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REPORT

on Asset Management II
(2007/2200(INI))

Committee on Economic and Monetary Affairs

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MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on Asset Management II
(2007/0000(INI))

The European Parliament,

- having regard to the 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] of the European Parliament and of the Council of 21 January 2002, 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,

- 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[5] 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[6] (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[7] (Insurance Mediation Directive) and Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance[8],

- having regard to its resolution of 15 January 2004 on the future of hedge funds and derivatives[9],

- having regard to the Asset Management Expert Group report of 7 May 2004 and Expert Group reports of July 2006, and to its resolution of 27 April 2006 on asset management[10]

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[1] OJ L 41, 13.2.2002, p. 20.
[2] OJ L 41, 13.2.2002, p. 35.
[3] Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)(OJ L 375, 31.12.1985, p. 3), 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.
[5] OJ L 79, 24.3.2005, p. 9.
[6] OJ L 235, 23.9.2003, p. 10.
[7] OJ L 9, 15.1.2003, p. 3.
[8] OJ L 345, 19.12.2002, p. 1.
[9] OJ C 92 E, 16.4.2004, p. 407.
[10] OJ C 296 E, 6.11.2006, p. 257.

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- having regard to the Committee of European Securities Regulators (CESR)' advice to the Commission of 26 January 2006 on clarification of definitions concerning eligible assets for investments of UCITS (CESR/06-005),

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

- having regard to the ECB annual report 2006, Chapter IV: Financial Stability and Integration of April 2007,

- 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] (MiFID Implementing Directive),

- having regard to the CESR Recommendations on Inducements under MiFID of 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] (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 - C6-0231/2007 - 2007/0143(COD)) (Solvency II Directive),

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

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

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

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

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

A. whereas the Parliament with this resolution does not intend either to address the five legislative measures of 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 to discuss modifications of supervisory cooperation

[1] OJ L 241, 2.9.2006, p. 26.
[2] OJ L 345, 31.12.2003, p. 64.

foreseen in these five areas,

B. whereas the European Parliament intends to play its full role in designing a more integrated European market for investment funds going beyond the forthcoming limited revision of the Directive 85/611/EEC as amended especially by Directives 2001/107/EC and 2001/108/EC (UCITS III Directive),

C. whereas open-ended real estate funds (OREF) and funds of hedge funds (FoHF) as well as other non-harmonised retail funds, remain currently 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 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 are different, from each other, in 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 so as to enable the establishment of a single market for these products;

2. Calls on the Commission to examine future extension of Article 19(1) of the UCITS III Directive on eligible assets to OREF and FoHF bearing in mind that eligibility is already granted to hedge fund indices (HFI); 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 this shall not interrupt the currently ongoing 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 single 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 this shall not interrupt the currently ongoing revision of UCITS III;

Private Placement Regime

4. Calls for a harmonised framework for private placement at EU-level in order to enhance the single market integration, based on a thorough impact assessment; underlines that such regime must provide for the necessary legal certainty for its players but should not over-regulate and hence over-burden the private placement activities between sophisticated and well-informed players by too detailed or too prescriptive requirements; 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; therefore calls on the Commission 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 the definition of who is eligible to invest is crucial; suggests that already existing investor categories in MiFID and Prospectus Directive should be taken into account; supports a broad definition of sophisticated investor; however, highlights that, despite already existing legislation, there are several issues which still need to be addressed, such as the criteria of annual income as well as transfer restrictions forbidding the sophisticated investor, eligible for investment under such a PPR, to sell the product to retail investors;

7. Suggests that, as a first step, a waiver from the notification process for UCITS should be introduced in the 2008 UCITS III revision, this 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 only apply to cross-border private placement and in this case override the existing national rules, it should, however, 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 these 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 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 not only apply 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 the marketing, advise and sale of all retail investment products by the end of 2008 at the latest, in particular the upcoming Solvency II Directive, the Insurance Mediation Directive and the UCITS III Directive 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 whilst 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 CESR that a payment or non-monetary benefit provided to or made by a legal entity within the same group which only offers 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)[1];

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 the Green Paper on the enhancement of the EU framework for investment funds (COM (2005) 314) 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, e.g. capital requirements, at the EU level for these funds can be achieved in order to

[1] CESR recommendation on inducements under MiFID, May 2007.

