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EFAMA INVESTMENT FORUM 2005
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"CESR's Investment Management Agenda: First Experiences & Future Priorities"
Keynote Address by Arthur Docters van Leeuwen,
Chairman of the Committee of European Securities Regulators

Ladies and Gentlemen,

First of all, I would like to thank EFAMA for offering CESR the opportunity to elaborate upon its first experiences and future priorities in the field of investment management. I must say I am very happy to be here today with you, especially because last year and the year before I was unfortunately ill the day I was supposed to speak at your conference. In the meantime, I met last November with your then President, Dr Mansfeld, to discuss issues of common interest to CESR and EFAMA, not to mention the frequent contacts between the CESR Secretariat and EFAMA's Secretariat, so we have created a good working dialogue.

Last year CESR was given the opportunity to elaborate upon its priorities for action in the field of investment management. A year on, some of those priorities have already been accomplished or are in the pipeline. However, we have only started. It is clear that there still remains a considerable number of issues to be tackled.

CURRENT STATE OF THE EUROPEAN FUND INDUSTRY

At first I would like to share with you the latest developments in the European fund industry. Last year showed a consolidation of the upward trend initiated in 2003 with asset levels up 10,9% from the previous year, pushing fund assets to an all-time peak of €5,342bn. Growth in 2004 in the

UCITS industry recorded a 11,2% increase to €4,188bn. The share of cross-border sales was surprisingly high, at around 60%. This is in my view a strong proof that despite the well-known problems in the legal framework, the single market on investment funds is working in Europe, though it can still be significantly improved.

Since the end of March 2004, there has been a sharp acceleration of net sales of UCITS. Demand of bond funds and money market funds has been particularly strong with 50% of total flows. Net sales of equity funds are also growing but at a steadier pace. This could be a reflection of the uncertain outlook due to growing concerns about the strength of the economic recovery, particularly in Europe, where performance has been weaker than forecasted. Negative news about the European constitution and the referenda may have played their part. Also, the long term impact of record-high oil prices remains to be seen.

FIRST EXPERIENCES OF OUR WORK ON INVESTMENT MANAGEMENT

Drawing on the needs expressed by markets stakeholders and CESR members, CESR approved, last year, a working programme for the Expert Group on Investment Management, that set as a short term priority two issues: the application of the transitional provisions of UCITS III and the eligible assets of UCITS. The objective was to move towards harmonised implementation of the UCITS legislation.

In February 2005 CESR published its **guidelines for supervisors regarding the transitional provisions of the amending UCITS Directives**. The guidelines were developed to converge the different administrative practices Member States had developed in view of the ambiguities contained in the text of UCITS III.

The solutions CESR developed did not purport to resolve the underlying differences of opinion among Member States in the interpretation of the various provisions in the Directives. Instead, they represented common, practical approaches, which CESR members agreed to implement in their day-to-day practices, to ensure both the efficiency of the market of UCITS as well as the protection of UCITS' investors.

I am particularly satisfied with the support received for these guidelines from the European asset management industry who, in general, considered CESR's guidelines as a practical and market-oriented solution bringing long-waited clarity. CESR is currently reviewing the way its Members have implemented these guidelines. So far the results look promising. We are aware that this exercise is a test for the CESR Members of the functioning of Level 3 measures, in particular because most of our work in the field of investment management remains, due to the current legal framework, of a Level 3 nature.

Another priority issue for CESR is the **clarification of eligible assets of UCITS**. UCITS III left room for different views in order to establish in which financial instruments UCITS can invest their assets. Some Member States have taken full advantage of the possibilities for product innovation imposed by the Directive, while others have taken a more risk-averse approach, with a strict adherence to the investor protection safeguards of the Directive. In October 2004 CESR received a mandate from the Commission requesting technical advice to clarify definitions of the Directive in this regard. Some of the most demanding questions posed by the Commission relate to whether and, to what extent, UCITS are allowed to invest in structured financial instruments, closed end funds, credit derivatives and index derivatives based on hedge fund or commodities indices.

