EUROPEAN PARLIAMENT

Directorate-General for Research

WORKING PAPER

# Consumer protection aspects of the UCITS amending directives of 17 July 1998

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# *PREFACE*

**Consumer protection aspects of the UCITS amending directives of 17 July 1998**[1]

This paper attempts in to examine the proposed directives critically from the consumer protection angle, to suggest changes and make comments. The paper can do no more than put forward various ideas, whose implementation will require further consideration. It is no substitute for the thorough study which, given the significance of these comprehensive rules, needs to be undertaken on the basis of the current debate and what is known about the wide-ranging rules in the Member States.

[1] Proposals for directives COM(1998) 449 final and COM(1998) 451 final amending Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

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# A. The proposed UCITS directives

### *I. Directive 85/61/EEC*

***Directive 85/61/EEC***

Council Directive 85/61/EEC on the approximation of laws, regulations and administrative provisions on investment funds known as undertakings for collective investments in transferable securities (UCITS) was adopted on 20 December 1985.

***Unit trusts/ UCITS and consumer protection***

Unit trusts or, more accurately, investment funds open to the general public are described as a 'standardised form of asset management which is governed by law, is carried out by experts and is intended for everyone and in which the risks are spread'[2]. Savings and investments are collected from the public and then invested collectively in the capital market, making it possible for larger investment sums, pooled know-how and risk-spreading to be achieved, even for small investors. Since the collapse of Bernie Cornfeld's IOS Fund in the late 1960s the unit trust has thus been particularly associated with the idea of consumer protection in the minds of the general public. It is, as it were, the 'entry-level package' that gives the consumer access to the capital markets. As consumer advice is built into the product, the consumer can be confident that the product is in keeping with his interests.

The present unit trust (UCITS) directive contains extensive rules on minimum conditions to be satisfied by unit trusts whose units can be sold across frontiers. Under Article 4(1) of Directive 85/611/EEC the home country principle applies. This means that, to carry on its activities, a UCITS needs authorisation only from the competent authorities of the Member State in which it is situated.

***Consumer protection through low-risk product range***

The directive puts the idea of consumer protection into effect by requiring investment companies to satisfy a number of minimum conditions. Unit trusts that are authorised under European law are limited to an accurately defined range of low-risk products. This was achieved by limiting high-risk securities to 10% of fixed assets, investments thus being largely restricted to shares and bonds quoted on the stock exchange. Limiting investment in any security to 5% was also intended to ensure that the risk was spread wide. Interest-rate and hedging tools, like options, were to be used only internally where technically necessary. Unit trusts that invested in other unit trusts ('funds of funds') were forbidden. The fact that the exceptions are restricted to investments in the state also makes it clear that, following the experience with IOS and other investments, the directive was based on the assumption that unit trusts raise money primarily from the general public, who are not so familiar with financial market risks.

[2] Definition by M. Laux, Managing Director of the Federal Association of German Investment Companies, quoted from Balk/Eller/Gutmann, Investmentfonds, 2nd edition, Bonn: Economica 1993, p. 13

***1994 Amending Directives*** On the other hand, the national law of some states authorised a number of other unit trusts that permitted more investments, such as certain money market funds (treasury bills, deposit certificates, commercial papers and bankers' acceptances), cash funds holding bank deposits and master-feeder funds that invest exclusively in other unit trusts. The proposal for an amending directive of 20 July 1994 (COM(94) 329 final - COD 453) sought to extend the European passport for investment companies to include other companies in accordance with the principle of defining products (see in particular the detailed definition of a master fund in Article 26b) in which money might be invested. The amending directive was not, however, adopted.

### *II. Contents of the 1999 proposals for amending directives*

***Service-provider versus product regulation*** The current proposals for amending directives seek to achieve the liberalisation intended in 1994 by adopting a different approach. A visible external sign of this is the division of what is in effect a single directive into two separate proposals for amending directives. While COM(1998) 449 essentially deregulates the clauses of the directive that concern products and so gives unit trusts access to most investment options in the capital market (**product directive**), the other proposal, COM(1998) 451, contains rules on the service-providing institutions, some of which clarify and tighten up their supervision and the minimum requirements to be met, while others extend their range of activities, especially in the management of individual portfolios – asset management – and pension fund management (**service-provider directive**).

***Deregulation*** Under the new directive investment in a number of higher-risk financial products, in addition to those commonly used at present, will be permitted throughout Europe. This will not create any new unit trusts, since they are already authorised under national law in a number of countries. It will, however, mean that national restrictions imposed by the host country (with the exception of public interest provisions) will no longer apply, as in the past, to higher-risk unit trusts driven out of a country that does not have such restrictions.

***New principles*** A number of principles that have hitherto applied under Directive 85/611/EEC and are also to be found in national legislation will consequently be changed or replaced:

- **Higher-risk instruments**, such as derivatives, are permitted if it is pointed out that they are explicitly intended for 'experienced investors'.

according to which internal risk cover is sufficient.

***New investment products***

Specifically, unit trusts will also be able to invest in the following in the future:

- **shares which are not fully paid**
- **shares** (up to 35% from the same issuing body if the stock index is replicated)
- all **money market instruments** (as defined at national level, 10% from the same issuing body)
- all **bank deposits** (10% per credit institution or 35% + 5 credit institutions in all)
- **investments in financial futures** (if risk cover ensured)
- **options** (if risk cover ensured)
- **OTC derivatives** (if risk cover ensured)
- units of other **unit trusts** (instead of 5%, now 10% or 35%, but at least 5 UCITs)

In addition, companies are permitted to engage in the **management of the assets of individuals** and pension funds besides unit trust business.

***Delegation and simplified prospectus***

The amendments will further permit investment companies to delegate certain functions in the future, the relations between the partners to be so governed by incompatibility rules that conflicts of interest are excluded.

An innovation is the simplified prospectus, which will be additional to the full prospectus and is intended to provide the investor with the most important information about the fund, its objectives, orientation and structure and about risks. The simplified prospectus will be compulsory and so, in practice, take the place of the full prospectus, which will be provided free of charge only on request.

### *III. Impact on the legal situation*

The amending directives will change the significance of Directive 85/611/EEC fundamentally. In its original form it sought to set minimum standards for an accurately defined range of unit trusts, which might then be marketed in the same way in all the Member States. Accordingly, its philosophy was that, where consumers were adequately protected, the ‘European passport’ should take effect.

The Member States should, moreover, gradually raise the level of protection. With the amending directives, liberalisation ‘as consumer protection’ is what the rules are trying to achieve. A wider variety of competition is meant to improve the consumer’s position through the market. As consumer protection thus becomes indirect, the requirements for receiving the European passport are reduced to a minimum in the interests of the greatest possible freedom of movement.

***Maximum rather than***

It is thus to be feared that this level, still referred to in the directive as minimum rules, will also be the highest level of consumer protection in the EU. On the

***minimum harmonisa-tion***

principle of the 'race to the bottom'[3] among rival supervisory systems[4], of 'competition in laxity', a 'ruinous race for prudential latitude' might result in the 'most careless supervisory system having the greatest opportunity'.

Although it is argued that competition and thus the consumer as potential client will not allow this to happen, investors in unit trusts are for the most part consumers without much power, and similar considerations might apply here as to capital-sum life assurance.

