Date: April 2007
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Call for evidence on UCITS Distribution

Background

1. One of the elements CESR will need to consider in developing key investor information is the diversity of ways in which UCITS funds can be "packaged" and distributed to retail investors. The White Paper notes that "the move from foreclosed distribution systems towards open or guided architecture – where intermediaries offer a range of third party products – is gathering pace". The accompanying Impact Assessment refers to the emergence of new trends in fund distribution; not only open architecture, but funds of funds and internet selling. Finally, the Commission's request for assistance addressed to CESR states that the fund information proposals should "set out how they would be applied alongside requirements for disclosure in relation to any product wrapper (e.g. for fund of funds / tax wrapper / savings plan) or other distributor disclosures".

2. In order for CESR to form reasoned disclosure proposals that take proper account of these issues, we need to be satisfied that we have sufficient information about, and analysis of, the current state of the market for UCITS funds. There is already material to draw on from the workshops held in the summer of 2006; from the reports of the expert groups published in July 2006; and from the documents published alongside the White Paper, notably the two studies on current trends in the European asset management industry prepared by ZEW / CEE and OXERA respectively.

Information CESR is seeking

3. We wish to obtain further evidence about the way in which UCITS funds are distributed, and the types of intermediation that may exist in the relationship between the UCITS provider and the end investor. To support our work we should have an informed understanding of :
   - the distribution channels through which a UCITS may be sold to retail investors;
   - the ways in which a UCITS may be "packaged" as part of a product or service, whether by the UCITS provider, an entity in the same group as the provider, or an independent third party; and
   - the ways in which a UCITS may be structured by its provider to facilitate different approaches to distribution and packaging.

   Each of these points is addressed in more detail below.

4. We would like to hear from individual firms that are involved in the provision and distribution of UCITS funds; from trade associations representing such firms; and from governmental and regulatory authorities responsible for fund authorization and supervision. Consumers and their representative bodies are welcome to contribute, although they may find it more convenient to respond to the questionnaire specifically directed at consumers (Ref. CESR/07-214).

Distribution channels

5. There are clearly many possible channels through which funds may be distributed, both within the fund's Home State and cross-border. It is probably not necessary for the purpose of this exercise to seek to identify them all or to quantify the precise breakdown of sales. What is

critical is the extent to which the UCITS provider is involved in the selling process. There appear to be three basic scenarios :

- the provider interacts directly with the investor (e.g. direct marketing, execution-only via own website);
- the sale is transacted by a company or agent in the same group as, or acting as a representative of, the provider (e.g. tied sales force, associated life assurance company, cross-border distribution agent); or
- the investor's relationship is with a third party which purchases the units on his behalf (e.g. execution-only broker, independent financial adviser, open/guided architecture arrangement).

6. In the first scenario, the provider has direct control over both the entire content of the information and the manner of its provision to investors at the point of sale. In the second scenario, the provider is not directly involved in the sales process, but is fully aware of the distribution charging structure and the sales procedure. The sale will be executed either through an agent of the provider, in which case the provider retains oversight of – and ultimate responsibility for – the sales process; or through an associate company, in which case compliance procedures at a group level should ensure the disclosure obligations are discharged.

7. The third scenario is distinct from the other two, however, in that the provider is dependent on others to ensure the necessary disclosures are made. The distributor may in addition make charges which are outside the control of the provider, and which it may not be practical or appropriate to disclose as part of the provider's information disclosure.

Call for evidence

8. In order to progress our work, we invite interested parties to respond with information on:
   - whether all types of current or projected distribution method fall within one of the three scenarios outlined above;
   - how the nature of the commercial relationship between the provider and the distributor affects the ability of the former to control what pre-sale / point-of-sale information the end-investor receives.

9. It would be helpful to receive statistical data showing the figures for sales of UCITS distinguishing between direct/tied sales (i.e. the first and second scenarios combined) and sales through third parties. This would help us to prepare an impact assessment of the likely cost for independent distributors to tailor the key investor information they receive from providers.

Packaging of UCITS funds

10. An investor who buys units directly from the UCITS provider will be registered as their holder and will from then on be a customer of the provider. However, it is likely that a relatively small proportion of investors hold their units in this way. There are many ways in which a UCITS can be "packaged" into a product or service, and those products and services may vary considerably in the degree of exposure they give to a particular UCITS fund. Some of the possible variations are described in the following paragraphs.

11. A UCITS "product" may, in its simplest form, be a wrapper that in some way enhances the benefits or mitigates the risks of investing in the fund. These types of product are essentially transparent; the investor knows he is buying units in a particular UCITS fund and that information about the charges, risks and performance of that fund is directly relevant to him. Other types of "packaging" may be less transparent. A fund of funds may hold several UCITS (from the same range or from other providers); their names will probably be disclosed in marketing material, and certainly in the reports and accounts, but the suitability of the fund of funds for the investor's needs is based primarily on its own benefits and risks, rather than those of the underlying funds it gives access to.