CESR published its first consultation paper in March. We received more than 50 responses. The Commission asked originally CESR to deliver its technical advice by end of October 2005. However, many consultation respondents asked the possibility for a second consultation, taking into account the difficult nature of this exercise and the significant interests involved. Therefore, the Commission has, at the request of CESR, extended the deadline of the mandate from the end of October 2005 to January 2006. This change makes it possible for CESR to consult the stakeholders for the second time during autumn 2005.

Many respondents to CESR's first consultation suggested that a distinction be made between possible comitology measures at Level 2 and issues that would need to be addressed at Level 3 of the Lamfalussy procedure. For that purpose, our second consultation paper will make a distinction between suggested comitology measures and other measures.

Indeed, the narrow scope of comitology under the UCITS Directive is very problematic in this regard. The Directive necessitates the Level 2 advice to follow a strict 'conceptional' approach, i.e. to list criteria for the eligible instruments, whereas several CESR members would have suggested a more 'behavioural' approach, the cornerstone being factors for the investment manager to take into account when making investment decisions.

Also, a number of respondents stressed that CESR should take into account the cost implications of its recommendations, and that a cost benefit analysis is necessary regarding the possible comitology measures. The second consultation paper therefore will include questions that aim to gather information from market participants to be used to evaluate the possible impacts of suggested measures.

I welcome you to participate in our second consultation on this challenging exercise in October-November, so that we can provide the Commission with a well-informed advice in January.

Upon a request by the European Commission, CESR reviewed the **implementation by Member States of the two UCITS Recommendations**, which deal with the use of financial derivative instruments and simplified prospectus of a UCITS. The results, published last July, showed that the overall implementation of the Recommendations is at a reasonably good level in the Member States. Nevertheless, a group of several Member States have indicated that the implementation of the Recommendations is still underway. The level of implementation varies considerably between different sections of the Recommendations. For instance, regarding the Recommendation on the simplified prospectus, the level of implementation on disclosure of costs and fees has not been achieved as effectively as most of the other recommendations. Particularly the level of implementation regarding the indication of the existence of fee-sharing arrangements and soft commissions is unsatisfactory.

CESR is well aware of the great importance to the industry of the **simplification of the cross-border notification procedures of UCITS**, as expressed in the Asset Management Forum Group Report last year and the IMA/EFAMA report last spring. CESR's aim is to develop guidelines dealing with the procedures and documentation needed in the notification process, including forms and model attestations. CESR is also discussing the host Member State's ways to react when it has concerns regarding the notification. We aim to publish a first consultation paper on this issue in the coming months, even if it has proved not to be easy to change the different practises Member States have developed since the 1985 Directive. I am of the view that the on-going work on the eligible assets could significantly contribute to diminishing the problems related to passporting by facilitating convergence in the investment policy of the funds, which currently seems to be the major source of the problems related to passporting.

As a conclusion of the experiences so far in the field of investment funds I would stress the following two main points:

- As you all know, the landscape of this business in Europe is clearly divided into the exporting and the importing countries. Most of the countries act almost solely as host Member States, while some countries act dominantly only as home Member States. This division is also the framework within which we have to work in CESR, trying to get the national regulators to converge their approaches. We try to have a very pragmatic approach to reach consensus among the CESR members on concrete solutions and steps forward to the problems of the markets, without necessarily trying to solve the fundamental disagreements among jurisdictions on the interpretation of the Directives, as we did with the transitional provisions of the UCITS III, and as we are currently doing to simplify the cross-border notification procedure of UCITS. I believe this pragmatic approach is the only way forward in the current regulatory framework.

- We have witnessed an increasing participation of the fund industry in the regulatory procedures. CESR has given significantly more room for the voice of market participants than was the case in the previous regulatory model on UCITS – at every stage of our work. We are pleased with the active role adopted by the asset management industry. Your input is a reminder to CESR that you regard the UCITS framework as a key to remain globally competitive. UCITS regulation profits from intense debate and consultation in a transparent procedure. Although we are aware that UCITS compete with less regulated, less transparent and less supervised products, the current approach - open and interactive- is the best tool to strengthen the UCITS brand.

