fefsi

Annual Report | 2001 - 2002

INVESTMENT FUNDS PHILOSOPHY

Equal opportunities for everybody
in all investment markets

FEFSI'S MISSION

To maintain a high level of investor protection and encourage investor confidence

■

To preserve the integrity of the European investment funds industry

■

To promote the highest ethical standards in all areas of the fund business

■

To be the competent and representative business partner of regulators, other associations, the press and the public in and outside Europe

Annual Report 2001 - 2002

CONTENTS

PRESIDENT'S STATEMENT

GROWTH IN INVESTMENT FUNDS DESPITE DIFFICULT STOCK MARKETS

Ever since March 2000 stock markets worldwide have been more or less constantly weak and characterized by very high volatility. Naturally these circumstances have had a negative effect on investors' confidence in equity funds and on net inflows to equity funds. But investment funds do not only consist of equity funds and investors have instead turned their interests to money market funds and bond funds to such an extent that total assets under management in the European investment funds industry unexpectedly increased during the year 2001 despite the falling stock markets.

Naturally, gloomy markets affect the investors – and the industry - in many ways. With positive markets and good performance in the funds it is much easier to keep investors satisfied. With decreasing worth of the portfolios, investors tend to increase their focus on costs and require more financial advice and general assistance. Thus, the industry has had to face falling margins due to the shift from equity funds to fixed income funds while at the same time more efforts have had to be made to live up to expectations in order to retain the customers.

FEFSI TAKING THE INITIATIVE

Against the demanding background of difficult markets and increasing competition FEFSI has been more active than in earlier years and initiated several issues in order to support the European investment funds industry in the development towards a single financial market. Among the most important issues are the following:

A report on **discriminatory tax barriers** in the European investment funds market was published in June 2001. The report, which was carried out by PriceWaterhouseCoopers in collaboration with FEFSI, shows that discriminating tax measures against foreign investment funds exist in several EU Member States. The report was followed up by individual letters from FEFSI to national authorities in the countries in question urging them to moderate existing practices or regulation.
A study on **cross-border marketing** constraints for investment funds within Europe was published in January 2002. The study, which was carried out in collaboration with PriceWaterhouseCoopers, is based on feedback from practitioners' experience and clearly shows that regulatory and administrative practices of EU Member States´ Supervisors are constraining the development of a single market for investment funds. A review of the requirements imposed is definitely needed.
In order to maintain a high level of investor protection and preserve the integrity of the European investment funds industry FEFSI has worked upon – and will continue to – **establishing professional standards and guidelines**. The recommendations should contribute to the harmonisation of the business behaviour of the various European investment managers. They reflect demanding standards that are essential for companies operating in the European fund business, which should be characterised by the highest quality in terms of integrity and transparency. The best practice recommendations issued during the last year dealt with *Investment Fund Managers as Shareholders, Investment Policy Principles, Principles for Business Transactions and The Disclosure of a Total Expense Ratio.*
The development of the **web site fefsi.org** (launched in April 2001) towards an Investment Funds Knowledge Centre. The aim of the website is twofold: to improve public understanding of the investment funds industry and policy issues that affect it, and to provide - in an ongoing interactive process – basic information about the European investment funds industry. Moreover, an intranet level has been designed to exclusively support FEFSI's member associations and their members.

PRESIDENT'S STATEMENT

A NEW UCITS DIRECTIVE PUT INTO PLACE

Providing professional input to the work on, and contents of, all the EU directives affecting the investment funds industry has been – and will continue to be – one of FEFSI's principal tasks. Of course, the most important directive of them all, the UCITS Directive, has been the main focus of our attention for a very long time.

It was therefore an important step forward when the new UCITS Directive after over a decade of struggling finally went into force in February 2002. I dare to say that FEFSI's collaboration and creative ideas on how to solve outstanding issues played an important role in the final stages of adoption. The role in the fast expansion of the European investment funds industry played by the old UCITS Directive cannot be underestimated and new opportunities for growth will be in place with the new Directive. Having said this, the new Directive leaves a lot of questions to be solved – clearly listed in the accompanying review clause. Here FEFSI's experience and role as the common voice of the whole European investment funds industry will provide a necessary and important contribution to the work that has to be undertaken.

FEFSI – GOING FORWARD

My terms of office as President will end by June 2002. I can look back with satisfaction on a prosperous cooperation with the Board of Directors together with the secretariat of FEFSI. Many of my ambitions presented at the Annual General Meeting in Oslo two years ago and in Berlin last year have been achieved. But of course there is more to do. The development of the financial world is extremely fast and FEFSI has to face the new challenges of the European investment funds industry and keep up with the changes.

I feel confident that FEFSI will be able to live up to expectations and fulfil the important task of supporting and strengthening the European investment fund industry going forward.

Kajsa Lindståhl
President

REPORT OF THE SECRETARY GENERAL

Amongst the many issues FEFSI dealt with in 2001 and the first half of 2002, integrity of the industry, its public web site, the new UCITS Directive, cross-border distribution of funds, the Pensions Directive and taxation may be singled out as its top priorities.

1. INTEGRITY OF THE INDUSTRY

Fund assets measured in relation to GDP in the European Union increased from 25% in 1996 to 51% in 2001 as a result of the remarkable development of the European investment funds industry during the nineties, together with a fundamental change in its structure. This change is illustrated, for instance, by a growth of the proportion in equity funds from 18% in 1991 to 45% in early 2001. In a little less than ten years, investment funds have gone from strength to strength, developing from a niche product into one of the most favoured and popular savings products in Europe. Thus the task of setting industry standards has become essential in order to preserve the integrity of the industry and maintain the existing high level of investor protection.

As a leading sector in the field of financial services, the European investment funds industry has a great deal at stake in terms of responsibility. FEFSI Directors agreed that FEFSI must be seen as a driving force in financial services, rather than simply yielding to market pressures or reacting to initiatives by supervisory authorities. A broader exercise was undertaken with a view to recommending principles and defining certain standards of practice within the industry. The exercise took account of three main questions, ie *investment fund managers as shareholders, investment policy principles, and principles for business transactions (including affiliated transactions)*. (For more information, please turn to the full standards at the end of this report.) The question on how to handle performance figures had already been dealt with by FEFSI two years ago.

The agreed recommended principles reflect FEFSI's understanding of proper business behaviour for investment fund managers in Europe and are *Best Practice Recommendations* on how to handle them. They are based on internationally accepted rules, whilst leaving room for the individual background of the various countries, be they large or small. The broad principles for a definition of the total expense ratio (TER) was also agreed in order to inform investors accurately of all costs involved and to offer them a true cross-border basis for comparability. It was agreed that FEFSI should recommend that this be disclosed in the annual and semi-annual reports, and in the Simplified Prospectus.

2. FEFSI's WEB SITE

April 2001 saw the opening of FEFSI's public web site www.fefsi.org set up with the expertise of its partners, Andersen and Standard & Poor's.

FEFSI's *Investment Funds Knowledge Centre* provides a wealth of information on:

- Members and activities;
- State of the industry in Europe and FEFSI member countries;
- Investment funds and information to investors prior to purchasing fund units;
- Pan-European regulation with direct or indirect relation to the industry;

– FEFSI's *Best Practice Recommendations;*
– FEFSI opinions and views on major issues;
– Views of the European Commission ('Commission'), European Parliament ('EP'), Council of the European Union ('Council') and other European institutions on issues relating to the industry;
– Investment funds industry worldwide.

After only 12 months of existence, FEFSI's web site has established itself as a reliable tool for tracking all important developments affecting the European investment funds industry.

3. NEW UCITS DIRECTIVE

Ten years of discussions were finally concluded in February 2002 when the proposals for modernising Directive 85/611/EEC, the Directive governing the European investment funds industry, were formally adopted and published. The next two important phases now will be the implementation and the review of the new UCITS Directive.

After the Council of Ministers of Finance (ECOFIN) on 5 June 2001 reached a Common Position on two amending proposals[1], the decision-making procedure made swift progress:

– the EP adopted the Common Position on 23 October 2001 with only three amendments, later endorsed by ECOFIN on 4 December;
– The new text was signed on 21 January 2002, published and entered into force on 13 February 2002[2].

