Fully integrated market of funds

We are far from a fully integrated market:

- harmonized market is limited to Ucits
- marketing Ucits abroad is not easy
- even if it became easy, the market would not be integrated (50% of the market- perhaps more- consists of non Ucits)

What would be a fully integrated market?

- a market where fund managers could sell their funds easily everywhere
- a market where fund managers could set up funds everywhere in Europe, or merge them where they choose to do so
- A market where investors could buy a wide range of funds.

Such a market is beneficial for both parties (and for the distribution networks), and mainly for the retail investors:

- wider choice
- benefit from industrial advantages of higher size.

What are the main impediments:

- we can advocate for technical improvements to facilitate registration of Ucits (and we do); or advocate to get rid of the registration process of funds in the host country (ad we do), or advocate to monitor tax discrimination (and we do), or to allow master – feeders (and we do so, but it requires a modification of the Ucits Directive…)

- but we still will stick to the kind of problems faced with Ucits as they are today: a fully integrated market of funds needs further steps, which involve regulation framework and regulatory practice.

<u>The need for modifying the Regulatory framework to permit a real integration of the fund market.</u>

The European regulatory framework puts the emphasis on the product. It was probably the best approach in the 80s.

But we will quickly experience its limits and we are by now experiencing some of them:

A) financial innovation is going faster than the regulation: consequently, the Ucits directive will be forever challenged; modifying the Ucits Directive has proven to be a very long process (Ucits 2 has aborted, Ucits 3 has been discussed for nearly six years and is not entirely implemented); cross-boarder business of new products or even of slightly different products will be thwarted if we stick to the present regulatory framework; and, of course, cross boarder business of funds is yet impossible, or very difficult for non Ucits.

B) Non Ucits are increasing everywhere in Europe: hedge funds, funds of hedge funds, private equity, real estate. Different and inconsistent regimes are put in place.

<u>What we observe is not integration, but increasing fragmentation of the market.</u>

C) We are far away from being authorised to manage funds in other countries:

. Under Ucits dir., authorised management companies are not automatically authorised to receive delegations from other authorised M.C.: Member States MAY permit delegation; they can refuse them.

. Ucits dir. allows only management companies to manage funds in the member state where the M.C is established. We know perfectly that in some countries, it is very difficult to sell foreign funds. The only way to significantly sell funds is to set up them under the local law, which means set up as well a M.C. (long, costly, uncertain profitability…)

Why is it outstanding on both issues?

It is clearly because funds are sensitive products, that investor protection is at stake, and that, being in charge of investor protection, most regulators need more comfort on several key issues which are only covered in broad terms by the directives:

. how management companies are organised?

. what are the applicable rules of conduct?

Establishing the provisions for each issue is by now up to the different member states. As a consequence, across the European Union, the regulations are very different strongly, and it is a very commonly heard remark that there is no real level playing field in Europe. This is uncomfortable for investors, for fund managers and for regulators.

Examples:

1) to be authorized as a management company, it is necessary in some countries to fulfil a very detailed application form; in others, a lighter one.

In some cases, a comprehensive description of the investment process, fund administration, staff, means , risk management organization is needed.

In other cases, sometimes the same, emphasis is placed on the compliance and audit functions etc…

In some countries, very detailed rules have been edicted to cover specific points (who may be member or the board, description of tasks of any employee…) which are not examined at all elsewhere

2) the rules of conduct differ strongly : just have a look to the different websites of national authorities and industry bodies to be aware of these differences.

As long as we have not within the directives or their implementation measures drawn by Cesr a common understanding of what must be a management company, and what should be the applicable Rules of conduct, we can be sure that it will still be impossible to benefit from a real passport. And the fully integrated market of funds will remain a purpose, not reality.

<u>We need to put emphasis now on the provider much more than the Ucits product.</u>

<u>AND We need to consider funds which are not Ucits.</u>

Fragmentation is going on, very quickly: new types of investment funds have appeared, and they are not only bought by sophisticated investors.

Different legislations have been put in place within as well major and smaller countries to face this demand and try to protect investors.

By now, the market is becoming a patchwork: it remains impossible –or very difficult and costly- to sell foreign funds such as private equity, hedge funds, real estate funds, where this kind of funds are available when of domestic origin.

Again, there is no level playing field, and national markets are generally protected by regulations.

It would be necessary to consider how to harmonize these funds, or, at least, to set up a common regime for private placement: starting from the idea that investors'protection has not the same meaning for retail or qualified investors, harmonizing the private placement would be helpful.

To conclude, if we want to achieve a fully integrated market, big changes are needed within our regulatory environment; convergence such as what Cesr is aiming at obviously good news, useful, but it is only a first step.
The next one would be to make progress on what I should call the functional approach of investment management, switching our efforts from the product to the provider.