

RESPONSE TO CESR CALL FOR EVIDENCE ON UCITS DISTRIBUTION

We welcome CESR's Call for Evidence and before moving to some specific comments would like to make some observations generally about the state and trend of European UCITS distribution.

The mutual fund industry is experiencing perhaps four major trends in distribution models.

1. Polarisation in the type of intermediation between UCITS and the client

At one level we have intermediaries which are little more than sale administrators who assist in the filling in of application forms, but who do not provide continuous support to clients. This is for those clients who feel increasingly confident in their ability to manage their own financial affairs but who value a degree of assistance, particularly when starting off. At the other end of the scale we are seeing intermediaries move towards a more solution-oriented offering. So, rather than simply pull together a portfolio of funds the adviser will try to put together some form of package that will assist the client in saving for a specific objective such as retirement without regular and costly intervention by the adviser. Accordingly we have seen a rise in multi-manager products which incorporate asset allocation at the fund level rather than leave it to the intermediary, and "target" or "lifestyle" funds which offer a graduated asset allocation through an investor's life stages on an explicit timescale. In conjunction with this, the solution may include the use of a number of different tax or product wrappers around the funds. This may involve further stages of intermediation between the UCITS product provider and client.

2. Open architecture is becoming more accepted by distributors.

This is due to a variety of reasons. Increasing investor sophistication in some markets means that investors are no longer willing to be fobbed off with the bank branch salesman posing as an investment adviser. Rising regulatory standards of best advice have also had an effect as has investors' increased willingness to complain and seek redress if they feel they have been disadvantaged. The increasingly complex character of investor demands has also put a strain on distributors' proprietary ranges as they struggle to maintain a full shelf of options. Buying in best of breed from outside has become a necessary part of offering a competitive full service.

3. The growth of fund trading platforms is creating a new type of intermediary.

Platforms have been around for many years, but the advent of internet technology and acceptance by retail clients and intermediaries of internet transacting has provided a turbo boost. Such platforms operate essentially in one of two ways: as an outsourced back office system for intermediaries or as a single point of entry for individuals wishing to manage their own investment portfolio. Initially acting as simple trading venues such platforms have now developed to the extent they will offer bespoke products and wrappers either to extend the range of product choice, or to offer tax-advantaged ways of holding other products maintained on the platform.

4. There is a blurring of the line between retail and institutional sales channels.

At one level this means that retail clients and their advisers are seeking products which in the past may have been seen as primarily designed for institutional investors. Along with that intermediaries are often seeking institutional product pricing for retail market sectors. While this might appear at first sight unalloyed good news for investors, it is not always clear whether the full benefit of that pricing is passed on or is retained within the value chain. Anecdotal evidence suggests that the costs of distribution are rising relative to fund providers' fee structures. It is also worth noting that relentless discount warehouse type pricing will impede in the relatively short term the ability of product providers to develop new and innovative products.

Of these four trends three have direct implications for the way in which UCITS arrive in the investor's pocket: the increasing use of wraps/product solutions incorporating UCITS but where the client buys the wrap/product/service rather than the UCITS itself; the purchase via one party of another party's products; and the ability to access an entire funds market from a single entry point.

There are other smaller trends underway, and doubtless other trends will emerge. It is arguable for example that the full effect of the demographic-driven pensions time bomb has yet to find its way through to the retail market. A snapshot of the market taken in May 2007 may not be a good basis for map-making in 2009.

The combined consequence of these trends is that UCITS distribution is becoming increasingly complex and multi-layered. A direct relationship between a UCITS provider and the investor is increasingly becoming the exception, rather than the norm.

We therefore find it interesting that in considering distribution models for the purposes of "developing key investor information" CESR does not begin at the investor end of the process. We believe that there is merit in such approach, not only philosophically, but because it also has the effect of simplifying much of the analysis. If one is drawn into the fractal world of distribution strategies there is a danger of missing out on the essential character of the transaction which occurs between a fund manufacturer and a fund investor. We believe starting from the investor's perspective is preferable.

In that spirit we offer the following analysis. An investor buys a UCITS fund either as a product in its own right or embedded within another product (such as an insurance contract); and he buys it either directly from the manufacturer or via an intermediary. That is the essential matrix within which all UCITS are sold although there are many shades of difference in the details of each situation and sale as we noted above.

