

## Commission Open Hearing

### Initial orientations for deepening the Single Market for UCITS Investment Funds

Charlemagne Building

26<sup>th</sup> April 2007

#### SESSION I. CROSS-BORDER FUND NOTIFICATIONS

*Moderator: Dr Wolfgang Mansfeld, Member of the Board, Union Asset Management Holding AG and President BVI.*

*Panel members: Mike Champion, Head of Product Development, Schroder Investment Management Ltd.; Jean-Marc Goy, Counselor to the Director General, Commission de Surveillance du Secteur Financier, Luxembourg; Marta Klosinska, Advisor to Chairman of the Financial Supervision Authority, Poland; Robert Slange, Legal Counsel, ROBECO.*

**Dr Wolfgang Mansfeld** recalled in a short introduction the distinction between requirements harmonised by the UCITS Directive and activities which fall outside the scope of the Directive. The latter are subject to supervision by a host Member State and seem to create more controversy and difficulties.

The moderator opened the discussion by asking industry representatives if the exposure draft meets their expectations regarding postulated changes. He inquired about any particular areas which are welcome and what is missing in proposed solutions.

**Mike Champion** briefly reiterated current difficulties with proper functioning of the UCITS passport. He stressed that the notification procedure remained a lengthy and costly process even after CESR guidelines. Divergent rules applying to the form and the content of the simplified prospectus have made the situation even worse. He highlighted the opportunity cost

borne by UCITS promoters and the un-level playing field with other investment products. He confirmed that market share of competing products including insurance products is growing substantially quicker than UCITS in some countries (for example the certificate market in Germany). This trend will continue unless appropriate legislative initiatives are undertaken.

He recalled that amendments to the UCITS Directive have already been discussed for several years and underlined that the industry needs quick implementation of changes by 2009.

Some elements of the exposure draft indicate that the Commission is listening to the industry. He expressed his support for regulator to regulator communication and an almost immediate right to start marketing of units of a fund in another Member State (3 days after transmission of notification file to the host authorities). Removing the possibility for a host Member State to question what has already been approved by

a home regulator is also crucial to improve the current situation.

However, he mentioned some issues which are missing or need fine-tuning. The exposure draft does not envisage more liberal regime for marketing of UCITS to institutional investors. He pointed out that under the Prospectus Directive there are already derogations for transactions between institutional investors. This could serve as an example for funds as well. Ensuring a fully electronic notification procedure would be welcome. He proposed a requirement that in a given Member State only one competent authority should be responsible for the notification procedure and supervision of marketing in that State. He closed his statement by demanding a clear definition of the home/host Member State powers outside the UCITS Directive.

**Robert Slange** broadly agreed with the preceding speaker. He confirmed that the regulator-to-regulator approach as well as electronic filing of documents is welcome. He also insisted on ensuring a level playing field between UCITS and substitute products. Nowadays, asset managers are encouraged to structure investment products in a way that allows them to market their products across the EU subject to provisions of the Prospectus Directive. He also mentioned that the proposed language regime already exist under the Prospectus Directive. More consideration should be given to non harmonised issues in the exposure draft. In many cases it is difficult to determine what local rules are applicable. Moreover, they can be subject to frequent changes, which are difficult to follow. Therefore, it is particularly important that a list of local rules referring to marketing and advertising in a host Member State are published. Those rules should be clear without any space for ambiguities or divergent interpretations. This is of particular importance taking into account the increased responsibility of a fund provider that would result from the

implementation of the regime proposed in the exposure draft.

**Dr Wolfgang Mansfeld** asked industry representatives to specify whether delays in the notification procedure are caused by extensive host regulators' control of compliance with local advertising rules or by double-checking that a notified fund complies with harmonised provisions of the UCITS Directive.

The industry representatives confirmed that host member states' interventions are in both areas. The situation is different in different countries. They mentioned that recent CESR guidelines have not had much impact on the process. There are still cases where host regulators intervene for example, with the text of a prospectus already approved by a home regulator.

The moderator turned to regulators. He indicated that they act as both home and host authorities. He asked about the problems which may arise under new the notification procedure and if additional responsibilities may lead to an increase of fees.

**Marta Klosinska** acknowledged that sole responsibility of a home Member State for supervision of compliance by UCITS with harmonised provisions is not regarded as a problem from her perspective as a regulator. She was more concerned about practical aspects of the proposed notification procedure. It should be clarified when the 3-day period starts. If this would be the day when documents were sent, it might be possible that UCITS would have a right to market its units before host authorities received its file. She mentioned that this might be difficult for home authorities to establish if a notification file is complete (i.e. compliant with the host Member State's marketing and advertising rules). To ensure that no information is missing home authorities would need to know these host Member State rules in detail.

**Jean-Marc Goy** – confirmed that improvement to the notification procedure is one of the fields which really require legislative initiatives. CESR guidelines were a step in a right direction, but not sufficient enough. He made it clear that already the current wording of the UCITS Directive does not allow the host authorities to double check these issues which under the Directive are subject to approval by home authorities. He acknowledged that the proposed solutions would shift tasks between a home and a host regulator. More of a workload will be assigned to a regulator acting as a home authority. This would not necessarily imply an increase of fees. On the other hand, the workload of the host Member State authority would be reduced.

**Dr Wolfgang Mansfeld** turned to the questions relating to the non-harmonised area. What shall be meant by ex-post control? What business risk for fund promoters is involved when host authorities establish that notification is incomplete or compliance with local rules is not properly ensured? How might this impact a right to continue marketing in a host Member State?

**Mike Champion** considered that further clarity is needed on home and host supervisory powers. He illustrated his concerns with two examples. 1 - Since according to the exposure draft key investor information would not necessarily be a specific document, the line between home and host powers is vague when the key information is incorporated into a marketing document. 2. Additional cost, complexity and delay will continue if it is possible for a host Member State to require pre-approval of marketing documentations. This may lead to a situation where fund units can be marketed in a host country (3 days after notification) but marketing documentation has not been approved yet. Moreover, it should be permissible for documents provided to the host authorities within the notification procedure to include details of a new fund which has already been

authorised in the home Member State even if it will be launched at a later date. Otherwise there will be a constant updating of marketing materials. He used an example of the addition of a new sub-fund to an umbrella fund.

