

Commission White Paper on Investment Funds

IFIA

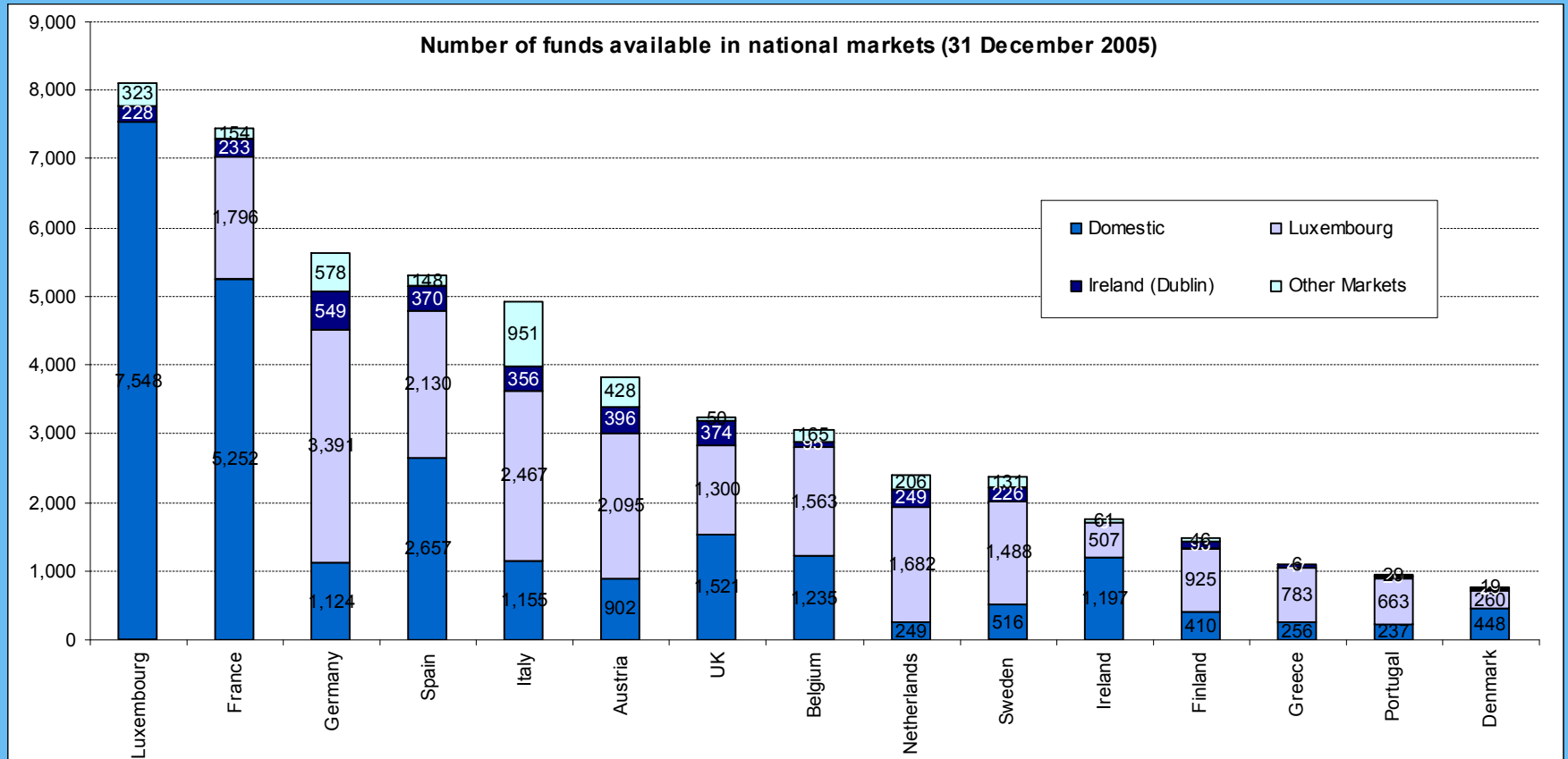
Dublin, 8th December 2006

European Commission 
Internal Market & Services DG

I. Context

1. Four-fold growth in AuM in 10 years:
2. Increasing use of pass-port:
3. International brand:
4. More diverse and structurally complex UCITS:
5. Funds as building-block for retirement products.

