

## **EPFSF Breakfast Discussion**

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### **Will changes to the UCITS Directive open the market?**

**Speech from Francis Candylaftis  
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Ladies and gentlemen, good morning

Thank you for giving me the opportunity to comment on the proposed modifications to the UCITS directive.

Let me say a few words about Eurizon Capital (EC), the asset management (am) company of the ISP group.

EC has 18% of the Italian mutual fund market and as such is the first asset manager in the country. In Europe, EC mainly operates out of Italy and Luxembourg, with an office in London. We distribute ucits funds in Asia out of Singapore and have 49% of the tenth largest Chinese am company. Our AuM amount to 160 billion euro in long only funds and funds of hedge funds.

Coming to the topic of today: the UCITS, I will divide my comments in three parts:

- Some remarks regarding the regulatory evolution of the UCITS in relation to the asset management industry,
- Comments on the proposed regulatory changes for the UCITS IV,
- Some considerations on issues related to the UCITS IV resulting from the current crisis.

#### **REMARKS ON THE REGULATORY EVOLUTION OF THE UCITS IV FORMAT**

##### **IS THE EVOLUTION OF UCITS MAKING IT LOOSE ITS TRUE PURPOSE?**

Back in 1985 when the UCITS directive was approved there was a perfect coincidence between UCITS and asset management.

Today investors who buy ETFs or structured funds, buy UCITS but do not buy asset management any longer, I mean active asset management. Over time and in particular during the last few years, there has been a diverging evolution between the form and the substance with the respect to the initial symbiosis.

In a space of a few weeks, with the current crisis, structured bonds have definitely become products of the past. Investment banks and trading rooms will have to wrap their ideas into other dresses. UCITS may become trendy.

It is not necessarily something negative but we all have to be aware of it. Today, in this room, policy makers and asset managers are gathered to comment on amendments to the UCITS directive. Five years from now, UCITS V will perhaps be discussed only by subsidiaries of trading rooms?

Is it the type of UCITS the Commission had in mind a few years ago, when writing the White Book, they were talking about the asset management of the tomorrow pension monies?

In a few years from now, we could end up with the unexpected combination of a successful UCITS and a struggling asset management industry!

##### **UCITS AND MIFID, PRODUCTION AND DISTRIBUTION**

The specific question I have been invited to address is: "will the proposed changes to the ucits directive open the market?"

Recently the fund management industry has been under pressure, not because of the fragmentation of the European fund market, but because its true merits are widely unknown to retail investors and are ignored by the distributors who have had no incentives, despite the Mifid, to change the situation. If lawmakers and regulators are convinced of the intrinsic qualities of the UCITS, as a vehicle for asset management products, then attention is required on the distribution and promotion of the UCITS.

Will the UCITS IV open the market? The short answer is: Yes, we believe that the proposed changes will play in favour of a more open market but I believe that the impact on the way the market operates, will not be as strong and visible as sometimes expected.

For a start let's remind that the market is already open: over the last 10 years the combined market share in Europe, of Luxembourg and Ireland domiciled funds has gone from 18% to 37% and we know that these are exporting countries without domestic investors' base.

For Italy alone the trend over the same period is much stronger, going from 20% to 53%.

However we support the proposed changes. They will form an additional toolbox which will make asset managers' operations somehow more efficient and help reduce the time to market of their products over the entire European space. But will the benefits derived from this improved efficiency be significant enough to win the market share of the end investors' wealth, lost yesterday to the benefit of structured notes, today to the benefit of certificates or bonds issued by banks?

Let us not forget that potential cost savings only regard the production side of the asset management, which only accounts for a small portion of the UCITS total costs borne by the client.

## **SPECIFIC COMMENT REGARDING THE PROPOSED CHANGES:**

### **THE KII**

The two proposed changes that we like most, are the KII and the notification procedure for cross border distribution, because these measures can have an immediate impact.

The first one, the KII, though not a substitute to the advise that the retail clients will always need, goes in the right direction of a concise, comprehensible document for a true and better information to the client. It will improve the competitiveness of UCITS products. However, I believe that if clients are to appreciate the new information tool, the KII should also be required for all investment products offered to the retail segment. Otherwise the KII, like many other excellent features of the UCITS funds, may surprisingly turn out counterproductive for the industry.

### **THE NOTIFICATION PROCEDURE FOR CROSS BORDER DISTRIBUTION**

Out of all the measures under consideration, the notification procedure for the cross border marketing of ucits funds is the one that carries the most positive effect in the short run on am's operations. It brings benefits that do not require any additional investment from the am and will contribute to drastically reduce the time to market of new products.

If properly and strictly enforced, that is to say as a regulator to regulator procedure with a few days (not a month) approval time period, this change makes the need for the management company passport less pressing, even if it cannot admittedly solve the problem of marketing funds in countries where people have a strong preference for domestic products.

The three other proposed changes:

### **UCITS MERGER**

The cross border ucits merger and all the other proposed modifications alike, can prove very useful in the current environment of decreasing AuM, for they potentially make easier and

more effective, synergies and benefits deriving from the concentration trend that we can expect at the industry level.

