

Call for Evidence

- Broad support for the management company passport
- Emphasis on the need to avoid burdensome framework and additional costs
- Lack of harmonisation in certain areas (organisation and risk management requirements, depositary…) may raise supervisory issues
- Need for a clear split of functions and responsibilities between players (UCITS, ManCo, depositary) as well as between regulators
- Need for efficient cooperation between regulators (supervision and enforcement)
- Suggestion made to require some physical presence in the MS of the UCITS.

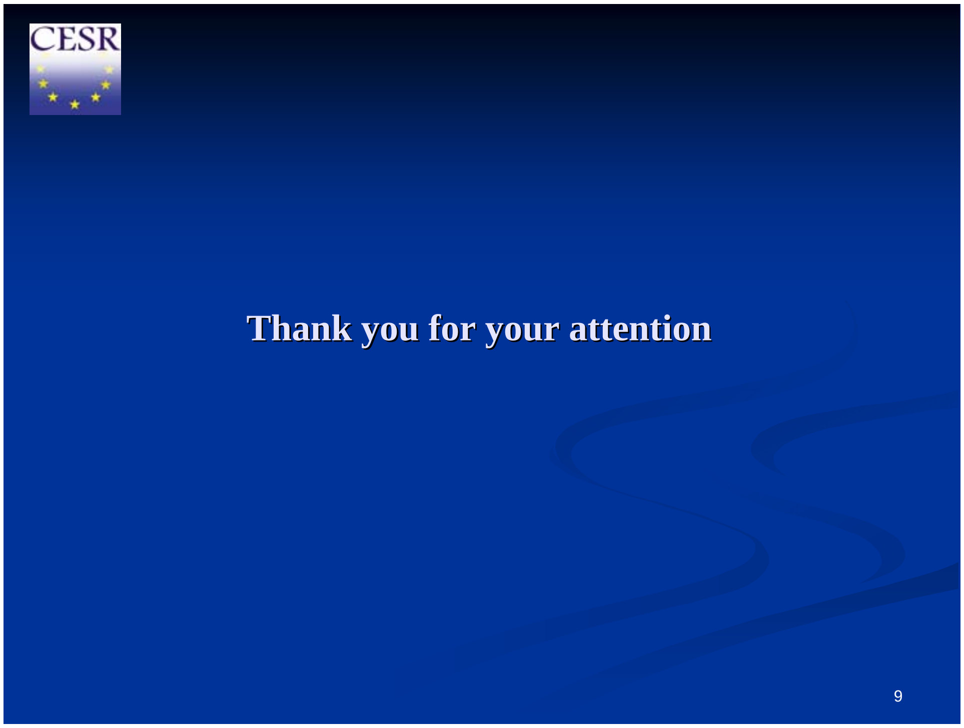
7

CESR's work on the mandate

- Reflection conducted within the Investment Management Expert Group chaired by Lamberto Cardia, Chairman of CONSOB.
- European Commission as an observer
- Consultation: Open hearing 13 October 2008
- Main issues identified

- Identification of non-harmonised rules and supervisory concerns that may arise. Which split of supervision between regulators?
- Depositary: in the UCITS MS, which role? Which relationship with the management company?
- Which flow of information between regulators and other players?
- Which framework for an effective enforcement (contractual funds)?
- Possible physical presence in the MS of the UCITS. Which benefits to the supervisory framework?

8


CESR
Thank you for your attention
9

Presentation by
Dr. Wolfgang Mansfeld
President of BVI

UCITS-Workshop

Dr. Wolfgang Mansfeld
President BVI

Brussels, 15th September 2008

BVI

Remarks regarding UCITS IV

On the Key Investor Information

- Right way but impact on consumer choice not be overestimated
- Level playing field issues to be kept in mind

On the Management Company Passport

- Industry taskforces concluded that (almost) full passport is possible without creating regulatory gaps
- No indication that retaining administrative function in fund domicile is condition for effective fund supervision.

BVI

2

Presentation by
Claude Kremer
ALFI Chairman

UCITS IV

EP Workshop 15 September 2008

Claude Kremer, ALFI Chairman

1

UCITS IV

- ALFI welcomes the draft directive released on 16 July 2008
- All topics of the draft directive will bring further efficiencies to the overall UCITS framework
- Draft directive not to be seen as dependent on the outcome with regard to ManCo passport
- ALFI participated in the CESR call for evidence on ManCo

2

Notification Procedure

ALFI welcomes the new version of the notification procedure:

- Regulator to Regulator notification process
- No ex post control on UCITS IV matters by the Host Member State competent authorities that remain only in charge for provisions falling outside the UCITS IV scope, marketing and disclosure purposes and operations linked to paying agency services
- Cost efficient and speedier time to market
- Simpler language regime, translation only mandatory for the KIID

3

Key Investor Information Document (KIID)

ALFI supports the Commission's approach and stresses:

- Conciseness: focus on the key investment objectives, risks, fees and performance indicators
- Simplicity of terminology: same regime as applicable for the summary of the prospectus regime
- Harmonisation: permits promoters to use the same document across the European Union
- Comparability: allows retail investors to compare UCITS products EU wide.

4

Mergers: the way ahead

ALFI supports draft provisions on mergers:

° Competence of the regulatory authorities of the merging fund
° Depositaries of both merging and receiving fund to verify the common draft terms of merger
° No disqualification of the merging and receiving independent auditors
° Exit solutions for disagreeing unit holders

5

Management Company Passport (MCP)

ALFI participated in the CESR call for evidence and raised the following issues:

° UCITS global brand
° Product-centred regulation
° No empty shells
° No new or additional risks, uncertainties, inefficiencies or complexities
° Cost/benefit analysis

6

Management Company Passport (MCP)

- CESR must address all such issues (not only some remaining supervisory issues) in order to make sure that the potential advantages are not outweighed by legal, regulatory or tax risks and uncertainties

- Current high level of investor protection must not be put at risk

7

Thank you

www.alfi.lu

8

Presentation by
Alain Leclair
Chairman of AFG

UCITS IV

Workshop, European Parliament
September 15, 2008

Alain Leclair
Chairman,
French Asset Management Association
(EFAMA Board member)

Introduction

- **We strongly support** the revision of the UCITS Directive, on which AFG and EFAMA have been working for many years in *close association* with the EU Commission and the European Parliament
- With a **crucial pre-requisite for the full revision package:** an *enhanced cross-border cooperation between regulators*
- **And with essential objectives** to the benefit of both investors and European fund industry to:
  - *realise economies of scale and foster competition*
  - *improve transparency*
  - *keep pace with innovation*
  - *reinforce the UCITS 'brand' Competitiveness at worldwide level*

2

1. Notification

- **Major improvement** to speed up the cross-border notification of funds:
  - ‘regulator to regulator’ procedure
  - ex post control of the marketing/advertising rules by the host regulator
  - English as a possible language of communication between regulators

- **A remaining issue for AFG**: the *maximum time frame* set up (1 month) for the home regulator to communicate the file to the host regulator. AFG requests for 3 days, which currently applies to the other financial products (Prospectus Directive): need for level playing field with other ‘substitute products’

3

2. Key Investor Information (formerly « Simplified Prospectus »)

- Major improvement to enhance **investor investigation** through **the EU Commission’s and CESR’s constructive approach** towards:
  - a principle of *full harmonisation* and *simplification* of the document
  - *4 key information items* (invest. objectives, past perf., costs and associated charges, risk/reward profile)
  - a *maximum two-page Key Investor Document (KID)* developed by CESR

- **Remaining issue for AFG**:

  Preventing *other key information items* from being added by national regulators

4

3. Mergers

- **One of the major sources of economies of scale**

- Will allow for **urgently needed cross-border rationalisation of fund ranges** (with appropriate tax treatment, either through a EU Commission's Communication and/or through bilateral agreements between regulators

- **Remaining issue for AFG**: need for *time frames* shorter than 1 month to authorise domestic mergers (e.g. one week under French law)

5

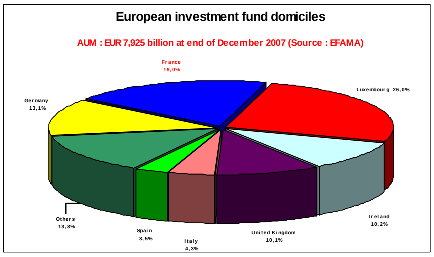
4. Master-feeders

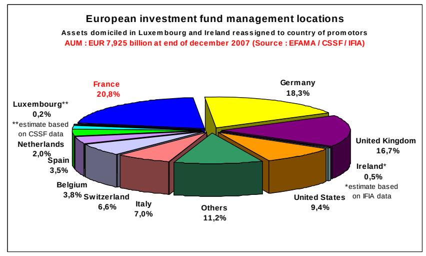
- **One of the other sources of economies of scale**
- A tool for **European asset management integration**
- **Long-standing experience in France** for 10 years with 799 feeder funds and 667 master funds representing € 352 bn.
- **AFG's remaining request to enhance investor protection:** adopting appropriate (and clearer) measures at the feeder and master levels to avoid *late trading*

6

5. Management Company Passport (1/4)
mapping of the EU fund industry and location

- Where the EU **fund management** business is located:





- Some Member States are mere countries of fund domiciliation and not real fund financial management places

7

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5. Management Company Passport (2/4)
Main expected benefits

- Economies in terms of structure and capital requirements: € 380-760 Mio per year for European management companies (EU Commission)

- Fostering competition among EU management companies thanks to:
  - lower costs
  - a wider range of ManCos will be able to set up foreign UCITS
  - and an easier access to more ‘entrepreneurial’ actors from many Member States

8

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5. Management Company Passport (3/4)
legal background

- **The ManCo Pass has not been included in the European Commission's proposal**

- **Treaty establishing the European Community** (Art. 43 and 49): *« 2 'fundamental freedoms' central to the effective functioning of the EU Internal Market » (Eur. Com. website)*: **Freedom to provide services** (i.e. on a cross-border basis) and **Right of establishment** (i.e. through a foreign branch)

- **Need to solve the current contradiction in the UCITS Directive**: the 2 'fundamental freedoms' (*Art. 6 UCITS*) have no effect for management companies, since UCITS and management company are required to be in the same Member State (*Art.3*)

9

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5. Management Company Passport (4/4)
operational proposal

- **Clear supervisory approach**:

  - **Fund rules** under the supervision of the **fund regulator** and

  - **ManCo organisation and functioning rules** under the supervision of the **ManCo regulator**

- … complemented by **enhanced cross-border cooperation principles** (and role of CESR)

- **Additional safety measure**: depositary will remain in the fund domicile

- **Huge improvement for investors**:

  - more transparency: the fund regulator will be in direct connection with the financially managing ManCos located in the EU

  - wider choice of funds

  - lower management costs

10

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Session II - How to prevent UCITS from becoming a museum piece?

Presentation by
Paul Freeman
Head of International Product Development

BlackRock

Paul Freeman
Head of International Product Development

15 September 2008

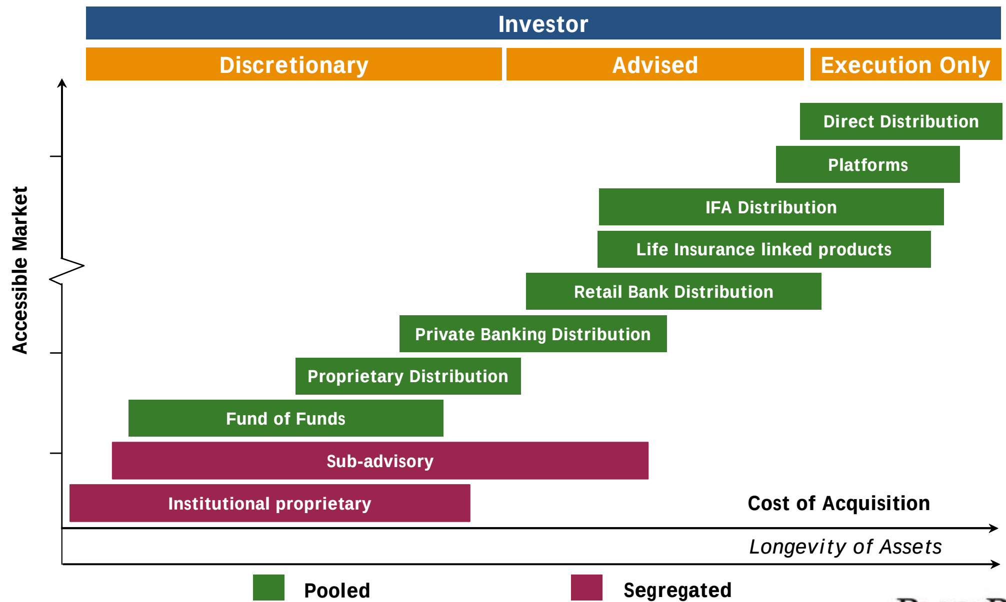
BLACKROCK

BlackRock Overview

- BlackRock is one of the world's largest publicly traded investment management companies with $1.43 trillion (€989bn) under management
- We have $133bn of Dublin, Luxembourg and UK UCITS
- Globally we have over 5,000 employees, based across 24 countries, in nearly 50 locations
- We are currently ranked #2 in cross-border retail funds*
- Our UCITS are registered in 35 jurisdictions, 16 of which are non-EU
- 47% of BlackRock's 2007 UCITS sales were generated from outside the EU

**Source: Feri FundFile, May 08. All other information sourced internally.*

Investment Fund Distribution Channels



2 BlackRock Template - Hardcopy BLACKROCK

UCITS as a 'Global' Brand

- UCITS represents an understood standard around the world, with both distributors and regulators
- It is recognised for its strong investor protection safeguards – (e.g. prudent investment powers, liquidity requirements and risk management)
- UCITS III, while critically important for innovative product development, generated unintended concerns outside the EU
- We should remember that we are selling to their citizens. Are we so accommodating the other way around?
- We should be proud of the success of UCITS – it is a fantastic endorsement of good European regulation
- But we must ensure that future development considers the global nature of UCITS distribution

3 BlackRock Template - Hardcopy BLACKROCK

Current Product Design Requirements

	Harmonised (UCITS)	Non harmonised
Investment Powers	Prudent	Wide ranging
Investment diversification	Broad	Narrow
Liquidity (Investor access)	Easy access	Restricted access
Risk Management	Prudent	Prudent
Investor disclosure	KII	KII

- Investors should be allowed access to both types of product
- Regulatory focus on non harmonised for Retail should be at point of distribution, with a minimum standard of Product Regulation
- Development of a "harmonised" private placement regime for institutional investors

The UCITS Challenge

- Developing UCITS regulation has never been easy!
- UCITS IV should have been though – it's *only* a simple package of efficiencies, isn't it?
- The real challenge for regulators is the 'institutionalisation' of UCITS
- The danger is that UCITS tries to offer every solution to all situations
- To remain a 'gold standard' UCITS needs to have limits – it can only be stretched so far
- Solution =
  - Development of an accepted standard for non harmonised funds (2nd Tier Regime)
  - Private Placement regime

The following notes should be read in conjunction with the attached document:

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Presentation by
Heinz Macher
Raiffeisen Capital Management

Workshop UCITS

How to prevent UCITS from becoming a museum piece?