The new Directive contains several significant changes (detailed information may be found at www.fefsi.org), such as:

– *Wider investment opportunities*: subject to certain conditions, it will be allowed to invest in money market instruments, units of investment funds, deposits with credit institutions, financial derivative instruments (including OTC derivatives), and the investment limits are amended for index (tracking) funds;
– *More complex risk-spreading rules*: application of the existing 5-10-40% rule to money market instruments, introduction of limits to cumulative investments in transferable securities, money market instruments, bank deposits and exposure arising from OTC-derivative transactions, and consideration of companies part of the same group as a single body (the 'group concept');
– *Wider scope of activities*: in addition to fund management, management companies will be allowed to manage portfolios on behalf of private and institutional investors, including pension funds. As non-core activities, they can offer advisory services as well as custody and administration of units of funds, including third-party funds;
– *A second new passport*: the management company will be able to carry on within another Member State the activity for which it has been authorised. This, however, does not include fund management as Article 3 continues to stipulate that 'a UCITS shall be deemed to be situated in the Member State in which the management company has its registered office';
– *Investor protection strengthened*: the introduction of a Simplified Prospectus will contain clear, concise and essential information:

[1] COM(2000) 329 relating to the UCITS product
COM(2000) 331 relating to the management company and the Simplified Prospectus
[2] Official Journal L41 including Directive 2001/108/EC (the 'product directive') and Directive 2001/107/EC (the passport for the management company and the Simplified Prospectus)

- *Brief presentation of the basic data on the UCITS* including Member State of incorporation, the identities of the management company, the depositary, the auditor and the 'promoter';
- *Investment information* including presentation of investment objectives, investment policy, the fund's risk profile, historical performance and disclaimer, and the profile of the fund's corresponding typical investor;
- *Economic information* including tax regime, entry and exit commissions, other fees and expenses;
- *Commercial information* such as how to buy and sell the units, how to switch from one compartment to another, when and how dividends are distributed,..;
- *Miscellaneous information* such as who the competent authority is, where the full prospectus and other annual or half-yearly reports may be obtained,... ;

– *Facilitating cross-border distribution of UCITS*: the fully harmonised character of the Simplified Prospectus means that the host country's competent authority can no longer demand new or additional documents or information.

Following a proposal put forward by the EP in its Second Reading, two further clauses were introduced into the new Directive:

– A *'grandfathering'* clause granting existing UCITS five years from the date of entry into force of the Directive to adapt their investment policy if it is out of line with the new requirements;

– A *review clause* calling upon the Commission to review within three years from the entry into force of the Directive a range of issues, which from the point of view of the EP (and strongly supported by FEFSI), require further consideration, ie:

- Cross-border marketing of UCITS;
- Structure and size of the market for all types of investment funds (including institutional funds, real-estate funds, 'guaranteed funds', etc.);
- Use of derivatives;
- Functioning of the passport for the management company.

Implications of the entry into force of the new Directive:

– Member States must implement the new Directive into their national legislation at the latest by 13 August 2003;

– New provisions must be applied in all Member States no later than 13 February 2004;

– Existing UCITS are granted five years, ie until 13 February 2007, to adapt their investment policies to the new rules;

– Existing management companies also are granted five years in which to adapt their own capital to the new requirements, where this was not yet the case.

Indirectly, the European investment funds industry is concerned by two other provisions contained in the new Directive:

– No later than 13 February 2005 the Commission is to present a report to the EP and the Council on the application of the new capital requirements accompanied, where appropriate, by proposals for their revision;

– No later than 13 February 2005 the Commission is to forward to the EP and the Council the above-mentioned comprehensive report on the application of the new Directive and proposals for amendment, where appropriate.

FEFSI welcomes the new Directive as a step forward towards a more unified European market for investment funds. It deplores, however, that the Directive falls short of establishing a real single market for UCITS. FEFSI strongly recommends that the following steps should be undertaken after the present modifications have been transposed into national law:

– Common interpretation of the UCITS Directive and harmonised supervisory practices;
– Coherent fiscal policy and abolition of tax discrimination;
– Abolition of administrative constraints with respect to cross-border distribution;
– Introduction of a passport for managers of funds allowing real cross-border management of UCITS.

4. CROSS-BORDER DISTRIBUTION OF UCITS

The Commission's Communication on e-Commerce and the new Directive on Distance Marketing of Financial Services have not solved the many problems linked to the cross-border distribution of funds and much remains to be done to achieve a single market for investment funds. Furthermore, a study released in January 2002 by FEFSI and PricewaterhouseCoopers documented many of the constraints placed on the cross-border marketing and registration of UCITS which result from regulatory problems and disparate administrative practices.

FEFSI is committed to giving its full support to the Commission in the realisation of a unified European market for investment funds. The introduction of the Simplified Prospectus in the new Directive is a promising step in that direction as it is designed to provide a fully harmonised set of information for the industry.

There are two further steps which potentially affect cross border distribution of funds but whether the impact is positive or not remains to be seen:

– Adoption of the *e-Commerce Directive* in June 2000[3] which sets out common rules to ensure the development of information society services without internal frontiers throughout the EU, based on the country-of-origin principle but where there is an exclusion for UCITS which, despite attempts by FEFSI to achieve clarification of what was intended, remains difficult to interpret and is likely to undermine the country-of-origin approach;
– Adoption of the *Common Position* in December 2001 on the Commission's Proposal for a Directive on Distance Marketing of Financial Services[4] to introduce standards for pre-contractual information where FEFSI has spent some time seeking to clarify its relationship with other information requirements in other directives.

The ideal world for the distribution of UCITS would:

– Dispense with the registration in the host country;
– Provide fully harmonised sets of information;
– Set out fully harmonised advertising and marketing rules;
– Maintain the current high level of investor protection;
– Be free of unnecessary administrative constraints and tax discrimination.

Given the standardised and regulated nature of the product it seems that much more rationalisation of the distribution process should be possible but unfortunately, cross-border distribution of UCITS remains subject to a complex regulatory framework, in particular with respect to electronic distribution, involving the following pieces of legislation:

– UCITS Directive;
– Distance Marketing of Financial Services;
– 1980 Convention of Rome;
– Council Regulation on Jurisdiction [44/201/ of December 2000][5];
– e-Commerce Directive;
– IOSCO Recommendations on Securities Activity on the Internet.

[3] Directive 2000/31/EC
[4] Commission's Amended Proposal [COM(1999) 0385], dated July 1999
[5] Transforming the Brussels Convention of 1968 in directly applicable EU law

The legal uncertainty that ensues from the incoherent interaction of these measures does little towards promoting any smooth cross-border distribution of funds. Also, regulatory and administrative practices of EU Member States' supervisors are significantly constraining the development of a single market in investment funds *(see FEFSI/Pricewaterhouse Coopers study on 'Cross-Border Market Constraints')*. A little effort on the part of the Commission to rationalise existing directive requirements and national supervisors to iron out some of the administrative differences would go a long way towards achieving increased efficiency.

5. DIRECTIVE ON THE ACTIVITIES OF INSTITUTIONS FOR OCCUPATIONAL RETIREMENT PROVISION

Despite the favourable vote of the EP in July 2001, no further significant progress was made at European Council level in regard to the Commission's proposal for a Directive.

The EP in its First Reading on 4 July 2001 adopted with a broad majority the Position on the Commission's proposal for a *Directive on the Activities of Institutions for Occupational Retirement Provision* (IORP). It strongly supported and further strengthened the 'prudent person' principle. It also adopted a number of amendments designed to strengthen the security of occupational pensions without imposing, however, mandatory coverage of biometric risks. Finally, regarding the scope of the directive, the Parliament supported FEFSI's view that the Directive should apply to all nationally regulated and supervised institutions offering funded occupational pension schemes, including those based on investment funds, and that all institutions operating under the second pillar should benefit from equal conditions of competition.

Most of the amendments, however, were rejected by the Commission on the grounds that they aimed at widening the objective of the Directive. This implies that a conflict with the EP is foreseeable in the Second Reading.

Independent of the position of the EP, no progress was achieved at Council level in 2001, despite the efforts of the Swedish Presidency during the first half of the year.
The main stumbling blocks are:

- Coverage of non-funded schemes, including book-reserves;
- Rules concerning technical provisions;
- Investment rules and the prudent person principle.