### *IV. Positions adopted by the Committee on Economic and Monetary Affairs*[5]

*1. Position adopted in March 1999*

***Economic Affairs Committee, March 1999: further deregulation***

In the position it adopted in March 1999 the European Parliament's Committee on Economic and Monetary Affairs essentially called for further liberalisation.

- It would like to see more latitude in the question of which higher-risk securities should be bought. It proposes that the distinctions made by the Commission should not be accepted and that, instead, the approach should generally be to provide appropriate safeguards against higher risks.
- In the case of bank deposits it would like to see the reference to 'sufficient financial and professional guarantees' deleted.
- Investments with the custodian should also be possible provided that they are insured.
- On the other hand, investments should be restricted to countries which have also adopted the EU's directives.
- Where the delegation of tasks to third parties is permitted, the Commission's proposal requires the competent authorities' prior approval. The committee considers this requirement unnecessary.
- The simplified prospectus should be enough for consumers since only lawyers can understand the full prospectus. There is no need for the latter to be made available. However, more information on risks should be included in the simplified prospectus.

*2. Draft report of November 1999*

In his draft report for the Committee on Economic and Monetary Affairs[6] the rapporteur not only proposes various terminological and formal clarifications but also a number of amendments intended to restrict the expansion of the areas of

3 Köngen, J., Mindestharmonisierung im europäischen Bankrecht - konzeptionelle Grundlagen, in: Everling, U./Roth, W.-H. (eds), Mindestharmonisierung im europäischen Binnenmarkt, Nomos, Baden-Baden 1997, 118

4 Reifner, U. (1998), Control of Banks in a Deregulated Market, in: Rudanko, M./Timonen, P. (1998) (eds), European Financial Area, University of Helsinki Institute of International Economic Law, Saarijärvi 1998:61 ff.

5 DOC_EN\RR\377\377123, 18.3.1999, rapporteur: Wilfried Kuckelkorn, and explanatory statement DOC_EN\RR\377\377123, PE 229.498/fin, pp. 13 ff.

6 PR\369453EN.doc, PE 229.813, 12.11.1999

activity of UCITS under EU law as proposed by the Commission. The report inserts a number of general instructions to the national legislatures and supervisory authorities to ensure investor protection, liquidity and the effectiveness of supervision.

- It must be possible to redeem bank deposits at relatively short notice to ensure liquidity. Evidence of liquidity is also required in the case of the other instruments.
- Departure from the principle of risk-spreading should be possible in the case of both stock indices and debt security indices.
- Cascades of funds should be explicitly prohibited (‘funds of funds of funds of funds’, etc.). A fund of funds should not itself invest in a fund of funds. A reference must be made to the combination.
- In the case of OTC derivatives the draft report merely calls for the same level of supervision.
- The maximum investment in one institution is reduced from 35% to 20%. The limit on OTC exposure is set at 30%. Proscribing combinations will ensure that the investment limits are effective.
- The possibility of delegating tasks of the management company to third parties is deleted.
- Master-feeder funds, where a fund of funds is the real unit trust in which the other funds may invest 100%, are explicitly authorised and governed by rules on the grounds that they reduce costs and are equally safe.
- In the policy on information for investors it is proposed that a reference should be made to updated information and that an appropriate form of publication of the authorised indices other than in the EU’s Official Journal should be permitted.
- The contents of the prospectuses are defined, a ‘clear and easily understandable explanation of the fund’s risk profile’ being required. A simplified prospectus must be made available in the official language of the host country.
- An assessment of the fund’s risk profile is prescribed.

# B. Consumer protection as an evaluation criterion

### *I. Consumer protection in the EC Treaty*

***EC Treaty***

Article 3(1) of the EC Treaty in the Amsterdam version[7] sets the Community three tasks in the financial services sphere which may cause difficulties for the establishment of secondary Community law and for the national legal systems.

> 'For the purposes set out in Article 2, the activities of the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein:
>
> (c) an internal market characterised by the abolition, as between Member States, of obstacles to the free movement of … services and capital;
>
> (h) the approximation of the laws of Member States to the extent required for the functioning of the common market;
>
> (t) a contribution to the strengthening of consumer protection'

While the initial goal of legal harmonisation is a means rather than an end, given the inherent barrier of the principle of subsidiarity, the goals of creating a single market in financial services and achieving a high level of consumer protection[8] give substance to the mandate set in Article 2 of the EC Treaty[9]. It is evident from developments hitherto that the consumer protection idea is not only an essential political condition for the acceptance of the process of unification but can also be described as the driving force of this process[10].

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7 For further details see Reich, N. (1999), Verbraucherpolitik und Verbraucherschutz im Vertrag von Amsterdam, in: Verbraucher und Recht, No 3, pp. 3 ff.

8 Article 95(3) (ex Article 100a) reads: '3. The Commission, in its proposals envisaged in paragraph 1 concerning health, safety, environmental protection and consumer protection, will take as a base a high level of protection, taking account in particular of any new development based on scientific facts. Within their respective powers, the European Parliament and the Council will also seek to achieve this objective.'

Article 153 (ex Article 129a) reads: 'Title XIV, Consumer Protection

1. In order to promote the interests of consumers and to ensure a high level of consumer protection, the Community shall contribute to protecting the health, safety and economic interests of consumers, as well as to promoting their right to information, education and to organise themselves in order to safeguard their interests.

2. Consumer protection requirements shall be taken into account in defining and implementing other Community policies and activities.

3. The Community shall contribute to the attainment of the objectives referred to in paragraph 1 through:

(a) measures adopted pursuant to Article 95 in the context of the completion of the internal market;

(b) measures which support, supplement and monitor the policy pursued by the Member States.

4. The Council, acting in accordance with the procedure referred to in Article 251 and after consulting the Economic and Social Committee, shall adopt the measures referred to in paragraph 3(b).

5. Measures adopted pursuant to paragraph 4 shall not prevent any Member State from maintaining or introducing more stringent protective measures. Such measures must be compatible with this Treaty. The Commission shall be notified of them.'

***Interests or protection***

Although several references are made to the protection of investors and consumers to justify the proposed amendments to the directive, 'the main objective of this proposal is to extend the scope of the UCITS Directive to other types of collective investment undertakings'[11]. 'Existing barriers to a free cross-border marketing of units issued by such undertakings need urgently to be removed through further legislative actions which extend the Single Market to other types of collective investment undertakings, while preserving a uniform minimum level of protection of investors'[12].

As the proposed amendments themselves do not pursue the goal of 'consumer protection', all that the following can seek to do is to compare the proposals with the criterion specified in the Union Treaty of 'a high level of consumer protection'.

### *II. Consumer protection in the financial services sphere*

***Definition***

In the context of financial services, consumer protection means the protection of the consumer's economic interests in the market. The consumer is characterised by the fact that he, a natural person, 'consumes', i.e. he takes goods and services from the market for the purpose, not of profit-making, but of individual use. This definition is to be found in the consumer protection law of all industrialised countries[13]. In the case of financial services this means that the only customer interests to enjoy the special protection of the EC Treaty are those which use the attainment of financial benefit as a means to an end that lies outside pure capital formation. Investor protection is thus not *per se* consumer protection: it is consumer protection only where the investment itself is subordinated to another, future consumption end. Such ends may be provision for old age, the education of children or later consumption.

The rules that normally govern the concept of consumer protection in financial services, which has its historical origins in credit law, can be differentiated as a function of the consumer interests concerned.

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[9] *Article 2*: 'The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement in the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.'

