

Open Hearing on Initial orientations for deepening the Single Market for UCITS Investment Funds

Brussels

26th April 2007

Summary report of discussions

Welcome remarks:

David Wright, Director, European Commission welcomed the 300+ participants to the open hearing. He recalled the context for this work – a fast-growing and globally successful fund industry delivering sophisticated investment solutions that European savers will increasingly need. He expressed the belief that the envisaged changes can unleash powerful dynamics for the consolidation of a crowded and fragmented European fund market – without undermining the important investor protection safeguards embodied in the Directive. The envisaged UCITS adjustments should allow elimination of unnecessary costs and wasteful duplication and enable the industry to reap all the scale economies and specialisation benefits on offer in the single market. The importance of these measures has been borne out in the consultations and impact assessment that have preceded this consultation – dating back to the report of the first asset management expert group in June 2004. These proposals command a wide degree of support and were endorsed by the European Parliament.

The consultation documents published in March represent a first attempt to translate these long-standing demands into legal reality. The Commission services are hoping for constructive and evidenced suggestions on how the stated objectives can be delivered more effectively; to limit the danger that the envisaged adjustments prejudice investor protection and effective supervision; to avoid inclusion of unnecessary detail or value-destroying complexity in the proposals. These will help the Commission to come forward with first-best legislative proposals. This will maximise the chances for the earliest possible adoption and implementation of these solutions to competitive challenges facing the industry.

OPENING SPEECH:

Alain Leclair, President, Association Française de Gestion:

Alain Leclair recalled the stellar growth of the European fund industry in recent years: he identified structural reasons why European asset management business should continue to prosper – the remaining potential for securitisation of European assets and savings, the replacement of collective/institutional investments by individualised products. In order to realise this potential, it is crucial that the industry benefit from cutting-edge regulatory framework. Protestations about regulatory fatigue should not get in the way of this important work.

Alain Leclair identified 3 reasons why the European framework for investment funds needs urgent attention.

- first to ensure a coherent point of sale regulation for all investment products. While MiFID lays the foundations for such an approach, the way it is currently taking shape gives rise to fears that it will exacerbate – rather than alleviate – regulatory imbalances between transparent and highly regulated products such as UCITS and new structured products.
- Second, to adapt prescriptive UCITS rules on eligible investments to prepare for a new wave of financial innovation. A new generation of financial assets will be brought to market in the years ahead – investment funds should be able to invest in these instruments.
- Third, to ensure the continued global competitiveness of the European fund industry. This position will be secured by serving third country markets with innovative and attractive investment products – including pooled investment in real estate and fund of hedge fund products.

Alain Leclair welcomed the efforts undertaken by the Commission to upgrade the current UCITS framework and to help the fund industry to respond to competitive challenges. This work should be complemented by urgent work on two other fronts:

1. Private placement regime to support easier cross-border investment by qualified investors. However, he warned that such an approach will be useful to only a limited population of investors;
2. Provision of a single market passport for fund of hedge funds through the creation of an 'alternative UCITS' regime to exist in parallel with the current UCITS regime

I. CROSS-BORDER FUND NOTIFICATIONS:

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

Panellists:

- *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.*

Discussions highlighted the urgent need to improve the functioning of the UCITS passport. The orientations proposed by the Commission services represent a promising and largely sound approach. There was broad support for moving to a system based on regulator-to-regulator communication as opposed to requiring UCITS managers to file information directly with host Member State authorities. There was acceptance that home authorities should be exclusively responsible for monitoring compliance of a UCITS with requirements harmonised under the EU Directive. However there are still some aspects of the proposals which need further refinement.

Discussants considered it crucial to introduce streamlined notification procedures and a clear definition of the respective responsibilities of supervisors in the importing and exporting Member States. UCITS face growing competition from other investment products which can be marketed cross-border more easily. A paramount consideration is to scale back any regulatory or administrative requirements that penalise UCITS compared to these other vehicles.

The orientations put forward by Commission services would benefit from further clarity as regards the scope and nature of any host country powers in respect of non-harmonised rules in the area of marketing and advertising. It was observed that many of these issues had been progressively harmonised through other EU legislation (e.g. MiFID) and the scope of any residual host country responsibilities could in practice be limited. It was suggested that these issues be definitively and systematically mapped.

Some enforcement authorities argued that the Commission services had correctly recognised the existence of host country responsibilities in a limited number of areas relating to marketing and advertising. Panel discussions revealed a need for further reflection on additional measures to limit the risk that violations are detected only after marketing has started – such as communication of proposed marketing materials or information on broad distribution arrangements, reinforced supervisory cooperation and exchange of information.