All hopes of any progress now rest with the Spanish Presidency, which appears keen to press on with a number of issues. On investment rules the intention of the Presidency seems to have worked out a compromise based on a 'prudent person plus' approach, ie a mixed approach based on qualitative rules and a concrete selection of a minimum set of quantitative and non-discriminatory rules.
In a meeting with the Spanish Presidency in late January 2002, FEFSI underlined the importance of the Directive for the completion of the single market for financial services and stressed the fact that the Commission's proposal offers a satisfactory solution on investment rules. However, breaching the gap between those defending the 'pure' prudent person principle and those in favour of the application of some basic rules appears to be very difficult.

6. TAXATION

FEFSI has set itself to tackle the issue of taxation on two fronts:

- the first relates to the political implications of tax discrimination across the EU, which were highlighted in a study FEFSI published together with PricewaterhouseCoopers in June 2001;

– the second is the proposed Directive on Taxation of Savings in relation to which FEFSI continues to mark its opposition to investment funds being treated less favourably than other savings products. More recently, it has spoken out against new rules that are particularly burdensome for 'funds-of-funds'.

Tax discrimination in most EU Member States is a major obstacle in the way of the realisation of the single market for investment funds. This was demonstrated in the PricewaterhouseCoopers/FEFSI study, the findings of which were viewed with concern by the Commission. The study has subsequently served as a basis for approaching the concerned Member States where discriminatory measures have been observed.

Another major cause for concern is the Directive on Taxation of Non-Residents' Savings Income over which Europe's Ministers for Finance reached a Common Position in December 2001[6]. FEFSI has strongly opposed the proposal for a long time for at least three reasons:

– It fails to cover all financial products, thereby discriminating against investment funds, and undermining any idea of a level playing field in the European market for financial services;
– It will incur significant costs to be paid by all investors for very little return on taxation of a disproportionately small number of non-resident investors;
– It represents a total absence of any European policy on savings and related taxation.

Opposition became stronger still when in December 2001, and against repeated warnings from the industry, Ministers for Finance saw fit to apply the so-called 'look-through' method to seize portions of interest payments in complex structures like funds-of-funds. Whilst the thresholds applied to determine whether an investment fund's income falls under the scope of the directive are normally dictated by the fund's investment policy or rules, fund managers will be obliged to define all income categories at sub-fund level in the case of funds-of-funds. This creates serious problems, in particular when a fund does not invest in other 'in-house' funds, but in third party funds. The application of this method means that fund managers will have to define the nature of the income (ie interest, dividends or capital gains) of each sub-fund. In addition, a fund-of-funds management company must be in a position to provide the paying agent with the necessary information on the fund-of-fund's income on a daily basis given that investors will redeem or repurchase on a daily basis and will require the relevant tax information. Clearly, this constitutes a discrimination against funds-of-funds and stands inexplicably in contradiction to the newly adopted UCITS Directive, which expressly avoids the introduction of a so-called 'look-through' method when determining the aggregate investment limits in single securities for the simple reason that this would have been too complicated, not to say impossible, to implement. It would seem, however, that political momentum is propelling the measure inexorably forward, against all better judgement.

7. OTHER ISSUES OF INTEREST

Capital Requirements and Operational Risk

The question of capital requirements and operational risk was raised by the fund industry in the wake of three important developments:

– The new UCITS Directive introduced rules on capital requirements for management companies of UCITS, which refer to Annex IV of the Capital Adequacy Directive[7], the Directive that deals with capital requirements for firms covered by the Investment Services Directive. The Directive also includes a clause to review the requirements in three years time;
– The Basel Committee on Banking Supervision in September 2001 issued a 'Working Paper on Regulatory Treatment of Operational Risk'[8]. As asset/fund management clearly is a business line in banking activities, the considerations of the Committee would indirectly affect all management companies existing within a banking group;

[6] Proposal for a Council Directive on taxation of savings income in the form of interest payments [COM(2001)400 of 18 July 2001]

[7] Directive 93/6/EEC of 15 March 1993

[8] ie the follow-up to a Consultative Paper of January 2001

– Finally, the Commission is of the view that credit institutions and investment firms[9] should be subject to a capital requirement for operational risk. Activities such as collective asset management, unit trusts, investment funds and pension funds carried out by subsidiaries of credit institutions should be subject to a capital requirement at group level[10].

Subsequently, FEFSI commissioned a research team of the University of Toulouse to carry out a study on operational risk in the investment fund business. The study is to analyse the following questions:

– What are the risks involved in the management of investment funds?
– How can they be measured and how important are they in terms of investor protection?
– What can be done to avoid them?
– How can they be covered?
– How should investment funds be regulated as far as capital requirements are concerned?

It is expected that the study will be completed in 2002 and provide FEFSI with better arguments with which to participate in the ongoing discussion on capital requirements for investment funds.

The Simplified Decision-Making 'Lamfalussy' Procedure

After what proved to be long and difficult discussions, the EP, as the last of the three Community institutions, approved in February 2002 the new rule-making process, based on the 'Lamfalussy Report'.

This new process is designed to speed up *securities markets legislation* by giving greater prominence to a process called 'comitology' in reference to a delegated capacity to set rules at committee level (as opposed to institutional level). This means that the European legislators will concentrate on the core political principles, the *'essential elements'* of each directive or regulation. In other words, the Council and EP acting on a proposal from the Commission would on the institutional level only agree to the key political direction and orientation for each subject and on the nature and extent of the implementing measures to be decided at the committee level.

At this committee level, the Commission, the newly created European Securities Committee and a network of national regulators (CESR) define, propose and decide on the implementing details of the framework directives (or regulations). The European Securities Committee (=Member States' high-level officials, eg secretaries of state) will have broad decision-making powers and will decide by qualified majority. The Committee of European Securities Regulators (ie CESR) will largely prepare its decisions and advise the Securities Committee on technical implementing measures. CESR will continue to have a decentralised structure and will be chaired by the relevant Commissioner, although it is meant to work independently from the Commission. A market practitioners' panel to advise CESR is currently being assembled through the national competent authorities, but on a personal basis and in function of expertise on respective subject matters.

This procedure does not apply to financial services, which are still subject to the 'traditional procedure'. This is particularly the case for UCITS. The *new UCITS Directive* is pre-Lamfalussy but not pre-comitology legislation, as discussions about comitology started long before the so-called 'Committee of Wise Men' was set up.[11] This is the reason why the new UCITS Directive includes new regulatory powers for the UCITS Contact Committee, namely the clarification of definitions in order to ensure uniform application of the Directive, and alignment of terminology and framing of definitions. Obviously, this process is not as far-reaching as Lamfalussy's, but no doubt it will be helpful in avoiding different interpretations of the new UCITS Directive.

[9] Firms covered by the Investment Services Directive 93/22/EC (ISD) of 10 May 1993
[10] Consultative Document of 5 February 2001 [Markt/1000/01]
[11] Discussions were concluded in 1999 with Council Directive 1999/468/EC, on which the new powers of the UCITS Contact Committee as Regulatory Committee are based (see new Article 53a)

Meeting the United States SEC

Besides presenting new developments relating to the UCITS Directive, FEFSI representatives and SEC officials held useful talks on the opening of markets, their experiences with the Profile/Simplified (full) Prospectus and information through yearly and half-yearly reports and the transparency of fees.

Meeting the ICI's International Committee

Continuing a long-standing tradition, FEFSI members held a meeting with members of the ICI's International Committee to discuss various topics of mutual interest, such as investment fund industry developments in the United States and Europe, capital requirements and insurance for the operational risk of investment funds, transparency of fees and pensions-related issues.

GATS and International Market Access

A new round table of global trade talks was launched at the 4th Ministerial Conference of Doha (Qatar) in November 2001. The agreement of all 145 WTO member governments (including China) to engage in a new round of negotiations on a wide-ranging agenda is important for the European investment funds industry as the work will now be towards a conclusion of negotiations against a firm deadline (end 2004). FEFSI has maintained the existing dialogue with the relevant services of the Commission on defining market access problems in specific third country financial services markets as well as supporting the pressure for more transparent regulatory disciplines in the financial services markets of WTO members.