He underlined that any grey area as regards applicable rules creates a potential risk and cost. These problems would probably have to be solved country by country. However, he would be ready to take the risk of (non-)compliance with local rules rather than continue with the current legal framework.

**Robert Slange** confirmed that the clearer the rules the lower the risk of fund managers to breach them unintentionally. He mentioned that harmonisation of advertising rules would also minimise this risk. He added that now it is almost impossible to use the same advertisements in different countries. Most countries should reconsider how their current rules on advertising add to investor protection and whether this could be achieved in a more efficient way. Like **Mike Champion**, he would be ready to give this new procedure a try.

All industry representatives referred to MiFID and interaction between MiFID and UCITS. In most cases, fund promoters use intermediaries for distribution of UCITS in host countries. Such distribution structure usually is subject to MiFID rules. Therefore in such cases the co-existence of additional local rules applied to marketing of UCITS was questioned.

**Dr Wolfgang Mansfeld** asked regulators about their views on what should be subject to their supervision as a host authority and how they would proceed if they established in the ex-post control that a fund was in breach with local rules after marketing had started.

**Marta Klosinska** disagreed that abolishing ex-ante control of marketing arrangements does not bring additional risk for investor protection. Now, in most cases there are issues which need to be clarified and settled

within 2 months of the notification procedure, before marketing starts. Some of them may be of significant risk for investors. To remedy such a situation ex-post might prove to be difficult. From her experience it occurred frequently that documents need to be amended following the ex-ante control by the authority. She therefore pleaded not to switch to ex-post control. As an example she provided nominee accounts which are not recognised by Polish law. For investor protection it would be better to check compliance with local marketing rules in advance.

**Jean-Marc Goy** underlined the need to draw a clear line between host and home supervisory powers. This is crucial to avoid the risk of ending-up with double-checking by host and home authorities again. Any infringements to local rules should be remedied immediately. Host authorities should contact home authorities as soon as possible to find appropriate measures to solve problems. He agreed that harmonisation of advertising rules might be an interesting idea. He pointed out that the fact that not all countries published their local rules on their websites confirms that the impact of CESR guidelines as non-binding measures is limited.

At the end of discussion the moderator raised the problem of delays in authorisation of funds. He noticed that no legislative changes with this respect are foreseen in exposure draft. **Mike Champion** referred to conclusion of Expert Group<sup>1</sup> which proposed 20 days timeframe for authorisation of a new umbrella fund and 10 days for the addition of a sub-fund. **Robert Slange** noticed that regulators should be interested in streamlining authorisation procedure to attract fund managers. This is subject to competition between regulators. Nevertheless, clearer rules would certainly help to improve compliance.

Some comments from the audience referred generally to the exposure draft. One participant suggested that provisions the governing notification procedure could be drafted more precisely. They should exclude any risk that notification procedure would again become burdensome and complicated in some years. Also impact of MiFID on distribution of UCITS should be taken into account. Another person argued that a further step could be considered towards the abolition of the notification procedure. If the aim of notification is to make authorities of a host country aware about the decision of a fund manager to enter its market, a simple internet link would be sufficient. He also questioned a requirement to establish a paying agent in a host member state.

In concluding statements panellists stressed a need for clear definition of the respective responsibilities of supervisors in the UCITS importing and exporting countries. Many of the marketing and advertising issues had been gradually harmonised through other EU legislation (e.g. MiFID). However, abolition of notification would not be achieved by level 3 coordination among supervisors. It has already been a long debate on how to streamline the notification procedure. Therefore, implementation of the final proposals by 2009 would be welcomed.

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<sup>1</sup> Report of the Expert Group on Investment Fund Market Efficiency, European Commission, Internal Market and Services DG, July 2006

## SESSION I. MERGERS

***Moderator:** Jean-Baptiste de Franssu, Chief Executive Officer, INVESCO.*

***Panel members:** Jella Susanne Benner-Heinacher, Managing Director, German Shareholders Association, DSW; Nathan Hall; Senior Tax Manager, KPMG LLP; Arnaud Oseredczuk, Head of Asset Management, AMF, France; Greet T'Jonck, Deputy Director, Supervision of Financial Information and Markets, CBFA*

**Jean-Baptiste de Franssu**, introduced the discussion by highlighting the importance of the UCITS fund industry (nearly €6 trillion at the end of 2006). Its success has spread beyond borders. UCITS has become a worldwide brand. However, according to Mr de Franssu, in comparison to the American fund market, the European landscape is characterised by too many small funds. The average size of UCITS (€ 200 million) is much smaller than that of American funds (€ 1bn). Mr de Franssu believed that there was therefore a strong need for rationalisation. He also referred to recent trends in the industry. The European market is increasingly becoming pan-European. Around 65% of the industry's flows go into cross-border funds. He pointed out that managers may not, in future need to pursue the strategy of having a range of funds in multiple domiciles. Thus, € 2 to 6bn could be saved annually. These savings could be distributed to investors. He stressed that cross-border mergers already happen, but they are stand-alone, complicated exercises because of the existence of different national regulatory frameworks. On the other hand, mergers are widely used on a national basis. For instance, in France 10% of funds are merged every year. Mr de Franssu believed that the role of the regulators was key. He considered that they need to work together, but also on the basis of reciprocity. Mr de Franssu concluded that there is a need to work on short term solutions, while the UCITS legislative framework is progressing,

since the competition from other products is intense.

**Nathan Hall** stressed the growing demand for merger activity. Also investors are increasingly investing cross-border. The momentum is therefore there. Cross-border merger will also allow access to more competitive tax regimes. Commenting on the exposure draft, Mr Hall considered that introducing the principle of the right to merge for UCITS was important. In particular, the fact that this right was given to UCITS independently of their legal form. As regards the coverage of the proposal, Mr Hall believed that including three merger techniques was a good start and asked the industry to react at this stage if there would be a need to take into consideration any other merger technique. As regard to the absence in the exposure draft of any requirement on the similarity of the investment policies of the merging funds, he pointed out that in many countries such as UK, Luxembourg, Ireland or France, this requirement does not exist either. The regulator takes investment policy into account when considering the interest of investors. In practice however, most mergers take place between similar funds. He stressed that he was not in favour of introducing prescriptive rules in this respect. Finally, Mr. Hall stressed the negative effect of tax at investor level if triggered by a merger, both capital gains tax and EU Savings Directive withholding tax. He argued that mergers should be tax free and regretted that the option of a Taxation Fund Merger Directive had not been pursued,

although he agreed that it would have been a difficult road. He believed that the Communication on tax issues announced in the White Paper is a positive move but would not solve the problem alone and suggested a third way: to actively engage tax authorities in the debate.