II. MANAGEMENT COMPANY PASSPORT:

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

Panellists:

- *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.*

Exchanges confirmed the strong interest in an effectively functioning management company passport. However, there were two distinct schools of thought on how to allow the remote management of funds.

The Commission suggestion that certain core administrative functions be physically undertaken in the fund domicile under the responsibility of the local supervisor was seen by some as a useful attempt to clarify the respective responsibilities of supervisors for fund managers and the fund itself. It could give enforcement authorities and depositaries in the fund jurisdiction greater traction over the activity of the fund. Supporters of this approach consider that it would help in enforcing compliance with harmonised UCITS provisions and local non-harmonised fund rules. The spectre of double taxation of the fund was also raised in the absence of real content in the fund domicile.

However, the arguments in favour of the 'partial management company passport' were hotly contested. By imposing a geographical fragmentation of the value-chain, the Commission proposals would significantly diminish the potential benefits of the management company passport - for no corresponding gain in terms of fund oversight or investor protection. The depositary and fund supervisors could discharge their responsibilities in respect of the fund without there being a need for any regulatory requirement for local substance. Seamless supervisory cooperation and information flow between all actors in the fund complex would be sufficient to ensure good outcomes. The Commission-proposed borderline between core administrative functions ('the fund') and management activities was challenged as arbitrary and not operational. Proponents of this view called on the Commission

One speaker suggested that industry may have to make some tactical calculations. Would it be better to settle for a second-best management company passport if this could be achieved in shorter political time-scales – than aim for a full-blown passport if the price to be paid was considerable delay in securing political agreement.

III. MERGERS

Moderator: Jean-Baptiste de Franssu, Chief Executive Officer, INVESCO CE;

Panellists:

- *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*

The French experience of 1'000 fund mergers per year (out of a population of 8'000 funds) reveals that most fund mergers are unproblematic. However, effective rules and procedures are needed to deal with the 1% of mergers where difficulties arise. The orientations presented by the Commission services exposure draft could make an urgently needed contribution to rationalisation of the fund landscape. They were applauded for their broad scope and operational clarity. The resulting scale economies would benefit both the industry and investors. The panel welcomed the fact that the proposal clearly stated the right for funds to merge. There were some divergences on whether mergers should be restricted to situations where the merging and dissolving funds implemented comparable investment policies. In reality, problems are limited to cases of extreme differences in investment policy between the merging and dissolving funds or insufficient investor information. Discussants were conscious of the need to ensure that end-investors share in the savings from funds mergers – but there were no ideas on concrete steps that could be taken to ensure such outcomes. Other conditions for successful conclusion of mergers were identified: common valuation methods to be employed by both merging and dissolving funds; review by an independent auditor; information flow to shareholders and measures to ensure that recent investors would not lose all of their initial 'entry fee' on exiting a merging fund. Cross-border fund mergers can be successfully undertaken if supervisors learn to trust each other, work together and co-operate in real-time. The panel suggested that the Commission give further thought to the role of the receiving fund competent authority and expressed support for the idea of a lead-regulator.

IV. Pooling

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

Panellists:

- *Steffen Matthias, Secretary General, EFEMA.*
- *Grainne 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.*

Discussants agreed that master-feeder-structures would be a useful means for achieving cost reductions. These reductions should be passed through to investors. In this respect, investor representatives welcomed the proposal to prohibit the master fund from levying subscription/redemption charges on the feeder – and the requirement to disburse any retrocessions received to the feeder fund. It is important that the master-feeder linkage and the aggregate costs of investment in the master-feeder complex be communicated clearly to retail investors. Some industry representatives regretted that the Commission services had not pursued the possibility of allowing feeder funds to invest in several master funds. A leading fund authority expressed the view that more flexible investment freedoms for feeder funds would imply little additional risk. The proposal that feeders should merely replicate the investment policy of the master was challenged by a trade association: it was suggested that feeder funds should be free to use derivatives not only for hedging currency risks, but also to enhance portfolio performance. The proposal that the master fund should have at least two feeder UCITS as investors was criticised as a disproportionate restriction: efficiency gains could be achieved with only one feeder. Moreover, master-feeder structures could be motivated by considerations other than pooling. Industry representatives considered the proposed requirement for masters and feeders to enter into a contractual agreement to be superfluous where both belonged to the same financial group.

