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CESR Call for evidence on UCITS distribution (Ref: CESR/07-205)

Dear Mr Demarigny

We welcome CESR's efforts to evaluate UCITS distribution conditions in the CESR member states for developing criteria of key investor information. We broadly support also the opportunity for market participants to submit information and experience in CESR's call for evidence on UCITS distribution. In the following BaFin will respond to the questions raised in the paper CESR/07-205 and give initial comments to the questions from a regulatory perspective.

1. Distribution channels

According to our experience all types of current or projected distribution methods fall within the three scenarios outlined. The possibility to control what pre-sale / point-of-sale information the investor receives is subject to the commercial relationship between the provider and the distributor. In the first scenario the management company itself is subject to the information obligations rising from Article 33 of the UCITS-Directive, such as the providing of a sales prospectus or reports. Further guidance for the investor by assisting in the decision making process, which investment fund is suitable for him, is according to our knowledge typically not provided in this scenario.

If the investor purchases fund units by a company or a tied agent within the UCITS group, usually pre-sale and point-of-sale information will tend to be biased to the funds of the group. Since in this scenario banks or financial services providers within the group are performing the sales, their information obligations come primarily from statutory regulations (MiFID). However, distribution agreements between the provider and the company or agents in the same group allow special agreements on information disclosure. Thus if the sale is performed by a company or an agent of the same group, the UCITS itself will have ways to influence the

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contribution of information. Also if UCITS are marketed through independent third parties – either being regulated under MiFID or according to the so called opt-out possibility – obligations to provide fair information or at least a simplified prospectus to the investor are mandatory according to statutory provisions.

Regarding exchange traded funds, it might be difficult for the provider to influence the distribution process. However, BaFin has an agreement with the industry which states that the market maker should provide some information to the investors.

According to a survey conducted for the German Investment Fund Association (BVI) of June 2006 (GfK Finanzmarktpanel / Sondereinfrage zu Investmentfonds Juni/Juli 2006 public distribution of investment fund units has been performed at 75 per cent through banks. 10.8 per cent of the total market have been marketed via the investment company itself. The Internet banking (direct banking) has a part of 10.2 per cent of the market. Independent financial advisors (*freie Vermittler*), which often are opt-out under MiFID have a relatively small percentage of the market (12.6 per cent). Assurance brokers sell 3.3 per cent of the total investment funds in Germany according to this study. Unfortunately there is no exact data available to differentiate according to the given three scenarios.

2. Packaging of UCITS funds

UCITS funds are distributed in the following scope of product families:

- a) Original fund products with the investor as the direct owner of the units are sold as units of single funds, units of fund of funds, or saving plans according to which fund units are acquired by e.g. monthly payments. The current German investment law allows saving plans for foreign UCITS in which fees are charged in total at the beginning of the agreed period of the plan. For domestic funds and foreign non-UCITS there is a prohibition to charge more than one third of the total investor premium per year for fees. For the sake of consumer protection the upcoming amendment of the Investment Act provides this prohibition to all saving plans nonetheless they are linked to units in domestic, foreign UCITS, or non-UCITS. Information obligations are the same as described above under no. 1.
- b) The second product family is the investment fund based life insurance (so called "*Fondsgebundene Lebensversicherung*"). Within this product the insurance premium is invested directly into investment fund units. The investor holds the investment

fund units indirectly somewhat as a beneficial owner. Since the fund units are separated from the assets of the insurance company in case of insolvency there is only a remote risk of a total loss due to the risk diversification of a fund. Information obligations for the insurance company are relatively low compared to the regime of the UCITS directive or MiFID. German insurance supervisory law provides only for details of the underlying fund and the assets the fund is investment in. Further information to be submitted to the investor (such as sales documentation under the UCITS-Directive) is not substantiated.

- c) A portfolio manager of an Investment Management Service (so called "*Finanzportfolioverwaltung*" or "*Individuelle Portfolioverwaltung*") usually receives fees for his services and buys with sole discretion fund units for the investor. The investor is owner of the purchased units, fees therefore occur additionally as described under a). The BaFin qualifies the purchase of funds by Investment Management Services in general not as public marketing under German Investment Act, consequently only information obligations under MiFID are applicable in this scenario.
- d) As fourth product family derivative structures can be distinguished, in particular certificates. Certificates are broadly used to circumvent the prohibition of public marketing of hedge funds. Although a UCITS can be used as single underlying of certificate structures as far as BaFin is concerned this has no significant market relevance. Due to the legal structure of certificates as bonds, the investor bears the risk of issuer's insolvency. Publicly issued certificates in any case can only be sold if a prospectus has been notified under the Prospectus Directive to a securities regulatory authority; information to be granted to the investor is ruled under MiFID and the Prospectus Directive.

Products mentioned above under b), c) and d) in general should be less efficient for the investor because of increased fees due to the interposition of an intermediate between Investment Company and investor.

3. Fund Structures

Unit and share classes can often be differentiated by means of the following criteria:

- Issue premium, redemption deduction, management fee, and/or depositary fee;
- foreign and domestic currency;
- minimum subscription values, usually the share classes with the lowest fees are only for the institutional investors;
- retention or profit distribution;

Seite 4 | 4

- often share classes are also not publicly marketed but offered through private placement to certain investors.

To distinguish the share classes with fees and subscription minimums is most popular.

For investor information sometimes simplified prospectuses are used solely for one share class. In any case according to the directive the simplified prospectuses have to mention the name of all share classes of the fund respectively the all sub funds of an umbrella. Only the full prospectuses have to contain the entire information regarding the existing share classes.

We hope that my annotations are helpful in your call for evidence on UCITS distribution. If you have questions with regard to our comments above please do not hesitate to contact me.

Yours sincerely

By order



Dr. Blankenheim