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Asset Management II

European Parliament resolution of 13 December 2007 on Asset Management II (2007/2200(INI))

The European Parliament,

- having regard to the Commission White Paper on enhancing the single market framework for investment funds (COM(2006)0686),

- having regard to Directives 2001/107/EC[1] and 2001/108/EC[2], both amending Directive 85/611/EEC[3] on undertakings for collective investment in transferable securities (UCITS), respectively, with a view to regulating management companies and simplified prospectuses and with regard to investments of UCITS (UCITS III),

- having regard to Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments[4] (MiFID),

- having regard to Directive 2005/1/EC of the European Parliament and of the Council of 9 March 2005 establishing a new organisational structure for financial services committees,

- having regard to Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision[5] (the Pension Funds Directive),

- having regard to Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation[6] (Insurance Mediation Directive) and Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance[7],

- having regard to its resolution of 15 January 2004 on the future of hedge funds and derivatives[8],

- having regard to the Asset Management Expert Group report of 7 May 2004, Expert Group reports of July 2006, and Parliament's resolution of 27 April 2006 on asset management[9],

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1 OJ L 41, 13.2.2002, p. 20.
2 OJ L 41, 13.2.2002, p. 35.
3 OJ L 375, 31.12.1985, p. 3, Directive as last amended by Directive 2005/1/EC (OJ L 79, 24.3.2005, p. 9).
4 OJ L 145, 30.4.2004, p. 1. Directive as last amended by Directive 2007/44/EC (OJ L 247, 21.9.2007, p. 1).
5 OJ L 235, 23.9.2003, p. 10.
6 OJ L 9, 15.1.2003, p. 3.
7 OJ L 345, 19.12.2002, p. 1.
8 OJ C 92 E, 16.4.2004, p. 407.
9 OJ C 296 E, 6.12.2006, p. 257.

- having regard to the Committee of European Securities Regulators (CESR)' Advice to the European Commission on Clarification of Definitions concerning Eligible Assets for Investments of UCITS of 26 January 2006 (CESR/06-005),

- having regard to the International Monetary Fund's Global Financial Stability Report: Market Developments and Issues of April 2007,

- having regard to the European Central Bank's Annual Report 2006, Chapter IV: Financial Stability and Integration,

- having regard to Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive[1] (the MiFID Implementing Directive),

- having regard to the CESR Level 3 Recommendations on Inducements under MiFID of 29 May 2007 (CESR/07-228b),

- having regard to Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on prospectus to be published when securities are offered to the public or admitted to trading[2] (the Prospectus Directive),

- having regard to the Commission proposal for a directive of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (COM(2007)0361) (the impending Solvency II directive),

- having regard to the ECOFIN Council conclusions of 8 May 2007,

- having regard to the Commission Green Paper on the enhancement of the EU framework for investment funds (COM(2005)0314),

- having regard to Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States[3] and Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies[4],

- having regard to the update of the Financial Stability Forum Report on Highly Leveraged Institutions of 19 May 2007,

- having regard to the report of the OECD Steering Group on Corporate Governance entitled "The role of private pools of capital in corporate governance: about the role of private equity firms and "activist" hedge funds" of May 2007,

- having regard to Rule 45 of its Rules of Procedure,

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1 OJ L 241, 2.9.2006, p. 26.
2 OJ L 345, 31.12.2003, p. 64.
3 OJ L 225, 20.8.1990, p. 1. Directive as last amended by Directive 2006/98/EC (OJ L 363, 20.12.2006, p. 129).
4 OJ L 310, 25.11.2005, p. 1.

