

**REPLY TO CESR'S CALL FOR EVIDENCE
ON THE SUPERVISORY FUNCTIONING OF THE PROSPECTUS DIRECTIVE
AND REGULATION**

EFAMA¹ welcomes the opportunity to reply to CESR's Call for Evidence on the Supervisory Functioning of the Prospectus Directive and Regulation.

In the context of this Call for Evidence, EFAMA will only reply to CESR's question as to whether the new prospectus regime is providing an enhanced level of disclosure and protection for investors.

As we already stated on many occasions (for example in our reply to the Commission Green Paper on the Enhancement of the EU Framework for Investment Funds²), a level playing field for funds and other competing savings/investment products is a crucial issue both for investors and for the European fund management industry.

Among the most popular products competing with UCITS are structured notes or certificates, which are subject to the much lighter regulatory regime of the Prospectus Directive rather than the onerous requirements of the UCITS Directive.

The market for securitized structured products/notes is currently experiencing enormous growth in many EU Member States. In Germany for example, nearly 700 new certificates are issued each day and 120,000 products already available for investment. The volume of assets invested in certificates has been recently estimated at EUR 110 Bill. and is expected to reach EUR 140 Bill. in 2007.

The advantages enjoyed by structured products and certificates are numerous: the approval procedures are much simpler and shorter than for UCITS and no notification is required to sell cross-border, giving them a great advantage in speed to market; there are no restrictions as to the underlying assets or to the diversification comparable to the UCITS eligible assets regime; and – lastly but most importantly – the level of

¹ EFAMA is the representative association for the European investment management industry. Through its 23 national member associations and over 40 corporate members, EFAMA represents (at end September 2006) about EUR 15 trillion in assets under management, of which EUR 7.3 trillion managed by around 46,000 investment funds. For more information, please visit www.efama.org.

² See <http://www.efama.org/55PositionPapers/2005/efamacommentsgreenpaperinvestmentfunds/documentfile> - pages 24-25 and the Annex with detailed comparison of UCITS vs. Prospectus Directive provisions

transparency and disclosure under the Prospectus Directive is much lower than for UCITS.

UCITS offer investors great transparency and high disclosure regarding costs, investment objectives, policies and risks, as well as performance. The fund producer must provide a full and a simplified prospectus, together with annual and semi-annual reports and frequent (usually daily) publication of the NAV. Regarding costs, UCITS must disclose the Total Expense Ratio (TER), entry and exit commissions, and the Portfolio Turnover Rate. Regarding the suitability of the product, quite detailed descriptions of the investment objectives/policy and of the investment risks protect investors before they make their choice, while extensive disclosure of holdings and performance keep them informed and allow them to review their investments.

Almost none of this is available to investors in structured products and certificates issued under the Prospectus Directive. Under the Prospectus Directive there is an obligation to publish a prospectus with a summary³, but there is no obligation to disclose either costs included in the product structure or wrapper, or costs related to the underlying instruments. Due to their lack of transparency, structured products and certificates can thus appear cheaper than funds, which are much more transparent.

Regarding the investment objectives, there is no obligation for a comprehensive explanation, and only basic information must be provided about the underlying. Only a rather vague requirement to disclose prominently “risk factors that are material to the securities”⁴ applies. No diversification rules or provisions for risk management apply to instruments under the Prospectus Directive.

While the Prospectus Directive applies to information to be made public at the issuance of securities and does not provide for information updates to existing investors, the UCITS Directive also provides for regular information updates for fund investors, as retail investors would otherwise have difficulties gathering themselves the necessary information.

While the Prospectus Directive provisions are appropriate for shares and bonds – instruments which presuppose a sophisticated level of investment know-how for direct investors – the same rules are now applied to new creations such as structured products and certificates, which are far more complex but are nonetheless being targeted at the average retail investor, increasingly marketed as options for retirement savings.

It is obvious that the lack of information and transparency poses enormous risks to retail investors and that – in the interest of investor protection – stricter disclosure requirements should be imposed. MiFID will not provide sufficient remedy to the deficiencies of the

³ However, extensive exemptions from publication requirements are provided by Art. 3 (2) of the Prospectus Directive.

⁴ See Annex XII – Item 2 of the Regulation for the Prospectus Directive 809/2004.

Prospectus Directive because it requires disclosure of existing information, and the information is currently not available, either to investors or to advisors. On this basis, it is impossible for advisors under MiFID to provide suitable advice to their clients. New approaches should be developed to assess the costs embedded in structured products, as the same methodology applied to UCITS would not capture them.

EFAMA is well aware of the fact that CESR's powers are limited by the current provisions of the Directive, but we take this opportunity to strongly urge CESR to recommend legislative change to the European Commission in this regard, which we will be glad to support.

We remain at your disposal for any clarification you might require.

Contact:

Steffen Matthias, Secretary General
Graziella Marras, Senior Policy Advisor

Tel. +32 2 513 39 69
e-mail: info@efama.org