

**Commissioner Charlie McCreevy's keynote
speech at
Scottish Financial Enterprise (SFE) Industry
Lunch**

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Current Issues in financial services: Investment Fund Policy

Ladies and Gentlemen,

It is a great pleasure for me to be in Edinburgh, particularly as Scotland is one of Europe's leading financial services centres.

These are great times to be involved with financial markets. Global capitalism is driving economic growth across the world. To achieve this, it requires liquid, dynamic and borderless capital markets.

European financial integration is only one part of in this big picture. But it is an encouraging story. European financial companies and markets are doing well. Prospects for growth are good. Increasingly, EU standards and regulation are seen as leading the way in the global economy.

Don't get me wrong. I am not claiming that European financial services legislation is solely or principally responsible for the spectacular development of European financial markets over the past decade. However, the process of EU financial integration has

enabled competition and facilitated structural change. It has helped many European financial centres to position themselves as major players in the European and global financial systems. Besides, the single EU capital market has given a focus; a locus; a political direction.

I am not claiming either that EU financial legislation is perfect. Or that the path to its adoption has always been smooth. Nor do I wish to downplay the scale of the implementation and compliance challenge. But I do believe that we have moved forward. We are well on the way to building a dynamic, highly integrated and sophisticated European financial system. Able to hold its own against all comers.

The time for grand designs is now over. The broad framework is in place. It is time to concentrate on ensuring that this framework delivers on its promise. That means implementing our rules, ensuring coherent application and constant evaluation. I would like to devote the rest of my statement to discussing how we are going to do this in one particular area – the field of investment funds where the Commission has just adopted a White Paper. It is absolutely appropriate that I do so at this event, given Scotland's reputation as a major centre of asset management expertise.

The Asset Management industry in the EU

Investment funds are an important pillar of the European financial system. This business has grown four-fold over the last decade. Its importance is set to grow as many European investors use them as one means to save for a prosperous retirement. They have also become a key investment tool for institutional investors such as pension funds.

The UCITS Directive has provided the focal point for the development of a vibrant European fund industry. It has provided a common regulatory concept and a single market passport. The market is increasingly organised on a pan-European basis. The UCITS model is considered as a 'gold-standard' inside but also outside the EU. With €5500 billion euro under management, the UCITS standard represents 75% of the investment funds market in Europe.

A sound and efficient regulatory environment is a precondition for the continued successful development of the market. However, the current legislative framework no longer allows the fund industry to adapt effectively to structural change. The sub-optimal functioning of existing provisions and a lack of flexibility in the Directive give rise to unnecessarily high compliance costs. This translates into missed business and investment opportunities for industry and investors.

So, what do we intend to do to help the fund industry to rise to these challenges? At European level, we must look critically at the functioning of our legislative framework. And make sensible and targeted improvements where necessary.

The Investment Fund White Paper

Last week, the Commission adopted a "White Paper on enhancing the Single Market Framework for Investment Funds".

The White Paper sets out a programme of reforms to UCITS legislation that should be set in motion without delay. These reforms have two aims: to improve economic efficiency of the fund business and strengthen investor protection and transparency.

The centre-piece of the White Paper is a package of targeted amendments to complete the existing Directive in a number of specific areas. It is an open secret that I do not have much faith in the ability of regulation to solve market problems. I am always concerned that well-intentioned EU legislative proposals can be denatured or diluted: so the cure becomes worse than the disease. However, in the present case, I believe that legislative action *is* needed to strengthen the existing framework. Effective single market rules can open new doors for this important industry. This is the clear conclusion from our dialogue with market participants and other stake-holders over the past year and a half.

Legislative amendments are needed to repeal value-destroying administrative burdens and requirements. To expand the possibilities for fund managers to take full advantage of the benefits of a continent-wide fund market. To improve the way in which the costs, risks and likely rewards of investing in a particular fund are disclosed to investors.

Target areas

We have targeted six areas:

(1) We will simplify procedures for pass-porting UCITS funds. The current notification procedure is slow. Costly. Open to bureaucratic abuse. It is time to replace it by information exchange between regulators.

(2) *Cross-border fund mergers*. In the absence of clear enabling provisions, cross-border fund mergers are complex, time consuming and expensive – if at all possible. Last year, 800 fund mergers took place in the EU. Of these only 28 were of a cross-border nature. We

will seek to create the appropriate legal and regulatory conditions for mergers. To ensure that the interests of investors in the funds concerned are adequately protected. A common EU-wide framework will allow fund domiciles to compete on equal terms to attract merged funds.