[10] See Reichenbach, H., Aufgaben der Generaldirektion XXIV: Verbraucherpolitik und Gesundheitsschutz der Verbraucher, Neue Wirkungskreise, insbesondere nach dem Vertrag von Amsterdam, in: ZEuP, 1998, p. 413.

[11] COM(1998)449, p. 4

[12] COM(1998)451, p. 3

[13] See, for example, section 1 of the German Consumer Credit Act; 15 USCA, section 1602, Consumer Credit Protection Act of the USA 'characterizes the transaction as one in which the party to whom credit is offered or extended is a natural person, and the money, property, or services which are the subject of the transaction are primarily for personal, family, or household purposes.'

***Information, social protection and general welfare***

**Informational consumer protection** signifies the strengthening of the consumer's role in the market by providing him with information, supporting him in his decision-making and ensuring transparency so that he may bring his own interests to bear when transacting business.

**Social consumer protection** concerns the consumer in the consumption process directly, irrespective of his decision-making freedom, and prescribes minimum social standards below which, according to the continental European understanding of the law, no transactions should be effected in the market. Social consumer protection is therefore particularly in demand whenever investment products affect social existence, as in the case of provision for old age.

**Collective consumer protection** concerns the (wide-ranging) interests of consumers as a whole, the protection of such interests being of indirect benefit to the individual. Such rules relate to the protection of their interests in an integral financial system, in the environment, ethics and morals and in social cohesion.

If this is related to protection in unit trusts, it can in principle be assumed that consumer interests are particularly affected in this form of investment. While those with substantial assets usually have direct access to capital markets, it is those who have capital available for investment only temporarily, during their consumption process, who need the protection described above. In this the emphasis so far has been on informational consumer protection because the investing consumer enters the market with an offer and thus already has some strength.

When it comes to provision for old age, however, case law and the legislator have recognised the social importance of private investments and provided for elements of social consumer protection (advice appropriate to the individual and the investment). Comprehensive safety precautions are also intended to safeguard collective consumer interests since an unstable market that invites abuses would impair the development of the EU's whole capital stock.

***'SALIST', product criteria***

In the letters of the word SALIST, which is introduced here for symbolic purposes, these elements are converted into criteria against which the consumer protection achieved with certain financial service products can be gauged.

**Security, Access, Liquidity, Interest, Social Responsibility and Transparency** are criteria to which the consumer can be referred as factors in the assessment of products. In the context of collective investment undertakings

⇒ *security* means the certainty the investor has that his investment will retain its value,

⇒ *access* indicates the opportunities the consumer has of gaining access to a product without discrimination,

⇒ *liquidity* complements security inasmuch as it can be used to measure how far investments can be converted back into consumption if the consumer's circumstances change,

⇒ *interest* means the return to be achieved and its reliability/probability,

⇒ *social responsibility* represents the will already apparent in the Anglo-Saxon countries and becoming clearer with pension funds to associate investments with ethical objectives and to exclude certain kinds of investment and

⇒ *transparency* is an overriding principle which is meant to give the consumer an opportunity to obtain the features referred to above as information in time to bear them in mind in his decision-making.

***Summary***

The following matrix lists the criteria which, in terms of consumer protection, the proposed directives must satisfy. The grey areas indicate the focal points of the directive, which are thus confined to security aspects and liquidity[14]

**Table 1: The proposals for directives in the consumer protection matrix**

| | **Information** | **Social protection** | **Collective** |
|---|---|---|---|
| ***Security*** | | | |
| ***Access*** | | | |
| ***Liquidity*** | | | |
| ***Interest*** | | | |
| ***Social responsibility*** | | | |
| ***Transparency*** | | | |

[14] Fonds-News of 16 February 1999 (http://www.infos.com/deutsch/news) publishes the opinion of George Festetics of the EFIFC (European Federation of Investment Funds and Companies), according to which the first part of the directive merely extends the old directive, whereas the second part raises 'sensitive questions concerning market access, the possibility of delegating services and a simplified prospectus for fund companies and unit trusts in the European Community'. He expects there to be difficulties in the European Parliament over the latter part.

# C. Consumer protection aspects of the proposed directives

### *I. Need to take account of national consumer protection in the directive*

***Effect on national law*** With liberalisation, the law as it relates to unit trusts in the various countries will not initially change, to the extent that they serve their clients there. Similarly, the very extensive national legislation on supervision will be affected only insofar as it excludes from the restrictions of national law unit trusts marketed from abroad within the scope of this directive.

***Luxembourg*** Eventually, the EU is likely to set, with this directive, not only the minimum but also the maximum standard for consumer protection in the case of unit trusts. This follows from the fact that unit trusts marketed from another country need to meet only that country's standards. Luxembourg is already one of the most important places for unit trusts. Roughly half of the unit trusts in which Germans put their savings have their registered offices in Luxembourg. A country like Luxembourg thus has, in relation to its population, an inordinate interest in selling units abroad and attracting foreign unit suppliers. As consumer protection for Luxembourgers takes second place to revenue for the Luxembourg economy (Luxembourg is the only country in the EU in which the individual citizen receives more from the state than he pays to it), it makes economic sense for this country to prescribe no more than the minimum standard required by the EU directive. This policy is evident from the fact that Luxembourg transposes some EU directives into framework laws as they stand. Units marketed under the Luxembourg authorisation rules will thus outclass other units in the future if extensive national supervisory systems in consumer countries with large populations have to compete with marketing legislation in home countries with small populations. The Delaware effect might therefore make Luxembourg the headquarters of most unit trusts, regardless of the other attractions of low taxes and banking secrecy that can be exploited for tax purposes.

***Synopsis of national legislation*** The Commission's proposals for the amendment of the directive should therefore have been accompanied by a synopsis of national consumer protection legislation that will no longer be covered by the directive in the future. This preliminary procedure would be more consistent with the subsidiarity principle and permit a more rational debate in the future. The present study cannot achieve this in the time available.

### *II. Problems and proposed solutions*

#### *1. Unit trusts as securities trading*

***High-risk securities with protection against risks*** The new amendments make for a significant reduction of the security of unit trusts. The admission of derivatives, the weakening of the risk-spreading principle, the mixing of asset management and fund management and the simplification of the information obligations will, despite the built-in safeguards, narrow the gap in the capital market between unit trusts and such higher-risk securities as shares and derivatives. The consumer's expectation that unit trusts will continue to be comparable to a classical savings contract in terms of long-term security, which is also why they have been known as 'investment *saving*' (in contrast to advanced *investment*), can no longer be upheld.

As a general rule, then, the minimum protection afforded by the securities directive should also apply to investment companies.

*2. Less security and liquidity*

Although the substitute safeguards for which the directive provides are not unsuitable, there must be serious doubts about their efficiency:

***Supervision no substitute***

- That a product originates from a sector in which there is **credit supervision** is no guarantee of security today, primarily because of the home country principle; nor is it a guarantee of consumer protection, primarily because of the abstinence in this area.
- The **home country principle** weakened domestic supervision significantly, since the latter is very remote from the area of activity of the foreign institution to be supervised. Luxembourg's supervisory capacities are in any case inadequate. **An added factor** is that information does not flow as it should because the supervisory authorities are not yet operating on the spot in some cases, and joint or networked supervision is not yet effective. Another very weighty argument is that, unlike the SEC in the USA, the European authorities have virtually no effective sanctions. The threat of closure is not enough because it is impracticable. Only hefty fines would have an impact.