FUTURE PRIORITIES

At last year's conference the working programme of the CESR Expert Group on Investment Management until 2006 was presented to you. It includes many issues we have not yet started to work on, including conduct of business rules in the field of collective investment management, outsourcing, non-harmonised funds, consistency between UCITS and the other Directives, convergence of supervisory systems and so on.

The further agenda of CESR on investment management will no doubt be significantly influenced by the future Commission working programme on UCITS. The European Commission published its **Green Paper on the enhancement of the EU framework for investment funds** in July. CESR is still discussing internally the paper, it is, however, clear that CESR will in any case play a big role in the working programme. The four priority actions indicated by the Commission are actually the ones I have already mentioned, on which CESR's role is central: transitional guidelines, eligible assets, review of the implementation of the UCITS Recommendations, and simplification of notification procedures. I am sure that CESR's input will be needed also regarding many other parts of the future Commission working programme. What issues will in the future fall in Level 1, 2 or 3, remains to be seen, and will affect CESR's agenda and priorities. The agendas of CESR and the Commission need to be coordinated in the future as has been done so far. So we will follow with great interest the results of the Commission consultation and the constructing of the future working programme of the Commission.

Generally speaking, I welcome the Green Paper. Discussion of the future regulation of asset management in Europe is very timely and necessary. UCITS III was a long-awaited step in the right direction to modernise the UCITS regime, but because of ambiguous drafting also created lots of problems in implementation and interpretation. Its pre-Lamfalussy structure does not represent the modern European model for securities legislation.

Therefore, CESR will continue to contribute in getting the current legislative framework on investment funds to work effectively and to facilitate the functioning of the Single Market in full cooperation with the Commission. CESR agrees with the Commission that lots of improvements can be achieved within the current framework. However, there are big expectations among the European asset management industry on the changes and improvements needed. CESR is of the view that there are limits set by the current UCITS Directive that can not be overcome by the work of CESR alone at level 3.

Drawing from CESR's positive experience on the way in which implementing measures have worked under the 'Lamfalussy style' FSAP Directives so far, and given CESR's initial experience in carrying out work in the field of investment management, CESR believes that the sector of investment management would significantly benefit from adjusting the UCITS Directive to the Lamfalussy process. This would allow the regulatory system to exploit the full flexibilities offered by the process, in particular, to address the requirements of financial innovation and market changes.

MEDIATION MECHANISM

Next I want to touch briefly on a general CESR exercise, which is likely to affect also the field of investment management. CESR published two weeks ago a draft paper on a proposed mediation mechanism to be established amongst EU securities supervisors. The decision of CESR to work in this area follows a report by the Inter-Institutional Monitoring Group (which regularly reviews the functioning of the Lamfalussy process on behalf of the EU institutions) and the views expressed by the Council's European Securities Committee, which called for CESR to establish a general mediation mechanism going beyond the Market Abuse Directive.

The objective of the proposed CESR mediation mechanism is to facilitate supervisory convergence at Level 3, by reaching a common understanding among CESR Members. The process is intended to concentrate on cross-border cases in a rapid, efficient and fair manner, respecting all applicable confidentiality and professional secrecy requirements. The outcome of the mediation process will not be binding, but CESR Members will nevertheless be expected to accept mediation requests, especially in disputes related to co-operation and exchange of information. The mediation mechanism will respect the limits of the EU institutional framework, in particular the prerogatives of the European Commission and the European Court of Justice. The mediation mechanism will be designed as a "peer mechanism" among CESR Members, but market participants will be entitled to bring to the attention of their national securities supervisors issues that the latter might decide to submit to the mediation mechanism.

The CESR mediation mechanism will cover cross-border disputes related to co-operation and exchange of information between securities regulators, enforcement of financial information, as well as operational disputes, especially those related to mutual recognition of decisions. This would

cover all applicable EU legislation in the securities field, as well as CESR Level 3 measures. An exception would be issues where legal proceedings have already been initiated at EU or national level; where the issue in dispute is being dealt with by CESR at Level 2 or Level 3; or, where national legislation does not provide any leeway for the CESR Member concerned to accommodate the demands from the CESR Member requesting mediation.