(3) The Commission will pave the way for master-feeder funds and other forms of entity-pooling. This means changing the diversification rules and other provisions of the Directive. We will look further at recognising virtual pooling. However, we need to know more about these techniques. Has virtual pooling found its way from the drawing board into commercial practice?

(4) An effective *management company passport*. Currently, management groups need to establish a fully functional management company in each fund domicile – adding cost and fragmenting management expertise. We will propose amendments to the Directive to allow managers to manage corporate and contractual funds in other Member States. We recognise that there are still open questions about the scope of the management company passport. About the conditions needed to ensure effective supervision of such structures. About the tax-efficiency of such structures.

(5) The *Simplified Prospectus* will be reconfigured and simplified. It was meant to provide investors and intermediaries with concise and understandable information about the risks, associated charges, and expected outcomes. However, it has been sabotaged by national gold-plating and divergent implementation. We will try to salvage it. Through better specification of the rationale and core principles of the Simplified Prospectus. By foreseeing detailed implementing legislation to give uniform concrete expression to these principles.

(6) *Strengthening Supervisory cooperation*: New freedoms for fund industry should not come at the expense of effective fund supervision and oversight. We will strengthen provisions for supervisory cooperation and ensure effective supervision of cross-border operations and fund structures.

Non-legislative measures

Alongside these adjustments, the White Paper foresees a number of complementary non-legislative measures. Following careful study, we believe that non-legislative action should be sufficient to limit any possible tax barriers to cross-border fund mergers. And so avoid the perils and pitfalls of tax harmonisation.

We also look at ways to tackle bottlenecks in fund distribution by building on existing legislation – rather than proposing new measures. We believe that the measures are already in place to ensure the quality and independence of investment advice and fund distribution. In the form of MiFID rules on inducements, conduct of business and disclosure of costs. The Commission will ensure that they are effectively implemented. That fund distributors put the interest of the end-investor first. We will publish a vade-mecum on the application of relevant provisions of MiFID to collective investments next summer.

The White Paper also explains what we will not do – possibly a first in terms of Brussels policy-making. It rules out legislative action in a number of areas where we find no compelling cost-benefit case. Thus we will not harmonise the process for initial authorisation by the home State authority. We will not impose centralised solution for fund order-processing. We will not create a depositary passport.

Looking beyond the current framework

The challenge does not stop there. We are faced with questions about the scope and approach of the EU fund market framework.

The non-harmonised segments of the fund industry have also grown spectacularly – particularly alternative investments, hedge funds, fund of funds, real estates funds. Some of these asset classes are becoming mainstream investments – available to a wide investor base. This leads some stakeholders to call for a fundamental revision of the scope and architecture of the UCITS Directive. However, our impact assessment reveals insufficient grounds to undertake such fundamental reform at this stage. The 'silver bullet' solution – the all singing/all-dancing risk-based asset management Directive – is over-sold. The risks are vastly under-estimated.

However, we do not dismiss the issues out of hand. Constant innovation in investment techniques and products means that we will continue to face hard questions about the scope and design of the European fund framework. But instead of leaping to hasty conclusions, we will examine these issues very carefully, in order to allow a more informed policy debate as these new products and asset classes mature.

Conclusions

The White Paper marks the transition from policy preparation to execution. The Commission will be pulling out all the stops to deliver this agenda. We recognise that the time-frames are long: the Brussels process moves at glacial speed. In the meantime, markets will move on. Nevertheless, without action on our side, the current legislative framework will continue to hamper industry efforts to remain globally competitive. We will press on with the preparation of legislative amendments and related work. This will be done in an open way. So that industry, Member States and all stakeholders have an opportunity to comment on our evolving proposals.

The watch-words here are simplification and liberalisation. The acid test of what we are doing is whether it creates real opportunities for the fund industry. We want you to hold us to account on that score. However, we must also ensure that these policy adjustments deliver real benefit to investors. Our efforts will be wasted if they do not deliver high-performing investment opportunities on competitive terms for end-investors.

A sound and efficient regulatory environment is a precondition for the continued successful development of European investment fund markets. That applies also to the EU financial industry as a whole. The approach taken in asset management is a good example for the overall regulatory approach of the Commission. Full consultation, proper impact assessments - and regulatory intervention only where clear benefits are ensured for European industry and consumers.

Thank you very much for your attention!

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