***Liability rules and class actions***

- The **future supervisors of unit trusts** will be their **consumers** and competitors. Any means that makes supervision easier for the consumer should therefore be encouraged. As the normal consumer tends not to know how unit trusts operate, the possibility of subsequently holding funds liable on the basis of their **prospectuses and marketing advice** should be extended, and **class actions** should be introduced to make enforcement easier.

***Liquidity problems***

- The internal obligation to offset investment risks with equity capital will not prevent **unit trust prices from fluctuating** more significantly in the future than they have done in the past. In the sphere of social consumer protection and **liquidity** this will give rise to serious risks because the short-term availability of money will be even more limited than today.

***Applying Article 11 of the securities directive***

- Considerable doubt is thus cast on the advantage of unit trusts compared to direct investment in shares, bonds and derivatives. The new unit trusts should therefore be subject to the same protection as generally applies to the acquisition of securities. The exception made for unit trusts in the securities trading directive is no longer justified, at least where Article 11 is concerned.

***Capacity to engage in futures trading***

- Where unit trusts have a large proportion of derivatives or are linked to sharply fluctuating indices, the capacity to engage in futures trading or a guarantee that the investor has experience and information relating to securities transactions and has personally been told of the risks involved should be required.

*3. Protection against insider trading and the combination of interests*

***Insider conflicts***

In Europe unit trusts largely depend on banks. The latter are the initiators, operators, depositaries, brokers and, with provision made for bank deposits, capital investment projects of unit trusts.

In the past there was considerable anxiety that banks might abuse this comprehensive position to influence the securities market to their own advantage through the influence they wield in the case of unit trusts. The following conflicts of interest are, for example, conceivable[15]:

- When issuing securities as syndicate leader, the bank offering the risk of initial underwriting as a service has **shares bought by its own unit trust**[16].
- Where the prices of securities held by the bank in its trading portfolio in large numbers suddenly fall, it is able to buy them up through its unit trust. As a result of **the shifting of the loss** the low-value securities thus disappear from the bank's balance sheet to the disadvantage of the unit trust.
- The bank charges **higher fees** when acting as broker for shares in its unit trust.
- If the bank needs capital, it has its unit trust deposit the **assets it now holds** with the bank, thus gaining liquidity.
- With **asset management** newly authorised alongside fund management, the trust and its administration may become dependent on a wealthy client from asset management since, by threatening to withdraw, he is able to wield greater power than the trust's scattered shareholders. Internal manipulations might be forced on the bank.
- The fund may be abused for **price support** purposes.
- Conversely, a bank may use the interest rate it pays on bank deposits to make a unit trust's situation **look better** than it is.

1. Whether such abuse occurs essentially depends on whether there is sufficient competition in the market and clients punish poor performance.

***Accurate reconstruction of transactions***

A principle that should, however, help in the fight against criminal manipulations is that it must be **possible to reconstruct to the day** the unit trust's investment behaviour and that the resulting documents must be available to the securities supervisory authority that oversees unit trusts.

As it is also for the host country to control abusive practices, it could gain an insight when rules on insider trading and fraud that are relevant in criminal law are breached.

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[15] For a case in which the depositary bank was involved in the establishment of the (harmful) investment strategy of a unit trust in the advisory committee see Frankfurt Higher Regional Court 16.U. 109/96, Judgement of 19 December 1996, NJW 1997, 745.

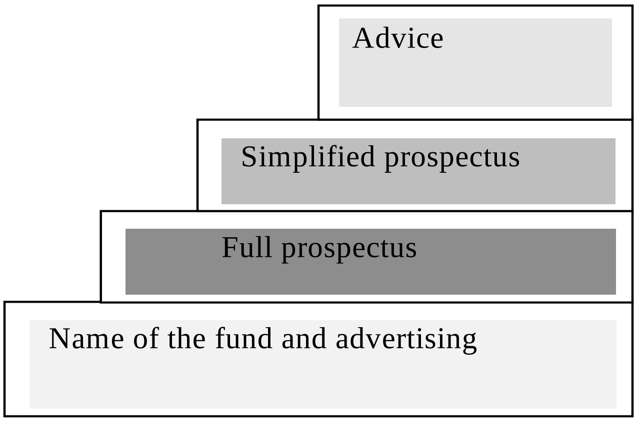
[16] It proved impossible, however, to confirm this strategy in an empirical study in Osnabrück. The problem with the study was that it covered only the syndicate leader and not the banks 'interested' in the issue.

***Acting as principal and agent***

2. The inclusion in the directive of a strict ban on acting as both principal and agent, as in section 181 of the German Civil Code, is also to be recommended. The current version of Article 5f(2) is inadequate in this respect. It should be made more stringent. In particular, acting as both principal and agent is permitted where the client has given ‘**general approval**’, which might be provided on a standard form. Approval will also be the rule in practice (as is already the case in data protection).

***Asset and fund management***

In the event of a conflict of interests between asset and fund management the ban on acting as both principal and agent will help to prevent particularly serious infringements. On the other hand, this will not be enough to prevent legally incomprehensible influences and, in particular, a situation in which the private clientele of the asset management designates the investment company. The admission of investment companies to private banking with a wealthy clientele should therefore be reconsidered in the interests of clear orientation towards the interests of the average consumer. This might be achieved through the removal of this opportunity or by permitting individual asset management only in the context of investment in the unit trust.




*4. Transparency, warnings and information*

(a) Consumer protection in the naming of unit trusts

***No name or warnings***

According to the directive, the consumer will receive information on the fund at four stages: designation in publicity, simplified prospectus, full prospectus and advice at the time of purchase.

However, the directive covers only the simplified prospectus and the full prospectus. In practice the other two sources of information are likely to be far more important to the consumer.

***Name of the fund***

The ‘name’ of a fund is the general signal by which the consumer’s attention is drawn to a given product. In Germany names are usually geared to the products managed in the fund, such as equity funds, annuity funds, mixed funds, property funds, money market funds and speciality funds (Länder funds, ‘tiger funds’, ‘EuroLux’, derivative funds, etc.). Such additions as ‘open-ended or closed-ended', 'public', 'accumulating' and 'distribution' reveal whether the trust absorbs and invests more and more capital or is closed when a limit is reached, whether it is intended for a broad public and whether the returns are distributed.

In contrast, the emphasis in the USA, the United Kingdom and France is on the legal form of the trust, examples being unit trust, mutual trust, open trust, SICAV (Société d'Investissement à Capital Variable) and Fonds Commun de Placement.

As it is now to be possible to authorise funds in which prices and risks vary to a greater or lesser degree, there would seem to be a need for the fund's capital assets and thus its risk structure to be clear from its very name. The directive should therefore generally stipulate that funds which include more than 10% derivatives must be referred to as derivative funds at least in the subtitle. It should also be prescribed that the designation of the fund include the object, the place of investment and the spread ('index funds' or something similar) in an abbreviated form of the name, which must also be used in advertising. This will increase comparability, and the consumer information will make it possible to indicate in simple and general terms which funds are suitable for which investment purposes and which investors.

***Protecting retirement provision***

Special protection should be provided when a fund is designated for **retirement provision**. The designations 'retirement provision' and 'pension fund' should be subject to the requirement that the funds belong to a special safeguard system, pay a pension for life and are recognised by national tax legislation as retirement provision products where such legislation contains appropriate clauses.

