

**FEEDBACK STATEMENT
ON
RESPONSES TO
OEREF EXPERT GROUP REPORT**

~JULY 2008~

The expert group report

On 13th March DG MARKT published a Commission expert group report (http://ec.europa.eu/internal_market/investment/consultations/index_en.htm)

analysing the EU market for open-ended real estate funds and invited stakeholders' reactions to it. This report concludes that there is currently no single market for open-ended real estate funds due to regulatory market entrance barriers which impede the cross-border distribution of these fund units. The report, which does not necessarily represent the views of the Commission, calls for an EU directive which would grant open-ended real estate funds a UCITS-like passport allowing fund managers to easily distribute their funds to retail investors across EU borders. It also recommends a set of key features designed to insure the suitability for retail investors and to provide a high level of investor protection.

Reactions

DG MARKT received 17 responses to the report, among them three from governments/ regulatory authorities (from DE, F and IRL), four from European and eight from national industry associations representing fund managers and distributors (from AT, DE, F and UK) as well as two submissions from individual UK industry players managing open-ended real estate funds.

Full support for an EU passport

All 17 responses fully support the expert group's recommendation to create an EU regime for open-ended real estate funds and ask the Commission to prepare a legislative proposal. Several respondents however made very clear that this initiative must not delay the current UCITS amendments.

Some respondents stressed that Commission activity for open-ended real estate funds has been long awaited and that an EU passport for open-ended real estate funds ranks among their top priorities.

All respondents are convinced that the report had accurately identified the main regulatory barriers and clearly made the business case for an EU regime for open-ended real estate funds. They argue that open-ended real estate funds are the biggest segment of non-harmonised investment funds with 12 domestic markets for retail investors so far. This asset class is both attractive for retail and for institutional investors, given the comparatively low volatility and correlation with other asset classes, the stable income and the positive effect of real estate exposure for the overall portfolio.

Two respondents regretted that the expert group, in line with the Commission mandate, limited its recommendations to open-ended real estate funds. One national industry association called on the Commission to also give closed-ended real estate funds an EU product passport, while a combined response from four European property associations which are members of the EU REIT Coalition asked the Commission to develop an overall strategy on the cross-border distribution of real estate investments, including real estate investment trusts. Other stakeholders called on the Commission to also consider funds of hedge funds when taking a decision on legislative measures for alternative investment funds.

EU legislative action on regulatory issues needed

All respondents strongly share the expert group's conviction that a true single market for the distribution of open-real

estate funds to retail investors could only be achieved through EU legislation, since non-legislative measures could not overcome the significant regulatory differences which currently impede cross-border distribution. Respondents agreed that the absence of a harmonised tax regime should not impede or slow down the work on an EU regulatory regime for open-ended real estate funds. As was the case with UCITS, they argued that a harmonised regulatory regime would help to diminish tax discriminations (of foreign real estate funds or of domestic investors in foreign funds). In addition, several respondents call for an EU private placement regime to also overcome barriers for the distribution of funds (including open-ended real estate funds) to institutional investors.

Coexistence of national and EU regimes

All respondents praise the high quality of the expert group report and believe that it can form an excellent basis for any possible Commission legislative work in this field. Respondents, however, almost unanimously call on the Commission to allow Member States to keep their non-passportable national regime beside the EU regime. Thus managers of open-ended real estate funds should be free, when servicing their domestic market, to choose between their non-passportable national regime and the passportable EU regime. Respondents recall that this approach has already been proven useful for UCITS and would also add value for open-ended real estate funds. National rules in Member States with more experienced real estate fund managers and investors could develop innovative product ideas which could influence the EU regime in the search for best practice.

Within or outside the UCITS Directive

Respondents disagree on whether the desired EU regime for open-ended real estate funds should form part of the UCITS Directive, be developed in a standalone directive (either solely for open-ended real estate funds or for all types of alternative investment funds) or whether the UCITS Directive should be transformed into an Investment Fund Directive with general provisions for all types of funds and specific provisions for UCITS, open-ended real estate funds and potentially other alternative investment funds. However, all respondents made very clear that the question of legal structure is only of secondary importance. All respondents stressed that the paramount objective is to create an EU passport for open-ended real estate funds and to avoid any delays. The respondents can be split into two camps:

1) Eight respondents¹ favoured integrating open-ended real estate funds within the UCITS Directive and argued that (i) this would ensure a high level of investor protection and at the same time avoid the erroneous impression that the level of investor protection for open-ended real estate funds is inferior to that of UCITS, that (ii) there is no danger of damaging the UCITS brand, given that the inherent risk of losing money with open-ended real estate funds is generally lower than for UCITS equity funds and that only very few open-ended real estate funds had to temporarily suspend redemptions. A standalone directive for open-ended real estate funds would be less efficient and contrary to the better regulation approach, as it would mean a duplication of UCITS rules. One respondent furthermore explained that there is not one single type of UCITS, but rather a set of very different

¹ Two out of these eight respondents would however not want open-ended real estate funds to be called UCITS.

funds under the UCITS roof (with completely different risk-return-profiles and liquidity). UCITS could therefore not be defined as an asset class, but rather as a brand for different types of funds meeting certain structural quality standards.

2) However, other eight respondents² prefer a solution outside the UCITS Directive, of which two favour a new Investment Fund Directive, three a standalone directive for open-ended funds and four an Alternative Investment Funds Directive which would be open to other asset classes (e.g. funds of hedge funds) at a later stage. These respondents highlight the differences between UCITS and open-ended real estate funds (notably with regard to liquidity and valuation) and conclude that the UCITS brand could be damaged, if UCITS were allowed to invest in significantly less liquid assets. They also argue that already UCITS III was difficult to explain to regulators outside the EU.

Recommended key elements for an EU regime

Almost all respondents agreed with the recommended key features for an EU regime for open-ended real estate funds. Several stakeholders stressed that these features should be seen as a coherent package, i.e. that elements need to fit together and that elements (such as the minimum redemption frequency) cannot be changed without impact to others (such as the minimum liquidity). Respondents stressed that the EU regime for open-ended real estate funds should be built as much as possible on existing UCITS rules and that a high level of investor protection is of utmost importance. Respondents were aware that the regulatory features

need to be discussed in more detail at a later stage.

The few comments concerning the key elements were focussed on the liquidity management and the redemption policy. One regulator highlighted the importance of mandatory liquidity management and of stress tests. Diverging positions were advanced on whether a minimum liquidity of 10 % should be mandated, although a majority of respondents supported this threshold. Some respondents also questioned the recommended minimum redemption frequency of three months and stressed that half-yearly redemptions should be allowed, too.

One regulator and one management company criticised the borrowing threshold of 60 %, arguing that this was far too high and proposed, instead, a threshold of 40 % and 20 – 25 %, respectively.

Several respondents commented on the valuation of real estate assets. One European industry association proposed that one single internationally recognised valuation method needs to be used consistently for the entire portfolio of an open-ended real estate fund. Different positions were put forth on whether only the current 'market price'³ or also a 'fair market value'⁴ (the latter at least under extreme circumstances) should be recognised. One national industry association emphasized that the management company should be allowed to deviate from the valuation price determined by the valuer(s), while others defended the proposal that valuations should be binding.

³ This is the price which could be achieved by currently selling the property, irrespective of any future developments.

⁴ Valuers using the fair market value do not only take into account the currently achievable market price, but also expected future price developments.

² One respondent does not take a position on this question.

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