- having regard to the report of the Committee on Economic and Monetary Affairs (A6-0460/2007),

A. whereas this resolution is not intended to address the five legislative measures foreseen in the UCITS III revision package, namely the facilitation of the notification procedure, the establishment of a management company passport, the revision of the simplified prospectus and the creation of a framework for fund mergers and a framework for pooling, or discuss modifications of supervisory cooperation foreseen in those five areas,

B. whereas Parliament intends to play a full role in designing a more integrated European market for investment funds going beyond the forthcoming limited revision of UCITS III,

C. whereas open-ended real estate funds (OREF) and funds of hedge funds (FoHF) as well as other non-harmonised retail funds currently remain outside the UCITS framework and hence do not benefit from a European passport, which limits the diversity of investment products available to retail investors as well as the investment strategy of UCITS,

D. whereas different national private placement regimes (PPR) and practices present an obstacle to the cross-border placement of investment products to sophisticated investors,

E. whereas diverging disclosure requirements for UCITS and other competing investment products, different national taxation rules on cross-border fund mergers, barriers to fund processing and diverging responsibilities of depositaries present an obstacle to a level playing field, enhanced competitiveness and consolidation of the European fund market,

F. whereas there has been much misconception over different vehicles of alternative investment and whereas instruments such as hedge funds and private equity differ as regards their fund raising, investment policy objectives and management control,

Non-harmonised retail funds

1. Welcomes the establishment of an expert group on OREF, but regrets the fact that the Commission has not given equal priority to the question of FoHF; looks forward to receiving both the expert group report on OREF and the results of the Commission study on non-harmonised retail funds aiming at the establishment of a internal market for these products;

2. Calls on the Commission to examine a future extension of the scope of Article 19(1) of UCITS III to cover OREF and FoHF bearing in mind that hedge fund indices (HFI) are already considered as eligible assets; highlights the need for a full impact assessment of the risks and benefits of such a change, thus paying particular attention to the protection of the UCITS brand; underlines that such an examination must not interrupt the revision of UCITS III;

3. Considers that, after taking into account the conclusions of the above-mentioned expert group report and Commission study, consideration should be given to the establishment of a internal market framework for OREF, FoHF and other non-harmonised retail funds as regulated products at EU-level underpinned by an impact assessment and taking full account of diversification, liquidity and valuation issues; underlines that such consideration must not interrupt the revision of UCITS III;

Private Placement Regime

4. Calls for a harmonised framework for private placement at EU-level in order to enhance internal market integration based on a thorough impact assessment; underlines that such a regime must provide for the necessary legal certainty for its players but should not over-regulate and hence over-burden private placement activities between sophisticated and well-informed players by means of requirements that are overly detailed or prescriptive; reiterates that national gold plating should not be possible;

5. Believes that a PPR should apply to all open-ended investment funds, including EU-regulated funds, nationally regulated funds as well as funds regulated in third countries; is, nevertheless, convinced that progress on the question of reciprocal market access where appropriate is essential; calls on the Commission, therefore, to negotiate such agreements with third countries, in particular with the United States, and requests the Commission to address this issue within the Transatlantic Economic Council;

6. Is convinced that a definition of who is eligible to invest is crucial; suggests that existing investor categories in MiFID and the Prospectus Directive should be taken into account; supports a broad definition of a sophisticated investor; highlights, however, that, despite existing legislation, several issues remain to be addressed, such as the criteria of annual income as well as the need to establish transfer restrictions forbidding the sophisticated investor, eligible for investment under such a PPR, to sell the product to retail investors directly or indirectly, for example by bundling it with other retail products;

7. Suggests that, as a first step, a waiver from the notification process for UCITS should be introduced in the revised UCITS III, that waiver being restricted to a small number of highly sophisticated investors such as the MiFID professional client;

8. Believes that, as a second step, the PPR should be extended to other products, to a more broadly defined type of sophisticated investor, and should contain a general waiver from local marketing provisions; asks the Commission to determine, by summer 2008, whether legislative measures are needed or CESR guidance is sufficient;

9. Is convinced that a European PPR framework should apply only to cross-border private placement and in that case override existing national rules, but should not replace national rules that apply to domestic private placement; favours, at least as a first step, a regime based on CESR guidance, but highlights that, in order to achieve more legal certainty, the need for European legislative measures should be examined;