(b) Consumer protection rules in the sale of securities

***Warnings and rules of conduct in securities transactions***

As regards **warnings**, it has already been pointed out that the exception made in Article 2(2)(h) of Securities Service Directive 93/22/EEC of 10 March 1993 for UCITS does not make sense now that unit trusts may invest in all types of security and take on increased risks because it unjustifiably gives preference to UCITS over other securities trading firms.

An examination of the provisions of this directive also makes it clear that considerable duplication would have been avoided if UCITS had been included in the securities trading directive and the banking law directives had applied only where UCITSs are equivalent to credit institutions. This approach would have made for stringent and transparent legislation.

With the current directive an attempt can merely be made to overcome the inequalities in the detail. It is noticeable in this context that, particularly where warnings and advice are concerned, there is no equivalent at all to Article 11 of the securities service directive.

Nor is Article 12 concerning the safeguard systems provided by this directive to be found in this form in the UCITS directive. Article 6b(2) merely requires '*details of any compensation scheme intended to protect investors*' to be communicated to the authorities of the host country. A reference to this effect is not to be found in the simplified prospectus in Schedule C of Annex 1.

Only in the case of individual portfolio management does Article 5f(2), third indent, require membership of an investor compensation scheme in accordance with Directive 97/9/EC. Otherwise, further EU rules are awaited, which may give rise to a problematical transition period.

Warnings ('only for experienced investors and for investors whose financial situation allows them to bear the risks involved in the investment in units of such UCITS') in the simplified prospectus will be no substitute for advice related to the individual or, above all, for the ability to effect futures transactions.

Making the securities service directive applicable to UCITS where these articles are concerned should therefore be considered.

# Appendix: Report of the European Parliament, adopted 17 February 2000

## I

**Proposal for a European Parliament and Council directive amending Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investments in transferable securities (UCITS) (COM(1998) 449 - C4-0464/1998 - 1998/0243(COD))**

The proposal was amended as follows:

(Amendment 1)
Recital 4

| Text proposed by the Commission [(1)] | Amendments adopted by Parliament |
|---|---|
| (4) Whereas money market instruments cover those *classes of* transferable instruments which are normally dealt in on the money market, for example treasury and local authority bills, certificates of deposit, commercial paper and bankers" acceptances; *whereas Member States should have the option of choosing the list of eligible money market instruments on the basis of objective criteria to take account of the existing structural differences in the money markets of different countries;* | (4) Whereas money market instruments cover those transferable instruments which are normally dealt in on the money market, for example treasury and local authority bills, certificates of depositcommercial paper and bankers" acceptances; *whereas it is necessary to ensure the concept of regulated markets in this directive corresponds to that in Directive 93/22/EEC([1]);* <br> (1) *OJ L 141, 11.6.1993, p.27.* |

[(1)]OJ C 280, 9.9.1998, p. 6.

(Amendment 2)
Recital 5

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|---|---|
| (5) Whereas it is desirable to permit a UCITS to invest its assets in units of other collective investment undertakings of the open ended type which also invest in transferable securities and which operate on the principle of risk-spreading; *whereas the requirement of risk spreading for UCITS investing in other collective investment undertakings is indirectly respected since such UCITS can only invest in units issued by collective investment* | (5) Whereas it is desirable to permit a UCITS to invest its assets in units of *UCITS and* other collective investment undertakings of the open ended type which also invest in transferable securities and which operate on the principle of risk-spreading; *whereas a UCITS or other collective investment undertakings in which a UCITS invests in should also be subject to effective supervision; whereas investments in units of UCITS and other collective investment* |

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| *undertakings complying with the risk spreading criteria of Directive 85/611/EEC;* whereas it is important that such UCITS adequately disclose to investors the fact that they invest in units of other collective investment undertakings; | *undertakings should not result in cascades of funds;* whereas it is important that such UCITS adequately disclose to investors the fact that they invest in units of other collective investment undertakings; |

(Amendment 3)
Recital 6

| | |
|---|---|
| (6) Whereas to take market developments into account and in consideration of the completion of the EMU it is desirable to permit UCITS to invest in bank deposits; | (6) Whereas to take market developments into account and in consideration of the completion of the EMU it is desirable to permit UCITS to invest in bank deposits; *whereas to ensure adequate liquidity of the investments in deposits the terms of these deposits shall include a break clause; whereas, if the deposits are made with a credit institution situated in a non-Member State, the credit institution should be subject to effective supervision;* |

(Amendment 4)
Recital 10

| | |
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| (10) Whereas new portfolio management techniques for collective investment undertakings investing primarily in shares are based on the replication of stock-indices; whereas it is desirable to permit UCITS to replicate well known and recognised stock-indices; whereas therefore it is necessary to introduce more flexible risk-spreading rules for UCITS investing in shares; whereas in order to ensure transparency of the stock-indices which the Member States consider to be replicable by harmonised UCITS and a wide acceptance of such indices, it is desirable to provide for adequate publication of the list of replicable stock-indices; | (10) Whereas new portfolio management techniques for collective investment undertakings investing primarily in shares are based on the replication of stock-indices *and/or indices on debt securities*; whereas it is desirable to permit UCITS to replicate well known and recognised stock-indices; whereas therefore it is necessary to introduce more flexible risk-spreading rules for UCITS investing in shares *and/or debt securities*; whereas in order to ensure transparency of the stock-indices which the Member States consider to be replicable by harmonised UCITS and a wide acceptance of such indices, it is desirable to provide for adequate publication of the list of replicable stock-indices *and an indication about where updated information, possibly by electronic means, can be obtained*; |

(Amendment 5)
Recital 13a (new)

| | |
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| | *(13a) Whereas the development of opportunities for a UCITS to invest in UCITS and other collective investment undertakings shall be facilitated; whereas therefore it is essential to ensure that such investment activity does not diminish investor protection; whereas taking into account the nature of investments in sufficiently diversified collective investment undertakings it may be necessary to restrict the possibility for a UCITS to combine its direct investments in a liquid financial asset with the investments made through these other collective investment undertakings; whereas, because of the enhanced possibilities for UCITS to invest in units of other UCITS and collective investment undertakings, it is necessary to lay down certain rules on quantitative limits, disclosure of information and prevention of the cascade phenomenon;* |

(Amendment 6)
Recital 14a (new)

| | |
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| | *(14a) Whereas, for prudential reasons, UCITS should, whether its chosen investment policy is to invest in a variety of liquid financial assets or to specialise in a certain category of such assets, avoid assuming an excessive concentration in liquid financial assets issued by and/or made with a single body;* |

(Amendment 7)
Recital 17a (new)

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| | *(17a) Whereas a codification of the Community legislation relating to UCITS will have to be prepared immediately after the adoption of the modifications to Directive 85/611/EEC contained in this Directive:* |

(Amendment 8)
ARTICLE 1 (1)
Article 1(2), 1st indent (Directive 85/611/EEC)

| | |
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| - the sole object of which is the collective investment in transferable securities and/or in other liquid financial assets *mentioned in Article 19 of* this Directive of capital raised from the public and which operate on the principle of risk-spreading; | - the sole object of which is collective investment in transferable securities and/or in other liquid financial assets *covered by* this Directive of capital raised from the public and which operate on the principle of risk-spreading; |

