

## EPFSF Briefing

# “Revision of the UCITS Directive: Towards a Competitive Regulatory Framework for Europe’s Investment Funds”

### Introduction

The UCITS directive (Undertakings for Collective Investment in Transferable Securities, UCITS) is a key facilitator to the successful development of the European investment funds industry by providing a globally recognised quality label for investment funds. Over 11.5% of European household financial assets were already invested in UCITS funds in 2007 and around 40% of UCITS originating in the EU were sold in third countries like Asia, the Gulf region and Latin America. In terms of market share, UCITS compliant funds account for around 75% of Europe’s investment funds market with total assets of around EUR 6 trillion<sup>1</sup>. Despite this enormous success, there is an urgent need to adapt the UCITS regime to today’s market needs and, hence, to allow fund managers to fully exploit the potential of Europe’s single market for investment funds. In recent years, UCITS have encountered increased competition from substitute retail investment products with some commentators taking the view that UCITS funds have become disadvantaged by the more flexible regulatory frameworks of retail structured products and insurance linked investment products - especially when it comes to the time and costs to market new products<sup>2</sup>.

### Intensive consultation laid the ground for the UCITS revision

In order to keep pace with the rapidity of innovation in financial markets the Commission released a Green Paper in 2005 to initiate a public debate on how to foster the competitiveness of Europe’s investment fund industry. Following on from this and based on the feedback received from various stakeholders, the Commission proposed a set of targeted modifications to the UCITS directive in a white paper in 2006 and held an open hearing in April 2007<sup>3</sup>. In March 2007 the Commission released another consultation document on the priorities for the UCITS revision and organised another public hearing in April 2008. Afterwards, concrete proposals for legislative amendments were released by the Commission on 16 July 2008. These measures were also accompanied by an impact assessment. It is expected that the proposal might be adopted by the EU Council of Ministers and the European Parliament in the second quarter of 2009. Ultimately, the provisions might come into effect in mid 2011.

### The Commission’s proposals

The Commission’s proposals aim at erasing regulatory barriers for the cross-border distribution of funds, creating a framework for mergers between funds domiciled in different countries and introducing master-feeder structures. In addition, the Commission intends to intensify the cooperation mechanisms between national supervisors and to replace the simplified prospectus by a new concept of key investor information.

---

<sup>1</sup> See EFAMA.

<sup>2</sup> The Commission explores potential competitive distortions in a call for evidence initiated on substitute retail investment products. A feedback statement was released on 3 April 2008 and an open hearing took place on 15 July 2008. The Commission intends to release a communication in autumn 2008 that shall explain whether it identified a need for legislative action or not. See press release IP/08/500.

<sup>3</sup> Besides, three expert groups on market efficiency, hedge funds and private equity were set up in 2006. In July 2008 another expert group report on open ended real estate funds was subject to a public consultation and an open hearing on non-harmonised retail investment funds took place in April 2008.

**a) Cross-border distribution of UCITS funds**

In day to day business, notification requirements are still an immense obstacle to the efficient cross-border distribution of UCITS funds. Rules on notification are not interpreted uniformly across member states and some national authorities require additional information, translations and sometimes the appointment of a local representative. In addition, the length of the procedures diverges significantly and regularly exceeds the maximum time frame of two months stipulated by the UCITS Directive. By contrast, more recent European directives on comparable investment products, such as the prospectus directive applying to securities, have abolished the requirement for a separate notification procedure altogether. This puts UCITS funds at a severe competitive disadvantage.

The proposed legal amendments of the Commission aim at lowering costs and avoiding delays for the notification of foreign funds. Under the amended regime, a duly authorised UCITS can be offered in another member state upon notification without any further delay. These amendments erase the ex-ante control capacities of host supervisor before the marketing of a fund can be started. In addition, information is to be exchanged electronically between regulators and, hence, will allow for a significant reduction of direct annual costs of notification and also shorten the time-to-market period for foreign funds significantly. This approach is welcomed very much by market participants as it not only fosters the creation of the internal market for investment funds but also allows for a more efficient and timely distribution of investment funds across borders.