The 7th FEFSI General Membership Meeting

FEFSI's Annual Conference took place in September 2001 in Brussels and had as central theme fund rating and its importance in distribution. Other sessions were devoted to EU-related affairs, such as UCITS, the Lamfalussy process and taxation, bringing together MEPs and officials from the Council and the Commission. A special keynote address was delivered at the Gala Dinner by Christian Strenger (DWS) who presented his 'Thoughts for the Future in Testing Times'. Mr Strenger spoke of the importance of:

– Being a frontrunner in proper behaviour as an example for all market practitioners;
– Management and operations not impaired by overdone cost saving efforts in leaner times;
– Managers setting high governance standards for themselves and not only for others;
– Affiliated transactions being fully transparent, but not forbidden; and of
– Fees being reasonable in the eyes of the customer, not the owner.

The 15th International Investment Funds Conference

The 2001 Conference was hosted by the Argentine Mutual Funds Association and took place in Buenos Aires. It was attended by representatives from 28 countries, with first-time delegates from Slovakia and Turkey. The conference closed with a Final Declaration, which stated that:

'(...) any consideration of capital requirements for asset management activities should be based on a full understanding of the reasons for such requirements, of the risk involved, of regulatory requirements applicable to investment funds and of alternatives to capital requirements such as insurance, compensation schemes, or contingency funds.'

8. OUTLOOK ON 2002

Most of the issues at the top of FEFSI's agenda in 2001 will continue to be so in 2002.

Integrity of the Industry

FEFSI will of course continue to promote the image and integrity of the European investment funds industry. It will be dealing with three key issues, ie the 'independence' of the industry, transparency of fees, and net asset value calculations and dealing with errors.

It will also turn its attention to investor education, advice and distribution. The industry has a vital interest in educating investors and in helping them with the right kind of advice. It will have to deal with questions such as: What is good advice? Who should be allowed to give advice? Do we need pan-European standards? Regarding distribution, the industry will be taking an active interest in those selling their products. FEFSI therefore will have the task of improving industry distribution standards and educating distributors. The industry will also have the task of dealing correctly with performance information.

FEFSI's Web Site

FEFSI is planning the opening of two new levels of its web site: one will be a common working area platform for FEFSI and its member associations, the other will be a special platform for 'members of members' who will have access to FEFSI's statistical databank and other key industry information.

UCITS

When the new UCITS Directive entered into force on 13 February 2002, it opened a new chapter in the creation of a single market for UCITS:

– Implementation of the new Directive:

- Avoiding interpretation and/or applications which vary significantly from country to country. What does equivalent supervision or equivalent level of investor protection mean in the context of investment in non-UCITS? What is a sufficiently diversified composition of an index in the context of index tracker funds? These are some of the problems which may arise from varying interpretations and FEFSI will have the task of monitoring the discussions at national and European level. It will intervene whenever necessary in the interest of maximum harmonised implementation;
- The introduction of the Simplified Prospectus in the new Directive was welcomed by FEFSI as a fully harmonised prospectus designed for the full benefit of investors. The key will be to ensure that the prospectus does not differ too much from one country to the next and contains information that is clear, easily understandable, and above all, easily comparable;
- FEFSI is currently updating the model prospectuses it released in 1999 (for full details, please see Annual Report 1999/2000 at www.fefsi.org). One of its main preoccupations will be to find a compromise whereby the harmonised prospectus leaves sufficient room to accommodate the individual backgrounds of the various countries and/or companies;
- On the subject of the acceptance of a passport, there is some question as to whether, if a Member State implements early, UCITS and managers from within that jurisdiction can exercise the passport before other countries have implemented. European jurisdiction states that:
  'Since the purpose of a period by the end of which the laws, regulations and administrative provisions necessary for compliance are to have been brought into force is, in particular, to give Member States the necessary

time to adopt transposition measures, they cannot be faulted for not having transposed the directive into their internal legal order before expiry of that period.' [12]

Clearly this is not satisfactory, and FEFSI will do all to convince the UCITS Contact Committee of the need to agree bilateral acceptance agreements;

- The grandfathering clause is another complicated matter. It was introduced by the EP in the Second Reading and states that Member States may grant funds that exist at the time of Directive's entry into force (13 February 2002) up to 60 months to comply with the new legislation. The question is what happens to funds that are set up in the time between 13 February 2002 and the entry into force of the new legislation at national level? Apparently, they would in no way benefit from the grandfathering clause.

– The Commission's study on depositaries:

Part of what may be termed as the Council's 'deal' over the new UCITS Directive was the obligation for the Commission to present within one year from date of entry into force of the Directive a report on depositaries. The aim is not to make proposals for further regulation of depositaries, but to ease future discussions on the issue. There would appear at this point in time to be at least one Member State in favour of more detailed regulation, and at least one Member State strictly against it. FEFSI has recently set up a Working Group to carry out a study on the tasks, duties and responsibilities of depositaries.

– Revision of the Directive:

The new Directive calls for a general review clause and FEFSI has committed itself to assisting the Commission in this task by working on the most important related issues. For instance, FEFSI member associations will be organising a series of workshops in 2002/2003 to study the market for, and the structure of, different types of funds such as real estate funds, protected ('guaranteed') funds, hedge funds, exchange traded funds (ETFs) and venture capital funds.

Cross-Border Marketing of UCITS

The fate of the Directive on Distance Marketing of Financial Services, currently in the Second Reading in the EP, will be a determining factor in the realisation of a single market for UCITS. The chances that the Parliament will support the Common Position reached in December 2001 are slim though not excluded. But any call for further amendments by the EP, in particular towards more harmonisation, could jeopardise the entire process. Other key points are the current administrative barriers to the marketing of UCITS across borders. FEFSI will continue to lobby for their suppression, at EU level with the Commission and at national level with the national authorities concerned.

Pensions

The Spanish Presidency plans to put the Commission's proposal for the IORP Directive on the agenda of the June ECOFIN meeting. As the chances for a Political Agreement are remote, the Presidency might have to settle for conclusions and partial compromises, at worst a simple Progress Report. This would mean further rounds of discussions lasting into the second half of 2002 under the Danish Presidency.

Taxation

Both issues discussed under pt. 6 will continue to be top priorities on the agenda:

– Directive on Taxation of Savings Income: the European Ministers for Finance have committed themselves to adopting the Directive by the end of 2002. In the meantime, the Commission has the task of convincing the most important non-EU financial market-places, in particular Switzerland, of the need to follow its approach of 'exchange of information' whereby each Member State will be required to forward to the other Member States informa-

[12] Case C-129/96 – judgment of 18 December 1997 [61996 J 0129]

tion on interest payments made within its territory to individual savers resident in another Member State. If a third country refuses to follow suit, the Directive will not be adopted at this is a *sine qua non* for the entry into force of the Directive, which must be adopted by unanimity. FEFSI, in any case, will continue at every opportunity to demonstrate the irrationality of this Directive;

– Eliminating fiscal obstacles to the cross-border marketing of UCITS remains essential, and FEFSI will pursue its principled action against the discrimination of foreign investment funds by writing to the Member States where this continues to be observed. It would seem that at least some of the Member States in question have already reacted to combined industry and Commission pressure and are proposing measures, some partial, to put an end to the criticised discrimination.

Capital Requirements and Operational Risk

The study FEFSI commissioned the University of Toulouse to carry out on the subject is due for completion by the end of 2002. Its main purpose is to strike a degree of objectivity in the debate over capital requirements for management companies of investment funds. Independent of the study, FEFSI intends to keep a close watch on the Basel II discussions and to inform the parties concerned of its opinion. It already has plans to react to the Consultation Document planned for May 2003.