V. SIMPLIFIED PROSPECTUS

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

Panellists:

- *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, EFEMA.*
- *Tina Wilkinson, Executive Director, BNP Paribas, Luxembourg.*

Proposals to replace the existing simplified prospectus by standardized and investor-friendly 'key investor information' enjoyed support across the full spectrum of stakeholders. This support extended to both the proposed content and form of disclosures, the working methodology and objectives to be achieved.

The practice of summarizing lengthy and complex prospectus documents should be replaced by a focus on conveying information that the consumer really needs and wants. Fund managers and supervisors may find it more efficient to work with document based disclosures short for administrative purposes or in case of cross-border sales. In other scenarios, there may be benefit in allowing fund distributors more flexibility in using and structuring disclosures. The fund industry called for other investment products (structured notes and unit-linked life insurance) be obliged to produce similar product and cost disclosures.

The workshop agreed on the need to involve industry, distributors and investors in the development of the next generation of fund disclosures. Effective consumer testing will be crucial to achieving a successful outcome.

Publication of key investor information should not be viewed as from the perspective of educating investors. Standardization is important, both to allow comparability to investors and to facilitate management issues for the industry. However, discussions of practical examples relating to the presentation of costs and charges revealed how difficult this will be. There are different ways to disclose costs and views differed on the best approach.

Two key conditions will have to be met if investor disclosures are to be effective. First, 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.

VI. PRIVATE PLACEMENT

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

Panellists:

- *Robbert Coomans, Advisor to the Board, ABP Investments, NL.*
- *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 workshop on private placement confirmed that the absence of an EU level understanding of private placement imposes significant costs and missed opportunities on cross-border investment. Both demand- and supply-side are constrained by the parallel existence of very diverse rules on private placement (or the absence of a coherent national approach) across the 27 Member States. These regimes are in place in most of the other developed financial markets around the globe. Why can we not build a coherent regime here in Europe?

A potential regime should provide a "free trade area" which combines elements currently available under the Prospectus Directive (exemption from provision to provide a prospectus) and under MiFID (exemptions from conduct of business rules and marketing rules etc.). In the interests of securing quick progress, there was some consensus in limiting the approach to authorised financial institutions. There is no need to reinvent wheel: existing definitions of 'eligible counterparties' laid down in MiFID and Prospectus Directive could be used. However, some interest was expressed in including professional and certain affluent individual investors subject to appropriate 'investable wealth' tests.

Some participants also argued in favour of focussing in the first instance on some products prospects – such as open-ended funds – in order to harvest 'low-hanging fruit'.

CONCLUDING REMARKS:

Stefan Bichsel, President EFAMA

Commission work on efficiency improvements passes muster. It attempts to give effect to a number of long-standing industry demands. It is subject to improvement on a number of key points. Mr Bichsel cited two issues: first more work needs to be done on the Management Company Passport: nothing less than a full passport is acceptable for the industry.

Second, in the rush to rectify the Simplified Prospectus, we should not throw the baby out with the bath-water. The idea of a standardised document should not be abandoned – because of implementation failures. The risk is that we end up with very different disclosure content and formats. This would multiply compliance costs as well as reduce comparability and transparency for the investors. Commission orientations in this regard need to be reviewed.

The proposed efficiency adjustments will improve industry plumbing. But it is a limited and insufficiently ambitious agenda. Facilitating industry rationalisation is the bare minimum.

Bigger challenges are facing the industry. A particular concern is the need for a level playing field between investment products – in terms of clear and comparable conditions for investment products at both the point of sale and the production level. In some markets, this is a life and death issue for the fund industry. To date, the European Commission has signally failed to do anything to address this problem. MiFID provides the possibility for imposing common point of sale disciplines across a broad universe of financial instruments. However, proposed implementation of MiFID has threatened to exacerbate the regulatory imbalance between already transparent products such as UCITS and other financial instruments – for example structured notes/certificates.

Attention must also be given to insurance products which fall outside the scope of the MiFID - either by bringing unit-linked life insurance contracts within the scope of MiFID or aligning the Insurance Mediation Directive with MiFID.

The challenges do not stop there. The Commission should grasp the nettle of UCITS scope. There is a pressing need to provide a single market framework for non-harmonised retail funds such as real Estate and Fund of Hedge Funds. Both investors and industry would benefit. Mr Bichsel added a common private placement regime to his list of urgent things to do.

The European Commission needs to raise the level of its ambition. It needs to take a leadership role in developing a Single Market vision for retail and institutional investment products. It can no longer duck important decisions on the regulatory approach to use (product vs. functional). Otherwise, it will fail to achieve its vaunted ambition of achieving the 'best regulatory framework for funds in the world'.

European Commission,
DG Internal Market and Services,
Asset Management Unit.