



**Eurofi 2008 -
Thursday 11/09/08**

**Session [5B] - EU PRIORITIES
FOR INVESTMENT FUNDS
AND EU SECURITIES
INFRASTRUCTURES:
Evolution of the UCITS
regulatory framework,**

remaining challenges for securities infrastructures

The Panel

Moderators: **Piia-Noora Kauppi**, MEP, Committee on Economic and Monetary Affairs, European Parliament;

Wolf Klinz, MEP, Committee on Economic and Monetary Affairs, European Parliament

Panellists: **Marc Raynaud**, Global Head of Mutual Fund Distribution, BNP Paribas Investment Partners;

David Wright, Deputy Director General, DG Internal Market and Services, European Commission

Carlo Comporti, Secretary General, Committee of European Securities Regulators (CESR);

Gertrude Tumpel-Gugerell, Member of the Executive Board, European Central Bank (ECB);

Alain Closier, Global Head of Securities Services, Société Générale;

The Debate

The non-harmonised market was growing considerably faster than harmonised funds, commented **Wolf Klinz**, MEP, Committee on Economic and Monetary Affairs, European Parliament, the moderator, opening the debate. UCITS funds were set up for the retail investor and yet a quarter of them were being sold to institutions. This suggested the need for more instruments to be eligible for inclusion, he said.

In addition, the brand had proved successful in places such as the Far East and Latin America, but competition within the European fund industry was hampering efforts to expand the brand even further. "With problems such as manual processing, we are unable to exploit economies of scale," argued Mr Klinz.

It was also important for the future of the industry to resolve the competing products difficulties, said Mr Klinz. The Commission had launched a call for evidence and the results were due in March. "Does a level playing field exist for fund management and capital markets products regulated on a different

basis?" asked Mr Klinz. He also wondered whether MiFID should apply to insurance products, again to ensure a level playing field.

There was great scope to take the UCITS brand far beyond Europe, agreed **Marc Raynaud**, Global Head of Mutual Fund Distribution, BNP Paribas Investment Partners. UCITS provided a perceived safety net for investors and in Hong Kong, in particular, the UCITS brand was widely employed and viewed as a label of quality.

But the UCITS industry, which was the bulk of the European market, faced three major challenges. The first was associated with efficiency, in particular reducing distribution costs for cross-border sales by evolutions in the UCITS regulatory framework and further standardization and automation of cross-border processing. The second was to increase innovation. Lastly, there needed to be a level playing field so that substitute products from the capital markets did not have an inherent advantage over UCITS funds.

Mr Raynaud provided more detail on the challenges and how they should be dealt with. In terms of efficiency, the different measures contained in the current UCITS IV package and the management company passport that was being debated at present would speed up regulatory processes and reduce costs. He believed that evolutions in cross-border processing should be market-driven, not proposed by regulators. But he conceded that sufficient momentum still remained to be built for the different proposals available to be put in place and that agreement between players was essential. As regards innovation, he advocated creating legislation that covered new asset classes rather than trying to squeeze ever more assets into the existing UCITS framework. This might involve the creation of a new "alter-UCITS" funds framework.

Lastly, while UCITS offered transparency and regulation in the financial sector, there were products with the same underlying objectives that had entered the marketplace without being subject to the same levels of regulation. "We must fight against anything that does not comply with a level playing field," said Mr Raynaud. He said that now UCITS IV was close to finalization the priority should be given to the second and third of the challenges he had identified, which were of great importance for the future of the funds industry.

It was an open question whether product regulation was the right approach or whether it had reached the stage where principles-based regulation would be more appropriate, said **David Wright**, Deputy Director General, DG Internal Market and Services, European Commission.

He agreed with other participants that the UCITS brand had been a big success all over the world. "Wherever we go, I notice that UCITS funds are on sale," Mr Wright said. He believed that total sales had reached nearly €6 trillion worldwide. He acknowledged that some people were unhappy that

Nice, September 2008

THE THINK TANK DEDICATED TO FINANCIAL SERVICES IN EUROPE

11 bis, rue Mansart - 75 009 Paris - FRANCE - Tel.: +33 1 40 82 96 03 - Fax: +33 1 40 82 96 03 - www.eurofi.net

the UCITS rules had been too prescriptive, but also that many people had considered this necessary to establish the brand.