European Parliament, 15 September 2008

Heinz Macher
Raiffeisen Capital Management

> Raiffeisen Capital Management

- Asset Manager of the Raiffeisen Banking Group, the largest private banking group with an Eastern European Strategy
- Market leader (21,9% market share in Austria)
- Total assets under management: about EUR 35 bn
- Strongly growing foreign business
  - Germany, Italy, France, Eastern Europe

> How to prevent UCITS …

… through
- meeting the investor's needs and protecting their interests!
- preserving the unique UCITS brand!

This means …

- maintaining the success factors of UCITS
- achieving further economies of scale (UCITS IV!)
- abolishing administrative barriers & tax discrimination
- fair competition between substitute products (Level Playing Field!)
- no opening of the UCITS Directive to regulate Real Estate Funds or Hedge Funds

Raiffeisen Capital Management

> … from becoming a museum piece?

Maintaining the success factors of UCITS
- Reduced management risk through supervised management
- Reduced investment risk through risk-spreading principle
- Product and cost transparency
- Comprehensive information for the investor

Investor protection!

Achieving economies of scale & abolishing barriers
- Fund pooling (master-feeders structures)
- Cross-border merger
- Management Company Passport
- Simplified, cheaper & quicker notification for cross border distribution

UCITS IV!

Achieving a "Level Playing Field"
- Equal level of regulation for substitute (competing!) products (especially regarding cost transparency)

Call for a fair competition!

Raiffeisen Capital Management

> To answer the questions …

The success of UCITS in Asia …

- gives proof of the quality of UCITS
- reminds not only to think European but globally as well
- shows the need for global cooperation between supervisors

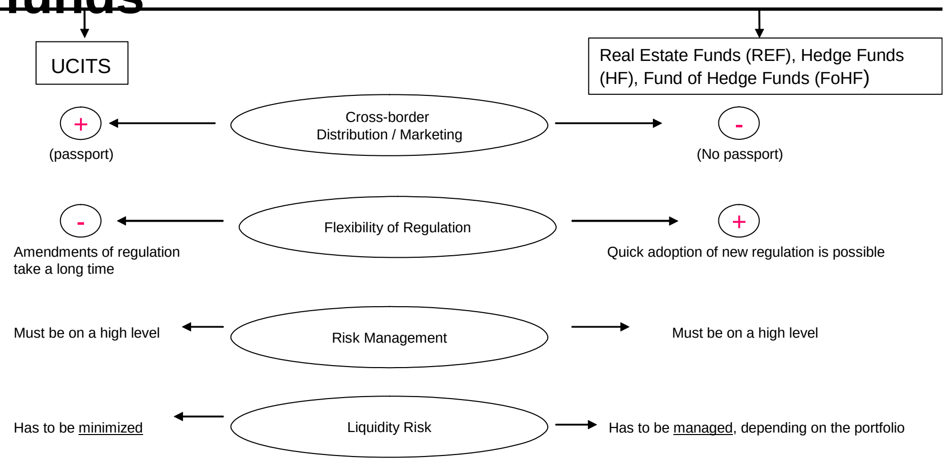
Role of supervisors in a sophisticated financial market

- Flexibility and sound supervision can be achieved by …
  - Principle-based supervision instead of overregulation
  - Reasonable supervision instead of hindering supervision
  - Improved and intensified communication by using electronic communication
- “Cross-border industry” needs “cross-border supervision”
  - “Cross-border supervision” through clear and systematic allocation of responsibilities and cooperation between the authorities of different countries
  - This splitting of supervision works already – e.g. under MiFID - and is necessary for an efficient supervisory of the international operating fund industry (cross-border merger & pooling, Management Company Passport)

 5

Raiffeisen Capital Management

> Harmonised - non-harmonised funds



- For REFs and FoHFs, an EU framework for cross-border (public) marketing is necessary (outside of UCITS Directive)!
- For harmonised and non-harmonised funds, a private placement regime is necessary!
- EU product regulation for single Hedge Funds!

 6

Raiffeisen Capital Management

> To answer the questions …

- Is there a need to rethink the product-based nature of UCITS in order to remain attractive in the long run?
  - Not a discussion for the short time.
  - Any modification would have to avoid damaging the UCITS brand
  - Product-based nature could be optimized through principle-based regulation (“prudent person” rule)
  - At the long term a risk-based regulation should be discussed

 7

Raiffeisen Capital Management

> To come to an end …

Thank you for your attention and …

… we would appreciate your support on these issues!

 8

Raiffeisen Capital Management

Presentation by
Dario Frigerio
Global CEO - Pioneer Investments

Dario Frigerio Global CEO – Pioneer Investments

Presentation to the European Parliament- Detailed Background Version

15 September 2008

80 years

PIONEER Investments

Introduction – *Dario Frigerio*

- Chief Executive Officer, Pioneer Global Asset Management S.p.A., which is 100% owned by the UniCredit Group
- Has an extensive experience in investments and in distribution of financial services
- Is actively involved in European regulatory affairs, has been Director of Efama and has participated in CESR hearings

PIONEER Investments

Presentation Title | May 2008 | Page 2

Pioneer Investments - A World-Class European- based Asset Manager

Building Trust, in Partnership with Financial Professionals, Since 1928

Global presence

- Distribution in 27 countries
- Around 2,500 employees, including over 400 investment professionals[1]
- Major global investment hubs in Boston, London, Dublin and Singapore, supported by 12 local investment centers

Industry distinction

- Fitch rated since 2004, with M2+ Manager Rating ("Strong") confirmed by Fitch in July 2008[4]

Breadth of business

- Total assets: **215 billion**[2] **Euros**
- **Top 3**[3] in Italy, Austria and Poland

Strong parentage, with corporate independence

- One of the top 10 banks in the world
- Strong corporate governance (majority of Independent Directors)

1. Source: Pioneer Investments as at June2008. Data includes estimates for Austria.
2. Source: Pioneer Investments as at June 2008. Data includes AUM of Pioneer Austria, which is yet to be incorporated legally
3. Source: Unicredit Research & Strategy on Total net Assets as at March 2008
4.Fitch Ratings' Manager Rating applies to the Milan, Dublin and Boston operations of Pioneer Investments

PIONEER Investments

How to maintain UCITS as a trademark

- **Governance** The existing corporate governance arrangements for UCITS must remain an important distinctive feature in order to **provide best consumer service** with a continuous improvement towards **independence, disclosure and self-regulation**. We are confident that, subject to some changes required to the existing draft package and the inclusion of a workable management company passport, the UCITS model is adequate for the medium term
- **Level playing field** The issue is not so much changing the UCITS framework beyond what is proposed in UCITS IV as finally creating a level playing field for UCITS against competitor products (structured products/ insurance products of all kinds) which are currently sold on the same shelf but without a requirement for the same corporate governance, risk management or disclosure regimes available to investors in UCITS
- **Harmonization** We support CESR's efforts to harmonise practices in areas such as eligible assets , lists management etc and believe its work is continuing to enhance the single market for investment funds.
- **Efficiency in long-term savings** The goal should be to reinforce UCITS position as a critical brick in long term retirement planning both inside and outside the EU;
- **Global reach** The quality of UCITS has received international recognition. The active support of EU agencies to consolidate and build on relationship with third country supervisors to facilitate the proportions of the UCITS brand globally,

PIONEER Investments

Supervisors. How can they keep control and at the same time give flexibility?

- **Enhanced co-operation** brings benefits both in terms of regulatory efficiency, investor protection and, if it works correctly, will provide benefits to the industry by easing market access and avoiding the need to create bespoke solutions for each market;
- In this context, **we support the UCITS IV package proposal** to enhance the regulatory co-operation tools at the disposal of UCITS Supervisors; We also support the recent CESR consultation in this area; It is important however that these measures do not increase the administrative and compliance burden on promoters.
- Such cooperation is key to the success of the **cross-border merger and master feeder fund, management company passport** proposals and the **putative management company** , In the absence of such cooperation framework, we are very concerned about the workability of the improved notification process, the cross border mergers proposal, the master feeder proposal and the proposed

PIONEER Investments

Presentation Title | May 2008 | Page 5

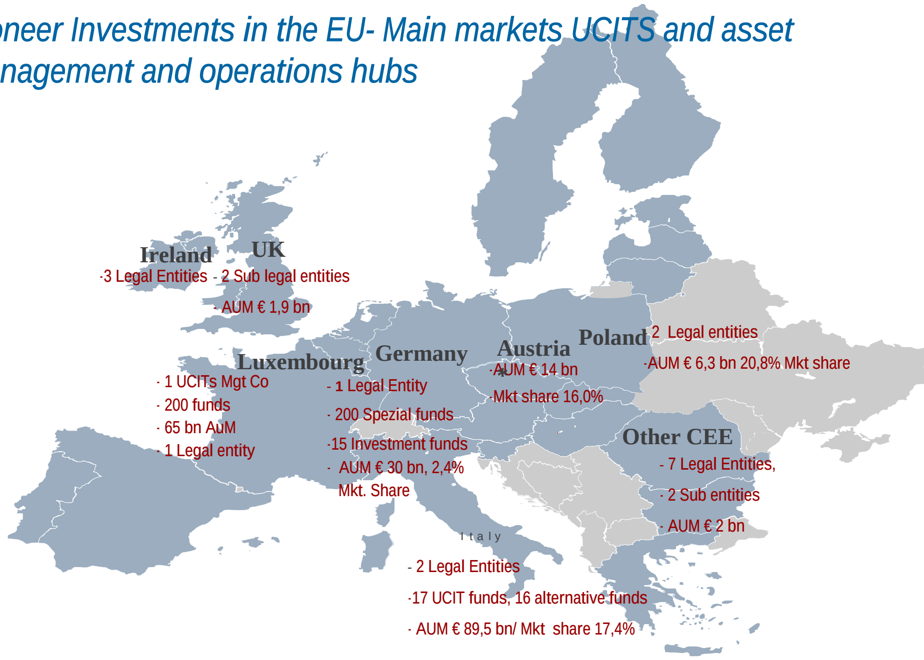
Pioneer as a case-study for UCITs IV impact assessment…

- As is well known, legislative proposals for amending UCITs IV have gone through **EU impact assessment analysis**
- It is important to remember that such analyses have led to the **recommendation for legislative action** to enable
  - **greater efficiency** in the industry enabling Fund Mergers, forms of Asset Pooling and also
  - **greater organizational flexibility** through the Company Management Passport
- **Pioneer Investments** as a pan-European player is a good case: it would **experience directly the potential benefits of the UCITsIV package**

PIONEER Investments

Presentation Title | May 2008 | Page 6

Pioneer Investments in the EU- Main markets UCITS and asset management and operations hubs



PIONEER Investments

NB Investment hubs in Ireland, UK, Italy, Germany, Poland

NB: Additional Pioneer Presence in terms of sub legal entities in Spain, France and The Netherlands

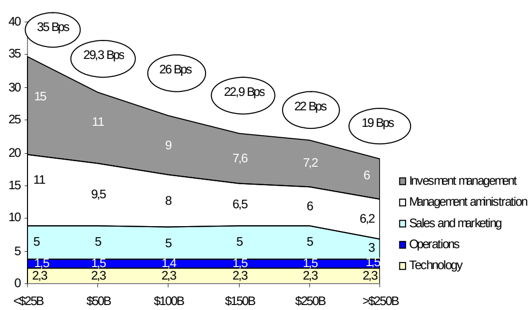
* Austria is not yet legally owned by PGAM, however the company is managerially under Pioneer responsibility and Pioneer has the majority in the Supervisory Board.

Presentation Title | May 2008 | Page 7

Potential benefits of asset pooling. Cost curves by size of firm Scale benefits exist and deregulation can help attain them

Cost per AuM, 2006

Bps



AUM firms

Source: 2006 McKinsey Asset Management Benchmarking Survey. **Please do not quote**

Our exercise was conducted estimating costs for two different sizes of firm (100 Bln and 50 Bln Euro AUM) and evaluating the benefits from merger. Results show that:

- **3,4 bps to be gained from scale**, essentially from Management administration and Investment management costs;

- before merger of Funds average costs amount to 26,3 bps;

- after merger costs would decrease to 22,9 bps;

- **a consequent reduction of costs equal to 12,9% is expected.**

PIONEER Investments

Presentation Title | May 2008 | Page 8

Harmonised and Non-harmonised Funds: differences, advantages and disadvantages

- **Harmonised Funds** regulation needs to remain sufficiently **consistent** across time if the UCITs brand is to be maintained. **Specific categories of harmonized funds** (in parallel with UCITs) to be crated for **real estate** and **alternative investments**?
- **Non-harmonized funds** have proven an excellent way to **experiment and test innovative vehicles** prior to broadening of Harmonized funds regulation
- At the present stage of market development, however, the **non-harmonised nature** of certain types of funds (real estate funds, hedge funds, funds of hedge funds) **may limit the ability of promoters to distribute these product types effectively cross border;**
- Moving away from the retail space, there is a pressing need (despite the Commission's recent conclusion to the contrary) to develop a pan-European **private placement regime** facilitating **cross-border marketing of non-harmonised product to 'institutional' investors**

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The case for harmonizing alternatives

- Increasingly **there is wider demand for access to alternative investment strategies** in particular, hedge funds and funds of hedge funds however the non – harmonised nature of these products severely limits the ability of promoters to distribute these products effectively cross border;
- The result is that these products can only be accessed by a wider audience through **locally authorised schemes or structured products and certificates. This failure of the single market causes significant additional costs** to investors who pay for the establishment costs of locally authorised schemes or structured products with diminished investor protection;
- We support the **development of a <u>specific</u> harmonised funds of hedge funds European (in parallel with UCITs), regime provided the essential characteristics of the funds of hedge funds product in terms of liquidity, risk diversification and other elements are retained**. Dilution of these essential characteristics would undermine performance and ultimately the reputation of the product. Past experience in certain member states is evidence of this risk. Subject to certain conditions these products should be capable of being sold as a retail product;

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The product-based nature of UCITS. A need to rethink it in order to remain attractive in the long run?