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 capital requirements;

UCITS-MiFID interaction

20. Welcomes the Commission's intention to solve possible conflicts of UCITS III and MiFID provisions on distribution, inducements and conduct of business rules in its vade-mecum; regrets, however, that the Commission has not published this guidance before the implementation of MiFID by the Member States; calls on the Commission to take account of Member State's implementing laws and regulations, to 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. Notices with regret that, in many jurisdictions, cross-border mergers remain subject to taxation while domestic mergers does not constitute taxable events; believes that since investors cannot influence such events and should be treated equally, cross-border and domestic mergers should be tax neutrally;

23. Calls on the Commission to prepare a taxation of fund mergers directive following the principle of tax neutrality set out in Directives 90/434/EEC[1] and 2005/56/EC[2] in 2008; 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 latter 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

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[1] 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, (OJ L 225, 20.8.1990, p. 1), as last amended by Directive 2006/98/EC (OJ L 363, 20.12.2006, p. 129).

[2] Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies (OJ L 310, 25.11.2005, p. 1).

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

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

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 of their countries of registration and the provisions of Community law on corporate governance;

Fund processing

30. Welcomes initiatives such as the EFAMA's Fund Processing Standardization Group , Eurofi and other initiatives at national level to increase the efficiency of fund processing; 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 the 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[1];

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;

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[1] Solution discussed in the Eurofi study 2007: Optimising cross-border distribution and processing of investment funds in the EU.

highlights the need for oversight to guarantee that the data is up to date and reliable[1];

Depositary

34. Regrets that not all Member States allow the 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; therefore, calls on the Commission to take the necessary legislative steps in the 2008 UCITS III revision to allow such credit institution branches to act as depositary and to clarify ways for an effective supervisory cooperation;

35. Believes that harmonisation of a definition of depositary functions could contribute to better understanding and 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 a be removed in order to achieve a harmonisation of depositary functions taking into account the already existing research on the different roles and responsibilities of depositaries across EU 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 any 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 (i.e. derivatives, including credit derivatives and indices, including hedge fund indices) has on the effectiveness of the depositary's oversight function;

Lamfalussy

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 IOSCO proposals to bring more clarity in this respect, urges

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[1] One of the options discussed in the Eurofi study 2007: Optimising cross-border distribution and processing of investment funds in the EU.

the industry to agree on a code of conduct on 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 this discussion (e.g. within 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 of eligibility of investors as well as regulation of the counterparties exposure are crucial; underlines, at the same time, that entities regulated by the MiFID are subject to suitability and appropriateness tests for distribution as provisions against misselling;

42. Considers that financial stability issues need to be addressed at the global level via enhanced cooperation of supervisory authorities and central banks in international bodies such as IOSCO as well as through a regular dialogue between the governments and legislators; urges the Commission, the ECB and CESR to take an active role in stimulating this 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, however, concerned 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 to promptly recall his shares; if no re-call takes place, the borrower should only be allowed 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 SMEs; however, is also aware 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 regulation of the counterparties exposure is crucial as well as clear criteria of eligibility of investors to limit the retail investors' exposure to private equity;

47. Recognises that employment effects often are a public concern; notices that available data contradict each other about their aggregate effect 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 to better understand the impact of

alternative investments such as hedge funds on the one hand and private equity on the other on financial stability, corporate governance, consumer choice and protection as well as employment; looks forward to examining these in the forthcoming parliamentary reports on hedge funds and private equity, based on the outcome of the studies commissioned in August 2007 (IP/A/ECON/IC/2007-23), suggests that these reports should include among others an examination of:

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

-under which conditions retail access to these asset classes could be permitted;

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

EXPLANATORY STATEMENT

I. Importance of the fund industry

The investment fund industry is not only a significant part of the financial system, but also contributes to the stability of the economic and social system by channelling savings into productive investments.
The cornerstone of the EU framework for investment funds is the 1985 UCITS Directive which has led to the creation of a large and growing market for retail funds within the EU. Today, with € 6.213 billion invested in UCITS, this segment accounts for 78,9 % of the European fund market[1].

II. The White Paper

The European Commission analyses in its White Paper (COM 2006/686) published in November 2006 that the current UCITS provisions do not keep pace with the new competitive challenges and the changing needs of European investors. It foresees a progressive development of the existing framework through a targeted revision of the UCITS III Directive (notification procedure, simplified prospectus, pooling, mergers, supervisory cooperation). This revision will <u>not</u> be subject of this report because Parliament will amend the forthcoming proposal within the regular co-decision process which is about to start in early 2008. The rapporteur wants to comment on a number of fields beyond the limited revision of UCITS III but covered by the White Paper as well as on issues that have not been raised by the Commission.