I expect that the mediation mechanism will in the future significantly facilitate the proper functioning of the legislative framework of the Single Market.

HIMALAYA REPORT

Ladies and gentlemen, let me now refer, in a procedural sense, to the Himalaya report; it is too ambitious to set the scene on the current state of debate about the future of the European supervisory structure in one minute. I just want to give you some flavour of this debate. The main goal for CESR with the publication, last autumn, of our so-called Himalaya report "Which supervisory tools?" was to participate in this debate.

On substance, the supervisory system can be visualised as a 4 floor pyramid:

- The basis of the pyramid are the national supervisors.
- On the second floor the supervisors co-operate. This floor is what we now generally see as the level 3 of the Lamfalussy-system.
- The third floor is again co-operation but now with the possibility to delegate tasks or even powers to each other. This is now only provided for in the Prospective Directives; but we might start feasibility studies in other fields if only to streamline all sorts of different information requirements.
- The fourth (top) floor is about pan-European decisions. At this stage there are none, and nobody has made a strong case for this. It might be necessary for IFRS decisions, but then we must see to it that we do not weaken the role of IFRIC, the global interpretations committee of IAS. It might be necessary for credit rating agencies to be supervised, but until now we think that self-regulation and an open relation with supervisors is enough. And yes it might be necessary if consolidation…

All in all the top of the pyramid is so to speak shrouded in nebula, the nebula of the future. So let us go back to what is clear, to the basics. Using this vision again makes absolutely clear that equality in powers and sanctions is a 'conditio sine qua non', it is the fundament of the system how we can create effective operational co-operation on a home/host basis, multilateral and even pan-European. In a period of, let's say, 3 years, someone else should be able to say in this forum with clear examples "we all have *these* same powers and *this* is what we have done with it".

3L3 COOPERATION

The cooperation between the three level 3 Committees (CESR, CEBS, CEIOPS) has become increasingly a subject of interest. On various subjects, it has been pointed out by members of the level 3 committees, by the industry and by involved European and domestic institutions that the work done in one sector should be consistent with level 1, 2 and 3 work in the other financial sectors. An enhanced coordination of the activities of the 3L3 Committees is indeed a key objective to CESR.

In the ongoing dialogue with our "sister" committees we have found out that the list of items of common interest is extensive. The Committees should in general strive to align the work on these subjects. The results need to be consistent and/or take into account the effect in other sectors of such work. However, the results need not be identical. Differences need to be explained by the differences in objectives or underlying conditions. We can not deny the fact that the Committees are currently working on very different topics and on different levels of the Lamfalussy process. Also, a fact remains that the interests to be protected are different in each sector, and the directives differ in text and level of detail.

The three level 3 committees are currently working to define more precisely their cooperative framework. Already significant common projects have been conducted. I especially want to mention our recent joint report on cross-sectoral risks to the Financial Stability Table of the Economic and Financial Committee, building on the joint work already developed on issues such as credit risk transfers and off-shore financial centres. This first pilot report provides some preliminary ideas on the structuring of a regular reporting and highlights to the attention of the FST some issues that might be further analysed.

An example of the issues raised is cross-sectoral consistency, e.g. with regard to outsourcing of business activities. The Committees find it important to minimise the potential inconsistencies in the supervisory treatment across the three sectors. This would reduce the risk that some areas of business are shifted from one legal environment to another in order to obtain a more preferential treatment and reduce compliance costs. Especially as cross sector participations are increasing, the importance of consistent (though not necessarily identical) supervisory practices across the sectors increases.

DIALOGUE IS ESSENTIAL

Ladies and gentlemen, I can assure you that a continuous dialogue with the European asset management industry is essential to fulfil our ambitious agenda on investment management. I hope your cooperation with us will remain strong also in the future. Thank you.