**Jella-Susanne Benner-Heinacher**, considered it appropriate to clarify that the merger section of the exposure draft responded to a request of the industry and not of investors. She welcomed the idea to save costs, particularly if the industry would pass such economic benefits on to investors. However, she expressed some doubts as to whether this would actually be the case. Ms Benner-Heinacher also stressed the importance for the merging funds to have similar investment policies. Otherwise, the investor runs the risk of being re-directed to a fund that does not match his/her needs or preferences. She was convinced that higher efficiencies could be achieved if the investment policies were similar. She asked the Commission to include specific requirements or at least some guidelines on the similarity of investment policies. She also highlighted the importance of a fair and true valuation. Ms Benner-Heinacher supported the idea of involving an independent auditor but considered that the exposure draft should be more specific on the valuation rules and method in order to have more harmonised valuations. As regards the minimum information investors should receive, she mentioned the background and rationale of the merger (to be reviewed by the auditor); a comparison of investment policies; a comparison of the costs/charges of both funds; ; details on the asset valuation, the exchange ratio and the calculation methods used; the prospectus and last annual report of the receiving UCITS; information on the voting process and the possible exit scenarios; and specification of who will bear the costs of the merger (with the understanding that those should not be borne by investors). Finally, Ms Benner-Heinacher also believed that

mergers should not result in a taxable event for investors and asked the Commission to take action in this area.

**Greet T'Jonck** congratulated DG Internal Market for its outstanding work. However, she considered that the option favoured in the exposure draft to require only the approval of the dissolving fund supervisory authority did not allow taking the interest of the receiving fund's investors into account. She considered that the proposal should be rebalanced by giving a bigger role to the receiving fund supervisor. She also disagreed with the assumption that a merger had fewer consequences for the receiving fund's investors and mentioned the risk of performance dilution. With regard to disclosures, she defended the investors' right to receive fair, accurate and balanced information whatever the impact of the merger on them might be. Thus, the receiving fund investors should be informed as a matter of principle rather than as a matter of exceptional measure. According to Ms T'Jonck, letting the receiving fund decide whether or not the merger would have a negative impact on its investors (without any prior regulatory scrutiny) might give rise to conflicts of interest. She stressed that this is even more crucial since in the absence of a requirement to publish the draft term of the mergers (as required in the Cross-Border Merger Directive for companies), receiving fund investors will not be aware of the merger at all. Two further weaknesses of the proposal were the fact that the depositary of the receiving fund was denied an oversight role and that the auditor report focused only on the disappearing fund. She advocated more balanced arrangements on the supervision side and proposed that both regulators should be involved in taking a common decision on the merger, whereby the regulator of the disappearing fund could possibly act as lead-supervisor. Finally, Ms T'Jonck concluded by asking for a more ambitious project consisting on the development of an EU framework for UCITS mergers comparable to the one established

for companies under the Cross-Border Merger Directive.

**Arnaud Oseredczuk**, stated that the vast majority of mergers taking place do not present any problem. However, 1% of the cases may present a risk for investors. He believed that comparisons with the American case were not always relevant since the European market was not so much price driven. He also questioned the argument that mergers would benefit investors. This has not been the case in France, where a high number of fund mergers take place every year. However, he recognised that this was not a reason for the regulator not to create a facilitating framework as long as investor protection was ensured. He clarified that the French supervisor does not require similarity of investment policies but does check whether the interests of investors are preserved. If this is not the case, changes to the merger proposal may be requested. Mr. Oseredczuk also doubted that the right to exit without charge was really protecting investors,

particularly those dissenting investors who had just entered the fund that would disappear and who had paid a high entry fee. Finally, he supported the proposal to give the disappearing fund regulator a leading role and to enhance the cooperation of such a regulator with the receiving fund regulator.

In his concluding remarks, **Mr de Franssu** highlighted the need for more work to be undertaken on the investor protection issue, in particular information to be given to investors. Rebalancing the role of regulators involved in the merger process also deserves to be further explored. He considered that the idea of a lead regulator could be a way forward and suggested making a distinction between unproblematic 'fast-track' merger proposals and those more difficult merger dossiers. Mr. de Franssu also reminded that UCITS are sold outside the EU and that it was necessary to keep third countries' regulators informed about changes to the UCITS framework in order to avoid the reticence raised by UCITS III.

## SESSION II. MANAGEMENT COMPANY PASSPORT

*Moderator: Dan Waters, Director of Retail Policy and Asset Management Sector Leader, FSA.*

*Panel: Gareth Adams, Executive Director, Fidelity Investments International; Pierre Bollon, Director General, Association Française de la gestion financière, France; Martina Kelly, Head of Policy- Investment Funds, Irish Financial Services Regulatory Authority; Claude Kremer, Partner, Arendt and Medernach.*

Following a presentation from the Commission of its initial orientations in relation to the management company's passport, the panellists presented their views on the Commission's orientations.

**Pierre Bollon** said the FR market is clearly in favour of a full passport. Why are management companies which are fully regulated, are not able to manage funds cross border? A partial passport would be costly for fund managers, their shareholders and their clients. It would be more dangerous to have activities located in two places at the same time only to prove substance. The Commission's orientations would not improve things; they would create confusion as they seem to imply that management companies can be cut in two different parts. The idea to locate the NAV calculation in the country of the fund is strange as cases already exist where the NAV calculations are not done in the country of the fund. The substance requirement is reactionary. Most of the issues can be solved via supervisory cooperation: are we not in Europe?

**Martina Kelly** pointed out concerns about the ability for a supervisor to properly supervise a fund in the context of a full passport. UCITS are not only to be authorised, they are also to be supervised. We are favourable to the concept of a partial passport because we want to avoid the situation where we have to supervise an empty shell. The Commission refers to 'core

administration' but the specific proposals in this regard are too limited. Also in the case of contractual funds, there is a question regarding the application of Home country conditions to non resident entities and of investor redress. Another issue is risk management. This should also be subject to review by the Home supervisor of the fund. It is not possible to split risk management from the UCITS in its totality and we need to consider appropriate measures, perhaps level 2 measures. Finally, need to bear in mind that a full passport would be difficult simply because supervisory cooperation cannot do everything, especially when it comes to the enforcement of the rules applicable to a given UCITS in its Home country. It is not for the supervisor of a management company located in country A to check that the UCITS the management company manages on a remote basis in country B complies with the rules applicable to the UCITS in country B.