(Amendment 9)
ARTICLE 1(2a) (new)
Article 19 (1) (a) (Directive 85/611/EEC)

| | |
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| | 2a. Article 19(1)(a) shall be replaced by the following:<br>"(a)*transferable securities admitted to or dealt in on a regulated market within the meaning of Article 1 (13) of Directive 93/22/EEC on investment services in the securities field in a Member State and/or"* |

(Amendment 44)
ARTICLE 1(3)
Article 19(1)(e) (Directive 85/611/EEC)

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| (e) units of other collective investment undertakings within the meaning of the first and second indent of Article 1 (2); and/or | (e) units of UCITS and other collective investment undertakings within the meaning of the first and second indent of Article 1 (2) *provided that:*<br>- the other collective investment undertaking is authorised under laws which provide that it is subject to supervision considered by the ucits" competent authorities equivalent to the one that laid down in Community law, and cooperation between authorities is sufficiently ensured;<br>- the level of protection for unitholders in the other collective investment undertaking is equivalent to that provided for unit-holders in a UCITS, in particular the rules on borrowing, lending, uncovered sales of transferable securities and on the role and the liability of the depositary laid down by this Directive are respected;<br>- the business of the other collective |

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| | investment undertaking is reported in half-yearly and annual reports to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period;<br><br>- the other collective investment undertaking is, according to its fund rules or instruments of incorporation, not permitted to invest, in aggregate, more than 10% of its assets in units of other UCITS or other collective investment undertakings; and/or |

(Amendment 11)
ARTICLE 1(3)
Article 19(1)(f) (Directive 85/611/EEC)

| | |
|---|---|
| (f) deposits with credit institutions; | *(f) deposits with credit institutions which are repayable on demand or have the right to be withdrawn and maturing in no more than 12 months, provided that the credit institution has its registered office in a Member State or, if the registered office of the credit institution is situated in a non-Member State, provided that it is subject to prudential rules considered by the UCITS competent authorities as equivalent to those laid down in Community law;* |

(Amendment 37)
ARTICLE 1(3)
Article 19(1)(g) and (h) (Directive 85/611/EEC)

| | |
|---|---|
| (g) *standardised financial-futures contracts*, including equivalent cash-settled instruments, dealt in on a regulated market mentioned in the previous sub-paragraphs (b) and (c); and/or<br>*(h) Standardised options to acquire or dispose of any instruments falling within this Article, inlcuding equivalent cash-settled instruments, dealt in on a regulated market mentioned in the previous sub-paragraphs (b) and (c). This category includes, in particular, options on currency and on interest rates; and/or* | (g) *financial derivative instruments*, including equivalent cash-settled instruments dealt in on a regulated market mentioned in the previous sub-paragraphs *(a)*, (b) and (c) *or dealt in over-the-counter (OTC), provided that the counterparties to OTC transactions are institutions subject to prudential supervision, and belonging to the categories approved by the UCITS' competent authorities, and the instruments with a high rating based on a recognised rating scale are subject to reliable and verifiable valuation and they can be sold or liquidated on a daily basis* and/or<br>Deleted. |

(Amendment 13)
ARTICLE 1(3)
Article 19(1)(i), introduction (Directive 85/611/EEC)

| | |
|---|---|
| (i) money market instruments *which are not* dealt in on a regulated market, unless the issue of such instruments is itself regulated for the purpose of protecting investors and savings, and provided that they are: | (i) money market instruments *other than those dealt in on a regulated market which fall under Article 1 (8) (b)*, unless the issue of such instruments is itself regulated for the purpose of protecting investors and savings, and provided that they are: |

(Amendment 14)
ARTICLE 1(5)
Article 20 (Directive 85/611/EEC)

| | |
|---|---|
| *5. Article 20 shall be deleted.* | Deleted |

(Amendment 16)
ARTICLE 1(6)
Article 21(4), first subparagraph (b) and second subparagraph (Directive 85/611/EEC)

| | |
|---|---|
| (b) in relation to each securities lending transaction appropriate collateral shall be given covering the risk of default of the borrower. The value of collateral must be, during the entire period of the contract, at least equal to the total value of the financial instruments lent. | (b) in relation to each securities lending transaction, provided they are not carried out by recognised security clearing houses and exchanges, appropriate collateral shall be given to the UCITS covering the risk of default of the borrower. The value of collateral must be, during the entire period of the contract, at least equal to the total value of the financial instruments lent. |
| When a UCITS is permitted to conclude securities lending transactions with the depositary which performs for that UCITS the duties mentioned in Article 7 and 14 of this Directive, the competent authorities shall ensure that the collateral is interested, during the entire period of the contract, with a third party custodian and that measures are undertaken preventing the depositary from using it. | When a UCITS is permitted to conclude securities lending transactions with the depositary which performs for that UCITS the duties mentioned in Article 7 and 14 of this Directive, the competent authorities shall ensure that the collateral is interested, during the entire period of the contract, *with a blocked account, security deposit or* with a third party custodian and that measures are undertaken preventing the depositary from using it. |

(Amendments 36 and 45)
ARTICLE 1(6a) (new)
Article 22(1a) (new) (Directive 85/611/EEC)

| | |
|---|---|
| | *6a. In Article 22, the following paragraph shall be added:*<br><br>"1a.A UCITS may invest no more than 5% of its assets at any point in time in transferable securities dealt with, over-the-counter derivatives and deposits made with the same body.<br><br>*In no case may the transferable securities dealt with, over-the-counter derivatives and deposits made with bodies belonging to a single group at any point in time account for more than 15% of the assets of UCITS. For the purposes of this rule, group shall include bodies linked by the relationship defined in Article 1 of Directive 83/349/EEC".* |

(Amendment 42)
ARTICLE (1(6b) (new)
Article 22(3) (Directive 85/611/EEC)

| | |
|---|---|
| | *6b. Article 22 (3) is deleted.* |

(Amendment 39)
ARTICLE 1(6c) (new)
Article 22(3a) (new) (Directive 85/611/EEC)

| | |
|---|---|
| | *6c. In Article 22, the following paragraph shall be added:*<br><br>"3a.A UCITS which has adequate risk management controls may invest in financial derivative instruments, provided that investment in over-the-counter financial derivatives may not result in an overall daily exposure measured by its mark to market value exceeding 30% of its total assets." |

(Amendment 18)
ARTICLE 1(7)
Article 22a (1) to (3) (Directive 85/611/EEC)

| | |
|---|---|
| 1. Without prejudice of the limits laid down in Article 25, the Member States may raise the limits laid in Article 22 to a maximum of *35%* for investment in shares issued by the same body when, according to the fund rules or instruments of incorporation, the aim of the UCITS" investment policy is to replicate *the composition of a certain stock-index.* | 1. Without prejudice of the limits laid down in Article 25, the Member States may raise the limits laid in Article 22 to a maximum of *20%* for investment in shares issued by the same body when, according to the fund rules or instruments of incorporation, the aim of the UCITS" investment policy is to replicate *a certain recognised stock or debt securities index in a way that :*<br>- *its investment policy seeks to reflect the composition of that index*;<br>- *the index* represents an adequate benchmark for the market to which *it refers*;<br>- be published in an appropriate manner. |
| *2. Replicable stock indices shall be indices which Member States consider to :*<br>*-have a composition which is sufficiently diversified;*<br>- be easy to replicate;<br>- represent an adequate benchmark for the *equity* market to which *they refer*;<br>- be published in an appropriate manner. | |
| *3.* Each Member State shall send to the Commission the list of stock-indices which they consider replicable by UCITS, together with details of the characteristics of such stock-indices. A similar communication shall be effected in respect of each change to the aforementioned list. The Commission shall publish the complete list of replicable stock-indices and updates thereto in the Official Journal of the European Communities at least once a year. This list may be subject to exchanges of views within the Contact Committee in accordance with the procedure laid down in Article 53 (4). | *2.* Each Member State shall send to the Commission the list of stock-indices which they consider replicable by UCITS, together with details of the characteristics of such stock-indices *and an indication about where updated information can be obtained*. A similar communication shall be effected in respect of each change to the aforementioned list. The Commission shall publish the complete list of replicable stock-indices and updates thereto in the Official Journal of the European Communities at least once a year *or make such information publicly available in an appropriate manner*. This list may be subject to exchanges of views within the Contact Committee in accordance with the procedure laid down in Article 53 (4). |