The effectiveness of the measure will unfortunately be thwarted by the wide disparity of the fund tax treatment across Europe, not only at the investor's level but also at the fund level. Italian ucits for example will be de facto excluded.

### **MASTER FEEDER**

The introduction of the master-feeder structure where both funds are managed within the same group, can certainly generate cost savings and marketing efficiency. In order to make the most out of it however, it should be combined with the management company passport so as to have a potential impact not only at a domestic level but also at a pan European one. When used across various countries, the master-feeder structure can become a way to make the best out of the different national regulations and tax treatments, even if this was not part of the initial intentions.

When the master and the feeder funds are managed by two different companies then the structure is interesting for another purpose: it becomes an efficient alternative, from an operational point of view, to the delegation of fund management and makes white labelling easier. In this case, it is advisable, for the purpose of investors' protection, that the relationship between the two ucits be defined in a specific agreement as the master assets would account for at least 85% of the feeder assets and at the same time the feeder may be the prevailing investor in the master ucits.

### **THE MANAGEMENT COMPANY PASSPORT**

Let us come to the passport. The hottest issue apparently. At Eurizon we are not against it , but this measure, as currently contemplated, does not strike us as deserving the intense discussions it generates. We believe that the passport may be a way to take advantage of business opportunities such as the creation of domestic funds when the people of a given Member state for some reasons (tax, cost, protection) show a preference for local products. But we are less convinced by the passport as a potent enhancer of operational efficiency and competitiveness. (if anything it may be a more influential factor for non European companies).

Why?

As introduced in the latest CESR consultation paper, the passport will require asset managers to maintain an open communication line with the supervisory authorities of the country of the ucits and at the end of the day, this set up will result costly, probably as costly as maintaining a "light" management company.

Asset managers active in various locations across Europe usually have what I have called "a light " management company in the countries where they operate. As a rule, these various offices do not carry a genuine investment management activity, but provide client servicing, marketing and operational support, and maintain a reporting to the local regulator. Most of the time the true fund management activity is already centralised in one place.

Consequently, the rationalisation of the management activity made possible thanks to the passport will bring marginal benefits in terms of cost saving as we believe these companies will make the choice (will it be really a choice) of keeping their local presence where it exists. For this reason, we believe that operating with a European passport will only be possible for large asset managers because of the organisational set up it will require. The passport will be beneficial to the large asset management, as opposed to the boutique, which is not necessarily a negative thing for the retail market.

We would also express some reservation about the two step approval procedure for the passport, on a product by product basis, first with the home country regulator, then with the Authority of the ucits country.

If on one hand, this approach may seem logical, on the other hand it may prove cumbersome, costly and may significantly lengthen the time to market of the new products which is not in line with the spirit of this modification.

Ultimately, with this approach, the am may end up being constrained to satisfy a variety of potentially conflicting requirements imposed by different authorities.

As the purpose of all the changes we are debating is to improve the ucits format, understandably lawmakers and regulators have envisaged the granting of European passport on a fund by fund basis. But it would also be interesting to consider the passport, not from a product perspective, but within the framework of the management company directive.

In this case, a company, not just a product, could become European. The passport would enable the investment firm to set up and manage harmonised and non harmonised funds across Europe.

One of the merits of this approach which presupposes strong cooperation between the various regulators in Europe (cooperation that could, one day, lead to the institution of a single European Authority) would be to provide elements of a solution to open the non harmonised funds market in Europe while in a first step leaving to each regulator to define the investment and distribution conditions applicable domestically to products like funds of hedge funds...

## **OTHER RELATED CONSIDERATIONS**

### **DEPOSITARY BANK AND CAPITAL REQUIREMENT**

One of the tangible benefits of the on -going work conducted by the authorities to adapt the UCITS to the rapidly evolving and challenging environment (and in particular in relation with the passport) has been to draw the industry and the regulator's attention to some particular issues: one of them is the depositary bank.

It is a critical aspect of the ucits format for the investors' protection on which, under the current ucits directive, there is no total harmonisation.

Irrespective of the passport future, the point is that the continuity of the depositary bank's operations is an issue of paramount importance and should be guaranteed in any case. Reinforcement measures should be made in this respect.

With the current crisis we have seen that even banks and insurance companies can go bankrupt. We know that funds' accounts are segregated, but what ought to be avoided, is the operational disruption that would result from a custodian bank bankruptcy.

Here is my conclusion.

The proposed changes to the ucits directive will certainly play in the direction of a more open and smoother European market at the production level. It is more difficult to anticipate their impact at the demand level. We fully support lawmakers and regulators' endeavour to continuously improve the features of the ucits product and we are grateful for the results achieved so far.

Efforts should now focus on raising the awareness of the end investor community about the merits of the UCITS.

Lawmakers and regulators have tried to give their contribution thanks to the Mifid defining the ucits fund as a non complex product thereby intentionally making easier its distribution with respect to other investment products ranked complex.

We observe that so far the favourable definition has not been translated into a preferential treatment at the level of distribution.

However we are confident that once the inevitable short term negative impacts of the current crisis have subsided, the active asset management industry because of its organizational soundness and its solid protective regulatory system , will prove to be the best way to build and protect investors' wealth. Thank you.

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