10. Calls on the Commission to examine and reduce the tax barriers to the cross-border placement of those products;

Distribution, disclosure and financial literacy

11. Believes that the use of commission payments is an acceptable means of remuneration; points out, at the same time, that investor information including fee and spread disclosure is crucial to empowering investors to take more informed decisions and to increase competition; welcomes the MiFID provisions on fee disclosure, but recalls that MiFID does not apply to all competing investment products;

Competing products

12. Believes that cost and fee disclosure requirements at the point of sale as well as information requirements on risk and performance on an ongoing basis should apply not only to UCITS but equally to all competing products (i.e. certificates, notes, unit-linked life insurance); recognises, however, that it is not possible to provide for complete comparability between different types of investment products;

13. Requests, in this context, a review of the legislative framework on marketing, advice and the sale of all retail investment products by the end of 2008 at the latest, in particular the impending Solvency II directive, the Insurance Mediation Directive and UCITS III, in order to achieve a level playing field and a coherent approach to investor protection; invites the Commission to ask the Level 3 Committees for technical advice in this area while taking into account the diversity of products and distribution channels;

14. Asks the Commission to examine whether an industry-driven code of conduct might be helpful to increase fee transparency, taking into account the positive and negative impact linked to the code of conduct in the post-trading sector;

15. Welcomes the recommendation by the CESR that a payment or non-monetary benefit provided to or made by a legal entity within the same group which offers only its own products (in-house funds) should be treated in exactly the same way as one provided to or made by any other legal entity in the context of open architecture firms (third-party funds);

16. Notes that under Article 26 of the MiFID Implementing Directive, provisions on inducements apply to payments or non-monetary benefits made between two separate legal entities whereas products that are produced and distributed by the same legal entity do not fall within the scope of Article 26; calls on the Commission to examine the practical impact of Article 26 on the distribution of competing products and hence on open architecture;

17. Acknowledges that tracking of commissions, in particular retrocession fees, is a time-consuming and costly process expected to intensify with increasingly open architecture; therefore calls on the industry to examine whether common standards across the European Union for appropriate position keeping are necessary such as standards for identifying distributors or providing data, such as data file formats, data transmission protocols, reporting frequency;

18. Calls on CESR to report on the impact of Article 26 of the MiFID Implementing Directive on current softing and bundling arrangements in 2008 and to examine, taking into account already existing as well as possible future self-regulatory initiatives by the industry, whether a common supervisory approach across the EU would benefit investors;

19. Shares the concern expressed by the Commission in its Green Paper on the enhancement of the EU framework for investment funds regarding the emergence of guaranteed funds, misleadingly defined as such, when not backed by capital adequacy requirements; thus calls on the Commission to propose how the appropriate provisions, such as capital requirements for those funds at the EU level, can be achieved in order to ensure effective consumer protection; observes in this context that supervision requirements must be coherent and equally stringent both qualitatively, in terms of risk management standards, and quantitatively, as regards the resulting capital requirements;

UCITS-MiFID interaction

20. Welcomes the Commission's intention to solve possible conflicts between the provisions of UCITS III and MiFID on distribution, inducements and conduct of business rules in its vade-mecum; regrets, however, that the Commission has not published that guidance before the implementation of MiFID by the Member States; calls on the Commission to take account of Member States' implementing laws and regulations and clarify the legal status of the vade-mecum and its relation to CESR Level 3 measures as well as to the Commission's Questions and Answers on MiFID;

Financial Literacy

21. Points out that equivalent disclosure requirements of competing products at the point of sale on costs, risk and performance help the investor to make an informed decision only if he has a sound knowledge and basic understanding of the functioning of different investment products; highlights, therefore, the need for financial literacy;

Taxation of cross-border fund mergers

22. Notes with regret that in many jurisdictions cross-border mergers remain subject to taxation while domestic mergers do not constitute taxable events; believes that since investors cannot influence such events and should be treated equally, cross-border and domestic mergers should be taxed neutrally;

23. Calls on the Commission to propose a directive relating to the taxation of fund mergers in 2008, following the principle of tax neutrality set out in Directives 90/434/EEC and 2005/56/EC; stresses that the objective is not to harmonise tax but to determine that domestic and cross-border mergers should be tax-neutral if the investor keeps its investment in the fund before and after the merger or withdraws its investment as a result of the intended merger, before the merger takes place;