- **It would be disadvantageous to replace the product based** nature of the UCITS regime with, for example, a **risk based regime** that could presumably apply to all product types;
- **Mutual Funds have, overall and specifically in the markets where they are more established and where the investments culture is broader emerged stronger from the "credit crunch"** . In the USA, but also in the UK and to some extent in France and Germany flows in money market, bond and equity funds have been impressive, despite the global turmoil.
- This is **testament to the effectiveness of the regime which combined sophisticated risk management techniques with strong independent roles for the depositary bank, board of directors or trustees and the auditors**; these functions combined make for a product that should continue to be capable of standing the test of time;
- **MiFid** has shown it can successfully include the role and nature of UCITs within a risk-based framework
- **Expand the reach in terms of product coverage and risk control while maintaining their robust governance**

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Presentation Title | May 2008 | Page 11

Looking ahead- UCITs as a key to retirement and other savings programs

UCITs to play a unique role in life-cycle savings programs

:

- Distinctive features: **strong governance** and **risk control**, **accountability**
- Ability to provide **broad diversification at low costs**, ideal for asset allocation programs
- **"Bricks" for dc pension plans**, unit linked policies, accumulation programs in general
- **Flexible "de-accumulation**" financial programs for protection against uncertainty and in first phase of retirement

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Presentation Title | May 2008 | Page 12

Annex- The Household savings flows and the Mutual Fund Industry in the current turmoil

The sub-prime tornado: how do households react in different countries?

2007-2008	Currency & Deposits	Money Market MF	Asset allocation products: Mutual Funds , Life Insurance& Pension Funds	Bonds
US	*	****	***	**
UK	***	**	***	
France	***	*	***	
Italy	****			***
Germany	***	*	****	

Key Findings:

- Generalized flight to quality
- Money Market Mutual funds- big winners: $250 bn of Money Market net inflows in four months in the US. Asset allocation products speeding up in 2008
- Resilience Asset allocation products observed both in US and Europe

Mutual Fund flows and the turmoil July 2007- June 2008
Strongly positive in the USA and Asia, differentiated in Europe

bn €	Italy	Germany	UK	France	US	Asia
Equity	-33	-4	-12	-15	58	107
Bond	-55	-12	5	-5	82	28
Money Market	7	-1	2	-54	529	27
Other	-18	37	7	-39	-9	72
Total	-99	20	1	-113	660	234

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Note: "Others" generally includes Balanced, Total Return, Flexible, Real Estate and Alternatives (mostly Balanced , Flexible and Hedge funds in Italy; Balanced , Real Estate and Hedge in Germany; Balanced and Guaranteed funds in France; mostly Balanced in US and UK.

Presentation by
Jean-Pierre Paelinck,
Dr. Economics Ghent University

The investors' position

- High quality professional "fund management' activism"
- Acceptable performance (so far….) with shared benefits
- Sufficient (cross-border) choice of funds at affordable cost
- Key Investor Information with real intention to inform !

Euroshareholders 3

Supervisors as investor protectors

- Investors not directly concerned by management company passport (a supervisory challenge!)
- In favor of electronic notification from regulator to regulator because of less red tape

Euroshareholders 4

Fund mergers to reach critical size

- Pooling of fund assets towards more efficiency
- master-feeder formula without additional costs to the investor

EurosharehoIders 5

Errors of the past

- Excessive remuneration of fund managers
- Excessive costs
- Not so visible wisdom in recent financial turmoil in which both fund managers and investors seem both to have been misled

EurosharehoIders 6

Keep it simple

- Welcome the replacement of 10 directives into one UCITS IV to support European economic development
- With a "codified part" (rules that are not expected to change)
- Not sure about a general need to provide information into each local language
- Investors finally to really share benefits !!!

UCITS IV

Briefing papers by members of the Financial Services Expert Panels

Report on the legislative proposal amending the UCITS directive ("UCITS IV")

Briefing Paper for the Committee on Economic and Monetary Affairs of the European Parliament

Didier Davydoff

Managing director of IEM finance

Executive Summary

The UCITS directive is fairly different from other directives in the financial sector. It was the first directive implementing a European passport and it is not covered by the Lamfalussy process, which makes the European regulation clearer and more flexible. In the investment funds industry the passport is given to products rather than intermediaries.

UCITs are a very successful "European invention" which are sold not only in Europe but in other parts of the world also, especially in Asia where the demand is rising rapidly. As the investment funds industry is currently suffering from market conditions, it is important to ensure that the regulation is efficient enough to compete with other types of products and to continue to grow abroad. The proposals of the Commission are moving in that direction and should therefore be approved.

The barriers to marketing funds in other member states will be removed. The regulator of the host country will no longer need to check the suitability of funds coming from other member states. However, the proposal could go even beyond its current wording: the regulator of the home member state should not require a one month time frame in which to trigger the authorisation of the fund in other member states: other products such as warrants and certificates have much shorter delays.

The Commission proposes to facilitate the merger of funds. This could have a major impact on the industry, as successful funds on a domestic scale are often duplicated in another jurisdiction to be sold outside Europe. These funds will be easily merged. If there is no passport for management companies, this might lead to a concentration of the industry in a few financial centres. If a true passport for management companies is implemented, then the concentration of funds will increase but the industry could still be decentralised. In any case, the depository will still have to be based in the same country as the fund. Hence the increased concentration of funds will increase the concentration of depositories and other ancillary services (lawyers, accountants etc.) in international domiciliation centres.

The Commission also proposes to implement a "simplified prospectus", which can be seen as a source of cost in the short term, and as an investment in the long term as it will facilitate the selling of funds to private investors.

It would also be useful to extend the passport to some categories of current non-harmonised funds: private equity funds, real estate funds and hedge funds or funds of hedge funds. However, this target is difficult to reach as exchanges of views on these products between regulators are still at a preliminary stage. Hence, it would be wise to first extend the list of eligible assets of UCITs to these types of funds. In a second step a formal passport could be given to these categories of funds.

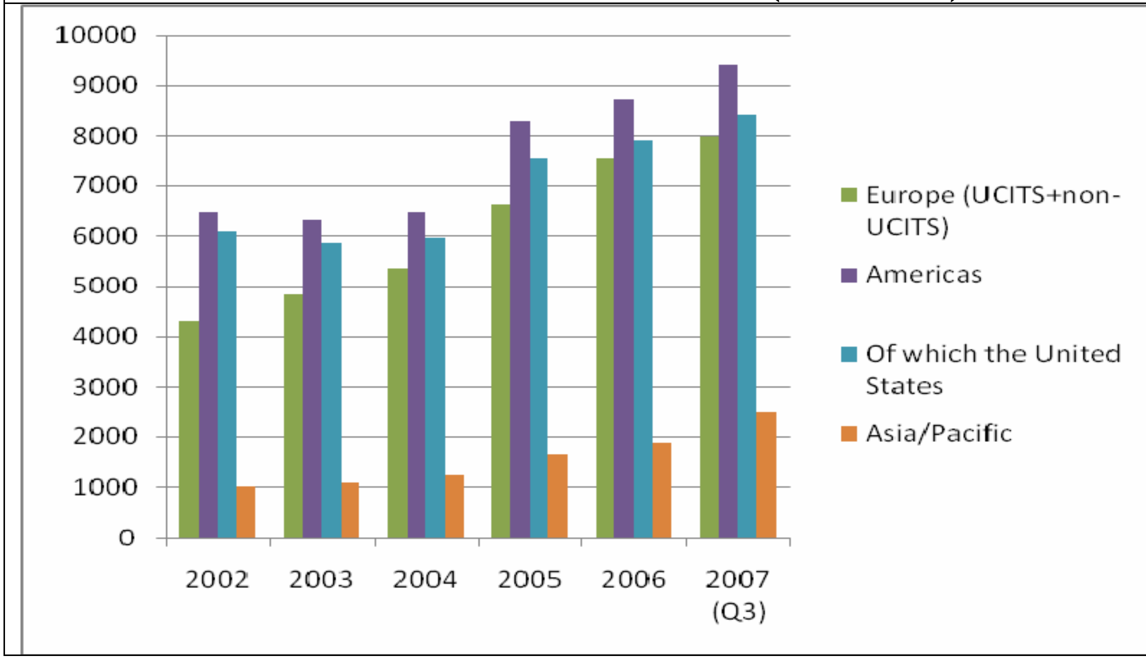
The European Parliament has asked me to answer the following question: "UCITS is a European invention and has been very successful since its inception. It now threatens to fall back if European regulation is not flexible enough in order to create a true single market platform. Is the current UCITS IV proposal sufficient in your opinion?"

A. General background of the proposal of the Commission

The UCITs directive specificity as compared to other directives in the financial area is threefold:

1. It was the first directive implementing a European passport within the European Union. Hence some characteristics of later directives could not be included. These included the Lamfalussy process, which is not applicable to UCITS. This segment of the market may suffer from a lack of flexibility and clarity in the respective roles of different levels of regulation and implementation of such regulation.
2. The UCITS directive provides products with a European passport, rather than to intermediaries. There has been an attempt to create a European passport for management companies but it failed in practice. Hence the architecture and the philosophy of this directive is fairly different from other financial services directives. Nevertheless, the directive has to be articulated (avoiding any inconsistency or over-lapping) with other directives, especially the MIFID.
3. Lastly, it is a unique experience of a European regulatory initiative translating into a business success. UCITS are a “European invention”. Whereas financial products are more developed in general in the US than in Europe, the size of the European investment funds industry is comparable to the one in the US. At the end of the third quarter of 2007, total net assets of investment funds in Europe amounted to around 8,000 billion euros (8,408 in the United States). Over the past five years, the European investment funds industry has caught up with the US, but this is partly due to the effects of exchange rates (the weakness of the US dollar).

Total net assets of investment funds (billion euros)

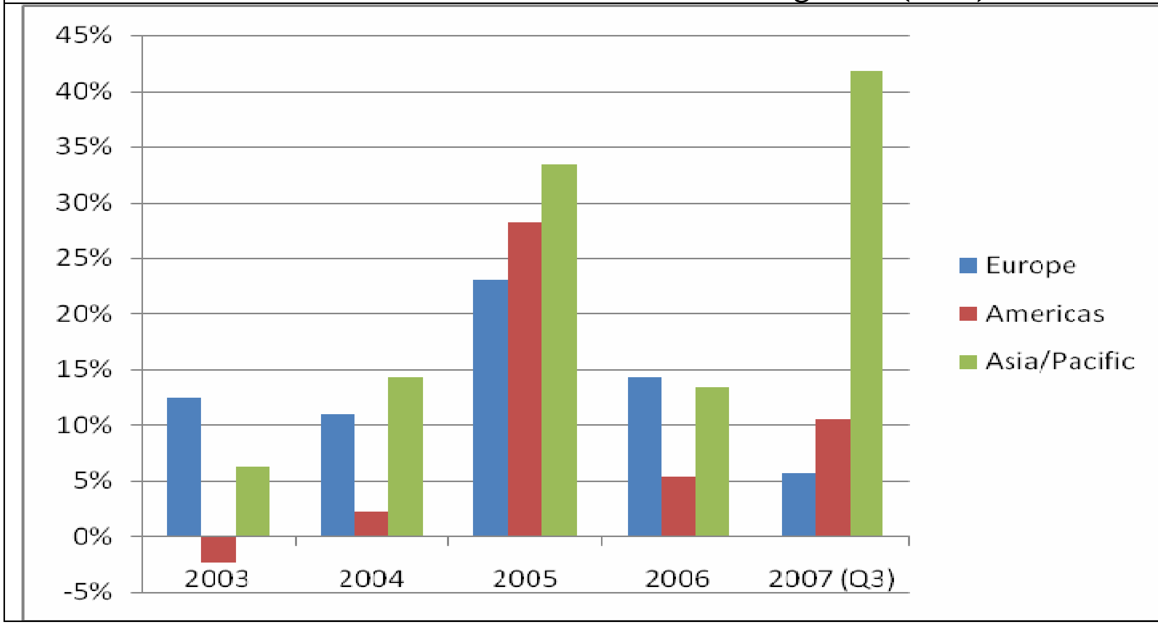


Source: EFAMA

22% of total net assets of European investments funds are non-UCITS. Main non-UCITS funds are institutional funds (936 billion euros at end of 2007) and real estate funds (199 billion euros). It can be argued that, at least for institutional funds, the reputation of UCITS also contributes to the success of non-UCITS funds worldwide.

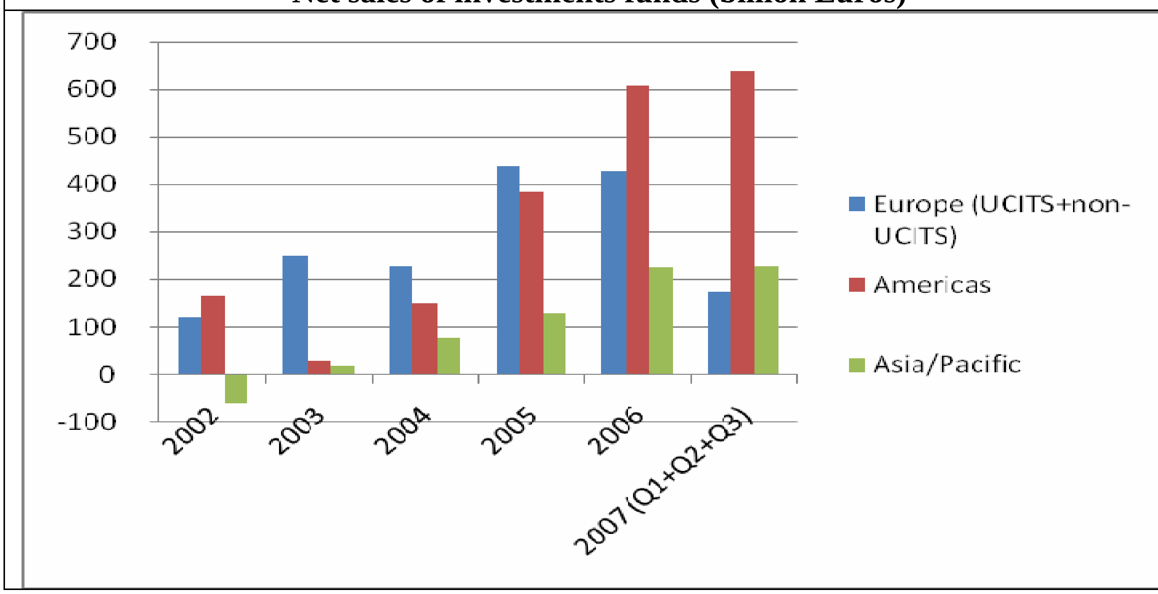
Some signals appeared in 2007, which could be interpreted as a threat on the contribution of UCITS to savings in Europe. The annual growth of net assets slowed down in 2007, whereas equity prices had not yet fallen. Net sales collapsed in Europe but not in the US. And the Asian investment fund industry is now much healthier.

Net assets of investments funds: annual growth (in %)



Source: EFAMA

Net sales of investments funds (billion Euros)



Source: EFAMA

The decline was confirmed at end of 2007 and over the first half of 2008. It is mainly due to the high volatility of equity markets and the rise in interest rates, which triggered big outflows from equity funds and bond funds. Furthermore, monetary funds (especially so-called "dynamic monetary funds" in France) were affected by fears that their assets included sub-prime securities. Hence this decline cannot be attributed to over-regulation. However, it makes it even more important to ensure that such regulation is flexible and efficient enough to face these difficulties.