**Claude Kremer** concurred with views of Martina Kelly. Market needs liberalization, but not at all prices. Full passport is attractive, but life is made of compromises. One should not only consider the point of view of the management company. Need to look at investor protection, at the role of the depositary, at the supervisor. They need local substance. BCCI case shows the need for effective consolidated supervision. The option of the partial passport is a pragmatic one, I support it as it is likely to attract consensus. Two things need to be clarified:

(i) Supervisory gaps (avoid 2 competing regulators or no regulator at all), for instance in relation to risk management. Who is going to control the VaR? In the case of a corporate fund, the Board has overall responsibility.

(ii) Need to look at unintended consequences of remote management. If corporate funds can delegate management to management company, trickier for contractual funds. Where is co-ownership located in the case of a contractual fund? There may also be negative tax implications. A fund in country B should not be subject to taxes in the country of its management company.

**Gareth Adams** said that freedom of movement is the only thing needed. Why should this be limited because of requirements linked to the depositary? One can rely on IT for the work of the depositary. Savings are evaluated to be EUR 762 millions per year. Risk management could be enhanced if centres of excellence are developed. The more locations, the more difficult supervision becomes. Split supervision already works. This can be resolved. Partial management company passport sounds like going abroad on holidays and not taking your oldest child home! It also risks exacerbating split supervision related problems. The use of the "core administration" concept in the COM orientations creates practical complications. What does it mean to have "the books" in the fund's Home Member State when everything is dematerialised? What is location? What if IT backup in another country? These questions should not make split supervision more complicated. We the industry should be better off buying in a 80% management company passport workable now than a 100%, full passport which is probably not going to be in place before ten years' time. There is a need to play by the same standards for good supervision, not for protectionism.

Geographical reorganisations should follow business logic.

Questions from the floor:

**Matthias Honninger** (BaFin, DE): Why not rely fully on Home country control? We do it for the product passport, why not for the management company passport? Letter box should be avoided though. This causes Problem of supervision for the Home Member State of the fund. Where should the depositary be located? (Answer from Chair: in the Home Member State of the fund).

**Martina Kelly**: we would be talking about two authorisations: for instance IE for the UCITS, UK for the management company. But UK has nothing to do for instance with supervising the fund's compliance with the Irish rules on stock lending, disclosure, investor information which are very detailed under IE law.

**W Van Someren Grève** (Robeco, NL): IE and LU wish to keep their industries on their territories. UCITS umbrella funds are already letter boxes, they are clones. There is double supervision already.

**C Kremer**: It is better to defend a pragmatic project that could work rather than an ideal one that does not work. Besides management companies, one must look first at investor protection.

**Dan Waters**: some regulators also think that a full passport is good (FR, UK).

**Pierre Bollon**: if substance has to stay in the country of the fund, why not a depositary passport then?

**Dan Waters**: we should not open new discussions. However, it is good to ask if a DE supervisor would be able to understand IE rules on investor disclosure. There is a real issue of supervision here.

**Martina Kelly**: we Irish regulators have no role in our mandate in relation to the promotion of the industry. We have only one mandate, the supervision of the market and the protection of the investors.

**Dan Waters:** real work needs to be done in relation to supervision. We need to work here with CESR.

**Jarkko Syyrila** (Investment Management Association, UK): after ten years of debate with the Commission on the issue of the management company passport, no progress has been made, disappointed with the initial orientations. If there is no trust between regulators, it is to the regulators to adapt. A full passport will not derail the quality of the UCITS label. We need centres of excellence for risk management. A partial passport creates huge ambiguities. We need clarity.

**Freddy Brausch** (Linklaters & Loesch, LU): a lot of sympathy with Pierre Bollon and Gareth Adams. As a lawyer I am afraid of the legal complexity and the legal monster of a partial management company passport. For instance, the uncertainty of the localisation of a contractual fund. Who is the competent regulator? In which interest is the passport? It should be in the interests of the investors.

**Pierre Bollon:** one thing is sure, LU funds are more expensive. And I think one of the reasons is that you must maintain there an artificial management company to comply

with the directive. Is this in the interests of the investors?

**Gareth Adams:** management company passport means more choice for investors. There is indeed an issue of complexity which needs to be addressed.

**Dan Waters:** why should there be a risk of double taxation?

**Claude Kremer:** we need to be careful.

**Pierre Bollon:** the criteria of the applicable law to define the fund domicile as set out in the initial orientations should provide the answer.

**Gary Palmer** (Dublin Fund Industry Association, IE): We need to make sure that tax domicile can be easily determined, not only legal one. Attention should also be paid at the reaction of third country regulators to the passport. Currently 30% of UCITS are distributed outside the EU.

**Florence Fontan** (BNP Paribas): There are inconsistencies in the initial orientations. The document requires that core administrative functions remain in the fund domicile, however, custody functions can be delegated.

## SESSION II: POOLING

*Moderator: Pauline Leclerc-Glorieux, Head of Department, Investment Services Providers and Products, AMF.*

*Panel Members: Steffen Matthias, Secretary General, EFEMA; Gráinne McEvoy, Financial Institutions and Funds Authorisation, Irish Financial Services Regulatory Authority; Guillaume Prache, Vice-Chairman, FAIDER, Fédération des Associations Indépendantes de Défense des Epargnants pour la Retraite; Julian Presber, Managing Director, State Street Bank Luxembourg S.A.*

**Mr. Claus Tollmann** (European Commission) introduced the session by elaborating on why the European Commission intends to introduce a master-feeder-regime instead of a broader concept that would allow the UCITS to invest in more than one master and why the European Commission does not plan to table proposals on virtual pooling. Furthermore, Mr. Tollmann presented the main features of the DG MARKT's initial orientations for a master-feeder-regime.

All panel members welcomed DG MARKT's initial orientations by arguing that master-feeder-structures would be an additional toolbox mainly to achieve cost reductions.