**b) Fund mergers and master-feeder structures**

Unlike the US market, the EU fund market is highly fragmented and investment funds are on average of a suboptimal size that is five times smaller than in the US. On average, European funds hold assets of EUR 178 million while their US counterparts have AuM of EUR 974 million in 2006. Around 54% of UCITS funds even have AuM of less than EUR 50 million<sup>4</sup>. As a result, the average total expenses ratio of cross-border equity funds in Europe is nearly twice as high as in the US. Experts consider that both investors and fund managers still fail to benefit from substantial scale effects that are estimated between EUR 3.1 and 8.6 billion annually<sup>5</sup>.

The Commission is aware of this situation and intends to achieve greater economies of scale by introducing a legal framework for both national and cross-border fund mergers. The amended article 35 provides for the basic principle that all UCITS funds irrespective of their legal form are entitled to merge. This new merger regime will be applicable for both cross-border and domestic mergers and their authorisation procedure will be harmonised as will the required level of information to be provided to investors. Fund manager welcome this approach as it will facilitate daily fund operations significantly and allow for the achievement of economies of scale. These might even ultimately lower the costs of fund management for retail clients providing that the operational aspects of the mergers are also covered by the Directive.

The proposed master-feeder structures will allow a feeder fund managers to invest between 85% and 100% of the fund's assets into one other fund (so-called master fund). By doing so, the investment manager of the feeder fund purchases units in the master fund on behalf of the feeder fund. This situation translates into various benefits. First, economies of scale can be achieved by the feeder fund thanks to the pooling of assets. Secondly, the fund management resources can be centralised in a single team of fund managers allowing cost savings and the further standardisation of processes, although fund sponsors will need to be alert to the need to disclose double-charging and "layering" of expenses. Thirdly, similar funds offered to different types of investors and with individual fee structures can be combined in one entity while at the same time the local presence of the feeder funds still allows clients to be served locally. Finally, in case of a merger of fund management companies, similar funds can be pooled in one master fund while different fund labels are maintained. From an industry perspective, these suggestions are very helpful and would contribute to achieving significant economies of scale. These also translate to cost savings that might ultimately reduce total expense ratios for investors. If the Directive correctly addresses the operational aspects linked to those new measures, these will effectively translate to cost savings that might ultimately reduce total expense ratios for investors.

---

<sup>4</sup> European Commission.

<sup>5</sup> See Invesco (2005). Benefits of an integrated European Fund Management: Cross-border merger of funds, a quick win?

### c) Key investor information

The simplified prospectus did not live up to its full expectation in recent years for either retail investors or funds managers. In practice, it proved to be too complex and did not allow average retail investors to compare funds across borders. For fund managers, the simplified prospectus was at the same time relatively costly and time-consuming for the industry. In addition, domestic regulators often require further layers of information to be provided in the simplified prospectus which was over and above the de minimus position applied across most Member States (so called gold-plating).

The exposure draft introduces a completely new approach by introducing the concept of key investor information (KII). The aim of KII is to provide in a short document all key facts to retail investors in a clear and understandable manner. Notably the standardisation of key contents of the KII will enable retail investors to truly compare funds and, hence, to make an informed investment decision. From a fund manager's point of view, it is crucial to inform clients in a meaningful and cost-efficient way. Hence, this proposal has been well-received by the fund industry.

### d) Cooperation mechanisms between national supervisors

The enhanced cooperation between national supervisors is a key requirement for the successful implementation of proposed amendments of the UCITS directive. The Commission intends to draw largely on provisions already in force in other financial services directives. These will probably include the equivalence of powers of competent authorities, the creation of mechanisms relating to exchange of information and the implementation of arrangements for verification of information and investigation on the territory of another Member State.