24. Believes that for practical reasons, tax neutrality should first be applied only to UCITS mergers and later to all other funds;

25. Underlines the paramount importance of supervisory coordination of UCITS and non-UCITS products, and calls for continued efforts to exchange information and practical cooperation among the financial authorities;

Investment Policy and Risk Management

26. Regrets that the current design of investment policies has resulted in assets such as FoHF and OREF to remain outside the scope of eligible assets under UCITS III, while fairly volatile and less transparent assets such as HFI are considered eligible by CESR;

27. Believes that defining eligible assets and setting investment limits does not guarantee the quality of investment management and could even give retail investors a false sense of security; suggests, therefore, that a shift from a prescriptive to a principle-based approach on the basis of asset-liability management as a more sophisticated form of risk diversification should be considered in the medium term; underlines that the revision of UCITS III should not be delayed by opening a fundamental discussion of such a change at this stage; underlines the need to analyse carefully the impact of such a change on the

performance of UCITS and the UCITS brand;

28. Believes that introducing principle-based provisions on risk management systems at Level 1 will help ensure financial stability and convergence in supervisory practices; expects the Commission therefore, once the legislative work on the evised UCITS III is completed, to draw up a list of principle-based criteria for the use of risk management systems, bearing in mind that such systems should correspond to the individual risk profile of each fund; calls on the Commission to examine whether management companies should be obliged to explain the appropriateness of a certain system and whether a general requirement for pre-authorisation of risk management systems through the supervisor or a clearer role of the depositary in the investment activity oversight are necessary; calls on CESR to complete its work on the harmonisation of risk measurement systems and to begin looking at liquidity management;

29. Considers it necessary, in order to bolster investor confidence, for all management companies established as joint stock companies and all distribution companies listed on a stock exchange to be subject to the national corporate governance regulations applicable in their country of registration as well as the provisions of Community law on corporate governance;

Fund processing

30. Welcomes initiatives such as those of the Fund Processing Standardization Group of the European Fund and Asset Management Association, Eurofi and other initiatives at national level to increase the efficiency of fund processing; notes, however, that the progress made so far is unsatisfactory; believes that the Commission should take action if the industry does not substantially progress in greater use of electronic and standardised fund processing by the end of 2009;

31. Draws attention to the difficulties of small and medium-sized distributors and distributors with limited cross-border activity when switching to automated and standardised solutions;

32. Notes the idea that standardised settlement deadlines could provide an incentive for more automation, simplify and clarify the processing of orders and reduce error rates;

33. Notes the idea of setting up a standardised process to facilitate access to reliable and standardised data on cross-border funds, for example, if appropriate, supported by a European funds reference database on static data such as prospectus and processing data; highlights the need for oversight to guarantee that the data is up-to-date and reliable;

Depositary

34. Regrets that not all Member States allow branches of EU credit institutions to act as depositary even though they are regulated at the EU level in accordance with EU financial services legislation; calls on the Commission, therefore, to take the necessary legislative steps in the course of the revision of UCITS III in order to allow such credit institution branches to act as depositary and to clarify ways for effective supervisory cooperation;

35. Believes that a harmonised definition of depositary functions could contribute to a better understanding and better cooperation between regulators and ensure a consistent level of

investor protection across Europe; recognises, however, the difficulty of overcoming national differences, in particular with regard to property law, terms of liability and insolvency protection rules; calls for further analysis of the legal barriers that would have to be removed in order to achieve harmonisation of depositary functions, taking into account existing research on the different roles and responsibilities of depositaries across Member States;

36. Highlights that a depositary passport should only be introduced after complete harmonisation of the role and responsibilities of the depositary are achieved; underlines that, before taking a decision, the interaction between a depositary passport, the management company passport, the fund and the regulator must be carefully examined;

37. Requests that the Commission should examine the impact the wide use of highly complex products, such as derivatives, including credit derivatives and indices, including hedge fund indices, has on the effectiveness of the depositary's oversight function;