(Amendment 19)
ARTICLE 1 (8)
Article 24 (1) (2) and (3) (Directive 85/611/EEC)

| | |
|---|---|
| 1. A UCITS may acquire the units of other collective investment undertakings *within the meaning of the first and second indent of Article 1 (2)* provided that *it invests no more than 10% if its own assets* in units of a single UCITS. | *1. A UCITS may acquire the units of UCITS and other collective investment undertakings mentioned in Article 19(1)(e) provided that no more than 10% of its assets are invested in units of a single UCITS or other collective investment undertaking. The Member States may raise the limit to a maximum of 20%.* |
| 2. The Member States may *raise the limit laid down in paragraph 1 to a maximum of 35%. However, in that case the UCITS must invest at least in five different collective investment undertakings mentioned in paragraph 1.* | *2. The investments made in units of collective investment undertakings other than UCITS may not exceed, in aggregate, 30% of the assets of the UCITS.* |
| | The Member States may *allow that, when a UCITS has acquired units of UCITS or other collective investment undertakings, the assets of the respective UCITS or other collective investment undertaking do not have to be combined to the limits laid down in Article 22.* |
| 3. A UCITS may not invest *in units of a* collective investment undertaking *within the meaning of the first and second indent of Article 1 (2), which invest more than 10% of its own assets in units of other collective investment undertakings.* | 3. A UCITS may not invest *in another UCITS or other collective investment undertaking that invests itself more than 10% in units of other UCITS or other collective investment undertakings.* |
| | *3a. The UCITS" fund rules or instruments of incorporation, its prospectuses and any promotional literature must include a prominent statement drawing the attention to the fact that the UCITS invests, as a part of its general investment policy, in units of other UCITS and other collective investment undertakings.* |

(Amendment 20)
ARTICLE 1 (9)
Article 24a (1) and (2) (Directive 85/611/EEC)

| | |
|---|---|
| *1. Notwithstanding the provision laid down in Article 19 (4), a UCITS may invest its assets in deposits with credit institutions furnishing sufficient financial and professional guarantees, provided that the UCITS places no more than 10% of its assets in deposits with the same credit institution or with credit institution within the same group.* | *Deleted* |

| | |
|---|---|
| *2. Member States may raise the limit laid down in paragraph 1 to a maximum of 35%. However, in that case a UCITS must invest in deposits with at least five different credit institutions. For the purposes of this rule, credit institutions belonging to the same group are considered to be one single institution.* | Deleted |

(Amendment 43)
ARTICLE 1(9)
Article 24b(1) (Directive 85/611/EEC)

| | |
|---|---|
| 1. *Notwithstanding the provisions laid down in Article 21,* a UCITS may invest, as a part of its general investment policy, *in financial-futures contracts and options mentioned in Article 19(1)(g) and (h), provided that the maximum potential exposure relating to the conclusion of each such derivative transaction is covered, during the entire period of the contract, by assets belonging to the UCITS of the right kind and sufficient in value.* | 1. A UCITS may invest, as a part of its general investment policy, *in financial derivatives, provided that the amount of the commitments entered into by the UCITS is not greater than the total net value of its activities. In calculating the value of the commitments, reference must be made to the current value of underlying activities.* |

(Amendment 21)
ARTICLE 1(16)
Article 53a, second indent (Directive 85/611/EEC)

| | |
|---|---|
| *-adaptation of the ceilings referred to in Section V and in Article 36(2) in order to take account of developments on financial markets, where such adaptations will not lead to stricter requirements for the UCITS,* | *Deleted.* |

**European Parliament legislative resolution on the proposal for a European Parliament and Council directive amending Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (COM(1998) 449 - C4-0464/1998 - 1998/0243(COD))**

*(Codecision procedure: first reading)*

**The European Parliament,**

- having regard to the Commission proposal to the European Parliament and the Council (COM(1998) 449)[(1)],

- having regard to Article 251(2) of the EC Treaty and Article 47(2) of the EC Treaty, pursuant to which the Commission submitted the proposal to Parliament (C4-0464/1998),

- having regard to Rule 67 of its Rules of Procedure,

- having regard to the report of the Committee on Economic and Monetary Affairs and the opinion of the Committee on Legal Affairs and the Internal Market (A5-0025/2000),

1. Approves the Commission proposal as amended;

2. Asks to be consulted again should the Commission intend to amend its proposal substantially or replace it with another text;

3. Instructs its President to forward its position to the Council and Commission.

## II

**Proposal for a European Parliament and Council directive amending Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investments in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses (COM(1998) 451 - C4-0465/1998 - 1998/0242(COD))**

The proposal was amended as follows:

(Amendment 22)
Recital 15a (new)

| Text proposed by the Commission[(1)] | Amendments by Parliament |
|---|---|
| | *(15a) Whereas a codification of the Community legislation relating to UCITS will have to be prepared immediately after the adoption of the modifications to Directive 85/611/EEC contained in this Directive:* |

[(1)] OJ C 272, 1.9.1998, p. 7.

(Amendment 23)
ARTICLE 1(1)
Article 1a (2) (Directive 85/611/EEC)

| | |
|---|---|
| 2. management company shall mean any company the regular business of which is the management of unit trusts/common funds and of investment companies (collective portfolio management); | 2. management company shall mean any company the regular business of which is the management of the *assets of* unit trusts/common funds and of investment companies (collective portfolio management) *including the activities mentioned in Annex II*; |

(Amendment 24)
ARTICLE 1(3)
Article 5(4a) (new) (Directive 85/611/EEC)

| | |
|---|---|
| | *4a. The Member States' competent authorities shall not grant authorisation, or shall withdraw authorisation from a UCITS, where factors such as the content of programmes of operations, the geographical distribution or the activities actually carried on indicate clearly that the entity has opted for the legal system of one Member State for the purpose of evading the stricter standards in force in another Member State within the territory of which it intends to carry on or does carry on the greater part of its activities.* |