The Chair, **Ms. Pauline Leclerc-Glorieux**, asked the panellists to explain the advantages of a master-feeder-regime, both for the industry and for the retail investor. According to Mr. Steffen Matthias (EFAMA) such structures have three main advantages. Firstly, they enable the so-called 'white labelling' (domestic management companies may offer a fund under their brand the assets of which are managed by a management company of another financial group). Secondly, a management company may sell its clients a fund without having to provide the expertise for the management of these specific assets. Thirdly, in cross-border cases the setting-up of a local feeder fund is sometimes easier than the notification of the master fund.

**Mr. Julian Presber** argued that with pooling in a broader sense the cost benefits for the fund industry could be significantly higher than with mere master-feeder-structures. **Ms. Gráinne McEvoy** supported this view. She was convinced that a broader concept where a UCITS invests without restriction in another UCITS (already subject to the provisions of the UCITS Directive) would pose little additional risks.

**Mr. Guillaume Prache** stressed that not only industry, but also retail investors should profit from the cost reductions. He requested the European Commission to further elaborate on the benefits of master-feeder-structures for retail investors. Mr. Prache expressed his strong support of the draft proposal to prohibit the master from charging the feeder subscription and redemption fees and the obligation to pay retrocessions into the feeder's assets. The envisaged disclosure of the aggregate costs of the feeder and the master, he said, are additional important measures to protect retail investors. **Ms. McEvoy** supported him by saying that investors need to be aware of the costs to be able to make an informed investment decision and supported the proposal of the European Commission in this regard. As envisaged by the European Commission double charging should be prohibited. Other important measures to protect investors are the disclosure of the investment objective and of the investment

policy of the master in the prospectus of the feeder. **Ms. McEvoy** outlined that the main risks associated with master feeder arrangements are multi-layering and lack of transparency and agreed that, as envisaged by DG MARKT, to avoid multiple fund layers the master should neither be allowed to invest into feeders nor into other masters.

**Mr. Presber** agreed with the concept of DG MARKT that the feeder should more or less duplicate the master, whereas **Mr. Matthias** was opposed to that concept. Instead, he argued, feeders should be free to use derivatives not only for hedging currency risks, but also for the enhancement of the portfolio. If sufficiently disclosed, the feeder may have a different risk profile than the master. **Mr. Presber** wondered why feeders could hold derivatives, but not other less risky instruments for enhancing the portfolio.

Several panellists criticised that according to DG MARKT's initial orientations concept the master should have at least two feeder UCITS as investors. They argued that efficiency gains could also be achieved with only one feeder. In most cases the feeder's

assets would be pooled with the master's assets anyway. They also stressed that pooling might not be the only motive for master-feeder-structures.

**Ms. McEvoy, Mr. Matthias** and **Mr. Presber** criticised the envisaged obligation of the master and feeder to enter into an agreement in order to stipulate their respective rights and duties. At least if both belong to the same financial group this would, in their opinion, add no value.

**Ms. Leclerc-Glorieux** raised the question of whether the feeder should only have the fiduciary duty towards its investors of selecting the master or whether the feeder should also monitor the master's asset management. **Mr. Prache** said that the feeder should at least monitor whether the master is in line with its investment policy.

The audience finally raised the question of whether tax issues (such as tax transparent structures) could impede cross-border pooling structures. **Mr. Presber** was convinced that this is an issue for pension funds, but not for UCITS.

### SESSION III: SIMPLIFIED PROSPECTUS

***Moderator:** Hubert Reynier, Managing Director, Regulation Policy and International Affairs Division, AMF.*

***Panel members:** John Chapman, Analyst/ Journalist; Jean Cooper, Financial Services Authority, UK; Olivier Eon, Testé pour Vous; Damián Fraire, Head of Business Information Research, Allfunds Bank, Spain; Graziella Marras, Senior Policy Advisor, EFAMA; Tina Wilkinson, Executive Director, BNP Paribas, Luxembourg.*

The Commission representative gave a short overview of DG Market initial orientations to improve investor disclosure, in particular the simplified prospectus. She highlighted that action is undertaken in parallel at two levels: (i) rewriting the relevant provisions of the UCITS Directive and (ii) starting to do some groundwork on the detailed content and format of adequate investor disclosure by means of a request for assistance to CESR.

The Chairman, **Hubert Reynier**, opened the panel discussion by providing some insight on the work to be done by the CESR-IM subgroup under the request for assistance. He indicated that a first meeting of the subgroup took place beginning of April. He stressed that discussions with stakeholders would take place at the various stages of the work undertaken and that some calls for views had already been launched. He welcomed market participants to react on these. He then announced the four key topics of the panel discussion: (i) new concept of key investor information; (ii) responsibility sharing issues; (iii) level of harmonization/standardisation needed; and (iv) practical example: presentation of costs.

***New concept of key investor information replacing the simplified prospectus.***

**Hubert Reynier** highlighted that one of the flaws of the existing simplified prospectus comes from its length. It is widely acknowledged that the current requirements mention too many items, or at least that they do not request sufficient prioritization

amongst them. Information should be made accurate and useful for the investor. In the light thereof, he asked panel members to comment on whether the new concept of key investor information could help to respond to these challenges and whether it met the actual needs of investors and industry.

**Jean Cooper** expressed the view, as a regulator, that the key to success is providing information that consumers will actually use in their decision making, in a way which helps them select appropriate products. She indicated that existing consumer research shows that desired outcomes are likely to be achieved where a limited number of key messages are plainly and clearly presented, without being swamped by other less important contractual information. If not, consumers might not read the information and/or not use it. She also considered it important to be led by evidence throughout the whole process to ensure that practical solutions are proposed which actually work for consumers, including evidence on their average levels of financial capability.

**Graziella Marras** considered that the work undertaken was a great step forward. The concept of key investor information would fit very well with the needs of the industry, provided that it is really limited to key product information useful for investors and allowing them to make an informed choice. She indicated that for the fund industry, it was crucial that key investor information should not be a tool for investor education or a regulatory tool. It should provide

product information and practical information only and should be drafted in clear language. She recalled that EFAMA had already provided in the past a two-page model of what such a simple and short document could look like. She found that the present proposal by Commission services was a welcome step in the right direction, but that more details were needed to judge whether the information would actually be passed on to investors and whether it would give a complete product picture. She identified two key issues for the fund industry: (i) the need for a clear definition of the exact role and legal status of key investor information and (ii) the need for consumer testing which should be crucial in the identification of key investor information, avoiding the mistakes of the past.