Among other things, it should be noticed that pan-European products sold by big American management companies compete with European ones, which are often too fragmented. European funds are too numerous and too small. The European investment funds industry needs a new wave of regulatory improvements for the next stage of its development.
It should also be mentioned that, behind a general positive trend of the investment funds industry over the last years, the picture is more contrasted when its breakdown by country is studied. Among the biggest European countries, two suffered from very high outflows namely Germany and Italy. The causes of such decline in these two countries are taxation and national regulation. As far as regulation is concerned, the industry was hampered by the competition of products that were more flexible than UCITS (certificates, warrants, structured products...). However, no major accident happened on these products and their development had no significant negative impact on the security of public savings. Therefore, European regulations should give UCITS a comparable flexibility, rather than imposing additional rules to the regulation of these competing products.

B. The proposals of the Commission

Previous improvement of the UCITS directive mainly focused on investment rules applying to the product itself. The current package of measures proposed by the Commission is more focused on efficiency.

The proposal of the Commission aims at dealing with four problems:
1. Addressing barriers to marketing funds in other member states' markets
2. Addressing the proliferation of small sized funds
3. Addressing the lack of organisational flexibility
4. Addressing the effectiveness of the simplified prospectus.

I interpret the question I have been requested to answer as twofold:

1. Firstly, in each area mentioned above, do the proposals of the Commission go far enough to tackling the competition and efficiency issues the industry is facing ?
2. Secondly, is there any additional improvement that should be included in the European regulation of UCITS?

I. Are the proposals of the Commission going far enough?

1. <u>Addressing barriers to marketing funds in other member states' markets</u>

It had been envisaged to diminish the barriers to marketing funds in other member states' markets by reducing the period available for the regulator in the host country to check the suitability of the fund before it is sold. A one month delay had been envisaged. However, even a reduction to one month would not be enough to address the competition of non-UCITS products such as certificates. And a shorter delay would not allow the host regulator to make relevant controls. Investors would be wrongly influenced by the idea that their regulator actually checked the fund when it will not be the case.
Therefore, the proposal of the Commission to rather allow marketing of the fund immediately after the home regulator has informed the host country seems to be the most relevant, as the regulator in the host country will make ex-post controls on an on-going basis. However, by giving the home regulator a period of time as long as one month for the notification process, the beneficial effect of this choice might be reduced. A three day delay would be more consistent with the philosophy of this choice.

2. Addressing the proliferation of small sized funds

There are almost 35,000 investment funds in Europe, excluding funds of funds. The average value of a UCIT is less than 200 million euros, whereas it is more than one billion euros in the United States. A small fund is not necessarily an inefficient one. One should recognise that there are fixed costs for the creation of a new fund, but small funds can also be adequate to meet a specific need of a specific category of investors. Furthermore, as for any business, the promoters of most new funds cannot be sure ex-ante that this initiative will be successful. This is not a sufficient reason to prevent the creation of new funds as it is an intrinsic component of the innovation process.

A first option would be to allow fund promoters to remove an unsuccessful fund. But this would prevent investors willing to go on with a given investment strategy to do so. Such investors could argue that although this strategy was not performing in the short term it might eventually do so in the future.

The Commission is right in proposing to create a master-feed framework and to facilitate fund mergers.

The master-feeder framework

The Commission proposes changing the directive to allow asset pooling in a "master-feeder" framework. A feeder fund is a fund which is entirely held by another fund (the master fund).
The proposal of the Commission foresees different conditions for the authorities to approve a master-feeder agreement if both funds are based in the same country or not. This is not consistent with the general philosophy of the single market. The requirements should be the same in both cases.

Facilitating the merger of funds

It is currently difficult to merge funds.
Facilitating the merger of funds will, among other things, apply when fund promoters create a first fund for domestic investors, and then a clone of that fund for non-European investors in another European jurisdiction. For example, it is usual that funds with a good track record in a member state are duplicated in Luxembourg to be sold abroad – in Asian countries like Honk Kong for example. The reason for this duplication is that the Luxembourg "label" is a marketing argument in these non-European countries. Facilitation of mergers of such funds will probably lead to a concentration of fund domiciliation in Luxemburg. In that case, two possibilities can be envisaged:

- If there is no actual European passport for management companies, as is currently the case, some management companies might move most of their human resources to Luxemburg. The management of big funds sold to both domestic and non-European funds could progressively move to Luxemburg.
- If the European passport for management companies became efficient, then the latter could locate all their means in their home country and remove their establishment in Luxemburg. However, this might diminish the prestige and therefore the value of the Luxemburg label.

3. Addressing the lack of organisational flexibility

The main discussion on this problem concerns the passport for management companies. The current passport does not work in practice and any management company willing to domicile a fund in any European country - for example in Luxemburg or in Ireland - has to create an affiliate in that country.

The Commission came to the conclusion that the status quo was the best solution. Indeed it is feared that the regulator in charge of registering a fund with a management company located in another member state would not be able to adequately control that fund.
However, several participants in the public debate strongly argued against that statement and suggested implementing a true European passport for management companies. What would be the predictable consequences of such a passport?

- The success of European UCITS in non-European countries – especially in Asia – is due the quality of the relationship established between some local regulators – mainly the Luxemburg regulator –and the financial community in these countries. It is feared that the value of the label "UCIT domiciled in Luxemburg" would diminish. However, the filter of the establishment of a local subsidiary in Luxemburg is based on the size, rather than on the intensity of controls by the local regulator on management companies: only big management companies can afford to create affiliates in several countries and the regulator in the host country relies on the controls of the regulator in the home country of the management company. In summary, the value of the Luxemburg label might diminish for the biggest market participants, but smaller participants would benefit from a label to sell their products abroad.

- If the European passport for management companies actually existed, it is likely that more funds could be domiciled in Luxemburg or in Dublin to be sold to European investors on a pan-European basis. This would diminish the fragmentation of the market and open the competition between market participants. All these consequences are clearly in favour of the interest of European investors.

- If the European passport was functioning, it is likely that some management companies would not look for any location in Luxemburg or Dublin any more. But the number of European funds domiciled in Luxemburg and Dublin will increase and this will increase the need for ancillary services such as lawyers, accountants and PR teams in these countries. Furthermore, the depository will still have to be actually based in the country were the fund is domiciled. Back office activities can be a source for creating many jobs. The concentration of these infrastructures would increase the efficiency of the industry. For example, the marketing of Irish funds sold to British investors might increase. From that point of view, the passport for management companies would be a benefit to both European final investors and to Luxemburg and Ireland as financial centres. From the financial regulation viewpoint, it would be ironic to note that the "European SEC" would simply emerge as a result of business trends associated with the European passport, at least for certain tasks of the regulators.

4. Addressing the effectiveness of the simplified prospectus.

The Commission proposes to harmonise the "Key Investor Information" in the simplified prospectus. The new simplified prospectus will be a source of cost for management companies in the short term. But in the long term it will facilitate the marketing of funds on a pan-European basis thereby diminishing the costs. It should rather be considered as an investment than a cost.

II. Is there any desirable additional area of reforms?

Non-harmonised funds are not covered by the proposal of the Commission. Three types of funds currently do not benefit from the European passport:

- Real estate funds
- Private equity funds
- Hedge funds and funds of hedge funds.

National regulators developed regulatory frameworks for these categories of funds, without looking for any harmonisation. Extending the European passport to these products would be a benefit to investors and to the industry:

- Individuals would have more investment opportunities and they would benefit from an increased competition within the industry.
- The industry might benefit from a European label, similar to the UCITS label and extend its business to non-European countries.

Nonetheless, one should recognise that exchanges of views between national regulators concerning the regulation of these three categories of funds are still at a preliminary stage. I would probably not recommend waiting for the conclusion of these exchanges of views. The European management fund industry needs an immediate impetus and the European passport for management companies should not be conditioned by an agreement on non-UCITS. Furthermore, one should be careful not to devalue the UCITS label which is based on a reputation of security, by adding much riskier products to the perimeter of the label.

A provisional solution could be to extend the list of eligible assets that UCITS can hold, beyond indices of hedge funds which were recently included in that list. Allowing UCITS to hold funds of hedge funds, venture capital funds and real estate funds would be a first step towards a single market for these products.

The Commission's UCITS IV Proposal: Is It Sufficient to Create a True Single Market Platform?

Briefing Paper for the Committee on Economic and Monetary Affairs of the European Parliament

Marco Lamandini
Full Professor of Securities and Company Law
University of Bologna

Executive summary

The UCITS IV proposal recasting the 1985 UCITS Directive (85/611/EC) does represent a significant and necessary regulatory improvement of the existing harmonized UCITS regime to foster the construction of a truly pan-European competitive market for European UCITS. The proposal tackles at least some of the regulatory obstacles to a deeper market integration and it should prove effective especially in its new provisions on (national and cross border) mergers and asset pooling. I also welcome the proposals of reform concerning, on one hand, the simplification of the notification procedure to be followed in order to market UCITS units in one or more host Member States and, on the other hand, the shift in the disclosure philosophy, as regards the information to be given to retail investors, from prospectus to "key investor information" (KII). In the legislative debate attention must be paid, however, to the adequacy of the safeguards provided for by the proposal in the interest of unit holders and potential investors at large. Nonetheless, despite the remarkable efforts of the UCITS IV proposal, it seems quite dubious that these major amendments to the UCITS Directive shall suffice to create a truly single market platform. On one hand, the current (provisional) decision of the Commission not to implement a well functioning management companies' passport due to concerns on their proper cross-border supervision, clearly restrains competition on a pan-European scale and limits the efficiency and flexibility gains expected by the industry from UCITS IV. It remains to be seen, therefore, the position which CESR shall take on the Commission request for assistance. On the other hand, it seems that the persisting lack of harmonization of advertisement and marketing rules, albeit partially cured by KII innovation, still makes it difficult for a fund to follow a one single pan-European marketing strategy. The same can be said of the "multitude of ways national tax laws discriminate against foreign funds" (as it has been said in the literature), so as to raise additional barriers to the sale of foreign UCITS funds in their territory. But in my view a major (and perhaps still <u>the</u> major) obstacle to the establishment of a truly pan-European competitive market for UCITS funds remains outside the scope of the Directive and is represented by existing distribution channels. Based on market forces alone, an open architecture for their distribution is still lagging behind. Retail investors' preferences are moreover biased, in many circumstances, by the fact that banks and other distributors often advise their customers towards fund products of the own group rather than towards the best performing funds. Rules should correct such market failure and restore a truly competitive European market where product selection is based merely on the criterion of fund performance in the best interest of retail investors.

1.The Committee has requested an opinion on the following question: "UCITS is a European invention and has been very successful since its inception. It now threatens to fall back if European regulation is not flexible enough in order to create a true single market platform.

Is the current UCITS IV proposal sufficient in your opinion?". This briefing paper endeavours to answer this (complex) question in the few pages requested and is organized as follows. Paragraph 2 provides a brief survey of the development of European investment fund regulation from UCITS I to UCITS III and shows its impact on the market. Paragraph 3 describes the recognized weaknesses of the existing UCITS regulation and the main features of the UCITS IV proposal of reform also in the light of its impact assessment. Paragraph 4 evaluates the UCITS IV proposal, it comments on its rationale and considers in detail a few new provisions which, in my opinion, should deserve close scrutiny from the EP. Paragraph 5 briefly tries to look ahead, and in particular to assess UCITS IV against the backdrop of the policy goal to establish a truly effective pan-European competitive market for UCITS.

2.The UCITS Directive was designed, from the outset, to promote the free movement of (harmonized) collective investment schemes and in particular to make it easier for a collective investment scheme established in one Member State to market its units in another Member State (recital 2, directive 85/611/EEC). To attain this goal the directive primarily focused on the UCITS as a product and on the cross border marketability of their units, rather than on the market access and regulation of those who manage the UCITS: a feature which, however, was subsequently covered in some detail by the UCITS III amendment (directive 2001/107/EC). As it has been correctly said in the literature ([1]), "the UCITS I Directive, for the most part, concerns an investment product (and), to a limited extent, regulates investment services providers in the more traditional sense. It stands, as a result, on the cusp between the official listing/public offer regime, which focuses on the capital raising process and trade in securities and the investment service regime which would follow. Its harmonization technique places it with the later investment services regime, however. Its market-integration mechanism of mutual recognition, home country control and the conferment of a regulatory passport is sharply different from the detailed harmonization mechanism used by the official listing regime in the initial phase of harmonization. Indeed, the UCITS Directive serv(ed) as a template in the securities regulation field for the regulatory passport which would come to dominate the regulation of investment services". The legislative history of the directive confirms that the primary goal of this piece of European legislation was the promotion of a single market for these financial products: in fact, albeit the Segrè Report had already advocated community action in 1966 to stimulate, through collective investment schemes, the emergence of a European equity capital market capable to attract the saving of the public at large, by 1976 (at the time of the first Commission proposal) and by 1985 (at the time at the adoption of the UCITS I Directive) collective investment schemes were still subject to quite different regulatory regimes in many Member States and, for this reason, were excluded from the two early free movement of capital directives. Collective investment was therefore fragmented along national boundaries. The UCITS I defined, therefore, a set of requirements which open-ended investment funds needed to comply with in order to be eligible for cross border marketing of their units throughout the Community. In particular, the 1985 UCITS Directive lays down common requirements for the organisation, management and oversight of UCITS funds; it defines a list of eligible assets the fund can invest in; it imposes rules relating to the diversification and liquidity of the fund's portfolio.

[1] N.MOLONEY, *European Securities Regulation*, Oxford, 2002, p. 244

The investment funds complying with the harmonized requirements set by the Directive are subject to the supervision of the Member State where they are established (i.e. "in which the investment company or the management company of the unit trust has its registered office" according to Article 3 UCITS) and they benefit of the mutual recognition by host Member States. However, the passport originally applied only to the investment scheme itself and did not extend to the management company and to the depositary, which had to obtain a separate authorization in each Member State where they wished to operate. The host Member States retain moreover the power to set additional marketing rules concerning the sale of the units in their territory and the supervision thereof.

