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Opinion of the Financial Services Consumer Group

Response to the Report of Expert Group on the Investment Fund Market Efficiency

Background

In July 2006 the Commission – DG Markt – published a report reflecting the outcome of discussions within the Expert Group on Investment Fund (UCITS) Market Efficiency over the period February – June 2006. The report should provide an assessment of the extent to which the existing EU legislative framework curtails the efficiency of the European fund industry. It provides a clear statement of the main expectations and concerns of the industry and sets out recommendations for harnessing the full potential of an integrated single market for investment funds. The Commission services have wished to submit this assessment to wider scrutiny and open debate before developing a basis for a formal position. Stakeholders have been invited to send written comments before September 20th.

FSCG Position

We are grateful for the opportunity to comment on the report of the expert group on Market Efficiency of Investment Funds (UCITS). We find the report very useful but several aspects were not adequately addressed which we will show below. The FSCG don't want to cover all issues but concentrate on those issues that seem most relevant to consumers/investors.

The FSCG welcomes the Commission's initiative to involve industry practitioners to come up with proposals for improving the investment funds regulation. It would however have been wise also to include consumer/investor representatives in a more direct way than just as observers. Greater consumer involvement in the

policy making can be one step towards balancing interests of providers and consumers, thus facilitating the process towards the European single market.

1. Getting products to the market more quickly

a. Authorization and notification

We do not object 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 in national markets, especially in the smaller Member States. It must also be prevented that comparable substitute products such as certificates are regulated compared with UCITS; the UCITS and the Prospectus Directive provide different rules in this regard.

But the time limit would of course require the regulator to come to a good decision, not as the expert group seems to say, just to approve the application. From our point of view the notification can not 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 distribution rules of the host State 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.

Concerning the definition of what an appropriate limit time would be, we recommend input from the CESR regulators. As there is no time limit for authorization but an average of two to four months and for notification of two months¹ the experts group's suggestion for time limits (20 business days for authorization, 3 days for notification) appears too short, especially the 3 days notification limit.

We support time limits but the supported limit must guarantee and ensure that consumer protection is not jeopardized.

b. Simplified prospectus

The simplified prospectus is a difficult document consumers often don't understand, especially as this document in most cases is too long, not written in plain language, not standardized and not transparent.

Therefore we strongly disagree with the expert group's view that for the decision on liability of a provider a defective simplified prospectus should be read together with the full prospectus. This suggestion is undesirable. To argue that the consumer's right to compensation because of a defective simplified prospectus could be neutralized because of an incomprehensible and often not assigned full prospectus is unacceptable. Investors should be protected from misleading, inconsistent or inaccurate simplified prospectuses whatever is in the full

¹ Article 46 UCITS Directive, 85/611/EWG

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prospectus. 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. Therefore, it is important that the simplified prospectus is consistent, correct, 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 regulation. Allowing individual firms discretion and flexibility will lead to confusion and will be difficult or even impossible to monitor. Therefore we ask for standardization of the simplified prospectus and not for a flexible format, like the expert group. The consumer must get transparent, brief, standardized, coherent and comparable information given to them on rather few pages.

In many Member States (e.g. in § 127 German Investmentgesetz) 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 simplified prospectus.

The information must be given in the consumer's national language (see below) and include details as to the underlying financial instruments and its risks, a Total Expense Ratio/TER (first developed by Fitzrovia) - that really deserves the name, contains all yearly cost elements ("all-in-fee") and is calculated in a harmonized manner, an understandable description of the portfolio strategy and references to the detailed information in the full prospectus.

Besides the concrete disclosure of the risk factors of the investment especially a standardized cost ratio covering all cost elements is of utmost importance. 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.

In order to develop a commonly accepted European standard of a simplified prospectus we suggest to consulting the involved parties, like the UCITS industry, consumer protection, supervision, marketing experts and sales and distribution experts; the workshops held by the Commission in 2006 provide a better basis for taking this work forward than the expert group's report. The development of a suitable standard should in any case be completed by market testing.

c. Language

We disagree with the expert's group opinion and therefore also with Article 44 of the UCITS Directive that allows not to translate the simplified prospectus into the host states language in the case of cross-border selling. From our point of view the understanding of the simplified prospectus is much more difficult if it is not written in the native tongue. But this understanding is important in the context of the decision for an investment.

We also disagree with the expert group's suggestion that the translation of the simplified prospectus should not be pre-checked by the host Competent Authority. This raises concerns about misleading or wrong translations of the simplified prospectus not pre-checked by the host regulator. The motivation of the pre-check is not to delay the selling of the fund. But it is important to ensure before the selling 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.

From our point of view consumer protection must be seen as a preventive instrument. Therefore the simplified prospectus should be translated in the language of the host state and the Competent Authorities should have to check the translated simplified prospectus before the fund can be sold.

2. Facilitating UCITS mergers

We agree with the evaluation that the European UCITS industry is characterized by a high degree of fragmentation (the size of EU-UCITS is 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 we support mergers provided that consumer and investor rights are respected.

Therefore 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 so that investors are able to evaluate the consequences for their investment. In this respect the definition investor information prior to the merger should be clearer, e.g. the simplified prospectus of the receiving fund should be not only 'offered to be provided to investor', but should be sent to the investors without any explicit request on their side.

Consumers must also be given the right to exit the merged fund without any charges.

Another very important point concerning fund mergers is to avoid adverse tax consequences for consumers. It must be impossible that cross border mergers 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.

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.

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 we see problems for

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example caused by different tax-treatments or different requirements because of different national law.

For this reason we are asking for pooling only being acceptable if consumer/investor protection is guaranteed (e.g. prevention of disadvantages of rising costs, of rising tax-payments, of unwanted, changing portfolio strategies).

4. Making the Management Company Passport work

The FSCG supports measures leading to a greater efficiency and access to better performing products. Investors in host states will however 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 the FSCG sees an urgent need for ethical standards for fund managers to be developed.

Going beyond this, we consider it necessary that all market participants being involved in the buying, selling, management and governance have to disclose any conflicting interests in an effective way.

5. More freedom for the Depositary

The role of depositaries is an important one from the point of view of investor protection and confidence as they have to oversee the activities of fund managers and to prevent improper behavior with the assets of investors.

We are however reserved to the idea of a *depositary passport*, as is the Expert Group, unless investor interests and their reliance on responsibilities of depositaries are not met adequately. Any harmonization should consider this.

From our point of view the distribution of the control to two different Competent Authorities should be thought over, as this must not lead to a lack of efficiency (e.g. by different administrative procedures) and uncertainty of investors. There are wide differences between the Member States regarding the control, function and responsibility of the depositary bank. For this reason a depositary passport could lead to custody-arbitrage and therefore threaten consumer protection and confidence.

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