Cross-Border marketing of UCITS



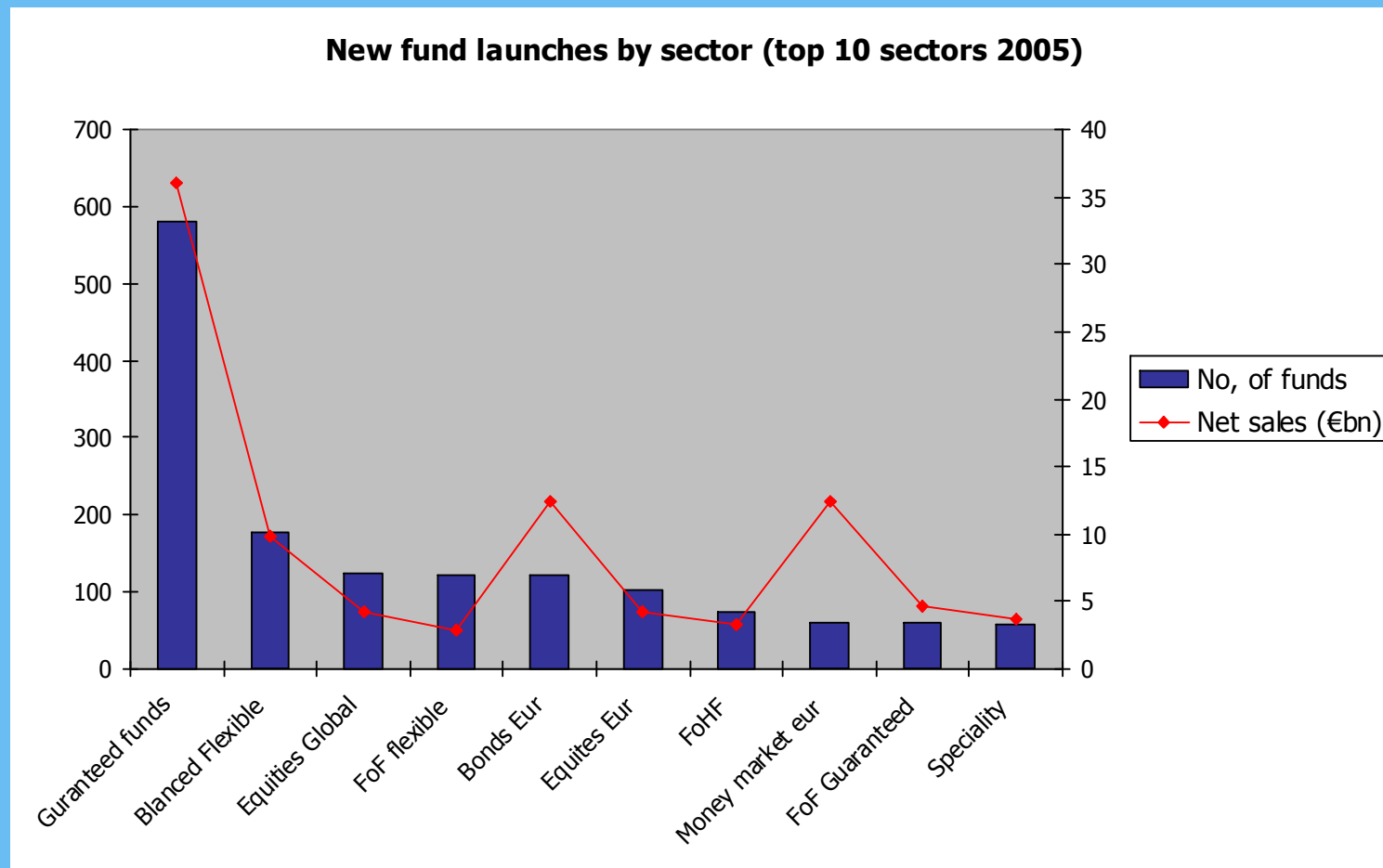
ZEW (2006)



Market impact of cross-border UCITS

- 2978 UCITS registered for sale in more than 5 countries = 12% of total;
- Account for 1.2 trillion€ AuM = 26% of total
- Yield net new sales of 106€billion = 30% of total.