12. In some cases, the product that the investor buys may take a different form, such as a life assurance contract, in which the name of the UCITS itself is not even mentioned – it may simply be used as an "engine" to provide the investment performance to deliver a promised or anticipated return. The product proposition may mean the investment return that the investor actually receives will be in some way modified from what the UCITS delivers, so the risk profile and performance of the UCITS are not directly relevant to investors in the product. Likewise, the charging structure of the product may be entirely different to that of the fund it invests in.

13. Packaging in the form of a service includes both administration services and investment management services (some may offer a combination of both). Administration may be a simple as a regular savings plan, enabling investors to make monthly or periodic purchases of units on specific terms, or it may be something relatively complex such as a platform that allows the investor to consolidate multiple investments and receive aggregated information about them. Such services are, like tax-wrapper products, transparent in that their purpose is to enhance the benefits of the chosen fund, but there may be a charge for the provision of additional services.

14. Investment management services will typically involve the provision of an asset allocation service that either advises the client, or undertakes fund selection and portfolio rebalancing on a discretionary basis. In the latter case, the investor's objectives and appetite for risk will relate to the portfolio as a whole, and he may have little or no interest in the particular funds that comprise the portfolio, as long as they are achieving the desired results. In this respect the service is akin to a fund of funds. Again, there is likely to be a charge over and above that of the constituent funds.

15. In short, we cannot assume that producing one set of key investor information for a particular fund will equally meet the needs of all retail investors in that fund (even leaving aside the possibility of it being marketed in more than one Member State). We need to understand the diversity of situations that UCITS providers may encounter and how these may cause the key information to be modified.

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16. We invite interested parties to respond with information on:
    - the types of product and service that may be offered to investors;
    - the extent to which the essential features of the UCITS (risks, charges, performance) may be modified by the features of the product or service in which the UCITS is wrapped;
    - the types of additional information required for an investor in the product or service (and any information concerning the UCITS itself that is not necessary for them);
    - how information concerning the UCITS is made available to investors in situations where there is no current requirement to offer a simplified prospectus.

17. Any statistical information that provides an accurate breakdown of product and service types would be helpful. Although it may not be practical for any one UCITS provider to give a comprehensive breakdown of all the possible channels through which end-investors hold units, it may be possible for some indications to be given, e.g. how much of the fund is represented by "packaged" products/services offered by the provider, or other companies in the same financial group.

Fund structures

18. The operator of a UCITS may choose to structure the fund in ways that suit its distribution strategy, whether that involves selling directly, through associates or through independent channels. The use of unit/share classes gives considerable scope for flexibility in this regard. The UCITS provider may offer classes that give investors a choice based on individual preference (e.g. for income to be distributed or accumulated as capital) or based on their particular status

(e.g. ability as non-taxpayers to receive gross income). It may offer a class which is effectively closed to certain investors (e.g. one that is targeted at institutional investors by setting an extremely high minimum investment amount). Or it may be available only through a specific distribution channel (e.g. for sales via a platform) or in a specific market (e.g. denominated in the local currency).

19. It is reasonable to suppose the key investor information will need to reflect the extent to which retail investors in a particular market have a choice of classes. It would be unrealistic to require disclosure, to a particular group of investors, of full information about classes that are not available to them. However, some information would be necessary in situations where share classes of a fund bear differing liabilities (e.g. if hedging of a currency class could affect the returns of classes in the base currency).

20. A similar situation applies in an umbrella scheme, where some information is relevant to the umbrella as a whole and some to each individual sub-fund. Investors need to be aware of their rights to switch to other sub-funds, and of any risk inherent in the umbrella structure. But it may not be useful to give an investor full information about every sub-fund if he/she is only interested in one of them.

21. The use of a fund of funds may enable providers to structure product offerings. Although, as noted above, the fund of funds is normally seen as an investment proposition in its own right, rather than the mere packaging of another fund, it may be possible to use it strategically to facilitate or restrict access to a particular fund. For instance, a provider may choose not to market a certain fund (perhaps one with an economic or geographical specialisation) directly in a certain market or channel, but to make it available only through a fund of funds.

22. The Commission's proposal to modify the Directive to admit feeder fund – master fund structures will provide further opportunities for UCITS providers to adapt the way in which units may be purchased, but since this is currently only a proposal it is not relevant to a call for evidence based on existing practice.

Call for evidence

23. We invite responses with information on:
    - the types of unit / share class that are offered to investors, and whether these are restricted or unrestricted in their availability;
    - how unit / share classes and funds of funds may be used to structure distribution;
    - how investor information is modified in situations where multiple classes are available to investors.

24. Respondents may wish to provide statistical data to support their comments. This might include a breakdown of the proportion of funds held in particular types of class (e.g. retail institutional, domestic currency / other currencies).