III. Scope of the report

<u>1. Non-harmonised retail funds</u>

A large range of non-UCITS funds are becoming more and more attractive to retail investors, but suffer from the absence of a passport and by consequence, retail investors across the single market have limited consumer choice.

Real estate funds are one of the largest categories of nationally regulated investment products. At the end of 2006, there were around € 188 billion in assets under management in real estate funds in the EU[2]. Open-ended property funds allow investors to diversify their portfolio with an asset class that benefits from low volatility and a low correlation with other asset classes (i.e. equity, bonds).

Funds of hedge funds are available to retail investors in several Member States. In 2002, assets in these products had totalled € 14 billion, but by the end of December 2006 this figure increased to € 73 billion[3]. Funds of hedge funds can offer portfolio diversification through

[1] EFAMA Quarterly Statistical Release N°29 (First Quarter of 2007).
[2] EFAMA: Annual Report 06/07. Regulation, Pensions, Industry Standards, May 2007, Brussels, p.36.
[3] FERI Fund Market Information Ltd (FERI FMI): European Fund Market Data Digest 2007, Fourth Edition published March 2007, London, p. 19.

exposure to various asset classes and strategies, thus reducing the risk inherent in single-strategy hedge funds.

2. Private Placement Regime

Several Member States have their own private placement regimes which differ substantially in terms of regulatory framework and general functioning. In April 2007, the Commission launched a call for evidence for a European private placement regime. The Commission defines it as a method of investment product sale in a non-regulated space where buyer and seller can conduct transactions under certain conditions that exempt them from requirements of public offering. The products on offer can either be harmonised (UCITS), non-harmonised or even off-shore products. Until now there has not been a clear decision as to whether such a regime should be open to all products, who should be eligible to invest and who to provide (place), and whether an originally privately placed product could be sold on to retail investors. Moreover, it is still open how to define the borderline between public offering and private placement and which parts of the already existing regulatory framework could be used for the construction of a European private placement regime (MiFID: eligible counterparties / professional client; Prospectus Directive: qualified investor).

3. Distribution and fees

Investors do not only have access to UCITS, but also to similar and therefore competing investment products under different legal frameworks, such as structured products (i.e. certificates and notes) and life insurance products (i.e. unit-linked). Given the increasingly open architecture of distribution, the appropriate comparison of cost, valuation, performance and risk is even more important for retail investors. However, it must be recognised that full comparability and hence an identical level playing field are unlikely to be achieved due to individual characteristics of different investment products (exit possibilities, taxation etc.).

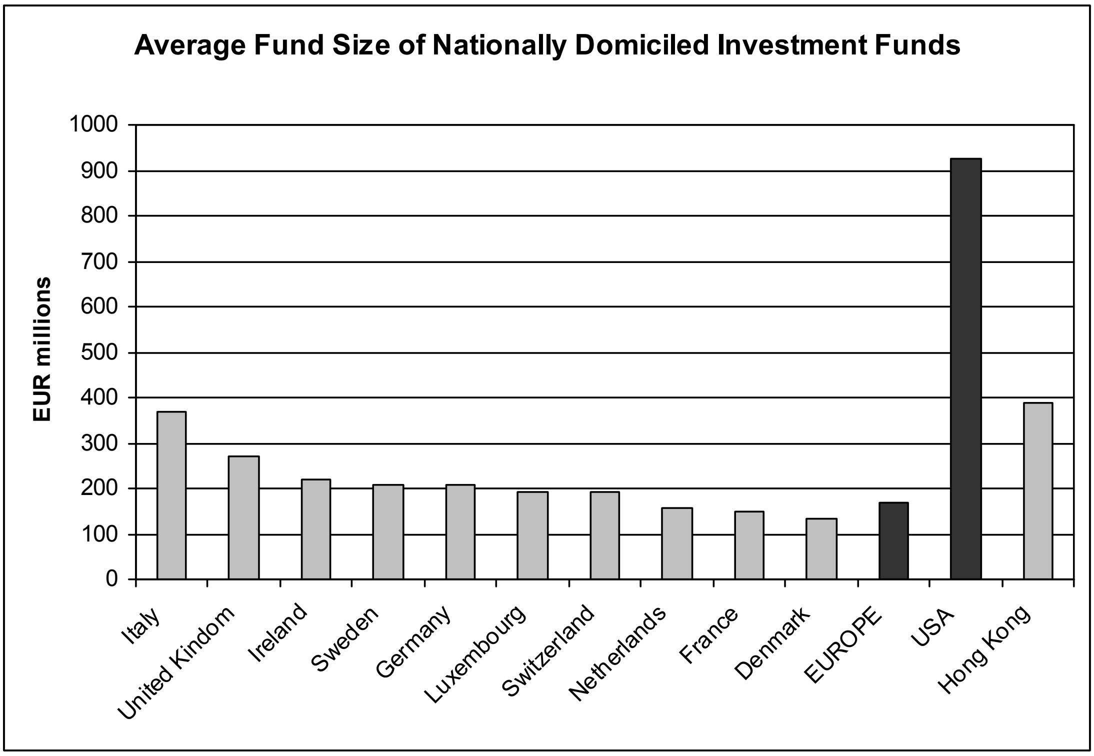
Fee structures often remain in-transparent because fees are included in returns without any indication of how they are broken down in the value-chain. This is particularly true for the retrocession[1]. Such lack of transparency undermines investor protection, business development and sound competition.
MiFID and its provisions on inducements[2] aim at improving fee transparency. However, it has to be noted that its disclosure provisions only apply to third-party funds and not to in-house distribution and do hence not foster open architecture. Moreover, it is not yet predictable what impact MiFID will have on already existing UCITS provisions and on softing and bundling arrangements.