Changing nature of retail funds



Changes in UCITS portfolios

Number of instruments/contracts held in portfolios of 641 Lux-domiciled sub-funds

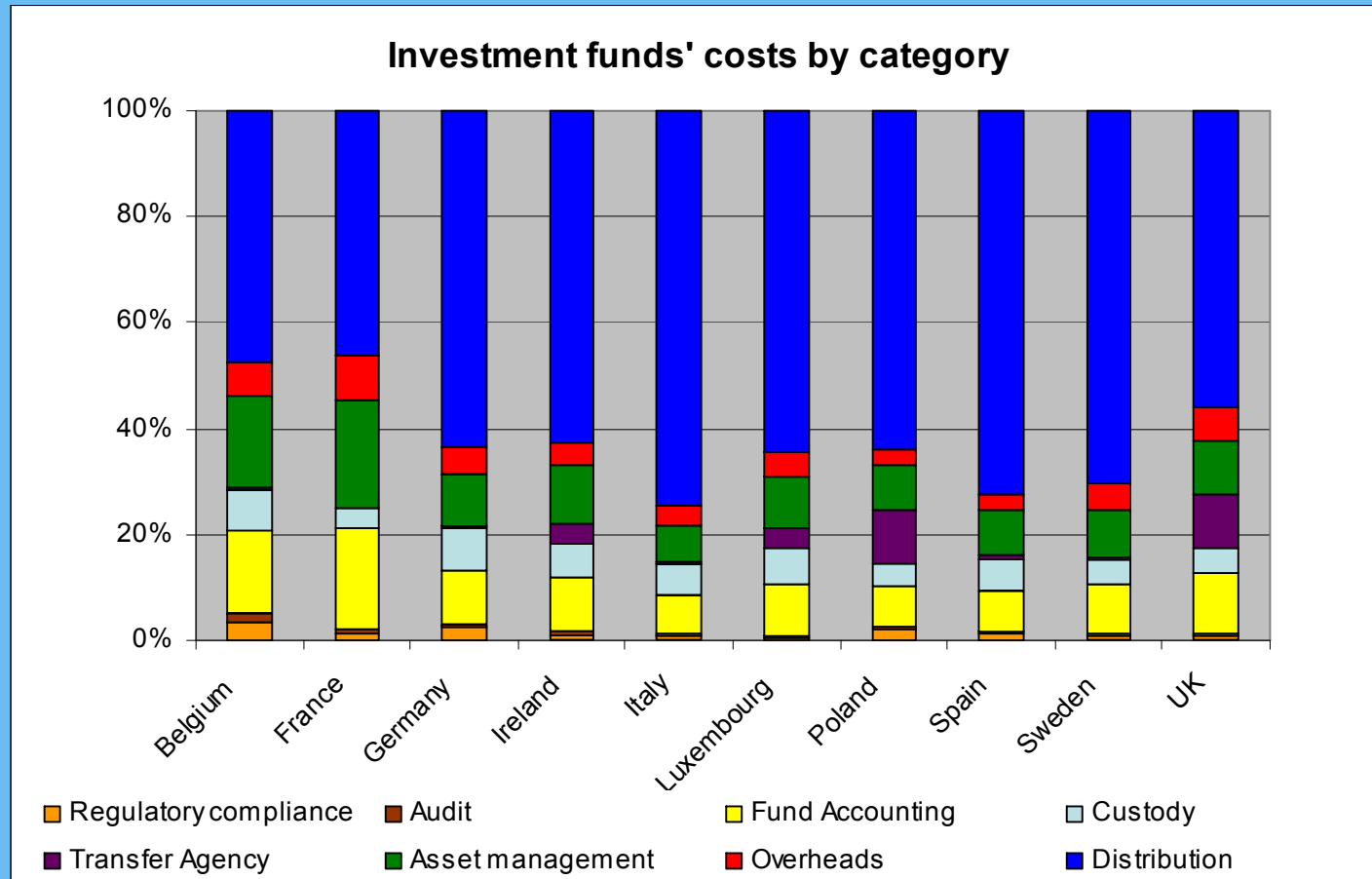
	2002	2005	Change
Securities	23'511	31'241	+33%
Derivatives	1'365	3'422	+151%
Derivatives/total	5.5%	9.9%	

Source: European Fund Administration S.A.

II. Challenges

1. Market access barriers:
2. Lack of scale & efficiency in fund management:
3. Obstacles to specialisation:
4. Inflexible portfolio rules hamper innovation:
5. Distribution = a major cost centre:
6. Competition from other investment products