Other Important Events on FEFSI's Agenda in 2002

– mid-May:	Meeting with the United States Securities and Exchange Commission, Washington, D.C.;
	Meeting with the Investment Company Institute, Washington, D.C.
– end-May:	FEFSI Fund Forum 2002 (formerly the 'FEFSI GMM'), Stockholm
– end-May:	FEFSI AGM, Stockholm
– mid-October:	International Investment Funds Conference, Berlin

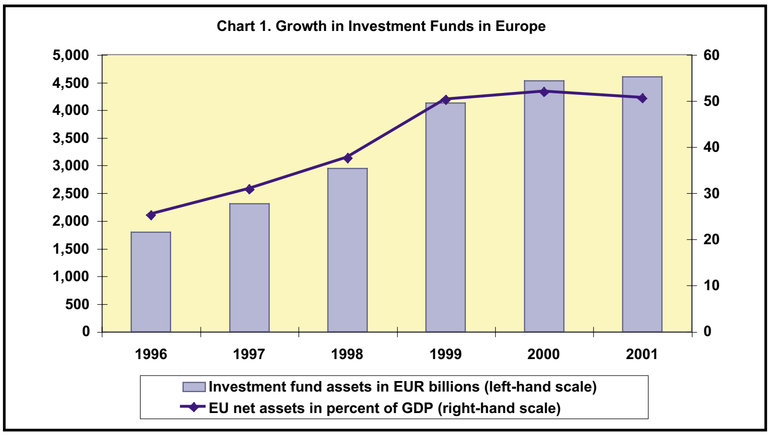
Steffen Matthias
Secretary General

EUROPEAN INVESTMENT FUND DEVELOPMENTS IN 2001

GROWTH IN INVESTMENT FUND ASSETS

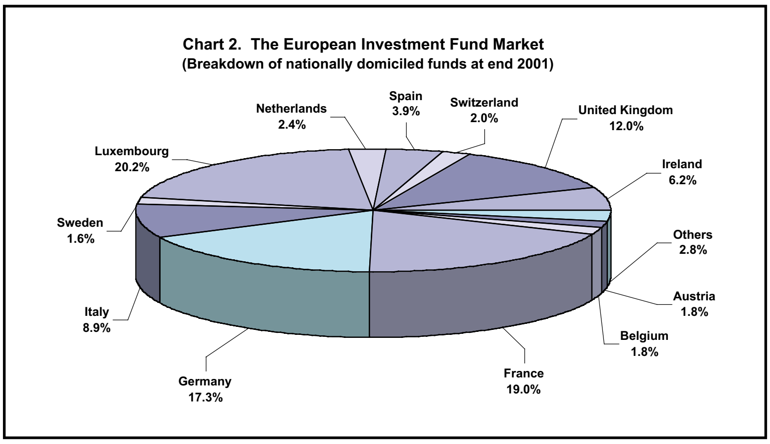
Despite the stock market downturn in 2001, total assets in the European investment funds industry increased by 1.5 percent to €4,599 billion at end year. With €3,614 billion invested in UCITS, this segment of the business accounted for 79 percent of the fund market. The remaining 21 percent was attributable to other nationally regulated investment funds.

Thanks to a constant growth rate of 21 percent over the last five years, investment funds have grown to become an important part of the European economy, whether measured in relation to GDP or to the European savings market (Chart 1). For the European Union as a whole, the ratio of investment funds relative to GDP grew from 25 percent in 1996 to 51 percent in 2001, but remained lower than in the United States (68 percent).



Source: FEFSI, Eurostat

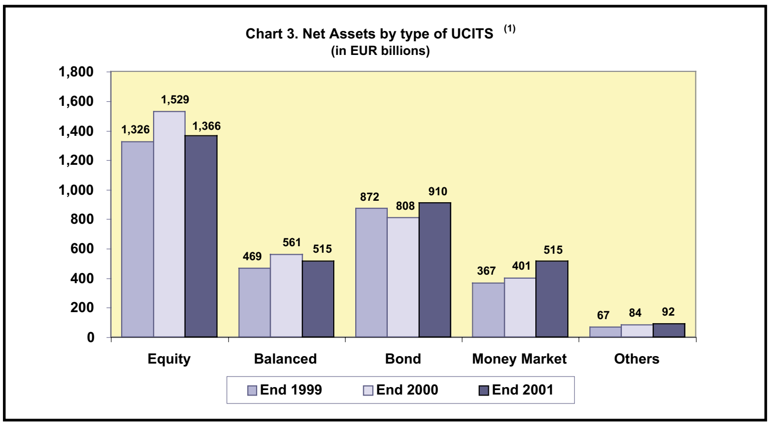
Three countries continue to dominate the European investment funds industry: Luxembourg as the leading centre for pan-European funds, and France and Germany as the largest marketplaces for funds in Europe. The United Kingdom and Italy follow in fourth and fifth place in this ranking (Chart 2).



Source: FEFSI

DEVELOPMENTS IN THE UCITS INDUSTRY

Although 2001 was not a great year in terms of growth, the European UCITS industry[13] managed to record a 2.3 percent increase in its assets, despite the sharp decline in stock markets worldwide. This result was achieved thanks to strong net flows to bond and money market funds (Chart 3).



(1) Excluding Ireland for which no asset breakdown by type of funds is available
Source: FEFSI

The overall result for 2001 was strongly influenced by the decline in stock markets, which began in March 2000 and culminated in the aftermath of the terrorist attacks in the United States on September 11. At its lowest point in September, the Dow Jones STOXX Broad Europe index had fallen by 28 percent compared to end-June 2001 and 37 percent compared to end-March 2000. The implied market uncertainty resulted in a sharp fall in net flows to equity funds, which became negative during the third quarter of 2001. The impact of the market downturn on stock prices and the reduced investors' appetite for investment risk resulted in a fall in equity fund assets to €1,191 billion at end-September 2001.

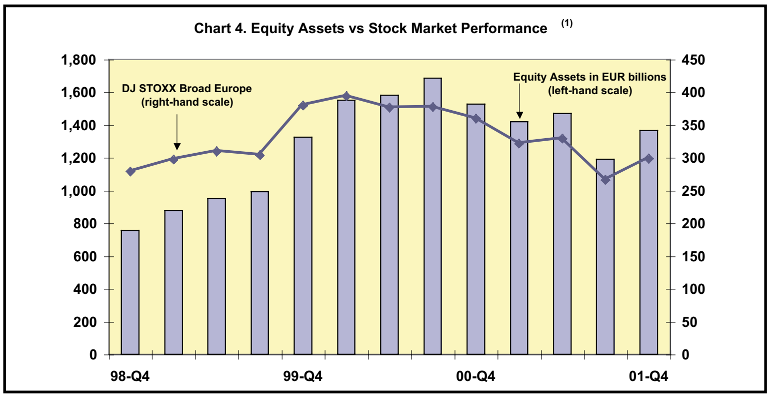
These developments highlight the extent to which the development in equity funds mirrored broad stock market trends. However, a number of factors lead us to believe that the unprecedented volatility on the world's share prices in 2000-2001 should have limited effect on the long-term prospects for equity funds.

First, equity fund assets increased by 15 percent during the fourth quarter of 2001 as equity prices rebounded from their September lows and net flows to equity funds turned positive again. Renewed interest in equity funds at the end of 2001 confirmed the robustness of investors' taste for equity exposure.

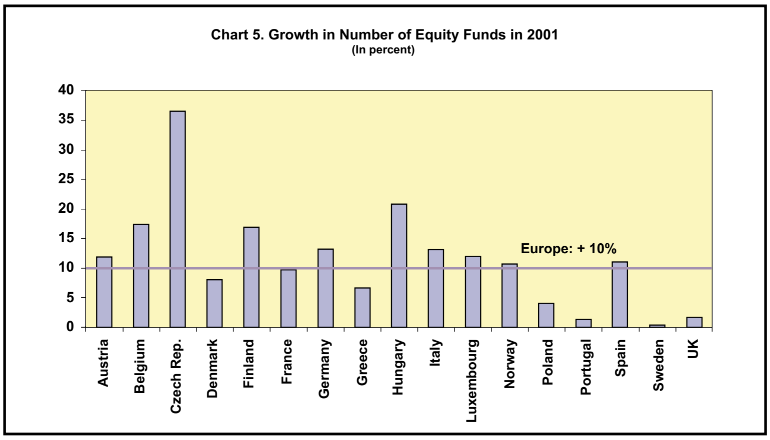
Second, the size of asset growth in equity funds since 1998 – an increase of 80 percent compared to a fall of 10 percent in 2001 – indicates that the stock market volatility in 2000-2001 had a limited effect on equity fund investors (Chart 4). Investors adopted a long-term approach to their investments and did not respond to the market downturn by redeeming shares *en masse*.

Third, the increase in the number of equity funds in 2001 (+ 10%) highlights the industry's drive to adapt their funds supply to the needs of European investors (Chart 5). This process reflected in part the increasing use of equity funds for saving in foreign stocks and diversifying portfolio internationally. The fall in the average share of equity funds investing mainly in domestic shares – from 58% in 1996 to 38% in 2001 –, and the ensuing broadening of the funds investing primarily in foreign shares, illustrates this trend (Chart 6).