**Olivier Eon** agreed that it was an interesting approach, provided that the information in its new format is effectively delivered to investors. He reminded panellists that information to investors is mainly provided at the point of sale. As to the exact scope of such information, it should encompass an accurate description of the investment strategy, of the costs, and of the possible risks and rewards of the fund (including the existence of a capital guarantee or not), not forgetting that risks and rewards are linked to the minimal recommended holding period. Key elements should be accurate. Mr Eon feared that, for complex products, there might be a danger in limiting information to a strict minimum and that this would actually be a backwards step for investors.

**Huber Reynier** pointed out that another concern raised by the existing situation was the articulation of key investor information for UCITS with the “wrappers” within which UCITS may be sold such as life insurance contracts, umbrella funds; and asked Ms Marras what were the industry views on this.

**Graziella Marras** expressed some concern about the fact that the exposure draft no

longer seemed to require information to be delivered in a document. She argued that the proposal was not sufficiently clear on this; that there might be pros and cons, but that further clarification was needed. On the question of whether the concept of key investor information, not necessarily laid down in a document, could be helpful for achieving a level playing field between UCITS and similar products, Ms Marras believed this to be a serious issue for the fund market, as products based on investment funds but using an insurance or a tax wrapper usually are less transparent, especially regarding costs. She underlined that MiFID alone does not create a level playing field, as part of the information requirements are embedded in Directives other than UCITS, which are less prescriptive. She welcomed the Commission initiative to touch upon the level playing field issue in the exposure draft, but considered that more information was needed on the exact details of the proposed approach in particular whether information would have to be provided on the underlying fund only or also on the wrapper itself? She stressed that the bigger part of the costs lay in the wrapper and that they should also be disclosed. She feared that this might ultimately lead to a shift away from UCITS to other non-UCITS funds. Ms Marras strongly argued that liability issues relating to the delivery of the information should be clarified so as to avoid documents ending up in drawers without being used.

**Jean Cooper** agreed that this is a very important issue, but not an easy one. In her view, messages need to be provided in ways which are effective for the different ways in which customers might buy UCITS or be exposed to them (eg within wrappers). She considered that it might be useful to explore ways of being flexible over how key information is presented and used, for instance allowing it to act as a 'building block' for the development of customer-facing disclosures by distributors.

### **Responsibility sharing issues.**

**Hubert Reynier** pointed out that, going further in the understanding of what needs to be changed to achieve the goal of a more accurate and focused disclosure, evidence shows that no significant improvement of the situation could be achieved without a clear responsibility regime for each party involved. He invited the panel members to comment on the two major shifts on liability issues proposed by the Commission services in the exposure draft.

**Tina Wilkinson** highlighted that product liability is the area most closely affecting the asset management sector. Product manufacturers should therefore provide clear information on how a product is structured. Explanation of product characteristics and costs can however remain a real challenge in key retail products such as guaranteed funds or absolute return funds with performance based fees. She stressed that the asset management industry should be consumer advocate. The key facts document should focus on product details. The challenge for the industry is to make it clear and understandable. Product classification can aid in avoiding selling issues at the product level by checking the appropriateness of the investment product to a specific investor group (sophisticated UCITS and institutional products). One caveat however, retail products are not necessary "simple" because they are retail. She furthermore considered that there should be a clear communication of responsibility to the intermediary to provide the key facts to investors. Ms Wilkinson felt that simplification of the key information and format should be seen as a sales tool and not a sales obstacle which it currently is. One should define the focus which the document actually can fulfil. In her view, the best approach is always to remember that this information is a tool for decision making. She advocated that the use of standard information formats should be supported to permit the greatest leveraging

of training of sales forces and investors. This would permit not just comparability, which is difficult to achieve, but would help to better structure the learning process for sales and investors alike.

**Damian Fraire** argued that whatever responsibility regime is provided for, efficient communication channels that permit the transmission of information from the fund manufacturer to the distributor, and further to the retail client, are currently inexistent. In the end, the question which remains is not how to create the best information for the investor but how to get such information to the retail investor. He considered that investors should be able to receive information documents in an easy way and stressed that currently, the time between the production and delivery of information to investors is far too long.

**Olivier Eon** then reflected the investors' point of view. He considered that the fund manager should be responsible for the consistency between the key information provided and the (full) prospectus. He stressed that it is critical that distributors be required to deliver key information as such to their clients. He believed that the distributor should complete such key information to include, amongst others, sales costs and tax treatment. In his view, the distributor should bear the overall responsibility towards its client, even if the distributor then reverts back to the manager in the course of the legal procedure. Mr Eon indicated a readiness to consider a lighter liability regime if this would be the only way to obtain more focused information. He highlighted that for some funds (structured funds), it might however be very tricky to summarize the fund's pay-off in brief terms. He furthermore believed that one might end up with situations where investors would be given only partial information, without being able to bring the case to a court.

**John Chapman** concluded the topic by stating that one has to be clear about what exactly is the "investor". In the UK,

approximately 90% of funds are sold through advisors. He considered therefore that as long as advisors and the media understood the product well, there should be no real issue. In respect of the respective responsibilities, he considered that the product manufacturer should provide key information and that it was the task of the distributor/advisor to get this across to their clients.

*Required level of harmonization and standardization.*

**Hubert Reynier** inquired what would be the exact level of harmonization and standardisation needed. In particular, how far should CESR go in the standardisation of presentation of the key investor information?

**Tina Wilkinson** stressed the need to standardise the information presented to the retail investor because of its complexity. Any documents produced are ultimately paid for by the investor. The more documents are used, the more expensive this becomes for the investor. She highlighted that it is important to remember that the simplified prospectus key investor information is not meant to address all the informational needs of an investor. It is not a financial education tool. The investor however needs to learn how to use the document; the more standardised it is, the easier this becomes. There are cost benefits and clarity benefits that will be apparent to the end investor. Cost benefits accrue as soon as the asset management industry can apply a shorter format, in a standard format that can be used in multiple markets and printed by the distributor from the electronic delivery of the information by the asset manager. The other side of the picture is however that the document has to be limited to what is actually provided by the asset manager, i.e. product information.