A recognized success of the 1985 UCITS Directive has been the alignment of Member States on a common and demanding platform of harmonized rules on open-ended investment funds inspired by both market integration and investor protection. As a result, UCITS have enjoyed, so far, worldwide reputation as a well supervised financial product and it is to believe that also for this reason the industry experienced a very remarkable development in most of the Member States in the last two decades and UCITS marketing is now largely successful also in Asia, in the Middle East and in Latin America. According to data released by the Commission, UCITS assets under management amount to € 6 Trillion as of June 2007. Despite the introduction of the passport, however, integration of the UCITS market into a pan-European market has been slow, partly due to diverging practices in the national fund industries (depending also on different investors' risk preferences in several Member States) and partly due to regulatory bottlenecks (due also to national gold-plating in the implementation of the Directive). To respond to the dissatisfaction of the industry, a few years ago the Commission brought about two major amendments to the original regime through the UCITS Product Directive (2001/108/EC) and through the UCITS Management Directive (2001/107/EC) both adopted on 21 January 2002 (UCITS III). The former substantially broadened the eligible assets in which UCITS can invest, allowing investments also in derivatives and funds of funds (thereby prompting a higher degree of retailisation of more sophisticated investment vehicles) ([2]). The latter provided, on one hand, the passport to the fund manager (allowed, under a single licence regime, to render its services also in host Member States) and, on the other hand, it introduced a simplified prospectus aimed at giving "key information about the UCITS in a clear, concise and easily understandable way". <u>Despite these efforts, however, the UCITS Directive still fell short of delivering a truly pan-European market for UCITS</u>. Data suggest indeed that "national markets so far remain highly dominated by domestic fund companies" and that "the growth of the EU fund industry should not obscure the fact that the market is far from being a unified market" ([3]). As a matter of fact:

a) "foreign fund (present in host Member States) are by far dominated by funds domiciled in Luxembourg, Dublin and other tax preference locations. These funds often are of the 'round trip' type: although being cross border in a formal sense, they are designed for a particular national market and the choice of the domicile results from tax reasons";

b) "in small European countries, investors suffer form lack of choice among products: while investors in big markets can choose among thousands of funds, availability is restricted to a few hundred in countries like Denmark, Greece, Portugal and Norway";

[2] On eligible assets see now Directive 2007/16/EC of 19 March 2007. For a status report on its effects compare PRICEWATERHOUSECOOPERS, *UCITS III/IV News*, March 2008, p. 1.
[3] F.HEINEMANN, *The Benefits of Creating an Integrated EU Market for Investment Funds*, ZEW, Discussion Paper no. 02-27, p. 2

c) “There are only 3 countries – Luxembourg, Ireland and the UK – whose funds are sold at least in 2/3 of all member countries. Many national fund industries do practically not export their domestic funds.

In no EU country there are today funds available from more than 6 other EU domiciles”: a finding that, although partly influenced by the “Luxembourg effect” – beneficial tax domicile used for round trip funds – nevertheless “shows the closeness of national markets”[4].

In addition to that, data on foreign funds’ market share confirm that “true foreign funds still play nothing but a minor role” ([5]).

3.The Commission, following the research and consultation process launched with the Green Paper on Investment Funds (COM 2005 314 final, 12 July 2005) and developed with the White Paper on Investment Funds (COM 2006 686 final, 15 November 2006) and its first Impact Assessment, identified a series of problems and regulatory bottlenecks to industry efficiency. It concluded that EU action in recasting the UCITS Directive would be justified on five issues: a) notification procedures to the host Member State supervisory authority; b) fund mergers; c) asset pooling; d) management company passport and e) a simplified prospectus.

Indeed, the Commission identified as problems requiring a change in the UCITS Directive the following:

a) First, the existing barriers to marketing funds in other Member States represented by the notification procedure introduced by the 1985 UCITS Directive. This proved in practice “often long and cumbersome”. According to the Commission, “host regulator’s requirements often exceeds those in the Directive and the two month limit is not always respected. As a result the procedure has been compared to a second authorisation of the fund”

b) Second, the proliferation of funds of a sub-optimal size. According to the Commission “the European fund market landscape is characterised by a high number of small funds. At the end of 2006, 54% of European funds managed less than € 50 million in assets. The average European fund is more than five times smaller than its American counterpart[6]. Managing large ranges of small funds is costly. It impedes the exploitation of economies of scale and increases costs”.

c) Third, the lack of flexibility in organising the industry value chain. The Commission finds that despite UCITS III “it is currently not possible for management companies to manage a UCITS in another Member State. Ambiguities in the Directive text and split supervision concerns have deprived the relevant 2001 provisions of their effect. As a result fund groups are obliged to establish a fully fledged management company in each Member State where they wish to base a fund range”.

d) Fourth, an ineffective simplified prospectus. The Commission finds that “despite the clarification provided by the Commission Recommendation in 2004 (2004/384/EC of 27 April 2004) the simplified prospectus has failed in its mission to provide investors with a useful tool on which to base their investment decisions.

[4] F.HEINEMANN, *The Benefits of Creating an Integrated EU Market for Investment Funds,* p. 3-4
[5] F.HEINEMANN, *The Benefits of Creating an Integrated EU Market for Investment Funds,* p.5

[6] It should be noted, though, that fund size differs considerably among EU Member States: in Italy and the Netherlands, for instance, average fund size is much bigger than in many other Member States: see F.HEINEMANN, *The Benefits of Creating an Integrated EU Market for Investment Funds,* p.5

The simplified prospectus is too long and complex and thus of limited value to the investors. At the same time, the production of the simplified prospectus is relatively costly and time consuming for the industry".

Based upon these findings, the UCITS IV proposal puts forward a reform (and recast) of the existing UCITS Directive whose essential features can be summarized as follows.

a) It envisages a radical simplification of the notification procedure to be followed before starting the marketing of units in a host Member State. Under the new Article 88, if a UCITS proposes to market its units in a Member State other than that in which it is established (such being the State where the investment company or management company has its registered office <u>and head office</u>: Article 4), it shall first submit a notification letter to the competent authority of its home Member State, including: i) information on arrangements made for marketing of units in that host Member State; ii) its fund rules, its prospectus and, where appropriate, its latest annual report and any subsequent half-yearly report translated; iii) its "key investor information" (KII) translated. The home supervisory authority shall verify the completeness of the documentation submitted by the UCITS and then transmit within one month such complete documentation to the competent authorities of the host Member State, enclosing an attestation that the UCITS fulfils the conditions imposed by the Directive. The UCITS may start marketing its units in the host Member State starting from the date of the notification, without having to wait for any formal approval of the host supervisory authority anymore. Under Article 89 the UCITS shall provide to investors in the host Member State all information and documents which it is required to provide to investors in its home Member State: however, such information "shall be provided in the way prescribed by the laws, regulations and/or administrative provisions of the host Member State" and the "KII shall be translated into the official language of the host Member State".

b) It introduces new harmonized rules on UCITS mergers, to be applied both to domestic and cross border mergers (Articles 34-44). Following the results of the impact assessment, these rules attempt at drawing a balance between investor protection and cost efficiency and are centred on disclosure. In order to minimize costs, however, the proposal restricts, under certain condition, the information to be given to unit holders of the receiving fund (a choice which will be discussed below).

c) It introduces new harmonized rules on asset pooling centred (only) on master-feeder structures (Articles 53-62): asset pooling structures whereby at least 85% of the assets of the feeder fund are invested in one single master fund. The impact assessment evidenced, on the contrary, that entity pooling in a broader sense, albeit providing additional flexibility to tailor feeder funds' composition, could amount to a relaxation of the existing provisions on eligible assets and in particular on UCITS funds of funds and that such "relaxation of these diversification requirements could have significant unintended consequences for investors";

d) It brings about a new concept of retail investors' disclosure centred on the "key investor information" (KII) document: a short stand alone document providing in a clear and not misleading manner only the information essential to retail investors to take an informed investment decision.

The Commission's proposal, based upon the findings of its impact assessment which showed substantial supervisory concerns about cross border fund management, maintains, on the contrary, the *status quo* as regards the management company passport, whereby "fund managers undertake cross border management through delegation-based solutions".

In recognition however of the interest of the industry for a truly effective Management Company Passport, with a letter of 16 July 2008 the Commission duly requested the assistance of CESR on the supervisory issues which would arise in the event that a UCITS fund was managed by a management company situated in another Member State. Following such advice, the Commission anticipates that it would be able to consider further amendments to its UCITS IV proposal "to introduce a viable Management Company Passport".

4. In my view the UCITS IV proposal does represent a substantial step forward in the right direction. It tackles indeed at least some of the regulatory obstacles to a deeper market integration and it should prove effective especially in its new provisions on mergers and asset pooling. As anticipated, on fund scale and connected cost efficiency there is a major delay of the European industry if compared to the US industry ([7]); a strive towards consolidation and asset pooling seems therefore justified and should normally improve the current situation. Attention should be paid however, in the legislative debate, on the safeguards for investors. In particular, the proposal on UCITS mergers relies on disclosure (Article 40), exit (Article 42) and, to a limited extent, voice for unit holders (Article 41). The (self)-protection of unit holders is complemented, moreover, by the authorisation procedure set out by Article 36, whereby "mergers shall be subject to the prior authorisation by the competent authorities of the merging UCITS home Member State" and "the competent authorities shall consider the potential impact of the proposed merger on unit holders of both the merging UCITS". As recognized also by the Commission, there is here a clear need of protection for investors; this stems from the very fact that the merger by itself affects the portfolio composition of the merging UCITS, necessarily encompassing a change in the risk profile of the investment: a change which varies depending on the degree of homogeneity of the pre-merger portfolio composition but can be very substantial where the merging UNITS follow very different investment policies. The remedy for dissatisfied unit holders provided for by the proposal is exit: "the laws of Member States shall provide that unit holders of both the merging UCITS and the receiving UCITS have the right to request the repurchase or redemption of their units, or where possible, to convert them into units in another UCITS with similar investment policies, without charge". It might be questioned, however, if an adequate level of investor protection does not require <u>also</u> that, in similar exceptional circumstances, unit holders be given on <u>an harmonized EC basis</u> extraordinary voice rights; that, in other terms, the Directive mandates that the merger be approved by a set percentage of unit holders. A solution which, in fact, the proposal envisages under Article 41 but leaves only optional to Member States. Similarly, I do not share the view of the Commission that information on the merger be given only to investors of the disappearing fund and not to investors of the receiving fund, unless the supervisory authority decides that also these investors be informed (Article 40). Such a "mediated" remedy introduces, in my view, unnecessary administrative discretion, it contradicts (at least in principle) the full disclosure philosophy embedded in the Directive and arbitrarily differentiates the protection granted to unit holders where the unit holders of the receiving fund can face risks of performance dilution similar to those run by the disappearing fund's unit holders. Consistently in the corporate field, the merger directives (herein included the cross border merger directive) provide that information be given to the shareholders also of the receiving company. On the contrary, on asset pooling I find fully convincing the balance drawn by the proposal and its rationale as clearly described in the impact assessment.

[7] See also CRA INTERNATIONAL, *Potential cost savings in a fully integrated European investment fund market*, Final Report to the European Commission, Brussels, September 2006, *passim*

Whilst it is clear that entity pooling in a broader sense would add flexibility in tailoring asset pooling according to changing trends and investors' demands, it is true that, as argued by the Commission, "some of the advantages related to the techniques are already available to industry players thanks to the current funds of funds regime" and the adoption of entity pooling in a broader sense would further relax the existing diversification requirements, deeply modifying the essence of the UCITS product.

Moreover I share the view of the Commission that "if the objective of the reform is to achieve economies of scale through the pooling of assets, this seems to be more easily attained through master-feeder structures (through entity pooling in a broad sense, feeder's assets would rather be split into a number of masters)".

In my view also the Commission's proposals concerning simplification of the notification procedure and "key investor information" (KII) are to be welcomed. The former correctly substitutes the existing cumbersome, often uneven (due to gold-plating in the implementation of the Directive) and long procedures currently existing in several Member States, with a real level playing field represented by a streamlined procedure based on a regulator to regulator communication, leaving to the host Member States only the *ex post* supervision on marketing arrangements and local marketing rules. The latter (the KII), in turn, brings about a conceptual revolution on the disclosure philosophy as applied to retail investors. The proposal acknowledges indeed that, as already noted in the literature ([8]), "a UCITS prospectus is likely to be used to a much greater extent by the average investor (…). UCITS disclosure policy should reflect the fact that the UCITS ultimately acts as an intermediary between the investor and the securities market; disclosure should accordingly be directed towards informing the retail investor who relies heavily on this form of intermediation. (…) Too much information may obscure material facts concerning the UCITS, however, and confuse the investor *who may be unable to distil the key information from the prospectus and may, in the face of overwhelming disclosure, ignore important facts.* The view has been growing in recent years that a simplified prospectus containing clear and essential information and crucially facilitating comparisons between different schemes would more appropriately address the needs of the average investor*"* ([9]). The KII, as described by Article 73, does represent, in my opinion, an appropriate response to such needs and, for the sake of consistency, calls for a more general rethinking of the disclosure documents to be used for retail purposes not only for UCITS marketing, but also in any other public solicitation to retail investors. The reform acknowledges indeed the rational apathy of retail investors in processing extensive investment information and recognizes the inadequacy of a disclosure philosophy based upon the unrealistic assumption that retail investors access and understand all information presented in the prospectus. The importance of the conceptual innovation represented by KII makes it crucial the provision of Article 74 according to which "Key investor information shall constitute pre-contractual information. It shall be fair, clear and not misleading. It shall be consistent with the relevant parts of the prospectus". I do not support, however, the inclusion in the same Article of the precision – which seems to me overly vague, unclear and contradictory - that "Member States shall ensure that a person does not incur civil liability solely on the basis of the KII, including any translation thereof, unless it is misleading, inaccurate or inconsistent with the relevant parts of the prospectus".

[8] N.MOLONEY, *European Securities Regulation,* p. 286

[9] On KII see also *CESR's advice to the European Commission on the content and form of Key Information Document disclosures for UCITS*, Paris, February 2008, *passim*.

The industry should be aware that most of retail investors shall take the investment decision solely on ground of the information received by the KII and should be clearly called to act consistently.

5. It remains to be considered, however, if these major amendments to the UCITS Directive shall suffice to create a truly single market platform. This seems to me quite doubtful. On one hand, the current (provisional) decision of the Commission not to implement a well functioning management companies passport (due to concerns on their proper cross-border supervision) clearly restrains competition on a pan-European scale. It limits the efficiency and flexibility gains to be expected by the industry from UCITS IV; moreover, it discriminates the regime of UCITS managers in respect to the full passport regime already applied by MiFID to investment companies. It remains to be seen, therefore, the position which CESR shall take on the Commission request for assistance and in particular if CESR will not be able, as it should be, to devise, also in this respect, a well functioning system of supervisory cooperation (as it was possible, albeit in a different context, with the Supplementary Supervision of Financial Conglomerates) capable to remove the risk, envisaged by the Commission, "to gamble with regulatory failure that could have huge effects on ordinary savers".

On the other hand, it seems to me that the persisting lack of harmonization of advertisement and marketing rules, albeit partially mended by KII innovation, still makes it difficult for a fund to follow a single pan-European marketing strategy, with an increase in fixed cost which diminishes the incentive for a fund to access host Member States unless there is a significant business potential. The same can be said of the "multitude of ways national tax laws discriminate against foreign funds" ([10]), so as to raise additional barriers to the sale of foreign UCITS funds in their territory.