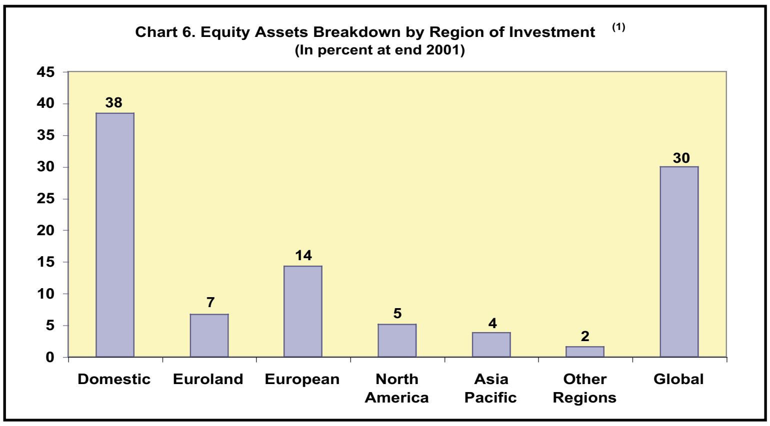
[13] UCITS is used in this section in the sense of publicly offered open-ended funds investing in transferable securities and money market funds.



(1) Excluding Ireland for which no asset breakdown by type of funds is available
Source: FEFSI

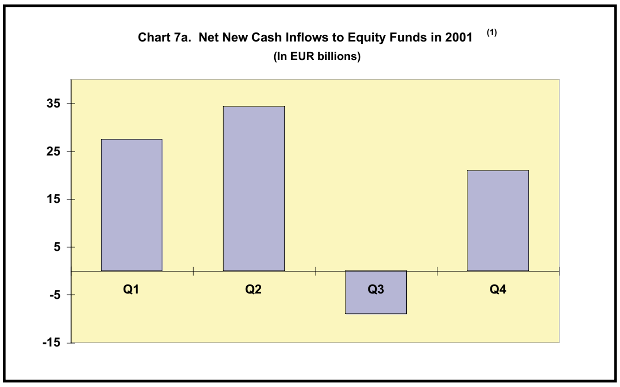


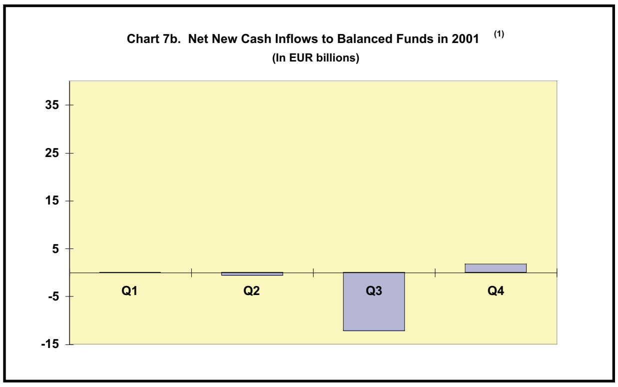
Source: FEFSI

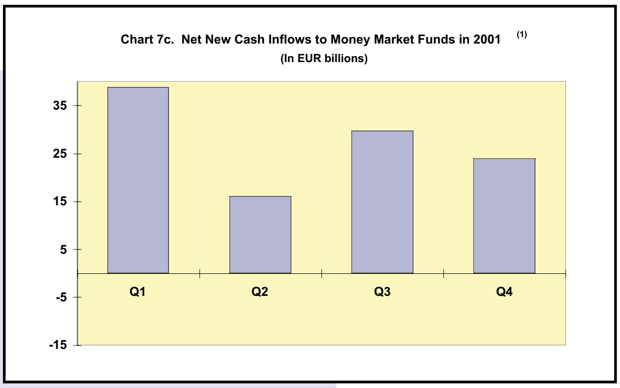


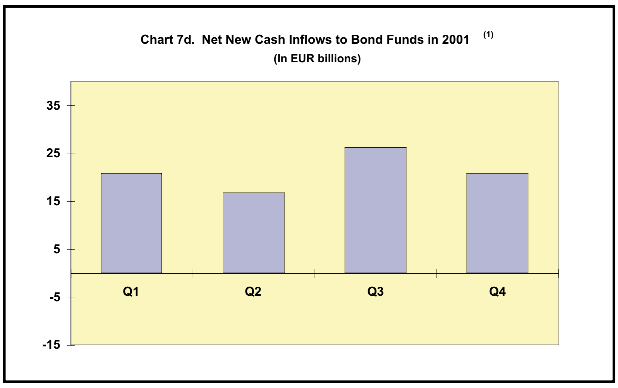
(1) Excluding data for Ireland, Luxembourg and Switzerland, for which no asset breakdown by type of equity funds is available
Source: FEFSI

Against the backdrop of volatile stock markets, money market funds scored the highest growth rate in the UCITS industry in 2001 (+28 percent) and by the end of December reached an all-time high of €515 billion, as money market funds posted robust net new cash flows throughout the whole year (Charts 7a-7c). Bond funds also recorded strong inflows of new money whereas balanced funds experienced net cash outflows – a development that reflected the weak performance of stock markets.



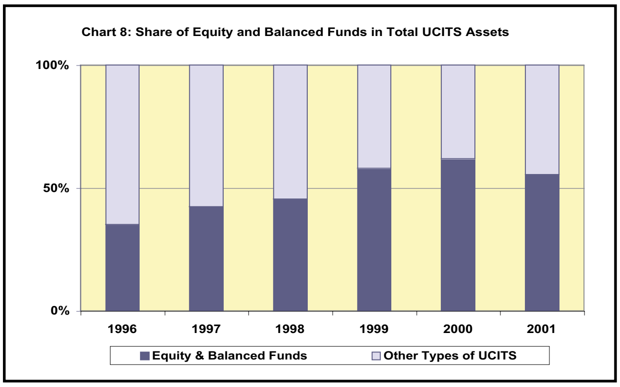






(1) For Austria, Czech Republic, Denmark, Finland, France, Germany, Greece, Italy, Luxembourg, Norway, Portugal, Spain, Sweden, Switzerland and UK; those countries represent 91 percent of the UCITS market. Source: FEFSI

Finally, the composition of UCITS assets changed in 2001 with the share of assets held in equity funds slipping back from 45 percent in 2000 to 40 percent in 2001. When balanced funds are taken into account, the proportion of funds assets with an equity exposure was 55 percent – a percentage significantly higher than in 1996 (Chart 8).



Source: FEFSI

CHANGES IN THE UCITS INDUSTRY ACROSS EUROPE

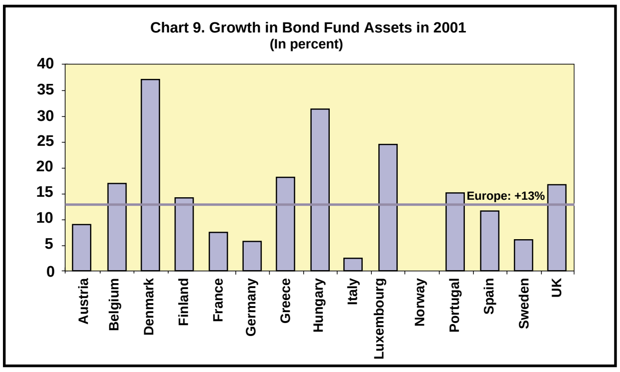
Luxembourg and France confirmed their strong position among the larger players in the industry thanks to a well-diversified UCITS assets allocation and their performance in terms of attracting new money (Table 1); by way of illustration, equity funds in Luxembourg and France attracted €38 billion and €33 billion in net new cash, respectively. The funds industry in the United Kingdom and Germany also received positive inflow into all types of UCITS but these were insufficient to cancel out the negative impact of the poor stock market performance in 2001 – albeit almost sufficient in the UK. On the other hand, the reduction in fund assets in Italy and Spain was driven by the size of the net cash outflows from equity and balanced funds. Finally, Ireland recorded the highest year-on-year increase of all European countries. This performance together with that of Luxembourg highlights the importance that both countries have taken as hubs for third-country's fund management groups operating on the European market.