### The management passport: a political hot potato

The introduction of a management company passport (MCP) is still under discussion. Although the MCP can raise the flexibility and efficiency in daily fund management significantly by enabling funds authorised in one member state to become managed by a management company registered in another member state, the Commission sees potential supervisory and investor protection concerns. For example, according to the Commission problems in allocating responsibilities between different supervisors could hamper the enforcement of rules, in particular in the case of cross-border management of contractual funds. The Commission has decided to seek advice from the Committee of European Securities Regulators (CESR) on this issue. CESR has already published for public consultation its draft advice which carefully addresses these concerns and has also arranged a public hearing. CESR will deliver its conclusion by 1 November 2008. Afterward, the Commission is expected to take into consideration CESR's conclusion and release a modified legislative proposal.

### Conclusion

The Commission's legislative proposal is the result of a long process of analysis and intensive consultation. Generally speaking, it provides a sound framework for a successful revision of the UCITS directive and to update the UCITS regime to current market needs. The Commission rightly addresses the most crucial items such as funds mergers, asset pooling and simplification of cross-border distribution rules. These measures are conducive to strengthening the functioning of the internal market for investment funds, to enhance market efficiency and should ensure that investment funds can compete on a level playing field with substitute retail investment products. At the same time investors stand to benefit from streamlined information standards (KII), providing full transparency in respect of cost and risk/reward. Finally, as often recommended by the fund management industry the opportunity to improve the European investment fund market by introducing the MCP based on CESR's recommendations should not be missed, providing that the implementation schedule for UCITS IV is adhered to.

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

**Chairman Financial Industry Members**

Guido Ravoet, *EBF Secretary General*  
Rue Montoyer 10, B-1000 Brussels  
Tel: +32 2 508 37 11 / Fax: +32 2 502 13 30  
E-mail: [g.ravoet@ebf-fbe.eu](mailto:g.ravoet@ebf-fbe.eu)

**Secretariat**

Catherine Denis, *EPFSF Director*  
Rue Montoyer 10, B-1000 Brussels  
Tel: +32 2 514 68 00 / Fax: +32 2 514 69 00  
E-mail: [cdenis@epfsf.org](mailto:cdenis@epfsf.org)

**Steering Committee**

Zsolt László Becsey MEP  
Pervenche Berès MEP  
Jonathan Evans MEP  
Robert Goebbels MEP  
Sophie In't Veld MEP  
Piia-Noora Kauppi MEP  
Wolf Klinz MEP  
Astrid Lulling MEP  
Gay Mitchell MEP  
Alexander Radwan MEP  
Dariusz Kajetan Rosati MEP  
Manuel António Dos Santos MEP  
Peter Skinner MEP (SC Chair)  
Ieke van den Burg MEP

**Financial Industry Committee**

Alternative Investment Management Association (AIMA)  
Association of Mutual Insurers and Insurance Cooperatives in Europe (AMICE)  
Association of Private Client Investment Managers and Stockbrokers (APCIMS)  
AXA  
Banco Bilbao Vizcaya Argentaria  
Banco Santander  
Barclays  
BNP Paribas  
British Bankers' Association (BBA)  
Chartered Financial Analyst – Institute (CFA)  
Citigroup  
Commerzbank AG  
Crédit Agricole  
Deutsche Bank AG  
Deutsche Börse AG  
Euroclear  
Euronext  
European Association of Public Banks (EAPB)  
European Banking Federation (EBF)  
European Federation of Accountants (FEE)  
European Federation for Retirement Provision (EFRP)  
European Insurance and Reinsurance Federation (CEA)  
European Mortgage Federation (EMF)  
European Private Equity and Venture Capital Association (EVCA)  
European Savings Banks Group (ESBG)  
Federation of European Securities Exchanges (FESE)  
Fortis Bank  
Futures and Options Association (FOA)  
Goldman Sachs International  
ING  
International Capital Market Association (ICMA)  
International Swaps and Derivatives Association (ISDA)  
Intesa Sanpaolo  
JP Morgan  
Lloyds TSB  
Lloyd's  
London Investment Banking Association (LIBA)  
MasterCard Europe  
Merrill Lynch  
Nordea Bank Finland  
PayPal  
Prudential Plc  
Royal Bank of Scotland  
Securities Industry and Financial Markets Association (SIFMA)  
Société Générale  
Standard & Poors  
UBS AG  
UniCredit Group  
VISA Europe  
Western Union International Bank