Let us first take the proposition that an investor buys UCITS either as a product in its own right or embedded within another.

If an investor buys a UCITS as a UCITS then he is entitled to material product information regarding the UCITS as currently set out in the Simplified Prospectus, or

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Key Investor Information as it is likely to become. This will typically set out fund objective, past performance, key risks and product charges.

If he buys a UCITS embedded in another product then he is not buying a UCITS, he is buying another product, in the same way as when he buys a UCITS he does not buy the shares in which that UCITS is invested. An investor is still entitled to material product information, but this will be different from the information regarding the UCITS itself. If we take the example of charges, it is typical for an insurance wrapper to have its own annual fee. This could be an all-in fee from which the manufacturer of the product pays the charges of the underlying assets. Alternatively it could be an additional fee for administration and management of the insurance contract wrapping the underlying assets over and above the fund's own charges. Or it could be a hybrid, additional but capped at an aggregate of the underlying plus wrapper fee. Variations abound, but the key and constant essential is that the fee which the investor pays and the one which affects the return he gets does not necessarily have any meaningful correlation with the underlying assets' charging structure. Giving the investor in such a situation data on the UCITS product would be not only confusing, but actively misleading. Giving the investor comparable information regarding the product he is actually buying is what is required – the underlying product cannot act as a surrogate for this.

From this we draw a simple conclusion – UCITS product information (which we regard as the responsibility of the UCITS manufacturer) should be available to the party which purchases the UCITS and that is it. It will not be sensible or feasible for the product manufacturer to have any direct obligation to any downstream consumer of the UCITS beyond the purchaser, as the basis upon which they might purchase an interest in the product could be radically different.

Moving on to the second proposition, we stated that an investor buys a UCITS either directly or via an intermediary. Intermediaries can take many forms and this is where the real complexity begins to emerge. An intermediary can be a financial adviser, a discretionary fund manager, a third party or tied sales agent, a funds supermarket or other transactional platform, a discount broker and even in some jurisdictions a broker trading as principal.

Where the investor purchases directly from the manufacturer the analysis is at its simplest. The material product information should be available from the manufacturer directly to the investor.

When an intermediary is involved then the product information should be available from the intermediary. Why should this be? Firstly it will often be the case that the manufacturer will not know the end client. Many intermediaries use nominee accounts to streamline their interaction with product providers. Others will have clients whose names appear on the fund's shareholder register, but even then it is common that all communications are routed through the intermediary.

Indeed, many investors are using platforms, private banking services and advisers as a means of having a single relationship with the intermediary rather than multiple and changing relationships with product manufacturers. Such an investor would see their

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relationship as being with the intermediary, not a product provider. This forms part of the appeal of increasing intermediation across the industry.

What can further complicate the picture here is the fact that an investor going through an intermediary is buying both a product and a service. He is buying the UCITS, but he is also buying the advice or transactional service. However, many investors will not instinctively make this distinction and it could confuse them to receive information from the intermediary regarding service fees and from a manufacturer regarding product charges, particularly when, as in the case of UCITS, there is a relationship between the two.

We therefore feel that the provision of key investor information should be predicated on the principle that it is the responsibility of the person with the relationship with the client to provide that information. For direct sales this will be the product provider, for intermediated sales this will be the intermediary. Further, UCITS product information should be provided to the purchaser only and any downstream user (such as an investor in a structured product based on a UCITS) should receive comparable information from the person from whom they purchase that product or the relevant intermediary for that product and not the underlying UCITS. Following this principle, with a clear linear chain of responsibilities between the end investor and the UCITS provider would offer simplicity and clarity.

In conclusion we feel the best way to avoid unnecessary complication in the obligation to provide information is to identify the obligation at the one immutable point – the investor and whom they deal with. This places the duty to inform the investor at the core of a relationship recognised by the investor and makes the obligation to provide information channel neutral: the investor will get the necessary information in whatever way he chooses to access a UCITS. Once that anchoring point is established then the duties and involvement of the parties in the value chain will naturally fall into place.

Should CESR wish to discuss any of these matters further we would ask that you contact the undersigned.

Yours faithfully

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