Table 1: Net Assets of Nationally Domiciled UCITS

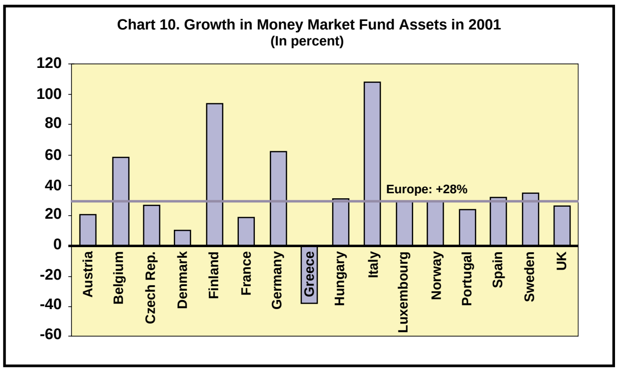
Members	EUR m	% chg (1)	Members	EUR m	% chg (1)
Luxembourg	851,060	7.4%	Sweden	73,551	- 11.6%
France	800,200	4.5%	Austria	61,930	3.2%
United Kingdom	411,988	- 0.8%	Denmark	37,974	10.3%
Italy	403,678	- 10.3 %	Greece	26,795	- 13.3%
Germany	239,666	- 5.1%	Portugal	18,640	5.9%
Ireland	215,188	48.1%	Norway	16,594	- 3.9%
Spain	179,359	- 2.0%	Finland	14,507	7.7%
Netherlands (2)	94,600	2.6%	Hungary	2,529	22.2%
Switzerland	84,949	- 3.3%	Czech Republic	2,050	- 4.1%
Belgium	77,017	3.2%	Poland (3)	1,593	- 4.0%

(1) End 2001 compared to end 2000; (2) as of end-June 2001; (3) as of end-September 2001.
Source: FEFSI

In the other countries, the stock market contraction had also a negative impact on asset growth, especially in Sweden, Norway and Switzerland where the proportion of equity funds in total UCITS assets was relatively high. Greece also suffered from negative outflows from money market funds, which adjusted to the exceptionally high level they had reached in 2001 (50 percent of total UCITS assets). The overall good performance of Austria, Belgium, Denmark, Finland, Hungary and Portugal reflected strong asset growth in the bond and/or money market segments of those countries' funds industry (Charts 9 and 10). Belgium also managed to record positive growth thanks to the importance of guaranteed funds in its market (€22.5 billion at end 2001).



Source: FEFSI

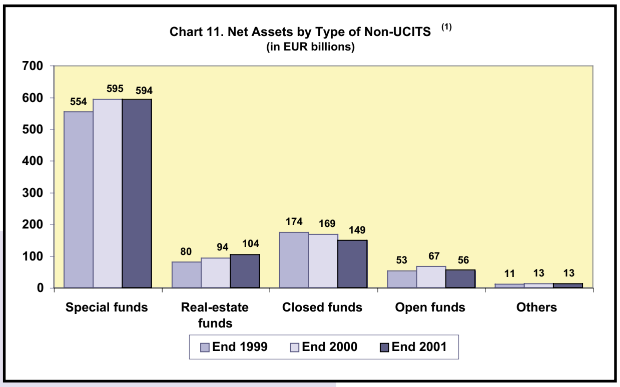


Source: FEFSI

DEVELOPMENTS IN THE NON-UCITS INDUSTRY

The non-UCITS market was dominated by four types of products at the end of 2001: (i) the German special funds dedicated for institutional investors (€501 billion); (ii) the British closed-ended investment trusts (€111 billion); the real-estate funds (€104 billion); and (iv) the French open-ended employees saving funds (€55 billion).

Whilst closed and open-ended non-UCITS were affected by the bear market in stocks in 2001, special fund assets remained nearly unchanged thanks to their lower equity exposure (see Chart 11). On the other hand, real-estate fund assets recorded a significant increase, in particular in Germany where total assets rose from €48 billion at end 2000 to €56 billion at end 2001.



(1) Excluding Ireland for which no asset breakdown by type of funds is available. Source: FEFSI

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n.b. Creation of a Dutch national association planned in late 2002

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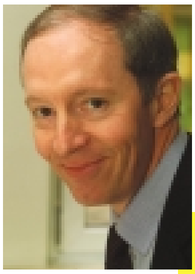
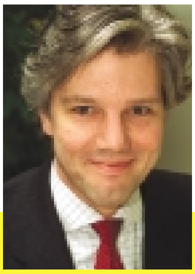
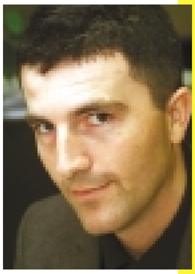



Ariadni Terzopoulou, Junior Policy Adviser

Gabriele Bozzi, Webmaster

Miriam Brunson, Administration


fefsi

PRINCIPLES FOR BUSINESS TRANSACTIONS

INVESTMENT POLICY PRINCIPLES

Introduction

In response to increasing requests by investors and the media, FEFSI has undertaken a broader exercise to set industry standards. The attached Principles reflect FEFSI's understanding of proper business behaviour for investment fund managers in Europe and are Best-Practice Recommendations on how to handle business transactions and how to implement the fund's investment policy. The Principles are based on internationally accepted rules but also leave room for the individual background in the various countries, be they large or small.

The recommended Principles should contribute to the harmonisation of business behaviour of the various European investment managers. They reflect demanding standards that are essential for companies operating in the European fund business, which should be characterised by the highest quality in terms of integrity and transparency. Managing money for third parties and having their trust requires fund managers to have sufficient organisational resources.

More recently, the question of transparency of fees has attracted increased attention. FEFSI in its work on the simplified prospectus has recommended – as early as two years ago - to use and publish a Total Expense Ratio (TER). Fund managers should clearly state the costs associated with running a fund through the use of a Total Expense Ratio (TER).

INVESTMENT FUND MANAGERS AS SHAREHOLDERS

Corporate Governance is a key issue for investment fund managers.

First and foremost, the fund managers' primary responsibility is to manage the investments in the sole interest of their clients. Thus, finding well-managed companies as objects of their investment placements becomes ever more important. Moreover, companies with sound and transparent corporate governance policies in place generally achieve greater efficiency and higher profitability.

Minority shareholders, which fund managers and their clients by definition are, generally find greater protection where corporate governance rules apply. Therefore, fund managers should conduct regular evaluations of companies' corporate governance arrangements.

Secondly, significant structural capital market changes are taking place in some countries that are leading to the reduction of industrial (cross-) holdings and the increasing attractiveness of securitisation over the traditional bank credit resulting in an ever-increasing presence of institutional investors.

The changing balance of power in corporate ownership needs a new approach to corporate governance. The retreat of traditional structures has left deficiencies, which have to be filled by the new owners. In other words, a new governance culture is needed and fund managers as institutional investors can contribute significantly to its development.

Thirdly, whilst fund managers experience ever-increasing expectations from investors for higher performance, it must be borne in mind that equity investment generally has a long-term outlook. Good future performance of companies and the creation of shareholder value will to a large part be determined by companies' long-term profit orientation. To achieve this objective, the company should endeavour to ensure the long-term viability of its business, and to manage effectively its relationships with stakeholders. The governance framework should recognise that the interests of the corporation are served by acknowledging the interests of stakeholders and their contribution to the long-term success of the company.

FEFSI expects fund managers to adopt a clear and considered policy towards their responsibility as shareholders that must necessarily be defined and cast against the backdrop of the sometimes widely differing corporate cultures, company law requirement and industry structure in the countries that are represented within FEFSI. As a consequence FEFSI has drawn up a set of Principles (recommendations for best practice) that are designed to provide fund managers with guidance on key points that can be shared across the aforementioned different national environments.

STATEMENT OF PRINCIPLES

A. FUND MANAGERS' COMMITMENT AS FIDUCIARIES FOR THEIR CLIENTS

As a general rule, the fund manager exercises the ownership and creditor rights of its investments in the sole financial interest of unit holders unless stated otherwise.

1. Exercise of ownership and creditor rights in general
Fund managers acting as fiduciaries for their clients should act in the sole interest of their clients.

In order to pursue this objective, fund managers should act responsibly as shareholders among others by making considered use of their voting rights in line with this Statement of Principles and by maintaining an ongoing dialogue as far as practicable with the companies in which they invest.