Moreover, in my view, a major (and perhaps still <u>the</u> major) obstacle to the establishment of a truly pan-European competitive market for UCITS funds remains outside the scope of the Directive and is represented by existing distribution channels. This is an issue already identified as requiring some kind of corrective action both in the literature ([11]) and in the regulatory setting (the Commission acknowledges in its impact assessment that, as things stand now, "at the distribution level the move towards the open architecture – i.e. the fact for a distributor of offering third party funds instead or in addition to its "in house" fund range – is slow, particularly in markets dominated by local banks"). In my opinion, market forces alone proved insufficient to overcome, at least in the short run, such a significant barrier to the establishment of a truly pan-European competitive UCITS market. Thus, community action is needed to push investment firms and banks towards an open architecture for UCITS distribution. To this purpose I believe that, taken into account the ownership structures of the industry, there is a clear need to tackle with specific measures (also through level II and level III measures under MiFID, if appropriate) the conflict of interest underpinning the existing pattern of national preferences.

[10] F.HEINEMANN, *The Benefits of Creating an Integrated EU Market for Investment Funds,* p.10

[11] F.HEINEMANN, *The Benefits of Creating an Integrated EU Market for Investment Funds,* p. 14: "so far European legislators have non addressed a further topic which might be promising given the above insights on distribution linked obstacles: Pressing fund distributors to behave less biased in selling funds. Of course it is not easy to design measures which could foster more neutral fund selection. The problem is that substantial additional regulatory costs must be avoided since there are not in the interest of the consumers. Nevertheless, given the large relevance of the distribution obstacle for the fragmentation of fund markets legislators should devote more thoughts and efforts to this issue"

These investors' preferences are indeed biased by the fact that banks and other distributors often advise their customers towards fund products of their own group rather than towards the best performing funds. Rules should correct such a market failure and restore a truly competitive market where product selection is based purely on the criterion of fund performance in the best interest of retail investors.

A last concern regards the lack of regulatory level playing field between the harmonized and widely regulated UCITS product and the non harmonized and scarcely regulated (at least in some Member States and off shore locations) alternative investment vehicles, which are nonetheless increasingly sold also retail throughout Europe. Persisting the approach of self restraint of the European legislator in setting harmonized, although flexible and MiFID-like rules for alternative investment vehicles (rules still lagging behind at EU level, despite the vivid debate occurred in recent years and months also in Brussels) ([12]), there might be indeed a risk of regulatory overkill for UCITS. The European path dependent and uneven approach to these increasingly competing financial products could work as a policy-induced disincentive to the further development of a truly pan-European UCITS market

[12] For some data see PRICEWATERHAOUSECOOPERS, *Investment funds in the European Union: Comparative analysis of use of investment powers, investment outcomes and related risk features in both UCITS and non-harmonised markets*, Study commissioned by the European Commission, DG Internal Market, Brussels; see also, *ex multis*, M.LAMANDINI, *Alternative investment vehicles and (self) regulation*, speaking note of the testimony before the Legal Affairs Committee of the EP at the public hearing "Transparency of Institutional Investors", Brussels, 25 February 2008 (available on the EP website), where additional references to the literature and the regulatory debate.

Proposed amendment to the directive on undertakings for collective investments in transferable securities (UCITS IV)

Briefing Paper for the Committee on Economic and Monetary Affairs of the European Parliament

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Executive Summary

The regulation of collective investment schemes (CIS) in the European Union is governed by the Directive on Undertakings for Collective Investments in Transferable Securities (UCITS). The Commission has proposed to amend the Directive and this brief discusses whether the proposals go far enough.

The aim of the amendment is to enhance the operation of the single market in UCITS. A fully functional single market would allow any UCITS authorised in any one Member State to be marketed anywhere in the single market. In addition, it would enhance efficiency if any service provider could offer their services to any UCITS from any location within the single market without having to establish a physical presence in the country of domicile of the UCITS. A true single market should not discriminate between different kinds of investment product with similar characteristics.

The present Directive does not achieve this and the purpose of the amendment is to move towards the single market goal. The proposed Directive will make it easier and quicker for a UCITS to get permission to market itself cross border in other Member States, insist that Member States allow UCITS to merge with other UCITS regardless of their legal form or their location in the EU, allow different UCITS to pool their assets for more efficient investment management and require the preparation of a simplified document of Key Investor Information. In addition, the Commission has asked the Committee of European Securities regulators (CESR) to seek a consensus on how to allow a UCITS management company to provide administration services to any UCITS from any location in the EU, so that the Directive can be amended accordingly.

These are good measures that command support and could lead to substantial cost savings or enhanced performance by UCITS. There are other concerns that could be addressed in any review of the UCITS Directive. In particular, the approach in the Directive, – which involves regulation of the investment product as well as the selling intermediary – is different from that for other investments. Moreover, the UCITS Directive, by imposing prescriptive restrictions on such matters as corporate governance and investment policies, can become out of date as a result of market developments. There is limited scope for the use of the Lamfalussy procedure with the Directive as drafted. Furthermore, the Directive only applies to certain (albeit the large majority of) EU CISs. Other CISs, outside the scope of the Directive, could benefit from a single market but at present have no EU passport.

There would be advantage in a wholesale review of the Directive but this would take time. It is therefore sensible to go ahead with the UCITS IV proposal, secure the gains it can bring and return to the broader issues at a later stage.

Proposed Amendment To The Directive On Undertakings For Collective Investments In Transferable Securities (UCITS IV)

1. Introduction

1.1. The European Commission has proposed amendments to the Directive on Undertakings for Collective Investments in Transferable Securities (UCITS) [1]. The proposed amendment, known as UCITS IV [2], is intended to increase the efficiency and hence performance of European UCITS by removing barriers to the efficient operation of a single market in UCITS.

1.2. The proposals have been the subject of considerable consultation. The Commission published a Green Paper in 2005 [3] and a White Paper in 2006 [4]. An exposure draft of concrete proposals was published in March 2007 [5]. The proposed amendments to UCITS were published in June 2008 along with an impact assessment [6].

1.3. This paper responds to the briefing request, repeated at Appendix A and discusses whether the proposals go far enough to maintain the success of UCITS as an investment vehicle in Europe and beyond.

2. UCITS

2.1. A UCITS is a collective investment scheme (CIS) that meets certain criteria set out in the UCITS Directive that ensure the CIS is suitable for retail investors. The regulatory approach in the Directive is in line with the requirements of the International Organisation of Securities Commission (IOSCO). Since intermediaries responsible for marketing UCITS are themselves covered by regulation (largely imposed through the Directive on Markets in Financial Instruments (MiFID)), UCITS are subject to a double level of regulation. This has beneficial consequences for investor protection but also increases costs and leads to some inflexibilities. A background note on UCITS is at Appendix B.

2.2. UCITS have been very successful. There are €6 trillion invested in CISs in the EU. Assets held in CISs have been growing at 10% a year. UCITS account for 70% of the CISs. They are sold throughout the EU and, in addition, according to a review by Pricewaterhouse coopers [7], 40% of UCITS are sold in Switzerland, Asia and South America where the UCITS brand stands for a well regulated product suitable for retail investors.

3. Barriers To A Single Market In UCITS

3.1. The original UCITS Directive and the proposed amendment aim to facilitate a single market in CISs. To assess whether the proposed Directive goes far enough, it is necessary to consider what the single market would look like. While there is no definitive description, it would be reasonable to describe the single market as being one where:

3.1.1. Any CIS authorised anywhere in the EU could be sold to any investor anywhere in the EU without further authorisation;

3.1.2. Any element in the CIS structure, whether investment manager, depositary, administrator, auditor or other service provider, could be located anywhere in the EU, subject to the appropriate authorisation, and offer its services from there;

3.1.3. A CIS would be subject to a level playing field with other investments that have similar characteristics for the investor.

3.2. The benefits of a single market operating in this way would be to enhance the scale, efficiency and performance of UCITS. Evidence prepared for the European Commission by CRA International [8] demonstrates that there are substantial economies of scale to be achieved in the EU. Allowing any investor access to any UCITS in the single market would increase investor choice, enhance competition, lower costs and enhance performance.

3.3. CISs must have administration, investment management, depositaries, distributors and other service providers. While it is possible for most of these functions to be provided by the same company, there is, according to Oxera Consulting Limited [9] a growing trend for specialisation in different functions. Specialisation can bring greater competence and efficiency.

3.4. The consultation process has demonstrated that the single market in UCITS, has not yet been fully achieved. This is because of a number of barriers that remain in UCITS and the way it is implemented.

3.5. Marketing UCITS Cross Border

3.6. UCITS are authorised by a single Member State. That authorisation is intended to give a passport for marketing in any country in the EU single market. Where a UCITS wishes to promote its funds in another country, it is required to notify the regulator in that country (the host regulator).

3.7. The process of notification is long, costly and cumbersome. According to an analysis by the European Fund and Asset Managers Association (EFAMA) [9], all Member States except the UK and Norway impose additional requirements beyond those in the Directive. Some Member States require cross border UCITS to notify the host regulator of small changes in the fund administration, or to notify the host regulator about all sub funds in an “umbrella / sub fund” structure, regardless of whether all the sub funds are to be sold, or to translate all CIS documents.

3.8. The Expert Group on Investment Management Market Efficiency (Expert Group) [11] stated that it can take from between two to four months from host regulator notification to the point where a UCITS can be sold. EFAMA estimated that the process of notification can cost €20 million, with an additional €25 million to maintain registration in each Member State.

3.9. Once a UCITS has been successfully notified to the host regulator, it is necessary for the promoter to market it successfully. Previous attempts to provide for a simplified prospectus for this purpose have not worked and there is no common form of simplified prospectus that is available to investors across the single market. The publication of guidance by the Committee of European Securities Regulators (CESR) [12] in 2006 does not appear to have solved the problem.

Cross Border Mergers of UCITS

3.10. Within individual Member States it is possible for funds to merge. This allows for a flexible response to changes in market circumstances. In practice, divergent tax and corporate law regimes inhibit cross border mergers. The Expert Group stated that Member States have taken action to prevent a merger from triggering a tax liability that would not have been incurred but for the merger. However, these measures do not always apply to cross border mergers.

Asset Pooling

3.11. UCITS that wish to maintain a separate legal existence may nevertheless wish to make efficiency gains by managing the assets of different UCITS in a single pool. This can be done through entity pooling or virtual pooling.

3.12. Entity pooling occurs where the assets of one fund are merged with those of another fund. The typical example of such a structure would be a “master / feeder” relationship where one fund (the feeder fund) invests all its assets in that of another (the master). There are advantages in such structures, for example, where the funds have different criteria for the investors (such as their tax status) but have similar investment objectives. Entity pooling is prevented by Article 24 of the UCITS Directive, which states that a UCITS must not invest more than 10% (a figure that Member States may raise to 20%) of its assets in another UCITS or CIS.

3.13. Virtual pooling maintains the separate legal identity of the assets in a fund but the investment manager operates the assets as if they were in a single pool. The administrator then manages the purchases and sales of each fund so that each makes identical gains or losses from the investment performance. This is not prohibited by UCITS but is costly to operate because of the risk management and IT systems necessary to deal with the enhanced operational risk.

Management Company Passport

3.14. The corporate governance restrictions in the Directive, although imposed to protect investors, mean that there is less scope than in a true single market for a UCITS to find the best service provider for each link in the value chain, regardless of where the service provider is located.

3.15. The administrator (management company) of a UCITS, in effect, has to be in the same country as the UCITS domicile. Changes to the Directive in 2002 were intended to create a management company passport. This should have allowed a UCITS to outsource its administration to the best fund administrator in the single market. However, the provisions have proved too cumbersome in practice. Some Member States interpreted the Directive as applying only to the minority of UCITS that were in the form of a company (rather than a trust or other contractual form). The potential gains of a management company passport have not been realised.

3.16. The opinion of a number of regulatory authorities is that the co-location of the management company with the UCITS is necessary in order to avoid overlaps, conflicts or gaps between the responsibilities of different regulatory authorities. Moreover, the process of operating subscription and redemption cross border has cost and operational risk. Nevertheless, the experience of many funds outside the EU is that these difficulties need not be insuperable. Within the EU the benefits of cross border specialisation of management function are being largely denied to the investors.

Depositary Passport

3.17. Similarly, depositaries are required to be in the same country as the UCITS itself, according to Article 8(1) of the Directive. It is possible for the depositary to be a branch of an entity in another Member State but of the 530 depositaries in the EU only 30 are branches of foreign entities.

3.18. In addition, there are differences between Member States in the definition of a depositary's obligations. The depositary is supposed to safeguard the assets of a UCITS but there are different understandings of what this means in practice. This affects the view on whether the depositary owes a duty of care to the investor, rather than an obligation to maintain certain procedures and oversight. There are differences in the extent to which the depositary's obligations may be overridden by *force majeure*. Different countries have different restrictions on the nature of an entity that can be a depositary, some countries confining this activity to banks. Some Member States impose restrictions on what other activities a depositary can undertake without creating a conflict of interest. According to the Commission communication on depositaries [13], these differences lead to a variation in the minimum capital requirements placed on a depositary ranging from €113,000 to €100 million.

3.19. The European Central Bank, in its comments on the Commission's Green paper in 2005 [14], argued for harmonisation of depositary duties and this echoed the Commission's own communication on depositaries in 2004.

Investment Restrictions

3.20. Currently the Directive only applies to certain kinds of funds. Real estate funds, for example, hedge funds and private equity funds do not meet the criteria in the UCITS Directive because of the investments they make, the borrowing they incur or the strategies they follow. Amendments to the Directive in the past have sought to extend the range of investment strategies that can be accommodated by UCITS. In 2002, for example, it became permissible for UCITS to invest a small proportion of their assets in derivative products. There was some ambiguity about the applicability of these amendments but these have been largely resolved by an Implementing Directive in 2007 [15] accompanied by guidance from the CESR [16] and subsequent guidance on hedge fund indices [17]. The investment restrictions are to protect investors but, as markets develop, innovation is likely to create new securities that are suitable for retail investors and which give access to a wider range of opportunities. Unless the Directive becomes flexible enough to accommodate them, UCITS will lose competiveness.

3.21. Moreover, so long as some CISs remain ineligible for classification as UCITS, there remains no mechanism for providing a single market for such funds. The Commission held a workshop in 2008 [18] to discuss the possibility of a regime for private placement of CISs aimed at specific classes of investor. The workshop identified a number of barriers to the cross border sale of such CISs in the single market.

The Level Playing Field

3.22. The additional layer of regulation, placed on UCITS, although consistent with IOSCO standards, could have the effect of distorting competition. UCITS have tougher regulation and more onerous disclosure requirements than, for example unit linked life assurance, even though they have similar characteristics in terms of the risk and reward to the investor.

4. The Effect of the Single Market Barriers

4.1. According to the Commission Green paper, only 16% of UCITS are sold cross border. The White Paper pointed out that new inflows to cross border funds amounted to 66% of net industry inflows (suggesting a rapid increase in cross border activity).

Moreover, the Expert Group stated that funds sold cross border in the single market had increased by 50% in three years. On the other hand, PriceWaterhouseCoopers have pointed out that 70% of cross border funds are based in Luxembourg. One consequence of the limited cross border activity is that, according to the White Paper, 54% of UCITS have less than €50 million. On average UCITS are five times smaller than their US equivalents.