Lamfalussy process

38. Highlights the importance of ensuring the choice of implementing instruments on the basis of the content and objectives of the underlying Level 1 legislation; calls on the Commission to propose a legal basis at Level 1 for the use of both implementing directives and implementing regulations at Level 2; points out that the new regulatory procedure with scrutiny must be applied to all Level 2 measures;

Hedge Funds

39. Points to the evidence showing that alternative investments such as hedge fund activities, while still inadequately understood in terms of their potential systemic impact, often result in higher market liquidity, dispersion of risk, in particular for traditional portfolios, and enhanced competition among market makers and intermediaries as well as in beneficial propriety research contributing to more information and more efficient pricing;

40. Considers transparency and disclosure for investors and supervisors of utmost importance and expects the forthcoming proposals of the International Organization of Securities Commissions (IOSCO) to bring more clarity in this respect, urges the industry to agree on a code of conduct for portfolio valuation, risk management systems, transparency of fee structures and enhanced insight in investment strategies; asks the Commission to play a more active role in that discussion (for example, within the remit of the G8);

41. Is convinced that access of retail investors to hedge funds should not be prohibited per se; points out, however, that given the often light regulation of hedge funds and their activities, retail access must be subject to strict conditions; highlights that clear criteria for the eligibility of investors as well as regulation of the counterparties' exposure are crucial; underlines, at the same time, that entities regulated by MiFID are subject to suitability and appropriateness tests for distribution as provisions against mis-selling;

42. Considers that financial stability issues need to be addressed at the global level through enhanced cooperation of supervisory authorities and central banks in international bodies such as IOSCO as well as through a regular dialogue between governments and legislators; urges the Commission, the European Central Bank and CESR to take an active role in stimulating that dialogue and proposing appropriate measures where

necessary;

43. Believes that hedge funds could help strengthening corporate governance practices by increasing the number of investors that make active and informed use of their shareholder rights; is concerned, however, that some hedge funds might boost their voting power at low costs through a variety of different mechanisms such as stock lending and borrowing; recognises that the latter is not only undertaken by hedge funds; suggests that the Commission should examine the feasibility and practicability of a provision that stipulates that where stock is held for the account of investors, a stock lending agreement must contain the right for the lender promptly to recall his shares and that if no recall takes place, the borrower should be allowed only to exercise the voting rights in accordance with instructions from the lender;

Private Equity

44. Considers private equity as an important source of start-up, growth and restructuring capital, not only for large listed companies, but also for small and medium-sized enterprises;, is also aware, however, of cases in which an increased level of indebtness brought considerable risks for companies and their employees when their management was no longer in the position to fulfil the repayment obligations;

45. Stresses the importance of transparency towards the investors as well as towards supervisory authorities concerning fees and raising funds, especially when resulting in the leverage of the financial position of the company taken private, as well as their management objectives, in particular when restructuring large companies;

46. Believes that the regulation of counterparties' exposure as well as clear criteria of the eligibility of investors to limit retail investors' exposure to private equity are crucial;

47. Recognises that employment effects are often a public concern; notes that available data contradict each other as regards the aggregate effect of private equity on the overall level of employment; invites the Commission to provide a better analysis;

48. Is convinced that a more in-depth analysis is needed better to understand the impact of alternative investments such as hedge funds and private equity on financial stability, corporate governance, consumer choice and protection as well as employment; looks forward to examining that impact in its forthcoming parliamentary reports on hedge funds and private equity, based on the outcome of the studies commissioned in August 2007; suggests that those reports should examine, inter alia:

– whether an industry-driven code of conduct is sufficient to enhance financial stability and investor protection or there is a need for more action by the legislator and supervisory authorities in terms of disclosure requirements through minimum reporting standards and the regulation of relevant players;

– whether there is an interest in or even a need for a European label for alternative investment instruments and, if so, what could be the criteria to distinguish different asset classes that would be covered by such an EU framework; and

– under which conditions retail access to those asset classes could be permitted;

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49. Instructs its President to forward this resolution to the Council and the Commission.