Cost of fund distribution

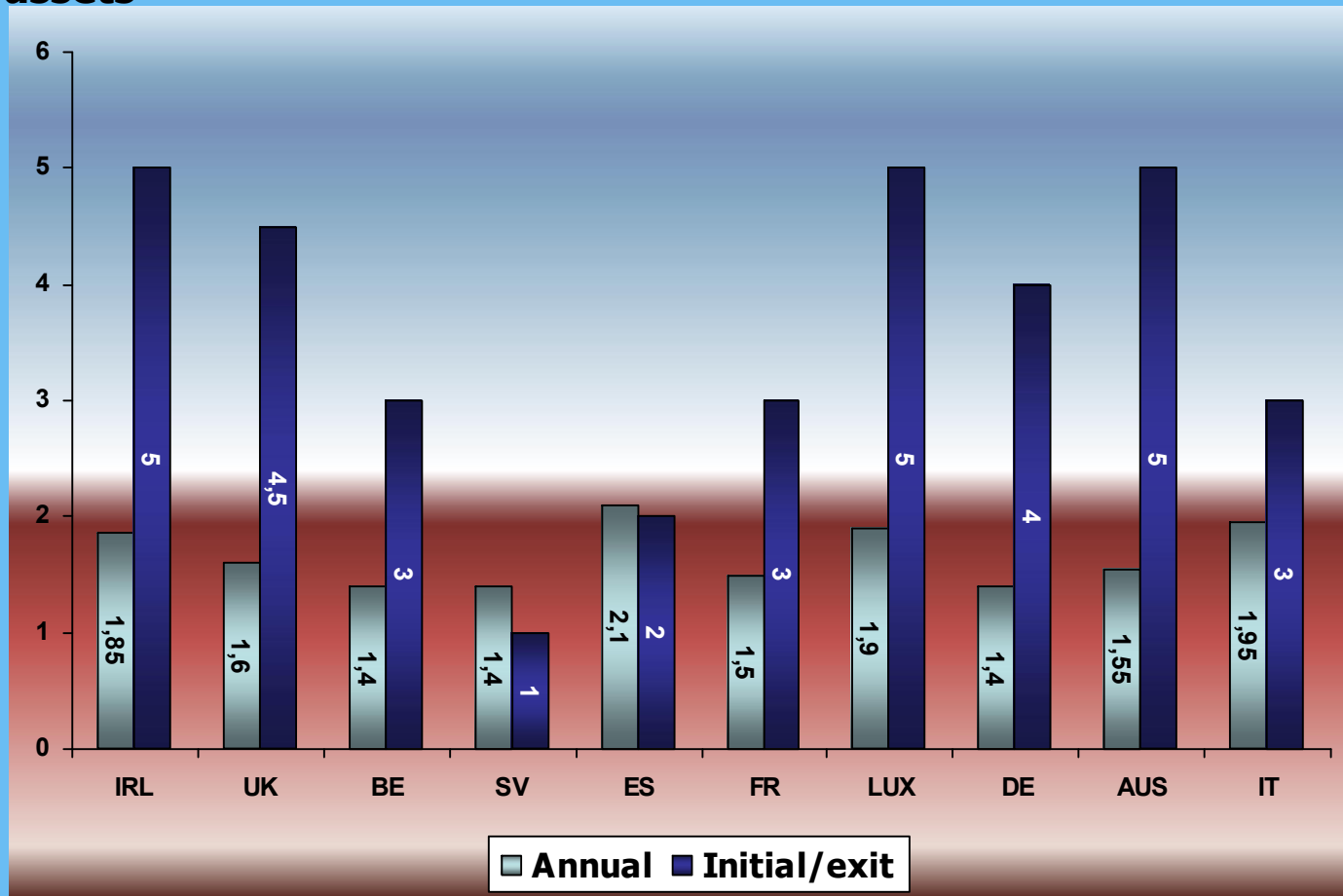


Source: CRA 2006



Cost of investing in UCITS

As % of assets



III. Boosting efficiency:

1. Remove residual obstacles to x-border marketing:
2. Facilitate cross-border fund mergers:
3. Enable pooling of assets from different funds:
4. Management company passport:
5. Ensure effective supervision of x-border structures.

X-border notifications

- Goal = Direct acceptance of home country authorisation as basis for marketing UCITS in other MS:
- How? Modify articles 44-47:
 - Reduce scope for host country queries:
 - Eliminate 2 month delay for host authorities to process filing;
 - Regulator-to-regulator filings and communication;
 - Streamline documentation requirements.

Facilitate fund mergers

- Establish common provisions governing all fund mergers:
 - Unitholder approval mechanism;
 - Unit-holder rights in event of fund merger;
 - Information obligations;
 - Independent oversight of merger process;
 - Supervisory mechanisms.
- Avoid capital gains tax claim on investor:
 - Look for non-harmonisation solutions;
 - Progress possible where domestic mergers do not give rise to tax event.

Management Company passport

- Allow corporate/contractual funds to be managed by manager in another MS:
 - Overcome inefficiencies and risks of delegation;
 - Recognise concentration/specialisation in centres of excellence
- Scope of the management company passport:
 - All collective portfolio management (incl. admin/valuation)?
 - Or limited to fund management?
- Effective supervision of manager/fund chain?
- Risk of double taxation of the manager/fund chain?