4.2. CRA International estimate that the cost of production and distribution of European UCITS is €16.979 billion, of which €7.710 billion would be saved if all European UCITS were operating at the same efficiency and gaining the same economies of scale as CISs in the US. This would amount to savings, or potential increased return, of 60 basis points. Distribution costs are the most fruitful source of such savings.

5. The UCITS IV Reforms

5.1. UCITS IV tackles some of the most important barriers to an effective single market that have been identified in the consultation process.

5.2. CESR gave guidance on the contents of Key Investor Information documentation [19]. Article 88 *et seq* of the proposed Directive deals with the **notification requirements** for a UCITS authorised in one Member State that wishes to sell to investors in another Member State. The proposed Directive provides that the UCITS should submit to its home regulatory authority a set of documentation that is specified in the Directive, including the UCITS rules and the Key Investor Information document. No other documentation may be demanded and only the Key Investor Information document must be translated into the language of the host Member State. The UCITS has discretion over other documents, provided it chooses a language that is customary in international finance or approved by the host regulator.

5.3. The home regulator has one month to check that the documentation is correct and to forward it to the host regulator. As soon as the documentation has been transmitted, the UCITS can be marketed in the foreign Member State. The host regulator is responsible for monitoring compliance with its marketing regulations but this is an ongoing role with no right of prior authorisation.

5.4. Article 35 *et seq* of the proposed Directive defines a **merger** of UCITS as occurring where all the assets of one or more UCITS (the merging UCITS) are transferred to another (the receiving UCITS). The Directive will require Member States to allow all UCITS, regardless of their legal form, to merge with other UCITS in the jurisdiction or from another Member State.

5.5. The proposed Directive provides that the regulator of the merging UCITS must be provided with specified documentation and then must give a decision on authorisation within 30 days. This regulator must consider the impact on the investors in both the merging and receiving UCITS and consult the regulator of the receiving UCITS unless the effect on the receiving UCITS investors is negligible. The depositaries of both merging and receiving UCITS must assess the consistency of the merger terms with the constitutive documents of the UCITS involved. The auditors must monitor the asset and liability valuation and the terms in which the units in one UCITS are exchanged for another.

5.6. There must be sufficient disclosure to the investors in the merged UCITS to allow them to make an informed decision. The consent of investors to the merger need only be obtained if required by national law.

The investors in the receiving UCITS must be provided with documentation only if the regulators consider that the impact of the merger on them is sufficient to make this necessary. The investors of all UCITS involved should have the right to redeem their investments without cost if they so choose and the costs of the merger should be borne by the manager or promoter of the UCITS.

5.7. The Directive does not deal with the tax consequences of merged UCITS. However, the Commission has foreshadowed a communication, clarifying that national tax-neutral arrangements devised by Member States should be extended to mergers involving UCITS domiciled in another Member State.

5.8. Article 53 *et seq* of the proposed Directive deals with **asset pooling**. This is to be permitted by allowing a UCITS (the feeder UCITS) to invest a minimum of 85% of its assets in another UCITS (the master UCITS). The structures must be kept simple, so a master UCITS cannot invest in another feeder or master UCITS. The investment in the master UCITS is subject to the approval of the feeder UCITS' regulatory authority.

5.9. There should be a legally binding agreement between feeder and master UCITS. There should also be adequate cooperation between the depositaries and auditors, respectively, of the master and feeder UCITS. The master / feeder relationship should be disclosed and explained to the investors of the feeder fund, together with the investment policy of the master fund. The feeder UCITS should monitor the activity and performance of the master UCITS. There are provisions limiting the fees and charges that can be levied and requiring a UCITS that converts to being a feeder UCITS to allow investors to redeem without charge.

5.10. Article 73 of the proposed Directive requires a UCITS to produce a **Key Investor Information** (KII) document. The proposed Directive specifies that the investment policy, the performance, the charges and the risk / reward profile must be disclosed in the KII. The KII must be written in simple language and must also explain where to get more information. The same KII must be used throughout the single market (except for translation). It must be consistent with the fund documentation and, so long as this is the case (and it is not otherwise misleading), the UCITS cannot be subject to civil liability based solely on the information in the KII.

5.11. The proposed Directive does not address the question of the **management company passport.** This is an important omission, given the strength of concern raised during the consultation process that fund administration should be capable of being performed anywhere in the single market. The Commission has stated that there is not yet a consensus on the solution.

5.12. There remain regulatory concerns about the supervisory conflicts, gaps and overlaps that may arise between the regulator responsible for the UCITS and that responsible for the administrator. The Commission has therefore asked CESR to consider the matter and seek a consensus by 1 November 2008. The Commission will then consider how to accommodate the resulting advice within the Directive.

5.13. In addition to the specific amendments, UCITS IV will involve a consolidation of the nine separate Directives that make up the UCITS legislation.

6. What More Needs to be Done?

6.1. The proposed Directive goes a long way to meet most of the concerns raised in the consultation process, for example as demonstrated in the responses to the Commission's exposure draft [20]. The Commission estimates that the direct benefits will amount to several billion Euro.

6.2. The proposed Directive does not directly address the difficulty that a depositary cannot provide services directly to a UCITS in another Member State. The Commission has stated that there needs to be convergence on prudential requirements, measures relating to potential conflicts of interest, clarity on the functions of a depositary that can be delegated, and consistency with regard to the nature of the asset safeguarding obligation. As is the case with respect to management companies, there are regulatory concerns about the enforcement issues arising when different regulators are responsible for the UCITS itself and its depositary. There appears to be less concern about this issue at present, although a number of commentators (including the Commission itself) have referred to the matter and so the absence of measures on this point in the proposed Directive should not be regarded as a serious omission.

6.3. A more significant matter relates to the structure of the UCITS Directive itself. The Directive imposes regulatory requirements on a UCITS as a product, in addition to the regulatory requirements imposed on the intermediary who is advising on or selling the UCITS as an investment. Although this is in line with IOSCO standards for CISs, the Directive has in-built inflexibility. The UCITS Directive imposes prescriptive requirements on disclosure, corporate governance and investment limits and these can be overtaken by innovation and market developments, especially since amending Directives is a long and difficult process. Moreover, this approach creates a distinction between the disclosure and other regulatory obligations on UCITS as compared with other products.

6.4. The time may come, therefore, when the UCITS Directive needs to be rewritten to overcome these problems. At the very least, it needs to be restructured to bring it into line with the Lamfalussy procedure, so that amendments to details (such as investment restrictions) can be made more easily in the light of market developments.

6.5. Such a rewriting would be a difficult process. There are difficult regulatory issues to be addressed. Moreover, intermediaries have invested heavily in meeting existing UCITS requirements. Changes would carry a significant cost.

6.6. Such a radical revision of the UCITS Directive needs to be undertaken over a reasonable period, ensuring full consultation with stakeholders.

6.7. Finally, consideration needs to be given to the possibility of a single market in non UCITS funds. The process of extending the investment limits for UCITS would encompass a broader range of funds. It may not be appropriate to include all non UCITS funds within the Directive for fear of diluting the effectiveness of the UCITS brand as a kitemark for a retail fund. There may need to be some additional action to deal with non UCITS funds.

7. Conclusion

7.1. The consultation process that has led to the publication of the Commission proposals on UCITS IV has been long and complex. There is a consensus that the current proposals address the key concerns that have been identified.

7.2. The most important and current issue not yet addressed in the proposed Directive is the question of the management passport. It is vitally important that this is resolved through the CESR process in time to be accommodated in a revised UCITS Directive.

7.3. The question of depositaries does not appear to be a great concern at present and there are key regulatory concerns to be protected.

7.4. The rewriting of the UCITS Directive to accommodate a different approach to UCITS regulation and create a level playing field with other investment products would be a major task that would take a long time to resolve satisfactorily. It is vital to retain the success of the UCITS brand. The resolution of this issue can reasonably be left to a future Directive amendment.

7.5. As noted above, it may not be appropriate to broaden the scope of the UCITS Directive to encompass all CISs that currently fail to qualify – especially those which are not aimed at retail customers – for fear of undermining the UCITS brand. Nevertheless, there remains a need for action to create a single market in those funds currently outside the UCITS Directive's scope.

7.6. It would be reasonable to conclude, therefore, that, although UCITS IV does not go quite as far as it could, it nevertheless achieves a considerable amount. It should therefore be allowed to progress, on the understanding that the management company passport issue is addressed urgently by CESR and the other issues are brought forward before too long.

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Appendix A

Briefing Request

"UCITS is a European invention and has been very successful since its inception. It now threatens to fall back if European regulation is not flexible enough in order to create a true single market platform. Is the current UCITS IV proposal sufficient in your opinion?"

Appendix B

Background to UCITS

B1. Developed in the USA in the early twentieth century (where they are known as mutual funds), Collective Investment Schemes (CIS) have become increasingly popular world-wide. Investors buy shares or units in the CIS. The CIS then manages the combined assets of a substantial number of investors and purchases investment assets, usually according to an investment mandate. The CIS spreads the cost of obtaining investment management expertise across a large number of investors and allows the small investor to invest in a more diversified range of securities than would be possible if acting alone.

B2. Many CISs are aimed at the retail investor and are subject to regulation. Whereas most regulation of banks, insurance companies and securities firms is focussed on intermediaries, the regulation of CISs is unusual in that it focuses on the product (the CIS). There are international standards for the regulation of CISs which are set out in principles 17 to 20 of the Objectives and Principles of Securities Regulation, first published by the International Organisation of Securities Commissions (IOSCO) in 1998 and updated since then.

B3. Typically, a CIS will issue its constitutive documents. These will set out the legal form, the structure of the fund, and the way in which it will conduct its business, including the investment policies, the rights of investors, the fees and other matters. The CIS will be a company or a contract (often a unit trust). The investment manager will be responsible for choosing the investments in line with the investment mandate of the CIS. There will be an administrator, responsible for the process of subscription and redemption of units, the valuation of the assets and liabilities, the pricing of the units or shares and the relationship with investors. A depositary or custodian will safeguard the assets. There may be a separate promoter or distributor, responsible for marketing the CIS. There will usually be an auditor as well as legal and other advisers. Many of these services will be formed by separate entities, under contract to the CIS itself.

B4. A UCITS is a form of CIS that is subject to particular regulatory requirements set out in the UCITS Directive that are intended to provide sufficient investor protection to make a UCITS a suitable investment vehicle for European retail investors.

B5. The UCITS Directive dates back to 1985. It is broadly in line with the IOSCO principles for CISs. Its main provisions are to:

- Define a certain category of CISs as being a UCITS;
- Prohibit the marketing or operation of a UCITS without authorisation;
- Place restrictions on the investment policies of UCITS so as to limit the risk being adopted by the investor;

- Impose rules on the minimum disclosures to investors so that they have enough information to be able to make an informed judgement on the suitability of the investment, taking account of its risks, the past performance, the fees and other matters;
- Limit the legal form to that of a company or contract (often a unit trust) and impose corporate governance requirements designed to build in checks and balances into the operation of the fund and encourage good risk management by the fund operator;
- Ensure that the checks and balances include the obligation to entrust investors assets to a depositary that would safeguard the assets and monitor the compliance by the investment manager with the Directive as well as the CIS's constitutive documents;
- Place capital requirements on the management company so as to ensure a degree of stability.

B6. The UCITS Directive was always intended to facilitate cross border operation of UCITS. The basic principle is that a UCITS, once authorised in one Member State should have a passport to promote itself to investors throughout the single market, without any further authorisation by other member States. It would be subject to continuous supervision by the regulator in its country of domicile in respect of the elements described in paragraph B4, while being subject only to supervision in respect of its marketing in each other EU country where the UCITS was sold to investors.

B7. The Commission's Expert Group on Investment Fund Market Efficiency (Expert Group), reporting in 2006, observed that the key elements of the UCITS provisions were the investment limits, the principle of home country authorisation and the oversight of the independent depositary.

B8. CISs that do not meet the criteria set out in the Directive may still exist and may be appropriate for retail investors. These CISs may have borrowing beyond the level acceptable in the Directive, may invest in assets outside the definition of "transferable securities" in the Directive, or in other ways be unable to meet the Directive's criteria. They are subject to national regulation but cannot benefit from the passport.

Is the current UCITS IV proposal sufficient?

Briefing Paper for the Committee on Economic and Monetary Affairs of the European Parliament

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Federation of German ConsumerOrganisations

UCITS is a European invention and has been very successful since its inception. It now threatens to fall back if European regulation is not flexible enough in order top create a true single market platform. Is the current UCITS IV proposal sufficient in your opinion?

Executive summary

- The current UCITS IV proposal is not sufficient from the consumers' perspective.
- Notification for cross-border distribution
    - In general there is nothing to argue against the introduction of time limits on authorization for the sale of UCITS in the home Member State (MS) or on notification for marketing in other MS.
    - A time limit of course requires the regulator to come to a good decision, not just to approve the application or count the number of documents attached.
    - In 2006 a proposal was made for 20 business days for authorization and three days for notification (consumer representatives has asked for ten days); now there is no limit at all what is not acceptable.
    - A time limit is important and must guarantee and ensure that investor protection is not jeopardized.
    - An ex-post check will be much less effective than an ex-ante check.
    - The obligation of the home Member State just to check the completeness of the notification file is not enough.
    - Host MS authorities must have emergency powers.
- Transparency with the new Key Investor Information (KII)
    - The Simplified Prospectus is a document consumers often don't understand; its complete reshaping is positive.
    - The decision on the non-liability for a KII is wrong.
    - In many MS (e.g. in § 127 German Investmentgesetz) consumers can claim compensation if the simplified prospectus is false (without taking into account the full prospectus).
    - Investors must be protected from misleading, inconsistent or inaccurate KII (irrespective of what is contained in the prospectus) as the KII will become the main source of information.
    - The KII must be translated into the host states language in the case of cross-border selling (the text is not prescribing this). Its understanding is much more difficult if it is not written in the native tongue.
    - The host Competent Authority should have to check the translated simplified prospectus before the UCITS can be sold.
    - The Total Expense Ratio (TER) must be harmonised containing all yearly cost elements ("all-in-fee") and be calculated in a harmonised manner.
    - It is to be ensured that the KII is consistent, correct, understandable and comparable to be effective. The best way to achieve these objectives are standards and guidelines to be set down by legislation.