2. Dialogue with companies based on the mutual understanding of objectives
Fund managers should maintain – where practicable – an ongoing dialogue with companies to scrutinise, among others:

- The company's commitment to shareholder value
- The company's commitment to established principles of corporate governance
- Annual reports and accounts as well as other information given to investors

In this dialogue fund managers must take the necessary precautions to avoid insider trading problems.

3. Policy and guidelines on how to behave as shareholders
Fund managers should disclose to their shareholders their policy towards their responsibilities as shareholders in the appropriate documentation, in particular in the annual report as well as on their website.

In particular cases, the fund manager should record reasons for a vote.

It is advisable for fund managers to identify an individual or committee (senior level) within the organisation to oversee the application of these Principles. Fund managers are encouraged to establish appropriate systems of internal audit of voting activity.

Proxy voting should generally be specific and avoid blank authorisations.

4. Relationship with related companies
Particular care should be taken concerning the policy towards companies with which particular links exist (e.g. the fund's depositary, business relations with companies belonging to the same group or companies in which a company belonging to the same group has a significant influence).

Particular prudence should be shown when exercising the voting rights of shares in related companies.

Appropriate procedures based on the principle that fund managers act in the sole interests of their clients should be put in place.

B. WHAT FUND MANAGERS EXPECT OF THE COMPANIES IN WHICH THEY INVEST

1. Commitment to long-term shareholder value and corporate governance arrangements
Companies should disclose a written commitment to long-term shareholder value and established principles of corporate governance.

Companies should disclose their long-term dividend policy.

2. Corporate control and equal treatment of sharehol-ders

A company's corporate governance framework should ensure the equitable treatment of all shareholders.

Companies should treat all shareholders equally in share buy-backs and generally for rights issues.

a) *One share – one vote*

Deviations from the "one share – one vote" principle should be avoided.

Where legislation allows a deviation including additional powers or votes (above those of ordinary shareholders), companies should not make use of them.

Investors should be able to obtain information about the voting rights attached to all classes of shares. Any changes in voting rights should be subject to shareholder vote.

b) *Corporate control matters*

The market for corporate control should be allowed to function in an efficient and transparent manner. Therefore fund managers, as minority shareholders, believe that no take-over barriers should exist.

Any take-over barriers permitted by current legislation should not be adopted or deployed without the approval of shareholders. A company should disclose the existence of specific anti-takeover devices.

c) *Equal participation in company profits*

All shareholders should participate equally in the profits of the company in which they invest. Where this is not the case, it must be explained.

3. Shareholder rights and general meetings

a) *Possibility to exercise the voting rights*

Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it difficult or expensive to cast votes, in particular with regard to minority and international shareholders.

Companies should encourage participation and voting in shareholder meetings, in particular to decide on fundamental changes[1] in the company or to shareholders' rights. Sufficient time should be allowed to exercise votes.

Shareholders should be able to vote in person or by proxy and by electronic means. Proxy solicitation mechanisms should be efficient and inexpensive, and permit the full use of electronic means.

b) *Information about general meetings*

All shareholders should receive timely notice and information on matters relating to meetings, such as the date, location, agenda, rules and voting procedures and issues to be discussed (details of resolutions).

All shareholders should receive sufficient notice and information with the ability to request items to be placed on the agenda and to ask questions, subject to reasonable limitations.

After shareholders' meetings, shareholders should have prompt and practical access (incl. via the Internet) to information on the substance of the discussion and the results of the vote.

4. Timely disclosure and transparency of company information

All shareholders should be fairly informed about company matters through annual and interim reports, ad hoc communications, analyses and press conferences.

All shareholders should receive relevant, timely and regular information on all matters of concern to them, including the publication of a financial calendar giving the dates of important events (annual general meeting, publication of interim reports, etc...) preferably one year in advance on a rolling basis.

[1] Such as, for example, modifications to articles of association, by-laws and similar fundamental documents of the company, authorisation of issuance of additional shares or other dilutionary schemes like stock-option plans, extraordinary transactions involving the merger of the company or the sale of all or a substantial part of its assets, and the dissolution of the company.

All company information should be readily accessible at no cost, and available to all shareholders in the domestic language and in English, using where legally and practically feasible of electronic data transmission techniques.

Disclosed information should be provided according to recognised high-quality standards (IAS, US GAAP or equivalent).

Where the auditor remarks on substantial deviations from the past year financial statements or from established best practices the company should require the reporting of such findings.

Companies should be accessible and prepared to enter into dialogue with investors.

Companies should appoint an investor relations' officer at senior level to deal with all shareholder relations' matters.

Companies should give details of their ownership structures and, in particular, they should provide timely information on holdings, and any changes thereof, by directors and other company executives in the company's own shares, financial instruments and derivatives.

5. Board matters

a) *A balanced composition*

The Board of Directors (or Supervisory Board) as an entity, and each of its members, as an individual, is a fiduciary for all shareholders, and should be accountable to the shareholder body as a whole. Each member should stand for election on a regular basis.

The composition of Boards, including Management or Supervisory Boards (where applicable) and their standing committees, should ensure appropriate representation of the interests of all shareholders. Board members should be able to give sufficient time to fulfil their duties and the reasons for their nomination should be provided.

The combination of the functions of Chairman and Chief Executive Officer should generally be discouraged, and if adopted should be publicly justified.

In the case of a two-tier Board retiring Management Board members should not be proposed for election to the Supervisory Board as a matter of course.

b) *Committee support*

Given the growing complexity of Board tasks, it is recommended to establish appropriate committees (such as an audit, nomination, and remuneration committee).

c) *A transparent remuneration policy*

Companies should disclose the principles regarding both executive and non-executive board members' remuneration. Such disclosure shall differentiate fixed pay, variable (performance related) pay, and long-term incentives, including stock option plans (incl. a valuation range) and pension arrangements.

Material elements of executive board members' remuneration including their participation in pension arrangements, stock-option plans or incentive schemes of whatever nature should be disclosed at least in the aggregate. Non-executive and independent board members should not participate in stock option or pension plans.

Stock options plans for the management (Board members and executives) of quoted companies should be limited to shares in that company where they are principally employed.

The exercise price of stock option plans should be set against a relevant performance benchmark and should not allow for downward adjustment of the stock price before expiry.

Given its importance the remuneration committee should disclose its essential findings in the annual report.

d) *A comprehensive set of rules governing conflicts of interest*

Companies should adopt and disclose their policy for handling and monitoring conflicts of interests.

6. Auditor independence

The Board or audit committee verifies the independence of the auditor with due regard to possible conflicts of interest and to non-audit income in audit groups.

FEFSI Board of Directors, Brussels, 5.02.2002

INVESTMENT POLICY PRINCIPLES

(1) The description of the **investment objectives and policy** in the fund prospectus must provide sufficient information to enable an investor to ascertain the fund's overall profile.

The fund's prospectus should therefore clearly describe, at least:

- The investment objectives and nature of the fund;
- The fund's policy for achieving those investment objectives, including any intended specialisation and projected exposure policy;
- The relevant geographical and industry areas for the investment (if any);
- Any proposed technique for risk management.

(2) The **implementation** of the investment policy must be **consistent** with the fund's prospectus and any of its marketing materials.

(3) Appropriate **internal control and compliance** mechanisms must be put in place to monitor the implementation of the investment policy. These mechanisms should be verified and reported independently.

(4) Regular **reporting** must be made to investors on how the investment policy has been implemented.

(5) The **name of the fund** should not be misleading nor give rise to confusion.

(6) The fund manager should verify that each investment fund is, and remains, **correctly classified** to reflect its investment policy and that it is included in the appropriate investment fund category or peer group to provide investors with fair comparative information.

FEFSI Board of Directors, Brussels, 5.02.2002

PRINCIPLES FOR BUSINESS TRANSACTIONS

(1) All business transactions should follow the "**at arms length**" and "**best execution**" principles in the sole interest of investors. This particularly applies to business with affiliated companies.

(2) Fund managers should adopt a clear and **transparent policy** for brokerage and other transactions, which is based on the principle of pluralism with appropriate procedures in place.

(3) In the choice of **counterparties** a sufficiently high standard of quality must be defined and observed on a permanent basis.

(4) Appropriate **internal control and compliance** mechanisms must be put in place for monitoring the above Principles for Business Transactions. These mechanisms should be verified and reported independently.

(5) **Compliance** with on the above Principles for Business Transactions should be communicated to investors.

FEFSI Board of Directors, Brussels, 5.02.2002

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