Asset pooling

- Facilitate co-management of assets gathered through different feeder funds.
- Which techniques to be enabled by UCITS amendment:
 - Master-feeder;
 - Allow feeder assets to be sent to >1 master;
 - Virtual pooling.
- What about pension fund pooling?
 - Liability pooling;
 - Tax transparency of pooling vehicles

Delivery of supply side agenda

- Targeted amendments to UCITS Directive:
 - Cross-border notification;
 - Management company passport;
 - New provisions on procedures/conditions for fund mergers;
 - Change diversification rules to allow pooling
 - Amplify provisions on supervisory powers & cooperation;
- Non-legislative measures:
 - Tax treatment for cross-border fund mergers.

IV. Better investor outcomes

1. Improve cost, risk, performance disclosures – fix the Simplified Prospectus:
2. Enforce MiFID investor protection rules (inducements, conduct of business, best execution).

Simplified Prospectus Mk. I:

- Overloaded with irrelevant info and legal disclaimers;
- Basis for civil liability claims?
- Not viewed in context of sales/advisory process – expected to do too much;
- Subject to local addenda or alterations;
- 'à la carte' approach to key investor disclosures (TER).

Simplified Prospectus Mk. II?

- Core info on policy, risks, charges and expected return;
- Short (2pg), simple, understandable to retail investor;
- Comparable content and format across EU;
- A support for self-directed investments or advised sales;
- For EU-wide use without further modification/approval.

SP: hard road ahead

Cost disclosure:

- Harmonise TER/other composite calculation method;
- Disclosure of entry and exit fees & transaction costs;
- Distribution/advice related costs to be disclosed by intermediary.

Risk disclosure

- Narrative description of risks not effective;
- Use of synthetic risk indicator (metrics?);
- Role of intermediary/advisor in assessing suitability for individual client.

What needs to be done?

- Modify UCITS Directive to:
 - Clarify guiding principles;
 - Permit adoption of binding implementing rules on content and format.
- Build on existing Directive to align national disclosures and streamline documents:
- Consumer/Industry testing to avoid mistakes of past.

Overview of relevant MiFID rules

- **Conduct of business requirements:**
 - Inducements;
 - Information requirements & risk warnings;
 - Suitability/appropriateness with 'execution-only' scenario for non-complex products (including UCITS).
- **Conflict of interest rules**

Retrocession fees in main markets:

	Average Retrocession Paid to Distributor (as % of management fee)				
	France	Germany	Italy	UK	Spain
Equity	47.75%	46.10%	59.65%	52.30%	51.20%
Bond Funds	48.40%	47.75%	61.25%	52.30%	51.45%
Balanced	47.90%	47.60%	60.30%	51.90%	52.20%
Money markets	35.60%	38.30%	52.80%	39.40%	36.90%
CPPI	41.10%	38.10%	45.60%	47.50%	51.40%
Fund of funds	45.00%	41.65%	49.60%	48.35%	43.35%
Hedge funds	12.50%	27.10%	20.80%	27.50%	20.00%

Inducements/commissions:

MiFID (+Implementing Directive) allow commissions if:

- Clear prior disclosure to the client "in a manner that is comprehensive, accurate and understandable";
- designed to enhance the quality of service to the client and "does not impair compliance with the firm's duty to act in the best interests of the client";
- "where the advice or recommendations are not biased as a result of the receipt of commission ... [the commission] should be considered as designed to enhance the quality of the investment advice to the client."

Delivery of investor-agenda:

- Fund disclosures:
 - Legislative track: Amend Directive provisions to specify better guiding principles:
 - Non-legislative track: promote comparable and investor-relevant disclosures based on existing legislation + market testing.
- Promoting investor interests in fund distribution:
 - Guidance on application of MiFID rules to fund distribution;
 - Monitoring and enforcement of MiFID provisions.

V. Non-harmonised funds

Non-harmonised retail funds

- Open issues:
 - Verify suitability for retail market:
 - Demonstrate added value of single market framework:
 - Assess options.
- Next steps:
 - Expert group on real estate funds (report autumn 2007):
 - Report on options for a SM framework (mid-2008).

Structurally complex products

- No need for EU level intervention in respect of hedge funds:
- Examine rules on selling restrictions/solicitation etc;
- Build towards private placement regime: assess business case and options - autumn 2007.

Legislative proposal: agenda

- Exposure draft (March 07)
- Consultation (April-May 07)
- Open Hearing (April 26/07)
- Draft proposal + Impact Assessment (Sept/Oct 07)
- Co-decision procedure.