**Damian Fraire** then expressed the distributor's point of view. He considered that a more standardised simplified

prospectus would enable the investor to achieve a better understanding of the product's structure before purchasing a fund. He felt that once the investment has been made, the current disclosure requirements do not permit the retail client to easily follow the changes which occur in the funds they invested in retail clients continue to view the simplified prospectus as not adapted to their needs, as it is difficult for them to access and understand the information. He insisted that retail clients demand that the simplified prospectus is complemented by an announcement of the different changes that will occur at the fund level and that the communication of corporate actions of the fund should be strengthened.

**Jean Cooper** stressed that while harmonisation can be important in relation to some kinds of information and the preparation of that information -- a good example is information about charges -- this is not always true across the board. She considered that the best outcomes for consumers might be achieved where firms are given the flexibility to adapt their disclosures to the particular circumstances in which they are selling or distributing a fund. By approaching the key information for investors without imposing a straight-jacket on how this information is to be delivered and packaged for investors, solutions can be developed which investors are more likely to actually use, because these are focused on the needs of particular investor groups, or particular ways of packaging or distributing funds, and make it easier to compare competing products. In this respect, she stressed the importance of consumer testing. More generally, firms are often best placed to properly understand the nature, risks and features of a particular fund, and so better placed than the regulator to clearly and effectively describe a particular fund and its particular risks. In her view, too much harmonization could restrict healthy innovation. For this reason, she believed that ensuring clear disclosures may require

focusing in some areas more on principles and outcomes and less on detailed prescriptive requirements.

**Olivier Eon** considered that, from an investors' perspective, harmonization should be as complete as possible. Investors should be in a position to compare funds from different jurisdictions and asset managers without being misled by inconsistent presentations or calculations. He also indicated difficulty in understanding why the exposure draft was not more precise on the form which key investor information should take.

*Practical example: presentation of costs*

As a concrete example of the required level of harmonization, the practical example of cost presentation was then discussed.

**Hubert Reynier** indicated that evidence shows that the different fees (management fee, entry fee, exit fee, Total Expense Ratio (TER)) are not easy to understand and to combine for the average investor. He invited Mr Chapman to present his views on the current use of TERs.

**John Chapman** believed that presenting costs by means of TERs alone presents a misleading picture of the overall effects of charges since investors have to combine their effect with entry and exit fees. He considered that RIYs (Reductions In Yields), used in the UK, show how much investment growth is reduced by the overall effects of all charges and expenses and advocated the use of CHERIYs (Charges and Expenses Reductions in Yields) to show combined effects of initial charges and TERs.

**Graziella Marras** replied that industry does not believe that it has been providing misleading information so far. Industry believes that the current presentation of fees in the simplified prospectus (entry fees + TER) is adequate and understandable for a majority of retail investors, who should receive further explanations by advisors whenever necessary. In respect of entry fees,

she considered that the maximum fee should be indicated since it is impossible for the fund producer to indicate the exact fee that will be paid by a specific investor, as entry fees are often discounted or waived. She stressed that the information should be useful and usable in all Member States where the fund is distributed and cannot be tailor-made. She considered that the proposal made by Mr Chapman presumed that the average investor would be able to understand such a complex concept, but she doubted that was the case. The industry's recommendation would be to keep it simple. There is no perfect solution but the current solution (TER) seemed less confusing. In any event, whatever the final decision is, it should be made with the help of consumer testing.

**John Chapman** answered to some of the points made by Ms Marras. He considered that you should not just leave it to investors to sort it out since they are not necessarily able to do so. The presentation of costs by reduction in yields worked well in the UK so he wondered why it would not function in the whole of Europe.

**Olivier Eon** considered that the proposed use of CHERIYs was an interesting proposal. However, he believed that it should not replace the detailed information on entry fees and TER, but be added to it. In addition, he stressed that the presentation of costs should be carefully considered since percentages of reduction in yield are not easy to understand for the average investor and that other presentation methods could be used (i.e a concrete investment example with cash figures). Finally, he also argued that an estimate of transactions costs, currently not included in TERs, should be included in TERs.

*Concluding remarks by Chairman*

**Hubert Reynier** concluded that the proposal to replace the existing simplified prospectus by standardised and investor-friendly 'key investor information' seemed to enjoy

support across the full spectrum of shareholders. However, some conditions will have to be met if investor disclosures are to be effective. First, one has to be clear on the objectives to be achieved. The legal status should be made clear in order to avoid the overloading of disclosures with legal disclaimers. Second, the respective responsibilities of fund managers and distributors must be clearly articulated. Distributors should be compelled to make use of these disclosures before selling funds to their clients. One should therefore ascertain that the flow of information between fund manufacturers and distributors is adequate so as to ensure that the investors get the right information. Standardisation should be achieved as much as possible both to the benefit of the industry and to allow more comparability for investors. Although investors need a high level of harmonization, at the same time a very rigid framework may however not be adapted to all situations and to future developments. Mr Reynier indicated that a multiple approach towards harmonization could perhaps be taken: some items should be completely harmonized, such as cost calculation and performance presentation while a more flexible approach may be more accurate for other items. The example of costs disclosure shows that there is still much work to be done. This will have to be done together with all stakeholders: regulators, investors as well as industry.

#### Questions/reactions from public

One of the comments raised by the audience was that the concept of "key investor information" was rather confusing. In the end, it should end up in a document anyway (for which a new name was suggested "KID" – "Key Investor Document"). He argued that if key investor information would end up being inserted in different documents, the concept would become too vague. He advocated the use of a 2-page document, also in the light of the notification procedure.

Another point raised by the audience related to the use of CHERIYs and in particular the issue that this could be used as a comparable tool. The examples given only related to funds, so the question was raised whether CHERIYs could also be used for structured notes. The importance of a level playing field was stressed: comparability should be looked at in this context and competing products should be included in a similar way.

A final remark related to the idea put forward by one of the industry panellists of using a more standardised terminology. The speaker suggested not criticising the use of RIY as such, but reminded panellists that the current discussion was on UCITS funds. The goal to be achieved would be too distant if trying to apply standardised terminology to all other products.