4. Taxation of cross-border fund mergers

Although the EU investment funds market only has two-thirds as many assets as the US market, it has over three times as many funds. This implies a relatively high proportion of

[1] Retrocession/placement fee/trailer fee: A portion of the management fee received by the manager and paid to the distributor in remuneration of its placement activity. The fee is usually recurrent and paid as long as the assets remain invested.
[2] Inducement = a fee, commission or non-monetary benefit that an investment firm may receive or pay in connection with the provision of investment and ancillary services to clients.

funds with a higher cost proportional to their size. Due to the small average fund size, European investors are charged an estimated € 2-6 billion more in annual fees than they would, if economies of scale were fully exploited[1]. National taxation rules are one of the major obstacles to (cross-border) fund mergers.



Source: Own chart, based on data from EFAMA Fact Book: Trends in European investment funds, 4th edition, July 2006, page 53.

5. Investment Policy and Risk Management

In the past there have been divergent interpretations of the UCITS III Directive (1985/611) rules by European supervisory authorities. Therefore, the Commission adopted a Level 2 Directive (2007/1178) which clarifies certain definitions and substantially widens the scope of eligible assets. However, UCITS are not yet allowed to invest in commodities and derivatives on commodities, hedge funds (HF), funds of hedge funds (FOHF) and open-ended real estate funds (OREF). The CESR work on hedge funds indices (HFI) as eligible assets is still on-going, but creates concerns among the hedge fund industry of an uneven level playing field in comparison to FoHF whose performance and transparency is often superior to the one of HFIs.

Since the investment policy of UCITS is fairly prescriptive, there remains the question as to how far the risk management provisions of UCITS should go. Many practitioners as well as academics see the investment policy rules on the one hand and the risk management system on the other as two sides of the coin. The current provisions of UCITS III Directive (1985/611) require the management company to employ a risk-management process, which

[1] European Commission, Internal Market and Services DG: Report of the Expert Group on Investment Fund Market Efficiency, July 2006, Brussels, p. 10.

must take into account the current value of the underlying assets, the counterparty risk, future market movements and the time available for liquidating the positions. Since the amendments to the directive (2001/107 and 2001/108) established a non-sophisticated UCITS as well as sophisticated UCITS (using financial derivative instruments), the Commission published a recommendation (2004/383/EC) on how to use financial derivative instruments in the case of sophisticated UCITS in 2004. This recommendation however fails to ensure a consistent definition of a sophisticated UCITS and what methods of risk management such a UCITS should use; that is whether a sophisticated UCITS should use the value-at-risk (VaR) approach and non-sophisticated UCITS a simpler commitment approach. From the supervisory side, the risk management programmes are notified to the regulator, but not authorised. It also varies in how far custodians, the administration of the fund and the fund managers contribute to the data put into the software as well as in how far depositories are involved in the oversight of this function.

6. Fund processing

Fund order-processing has not kept pace with the growth of the market and changes in distribution systems, which in turn has led to higher operational risks, processing delays and higher costs. At the moment, there is still around 50 % of cross-border transactions handled manually that costs two to three times more than automated orders[1]. Such inefficiencies do not arise from an insufficient regulatory or legal framework but from within the private sector. Hence, the European industry should step up its projects and progress in the automation and standardisation of fund processing.