The relationship between Level 1 and Level 2 has to be considered: the main decisions have to be taken on Level 1.
  - The development of a suitable standard should in any case be completed by market testing.
- Facilitating UCITS mergers
  - The objective of facilitating mergers can be supported provided that consumer and investor rights are respected.
  - Investors must be given adequate information regarding the merger, for example changes of costs, changes of tax treatment and changes of the portfolio strategy.
  - All the relevant information must be given in good time before the merger. The definition ‘prior to the merger’ should be clearer.
  - Investors must also be given the right to exit the merged fund without any charges (not only exit charges, but also part of the entry charges); a clarification on the charges concerned is needed.
  - Adverse tax consequences for investors have to be avoided by all means. Legislation should be accompanied by a taxation directive.
  - Funds that are going to be merged must give evidence towards their Competent Authority that the merger leads to a greater efficiency and cost advantages for the investors.
- Allowing pooling techniques
  - Pooling can lead to returns of scales. But with respect to cross-border pooling problems can arise for example caused by different tax-treatments or different requirements because of different national law.
  - For this reason pooling can only be acceptable if consumer/ investor protection is guaranteed (e.g. prevention of disadvantages of rising costs, of rising tax-payments, of unwanted, changing portfolio strategies).
- Making the Management Company Passport work: The issue of the management Company Passport is still contentious. In this context it is important to create the following surrounding conditions:
  - Investors will need to be able to contact a representative of the management company in their host state to deal with questions and problems that arise.
  - Furthermore there is an urgent need for ethical standards for fund managers to be developed.
  - All market participants being involved in the buying, selling, management and governance have to disclose any conflicting interests in an effective way.

As UCITS are an important long-term savings product widely used by European consumers, as it gives small investors easy access to a professionally managed and diversified basket of financial instruments at affordable costs and as the number of funds to choose is enormous (which makes the decision process much more difficult) legislation especially has to take care of the transparency, organisation, management and oversight of UCITS funds. So the UCITS framework should not only impact on the competitiveness of European funds on global markets, bur also on investor protection and the raising of transparency.

1. Getting products to the market more quickly: Notification for cross-border distribution

It has been argued that long and burdensome notification procedures do not allow for an easy cross-border distribution of funds.

There is no objection to the introduction of time limits on authorization for the sale of UCITS in the home Member State or on notification for marketing in other Member States. This measure could increase the choice for consumers/retail investors especially in smaller Member States.

But the time limit would first of all require the regulator to come to a good decision, not just to approve the application. The notification cannot just be seen as an annoying double-check by the host Competent Authority. In the host state the notification has to guarantee that marketing and distribution of the fund is compatible to the marketing and that distribution rules of the host State are respected without of course being prohibitive. Regulators must be allowed enough time to carry out their proper functions taking into account that competing mass market retail products should be regulated in a coherent, proportionate and consumer-oriented way.

At the moment there is a time limit for notification of two months13; no doubt that this period can be shortened. However, if it is argued that the two months' limit granted to host authorities is often not respected then first a different, professional handling of the notification process by the supervisory authorities is to be foreseen. If the process is organised in a more efficient manner a new time limit like for example 10 working days is realistic. The idea of the 2007 DG Markt Working Document was to introduce a three days' time limit (right to place a UCITS three days after transmission of the required documents to the host Member State authority). It also stated that under certain circumstances the host authorities must have the power to intervene and suspend marketing of a UCITS.

This has now been deleted just as their right to invoke emergency powers in the event of clear ground that a UCITS from another Member States is in breach of the Directive and a potential source of investor detriment.

The reason given for dropping the time limit altogether was that otherwise "investors bear high fees and are deprived of a broader choice of investments". These arguments must be put into question: according to the Commission the administrative costs amount to € 45 million which is not a whole lot compared with the amount of the assets. The balancing between initial costs and possible occurrences of investor losses (and loss of investor confidence) requires closer consideration. Concerning choice there is already in many Member States a lot of choice with thousands of UCITS funds being offered today. Here choice is not the problem but making an informed assessment on the proposed investment.

I oppose the plan of reducing the notification procedure to a simple, electronic, regulator-to-regulator communication which would mean that the distribution could start immediately after such a communication. Ex-post checks are not acceptable as this would mean installing a non-preventive system that would work inefficiently on the national level. It would facilitate negligent providers and bad offers infiltrating other domestic markets before they be filtered out. It has been experienced that ex-post measures are often not taken or taken in the last minute by the national supervisor. The wording in the draft directive is a clear sign for less controls and checking in the area of UCITS.

[13] Article 46 UCITS Directive, 85/611/EWG

Time limits have to be maintained and the role of the host Member State authority has to be strengthened to ensure that consumer protection is not jeopardized.

The obligation of the home Member State just to check the completeness of the notification file is not enough (as the danger lies in the contents, and the home MS authority is the responsible one). So if the ex-post check be introduced at all it should be extended to material law, not only to marketing and distribution. The mere ex-post check of the host MS authority reduces investor protection (as UCITS could be offered that don't comply with the national law of the host MS) which in the result means the initial mutual recognition of the home MS law.

2. Facilitating UCITS mergers

I share the evaluation that the European UCITS industry is characterized by a high degree of fragmentation (the size of EU-UCITS being at an average 1/3 to 1/5 of USA-UCITS). Suboptimal sizes of funds lead to relatively high costs of management and administration. Facilitating UCITS mergers could improve efficiency of many investment funds permitting them to achieve greater economies of scale. For this reason mergers are to be supported provided that consumer and investor rights are respected.

Investors must be given adequate information regarding the merger, for example changes of costs, changes of tax treatment, changes of the portfolio strategy and voting rights so that investors are able to evaluate the consequences for their investment. If it is said that details of the investor disclosure will only be developed through implementing measures it has to be made sure that the basic principles in the Directive are strong and that investor organisations are consulted closely in the implementation process.

Most important: cost reductions must be passed on to investors which has to be checked. It must be a precondition for a merger that the merging funds must lay open that and why significant cost advantages will stem from the merger and that these advantages will be passed on (e.g. by effectively reducing the annual administrative fee).

Consumers must also be given the right to exit the merged fund without any charges which – besides specific exit charges – must also contain at least part of the entry charges (Ausgabeaufschlag).

Another very important point concerning fund mergers: adverse tax consequences for consumers must be avoided. Cross border mergers must not cause adverse tax consequences to consumers. So, if there is legislation to facilitate mergers, it should be accompanied by a taxation directive protecting consumers from adverse consequences. Unfortunately there is no hint on this although the Commission in 2006 was considering such a directive to possibly come.

Some questions are left open: Are the statutory auditors in Article 39 para. 2 always independent auditors? When can the home competent authority consider the potential impact of the proposed merger to the unit-holders of the receiving UCITS “negligible”? How must Art. 40 para. 2 and Art. 36 para. 3 function together? What is adequate information? What means “without charge”? If UCITS could be converted into units in another UCITS with similar investment policies have the unit-holders still the right to request the re-purchase or redemption (see Art. 42 para. 1)? What means “appropriate and accurate information” in Art. 40? It stays vague how actively the information has to be provided to the investors (or just made available; in Art. 40 para. 3 it says “It shall be provided…” and in Art. 42 para. 1 “have been informed” (the information should be sent to the investors without any explicit request on their side).

Last but not least, funds that are going to be merged must give evidence towards their Competent Authority that the merger leads to a greater efficiency and cost advantages for the investors which the Commission argues to be one the main reason for mergers ("…benefit the investors through lower costs and higher performance"). These new management opportunities (framework for mergers, use of master-feeder-structures) shall make up for €6 million in savings and economies of scale.

3. Allowing pooling techniques

As stated by the UCITS industry pooling the administration of different funds that are similar to each other lead to returns of scales. This instrument can already be used nationally. But with respect to cross-border pooling there are problems for example caused by different tax treatments or different requirements because of diverging national law.

For this reason pooling should only be acceptable if consumer/ investor protection is guaranteed (e.g. prevention of disadvantages of rising costs, of rising tax-payments, of unwanted, changing portfolio strategies). It also has to be secured that cost advantages result from pooling and that they are passed on to investors; this requirement should be mentioned in the directive itself.

4. Pre-contractual information

a. Simplified Prospectus / Key Investor Information

Although the underlying idea was brilliant the simplified prospectus so far has been a document of very limited use for consumers. It too often is a document difficult to read that, not to understand for investors, in most cases too long, not written in plain language, not standardized and not transparent. On what basis can then investors decide and choose the right investment product especially in surroundings with an increased competition from other forms of financial products (see the similar products issue)?

Therefore, it is important that the simplified prospectus (respectively its replacement or rather restructuring and rewording by the Key Investor Information/KII) is focused on the key issues, correct and reliable, understandable and comparable if it is to be effective. The best way to achieve these objectives are standards and guidelines to be set down by legislation. Allowing individual providers discretion and flexibility will lead to confusion and will be difficult or even impossible to monitor. Standardization is key. Investors must get transparent, standardized, coherent and comparable information on the real key issues of a standard UCITS on two pages.

b. Liability

Information solutions per se offer limited protection in complex markets: Many consumers do not read complex financial documents especially at the point of sale where pressure may be exerted to buy a product. So information is not everything; a prospectus even if simplified can be wrong or misleading. Pressure has to be built up to ensure that this prospectus is accurate, correct and not misleading at all. Liability is most important in this context. Concerning the liability of the provider a KII should not have to be read together with the prospectus.

As in the text of the draft directive there is no mentioning of liability it has to be included; consumer organisations have fought for such a provision over the past two years. In the explanatory memorandum it says: "Article 74 also clarifies that that the key investor information constitutes pre-contractual information only. No civil liability should be attached to any person solely on its basis, unless such information is misleading, inaccurate or inconsistent with the prospectus." This is contradictory: On the one hand there shall not be any liability solely on the basis of the KII; on the other hand there is liability solely on the basis of the KII namely if it is inaccurate or inconsistent.

The principle of missing liability is a serious deterioration in investor protection. In many Member States (e.g. in § 127 German Investment Law) consumers can claim compensation if the simplified prospectus is false (without taking into account the full prospectus). We demand that in a pan-European market consumers must be also in a position to rely on the information of the KII as this will be by far the most important document before buying UCITS funds.

c. Degree of harmonisation, length, content, format and comparability

The most important result reached within the CESR work on the SP/KII (the author took part in one meeting of the working group in Paris in the summer of 2007) has been the progress on length and structure of the document. It shall be a fully harmonised document, in the language of the host Member State where the UCITS is offered, on two pages and with a special structure and order (for a classic UCITS fund: Objectives and Investment Strategy, Risk and Reward Profile, Past Performance, Charges for this fund, Additional information). An illustrative and depictive description shall be used. Some of these principles have been taken over into the Draft Directive which stays vague though.

And – what is still open – the KII must be provided as a separate, stand-alone document, not in the form of building blocks not necessarily embodied in one single document.

Following this perception it has to be demanded that the relationship between Level 1 and Level 2 has to be thought over. The core decisions have to be taken in Level 1, language being one of them.

d. Language

Unfortunately there is no word in the draft directive on the necessity on translating the KII into the languages of the host Member State where the UCITS is offered. Only in the accompanying FAQ document (MEMO/08/510, 16 July 2008) "Improved EU Framework for investment funds" it says: "This information will be provided in the local language of the country where the fund is sold to the investor." The draft directive only mentions the translation twice with regard to the KII, in Article 73 para. 6 and Art. 74 para. 2 not dealing with the compulsiveness of the translation. On the contrary: from Art. 72 it can be followed that the provider himself decides in which language the KII is offered: "…specify where and in what language such information … may be obtained by investors or potential investors or how they may have access to them. This argument is strengthened by Art. 89 para. 1a) mentioning that the KII can be translated "into a language approved by the competent authorities of the UCITS host Member State".

It must be indispensable that the KII is being translated into the language of the host state in the case of cross-border selling. Its understanding is much more difficult if it is not written in the native tongue, and it is important in the context of the decision for an investment.

This translation of the KII must also be pre-checked by the host Competent Authority to order to make investor information and protection more preventive. Otherwise it would foster misleading or wrong translations of the KII. The motivation of the pre-check is not to delay the selling of the fund. But it has to be ensured at an early point of time that the translation of the prospectus is clear and accurate. A clear framework should be designed defining the role of the host regulator, in developing the guidelines for translation requirements as well as the consequences to the provider for misleading translations.

Another problem of the Draft Directive must be mentioned: whereas in other directives like the PSD or CCD it is made clear when information must be actively "provided" or just "made available" the wording here is much more vague. "Provide" and "obtain" could be interpreted as "make available". Art. 76 must also be seen in this context; it allows investment and management companies to deliver the KII in a durable medium or by means of a website.

e. Cost information

Aiming at transparency and comparability cost information is one issue. The Total Expense Ratio (TER) is to be harmonised. At the moment it does not deserve its name it is not harmonised European-wide. It should contain all yearly cost elements ("all-in-fee") and must be calculated in a harmonized manner. In many markets a lack of competition exists, e.g. the Danish Competition Authorities have analyzed the Danish UCITS market and found out that they are approximately 25% too expensive. At the moment some important cost factors in some countries don't have to be included in the TER like costs for transactions within a fund (e.g. in Germany, see § 41 Investmentgesetz). Whereas the disclosure of the TER is common in the USA, Europe lags behind. I know that disclosure is not easy because bond funds for example do not record transaction costs as such and for some other reasons, but as these costs can be very high they has ti be found a way and CESR has already dealt with the issue.

f. Legislation procedure

From the above said it can be derived that the main principles to be followed and the main decisions to be taken on Level 1 have not been taken there, but are left to the next levels (although only further details on content and format are to be decided there). Under the main principles fall at least: the question if the KII alone shall attract liability, the decision if the KII has to be translated into the languages of the host Member States where the UCITS will be offered, the length and structure of the KII as worked out be CESR.

European legislation in not coherent at all in this respect: whereas in the Payment Services Directive and Consumer Credit Directive clear and descriptive principles are worked out (plus all the details in these non-Lamfalussy directives) here not even the principles are laid down.

In developing the details (Level 2) of a commonly accepted European standard of a KII it is furthermore important to go on consulting all the involved parties, what means also consumer and investor protection organisations, not only the UCITS industry, supervision, marketing and distribution experts.

The development of a suitable standard should in any case be completed by market testing.

5. Making the Management Company Passport work

The issue of the Management Company Passport is still contentious, but apparently time is still needed and potential supervisory and investor protection concerns have to be checked. Of utmost importance is the problem in allocating responsibilities between different supervisors. As CESR has been asked to deliver its advice to the Commission by 1 November 2008 (an ambitious timing) a timely result can be provided for. In this context it is however important to create the following surrounding conditions:

- Investors will need to be able to contact a representative of the management company in their host state to deal with questions and problems that arise.
- Furthermore there is an urgent need for ethical standards for fund managers to be developed.
- All market participants being involved in the buying, selling, management and governance have to disclose any conflicting interests in an effective way.

6. Any other business

Structured instruments / similar products / open-ended funds / certificates

The Commission should go on checking what product groups must follow similar legal requirements and products must follow stricter rules; its objective is preventing legal arbitrage and allowing a level playing field. The KIII should also be used in the context of wrapped products like life insurance products based on funds.

Different distribution channels

The draft directive should carefully take into account the different distribution channels and the coherence with other directives, mainly the MiFID and the Prospectus Directive.