The proof that the right approach had been adopted was evident in the fact that it was the only retail product distributed worldwide. But he warned that there were limits to extending the scope further. "We have to think carefully about the dilution of the UCITS vocation," said Mr Wright. "If we push everything into UCITS, we may end up with disgruntled customers, perhaps failures and the UCITS product would ultimately be less reliable." Some assets did not have a place within the UCITS framework, particularly at the more sophisticated end of the market.

So while there was a need to create greater scope for cross-border innovation, it should be recognised that some investment strategies were too illiquid and were not suitable for retail investors with small portfolios. They were probably more suited to the institutional market.

D. Wright added that retail products and institutional products indeed needed to be approached differently since the level of detail required was not the same and that product regulation as well as distribution regulation should be considered. He confirmed that at this stage a properly targeted private placement regime could be a solution for institutional clients and that "alter-UCITS" was an alternative option worth considering, although finding a solution to encompass the whole range of non-retail products not part of UCITS seemed difficult for him. He also thought that real estate funds deserved some form of framework to facilitate their development but the right option remained to be chosen.

Overall he wanted to avoid "bolt-on solutions" and to develop a coherent and overarching approach to the whole range of funds available, not only real estate, but also eg infrastructure funds... and promised that the Commission would be making some proposals before the break of the Parliament.

Carlo Comporti, Secretary General, Committee of European Securities Regulators (CESR),

admitted these were all difficult questions for CESR to address. He believed Europe was "at a crossroads of competitive dynamics and regulatory intervention". He identified three key pillars of protection for investors, which should be adhered to at all times regardless of future changes to the UCITS regulation.

The first was a duty of care by distributors and product providers. The second was financial literacy and the capability of investors to make investment decisions for themselves. The third was disclosure. "We need a combination of these three," said Mr Comporti. "Relying on one is not enough."

In terms of duty of care, there had been an improvement under MiFID. But there were still areas of weakness. In execution-only business, for instance, there was a presumption that retail investors could make decisions on their

own. There was also the question of co-operation between the product provider and the distributor and more structure was needed there.

As regards the financial literacy of investors, this was a key challenge. It was incumbent on investors to do their own due diligence on funds, but this was something they were not always capable of. "They don't have sufficient experience of taking investment decisions so they rely on advice," said Mr Comporti. "This goes back to MiFID again." There was also the problem that institutional investors did not necessarily understand the products they were buying either because they were over-reliant on third-party ratings of funds. "There should be more due diligence," said Mr Comporti.

On disclosure, there had been a lot of progress, and having one simple document for retail investors represented a large step forward, Mr Comporti believed. The Commission was currently testing this in the market and there was hope that a format would be finalised during 2009. "Is this a benchmark for other products?" asked Mr Comporti. "If so, we need to better co-ordinate the interaction between MiFID and the legislative text."

He pointed out that the Key Information Document was not applicable to other products such as life insurance. The issue of substitute products was in the hands of the Commission, Mr Comporti said. CESR was also involved in trying to create a level playing field. But the Commission's focus was more on outcomes for investors than for investment firms. Indeed, it was difficult to justify different treatments for investors for comparable products, Mr Comporti said.

But achieving equal treatment "goes beyond my remit", he added. Other factors, such as tax treatment of products, meant his organisation did not on its own have the power to provide a solution.

Overall, regulators would have to play a significant role, Mr Comporti said, but not a controlling role over the nature of products. There could be a filtering role to play as a stream of new products was launched but there was no intention to stifle innovation within the industry. "But sometimes innovation is not hampered by regulation, but by markets themselves," he added.

G. Tumpel-Gugerell, Member of the Executive Board, European Central Bank (ECB) reacted to the comments made on fund processing explaining that the envisaged TARGET2-Securities platform (T2S) could help the funds industry for settlement in markets where funds shares are dematerialized and have the same characteristics as traded securities.

Looking at priorities for EU securities infrastructures, **Piia-Noora Kauppi**, MEP, Committee on Economic and Monetary Affairs, European Parliament, thought that although there had been a significant change in securities structures, there was still a need to develop them further. The cost of fund transactions remained many times higher in Europe than in the US. This was costing the industry and its clients an estimated €2bn a year. So

Nice, September 2008

trading and post-trading needed to be looked at carefully. The solution was to increase competition, which MiFID had at least partially addressed. Also the industry should begin to consolidate. Finally, legal and fiscal obstacles had to be overcome. MiFID, which was useful legislation, had not been fully implemented yet.