(Amendment 41/rev.)
ARTICLE 1(3)
Article 5a(1), first two indents (Directive 85/611/EEC)

| | |
|---|---|
| - it has *sufficient* initial capital *of the following amount*: | - it has initial capital of *at least EUR 150 000. In addition, it shall maintain certain capital requirements that are at least equivalent to the higher of the following amounts:* |
| *(a) if it is authorised to manage only unit trusts/common funds and investment companies, ECU 50 000;* | *(a) an amount of capital to be determined in accordance with the rules laid down in Directive 93/6/EEC, having regard to the nature of the services provided;* |
| *(b) if its authorisation covers also the discretionary portfolio management service mentioned in Article 5(3), first indent, in addition to the capital mentioned in the previous letter (a), an amount of capital to be determined in accordance with the rules laid down in Article 3, paragraphs 1 and 2 of Directive 93/6/EEC (1) having regard to the nature of the service in question;* | *(b) an amount of capital to be determined by applying the following scale to the total amount of the assets managed:*<br>*- 0.1% up to EUR 1000 million managed;*<br>*- EUR 1 000 000 plus 0.02% of assets managed in excess of EUR 1000 million, subject to a ceiling of EUR 10 million.* |
| *-the persons who effectively direct the business of a management company are of sufficiently good repute and are sufficiently experienced also in relation to the type of UCITS managed by the management company. The direction of a management company's business must be decided by at least two persons meeting these conditions;* | |

(Amendment 35)
ARTICLE 1(3)
Article 5a(3) (Directive 85/611/EEC)

| | |
|---|---|
| 3. An applicant shall be informed, within six months of the submission of a complete application, whether or not authorisation has been granted. Reasons shall be given whenever an authorisation is refused. | 3. An applicant shall be informed, within six months of the submission of a complete application, whether or not authorisation has been granted. Reasons shall be given whenever an authorisation is refused. *After authorisation has been refused in one Member State, it may not be applied for in another Member State. The parallel submission of applications in more than one Member State shall not be permitted.* |

(Amendment 25)
ARTICLE 1(3)
Article 5f(1) second subparagraph (Directive 85/611/EEC)

| | |
|---|---|
| In particular, the competent authorities of the home Member State having regard also to the nature of the UCITS managed by a management company, shall require that each such company has sound administrative and accounting procedures, control and safeguard arrangements for electronic data processing and adequate internal control mechanisms ensuring, inter alia, that the assets of the unit trusts/common funds or of the investment companies managed by the management company are invested according to the fund rules or the instruments of incorporation and the legal provisions in force. | In particular, the competent authorities of the home Member State having regard also to the nature of the UCITS managed by a management company, shall require that each such company has sound administrative and accounting procedures, control and safeguard arrangements for electronic data processing and adequate internal control mechanisms ensuring, inter alia, that *each transaction involving the fund may be reconstructed according to its origin, the parties to it, its nature, and the time and place at which it was effected and* the assets of the unit trusts/common funds or of the investment companies managed by the management company are invested according to the fund rules or the instruments of incorporation and the legal provisions in force. |

(Amendment 26)
ARTICLE 1(3)
Article 5f (2) second subparagraph (new) (Directive 85/611/EEC)

| | |
|---|---|
| | *The competent authorities of the home Member State may, irrespective of a prior approval from the client of a management company, approve the activities of the management company referred to in the above-mentioned three indents provided that the provisions Article 10 (2) are complied with.* |

(Amendment 27)
ARTICLE 1(3)
Article 5g(1) and (2), introduction and first and second indents (Directive 85/611/EEC)

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| 1. *When a Member State permits a management company to delegate to third parties, on the basis of specific mandates and for the purpose of a more efficient conduct of the company' s business, to carry out on its behalf one or more of the functions included in the activity of collective portfolio management mentioned in Annex II, each mandate must be submitted to the competent authorities for prior approval.* | *1. The competent authorities of the home Member State may permit management companies to delegate specific investment decisions to intermediaries that are subject to prudential supervision, in accordance with investment-allocation criteria periodically laid down by the management companies.* |
| 2. The competent authorities shall approve the mandate only after having verified the compliance with the following pre-conditions: | 2. The competent authorities shall approve the mandate only after having verified the compliance with *all* the following pre-conditions: |
| - The mandate shall not prevent the effectiveness of supervision over the management company, | - The mandate shall not prevent the effectiveness of supervision over the management company, |
| - in *order to prevent conflicts of interest,* the mandate shall not be given to the depository *and to persons having qualifying holdings in the management company' s or the depositary' s capital or to any other person whose interests may conflict with those of the management company or the unit-holders,* | - *where the mandate is given to a third-country intermediary, cooperation between the prudential supervisory authorities must be ensured regarding the delegating party and the party delegated to act,* |
| | - the *mandate shall not be given to the depositary,* |

(Amendment 28)
ARTICLE 1(3)
Article 6a(4) (Directive 85/611/EEC)

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| 4. Before the branch of a management company commences business, the competent authorities of the host Member State shall, within two months of receiving the information referred to in paragraph 2, prepare for the supervision of the management company and, if necessary, indicate the conditions, including the rules mentioned in Articles 44 and 45 in force in the host Member State and the rules of conduct to be respected in the case of provision of the portfolio management service mentioned in Article 5(3) , under which, in the interest of | *4. Before the branch of a management company commences business, the competent authorities of the host Member State shall, within two months of receiving the information referred to in paragraph 2, prepare for the supervision of the management company and, if necessary, indicate the conditions, including the rules mentioned in Articles 44 and 45 in force in the host Member State and the rules of conduct to be respected in the case of provision of the portfolio management service mentioned in Article 5(3) and of investment* |

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| the general good, that business must be carried on in the host Member State. | *advisory services and custody services, under which, in the interest of the general good, that business must be carried on in the host Member State.* |

(Amendment 29)
ARTICLE 1(6)
Article 28(1) (Directive 85/611/EEC)

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| 1. Both the simplified and the full prospectuses must include the information necessary for investors to be able to make an informed judgement of the investment proposed to them. | 1. Both the simplified and the full prospectuses must include the information necessary for investors to be able to make an informed judgement of the investment proposed to them *and, in particular, of the risks attached thereto.* |

(Amendment 30)
ARTICLE 1(6)
Article 28 (1), second subparagraph (new) (Directive 85/611/EEC)

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| | *In particular, the prospectuses must include a clear and easily understandable explanation of the fund's risk profile (independent of whether or not derivatives are used and independent of the type of securities invested in).* |

(Amendment 31)
ARTICLE 1(7)
Article 29(2a) (new) (Directive 85/611/EEC)

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| | *2a. The provisions on rules of conduct to be observed in connection with the sale of shares for investment purposes and on information concerning safeguard systems set out in Articles 11 and 12 of Directive 93/22/EEC on investment services in the securities field shall apply mutatis mutandis.* |

(Amendment 32)
ANNEX I "Investment information" , 5th indent (new) (Directive 85/611/EEC)

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| | *-a brief assessment of the fund's risk profile.* |

**European Parliament legislative resolution on the proposal for a European Parliament and Council directive amending Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses (COM(1998) 451 - C4-0465/1998 - 1998/0242(COD))**

*(Codecision procedure: first reading)*

**The European Parliament,**
- having regard to the Commission proposal to the European Parliament and the Council (COM(1998) 451)[(2)],

- having regard to Article 251(2) of the EC Treaty and Article 47(2) of the EC Treaty, pursuant to which the Commission submitted the proposal to Parliament (C4-0465/1998),

- having regard to Rule 67 of its Rules of Procedure,

- having regard to the report of the Committee on Economic and Monetary Affairs and the opinion of the Committee on Legal Affairs and the Internal Market (A5-0025/2000),

1. Approves the Commission proposal as amended;

2. Asks to be consulted again should the Commission intend to amend its proposal substantially or replace it with another text;

3. Instructs its President to forward its position to the Council and Commission.

[(1)] OJ C 280, 1.9.1998, p. 6.
[(2)] OJ C 272, 9.9.1998, p. 7.

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