### SESSION III: PRIVATE PLACEMENT

***Moderator:** Carlo Comporti; Deputy to the Secretary General, Committee European Securities Regulators, CESR.*

***Panel members:** Robbert Coomans, Advisor to the Board, ABP Investments, Simon Gleeson, Partner, Clifford Chance; Alex Marshall, Managing Director and Senior Counsel, Legal Department, Goldman Sachs International; Sheila Nicoll, Deputy Chief Executive, Investment Management Association, IMA.*

The Chairman, **Carlo Comporti**, introduced the subject by presenting the preliminary results of a survey among Member State authorities on national private placement regimes. It revealed that only a few Member States have a legal definition of private placement. Especially for investment funds it is not very clear what constitutes a private placement. As far as restrictions exist they mostly follow the definition of a qualified investor as given in the Prospectus Directive.

Building upon this, **Uwe Eiteljörge**, Asset Management unit of the European Commission, illustrated the problems the industry and investors currently face engaging in a private placement across borders; highlighting the fact that there is no commonly agreed definition of private placement in the EU. He presented a call for evidence on private placement which the Commission had published on 20 April 2007 and the Commission's agenda on this issue. The call for evidence covers three areas of inquiry. The first one tries to 'set the scene' in focusing on the proper identification of the problem: What do the relevant national regimes and markets look like? To what extent are the shortcomings rooted in a Single Market failure? The second range of questions tries to identify the parameters of an 'ideal' private placement regime: Where is the borderline between private placement and public offering? Which types of products and investors should be eligible? What other restrictions would be needed? The final part inquires about the suitability of the elements of a private placement

regime that currently exist in various EU Directives like the Prospectus Directive, MiFID and the transparency Directive.<sup>2</sup>

The panel took these questions up in turn. There was unanimous agreement that there was a *Single Market failure*. **Robbert Coomans**, explained from an investor's point of view that while there were no limits to private placement in the Netherlands, the situation varies considerably across Member States. Therefore, a more harmonised framework would certainly help. **Simon Gleeson** stressed that the market was rather demand driven. He also said that laws in some Member States made private placement basically impossible. In his opinion this resulted from the fact that funds are repackaged into notes in order to avoid having to comply with many diverse sets of rules. Having to rely on national rules would put a heavy burden on investment funds in particular, said **Sheila Nicoll**. The problems regarding disclosure rules currently being heavily discussed would not be a major concern for open-ended UCITS funds but rather for Private Equity funds. The issue for open-ended funds would simply be to find a way to allow salesmen to talk openly to potential investors across borders. However, in the current situation, a salesman who wants to distribute registered UCITS funds, non-registered UCITS funds and non-UCITS funds would be faced with a multitude of legal regimes and would

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<sup>2</sup> Prospectus Directive 2003/71/EC; Markets in Financial Instruments Directive 2004/39/EC (MiFID); Transparency Directive 2004/109/EC

certainly need (expensive) legal advice on whom he could talk to and what funds he could offer. She presented a simple calculation that there would already be almost 7000 potential combinations of four specifications (for example, nature of funds, nature of investment, size of investment, number of investors) in 27 Member States. She asked why what is possible for the sale of single far Eastern equities under MiFID should not be possible for funds. Finally, **Alexander Marshall** affirmed that there certainly was a Single Market failure with serious impacts on cross-border deals resulting in inefficiencies and eventually increasing risks for investors due to evasion to potentially less well-suited substitute products.

In the second round the panel addressed the question of what an *'ideal' solution* would look like. **Carlo Comporti** asked the panel in particular which of the proposals from the expert groups they would prefer: The complete ban on retail investors proposed by the private equity group or the implementation of a minimum investment limit of €50.000, as proposed by the hedge fund group. **Robbert Coomans** stressed that clear rules would be needed. Otherwise no substantial improvement could be achieved. In his view, MiFID could serve as an example. He strongly warned against quantitative restrictions as these could trigger unwanted reactions by investors. **Simon Gleeson** had a lot of sympathy with the MiFID solution, i.e. accepting individual investors as far as they pass the suitability and appropriateness tests. She also referred to the line drawn between open-ended and close-ended funds in the Prospectus Directive. The envisaged regime should be restricted to open-ended funds, at least in the beginning. **Sheila Nicoll** cautioned not to be too ambitious in trying to build an 'all-in' regime. With respect to qualified investors the MiFID definition should be applied. **Alexander Marshall** agreed that one should start with a regime restricted to sophisticated investors. He mentioned that it

should be possible to agree quickly on the MiFID definition given that most competing countries had a private placement regime in place. He also said that many individual Member States had already managed to find an appropriate definition for a sophisticated investor. **Carlo Comporti** was in line with **Sheila Nicoll's** view that it would be overambitious to aim at an 'all-in' solution. Detailed distinctions of eligible products on the one side and eligible investors on the other would result in a very complex matrix. The approach should therefore focus on the more obvious restrictions. **Sheila Nicoll** added that any solution should strictly avoid coming up with new definitions but rely on the ones provided by the existing Directives.

The chair then invited the audience to address questions to the panel. **Ms. Inel**, FESE, suggested waiting to see how the situation develops once the Prospectus Directive and MiFID were both fully implemented. Otherwise there would be a risk of continuing with high frequency in changes in the legal framework with the costs and legal uncertainty that might involve. **Sheila Nicoll** made the point that clear distinction between private placement as the opposite of public offering and private placement as an alternative sales channel. However, it would be difficult to come up with a better name for it.

The panel was asked for its views regarding the risk that non-retail products would leak into the mass market - avoiding the rules applicable to public offers via a combination of private placement and MiFID. **Simon Gleeson** responded that this should not create a major problem as it happened in the securities market and should be unproblematic as long as the MiFID rules are complied with. **Alexander Marshall** added that the integrity of the market would be the real concern. It remained to be seen whether relying on MiFID alone would be enough.

Mr. **Ironmonger**, BlackRock, suggested that a quicker solution could be to rely on Member States to harmonise their regimes without an EU Directive. **Simon Gleeson's** reaction was that this would be hard to see as national rules would be far too diverse and as Member States have not moved in this direction at all so far.

Mr. **Galli**, Assogestioni, inquired whether an EU Directive could overwrite national buy-side restrictions, e.g. on pension funds or insurances. **Alexander Marshall** replied that investment rules and private placement

would be separate issues. Nevertheless, an EU private placement regime should help smaller pension funds to find suitable investments. **Robbert Coomans** added that such a regime should on the other hand not lead to new restrictions. For him this would be a 'worst-case' scenario.

**Carlo Comporti** concluded that there were two major issues for the European Commission to address: firstly, the definition of eligible assets and investment restrictions and secondly, the potential side-effects of product regulation.