7. Depositary

The depositary is one of the three fundamental pillars of the UCITS framework, alongside the fund and its managers. But depositaries are broadly defined and have no European passport. The absence of a precise EU legislative framework has led to diverging definitions of the role and responsibilities of the depositary. So far, that divergence has not resulted in obvious problems with the protection of investors. However, there are concerns that these differences may harm the free provision of services in the internal market. Consequently, further thought should be given to the authorisation of branches of EU credit institutions to act as depositary, to the depositary's safekeeping mission and to a harmonisation of its functions in general.

8. Lamfalussy

The Lamfalussy process did not exist when Directive 85/611/EEC was adopted. However, Lamfalussy-style mechanisms have already been applied for instance within the Level 2 measures to the UCITS III Directive definitions of eligible assets.
During the forthcoming revision process, the Commission should examine where Lamfalussy style mechanisms can be extended without restructuring the whole Directive. Thereby, it is crucial to ensure that any further new legislation or revision of the existing legislation will include the legal basis for both Level 2 implementing directives and Level 2 implementing regulations.

[1] Eurofi study 2007: Optimising cross-border distribution and processing of investment funds in the EU.

9. Hedge Funds

Global assets under management in HFs present about $ 1,537 million[1] compared to $ 55.0 trillion assets in the global fund management industry[2]. Despite the lack of a clear and common definition of a HF, the concept represents unregulated investment vehicles using investment techniques which try to use market imperfections. They use shorting techniques, extensive leverage, and derivatives, which are not available to other collective investment vehicles. However, many other financial institutions and investment funds share some of these features.

HFs contribute to a dispersion of risk, higher liquidity, increased competitiveness between market makers and intermediaries as well as substantive proprietary market research that leads to better information and price discovery.

In view of the difficulties some HFs have run into recently, there is a controversial discussion on the financial stability and systemic risk that might arise from HFs. Most supervisors opt for the supervision of HFs' counterparties and regulation of investors' access.

10. Private Equity

Although often being placed under one heading of "alternative investment", the financial instruments of hedge funds and private equity are of different natures. "Private" in private equity refers to the way of raising capital and not to whether they invest in private or publicly listed companies. Their activity thus starts with fund raising (usually from pension funds, endowments, financial institutions (banks, insurance companies), high-net worth individuals or funds of private equity funds). It is followed by fund management activity, i.e. leveraged buy-outs (LBOs, mostly investing in publicly listed companies and taking them private), venture capital, growth capital, mezzanine capital etc. LBOs are usually done by one part raised funds to three to four parts of debt, which later show on the targeted company's balance sheet. Typical exit strategies are either an initial public offering (IPO), a secondary buy-out by another private equity firm or a trade sale to another corporation. Despite concerns about high leverage of LBOs and potential social consequences, private equity remains a great source of start up and growth capital for SMEs and in many cases - due to the restructuring of the target company - ensures its successful development. In 2006, some 90 % of investments were made in companies with fewer than 500 employees[3].

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[1] Hedge Fund Review March 2007.
[2] Investment Company Institute December 2006.
[3] EVCA Yearbook 2007.

RESULT OF FINAL VOTE IN COMMITTEE

Date adopted	21.11.2007
Result of final vote	+: 38 –: 1 0: 1
Members present for the final vote	Mariela Velichkova Baeva, Zsolt László Becsey, Pervenche Berès, Slavi Binev, Sharon Bowles, Udo Bullmann, Ieke van den Burg, Christian Ehler, Jonathan Evans, Elisa Ferreira, Robert Goebbels, Donata Gottardi, Benoît Hamon, Gunnar Hökmark, Karsten Friedrich Hoppenstedt, Sophia in 't Veld, Piia-Noora Kauppi, Wolf Klinz, Kurt Joachim Lauk, Andrea Losco, Cristobal Montoro Romero, Joseph Muscat, John Purvis, Alexander Radwan, Bernhard Rapkay, Dariusz Rosati, Heide Rühle, Eoin Ryan, Antolín Sánchez Presedo, Manuel António dos Santos, Margarita Starkevičiūtė, Ivo Strejček, Cornelis Visser, Sahra Wagenknecht
Substitute(s) present for the final vote	Harald Ettl, Ján Hudacký, Werner Langen, Thomas Mann
Substitute(s) under Rule 178(2) present for the final vote	Holger Krahmer, Willem Schuth