Mrs Kauppi first invited **A. Closier** from Société Générale Securities Services, a major EU custodian, to express his views on the priorities for improving the competitiveness of EU securities infrastructures from a user standpoint.

As a user of securities infrastructures he agreed that competitiveness was the key objective but the industry needed to agree on what this meant. For him it meant safety, liquidity and lower costs for users encompassing all elements charged along the value chain ie infrastructure fees as well as internal costs for users. These cost reductions could be achieved more easily according to his experience by more integration and streamlined processes than by fragmentation leading to more complexity which was the direction in which the market was moving at present, he thought. Becoming competitive was also the condition for the EU industry to be in a position to establish a balanced dialogue with external partners and first of all with US partners and US infrastructures, as alternative axes of consolidation start developing across the Atlantic.

A. Closier then explained that consolidation initiated in 2000 which was mainly capitalistic had come to a halt in 2003 except for recent acquisitions made by LSE and Euroclear. EU authorities had then launched many initiatives to speed up harmonization and integration but he felt that changes were fairly limited for users so far. The Code had brought some improvements in price transparency, but interoperability seemed to be at a standstill. T2S was expected to simplify the post-trade organization and be a catalyst for harmonization but was a remote objective (2013). For users the main issue was better anticipating what could change in the short term ie in the next 5 years. He considered that MiFID would have the biggest impact in the short term and would bring further fragmentation of infrastructures and liquidity, at the trading level but also in clearing with new clearing houses being created. Other projects should develop in the coming 5 years: ESES should enable to reduce costs in the Euronext zone, transatlantic consolidation may develop leading to consider alternatives to EU level consolidation and harmonization should hopefully progress.

But he considered that these different initiatives would not be sufficient to significantly improve competitiveness since he anticipated more fragmentation and complexity at all levels of the value chain brought by MiFID and the Code of Conduct. The main issue was that the final target has not been clearly defined and that the different initiatives launched by the EU authorities were moving in two different directions: more competition favoured by the Commission - which may eventually lead to consolidation but was not its initial objective - and consolidation fostered by the T2S project of the ECB. Increasing competitiveness required choosing between these two approaches according to A. Closier, to define a clear organizational target for the market and the roles

of the different stakeholders ie users and infrastructures. This could possibly be done separately for equities and bonds on one hand and for derivatives on the other for which the business models and market dynamics were different.

G. Tumpel-Gugerell agreed that many things remained to be done. While there was more competition in trading, the post-trading environment was still untested, she believed. As a result fees were going down in trading but not in post-trading. This was why the Eurosystem initiated T2S which would however not only foster consolidation but also create opportunities for more competition, she believed, and drive harmonisation not only in 2013 but already now. She confirmed that there was interest from non-euro countries and that Denmark has already indicated to join the T2S platform for settlement in Danish Crowns and euro. She thought that other non-euro CSDs and Central banks may join T2S as well.

Streamlining its collateral management system was also a priority for the Eurosystem and to achieve this, it had started the CCBM2 project. T2S would lead to a harmonisation of business practices, but market participants needed to deliver an action plan to harmonise processes beyond settlement like in the field of corporate actions, she said. Furthermore, a common European cross-border supervisory framework was urgently needed and progress on this was within the remit of the national banking regulators/supervisors.

The code of conduct would continue to have a beneficial impact on the market, according to **Mr Wright**. "I don't agree with those who say that it has not done its job," he said. "It has greatly improved transparency in the market, led to unbundled services and brought more clarity for the industry as a whole."

For D. Wright the main issue was whether the industry could deliver what it had committed to in the Code and particularly for putting interoperability into place. He insisted that this was not the Code of the Commission and that the industry had to demonstrate its commitment. Otherwise the Commission would have to reconsider his position.

"There does not seem much point in talking about extending the Code until it has been possible to deliver on this part first." If the industry was unable to deliver on meeting the standards of the Code the next Commissioner and chairman of the economic committee was likely to take a hard look at any future proposals.

Responding to remarks made about recent transatlantic developments he claimed that the Commission had never tried to shape the outcome of consolidation projects and that it was very eager to make progress in mutual recognition between the US and Europe, such as for securities laws. This was likely to start at the wholesale business level, where Euronext and the New York Stock Exchange had already merged. If this happened the Commission would probably also be assessing transatlantic issues for post-trading. But the European industry needed to work together to achieve success on this front, Mr Wright cautioned.

Nice, September 2008