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**GREEN PAPER**

**ON THE ENHANCEMENT OF THE EU FRAMEWORK  
FOR INVESTMENT FUNDS**

(SEC(2005) 947)

(presented by the Commission)

## GREEN PAPER

### ON THE ENHANCEMENT OF THE EU FRAMEWORK FOR INVESTMENT FUNDS

#### Introduction

The investment fund industry has grown over the space of a decade to become a key actor in European capital markets. Investment funds mobilise household savings and channel them towards productive investments. The European fund industry currently manages over € 5 trillion of assets. This Green Paper evaluates the impact of European legislation which was put in place to support the development of the most common type of investment funds in the European market place – UCITS. These account for over 70% of the assets under management by the fund industry.

#### *What are UCITS?*

UCITS (Undertakings for Collective Investment in Transferable Securities) are specially constituted collective investment portfolios exclusively dedicated to the investment of assets raised from investors. Under the UCITS Directive<sup>1</sup> UCITS investment policy and its manager are authorised in accordance with specific requirements. UCITS' legislation aims to establish a defined level of investor protection. This is achieved through strict investment limits, capital and disclosure requirements, as well as asset safe-keeping and fund oversight provided by an independent depository. UCITS benefit from a 'passport' allowing them, subject to notification, to be offered to retail investors in any EU jurisdiction once authorised in one Member State.

There is a perception among most stakeholders that UCITS legislation could function better. It does not allow the full potential of the fund industry to be optimised on a pan-European level. Nor does it have the flexibility needed to cope with the challenges posed by rapidly evolving financial markets. However, there is no compelling case for fundamental legislative overhaul at this stage. Instead the focus should be on exhausting the possibilities offered by the current legislative framework. The Green Paper therefore identifies ways to facilitate the successful development of the fund industry in the short to medium term by building on existing legislation while at the same time guaranteeing the necessary high level of investor protection. The appended table summarises the steps that are currently envisaged. The focus on these initiatives in the coming two years should not, however, exclude reflection on more far-reaching actions that may be needed to ensure that the European fund industry can work efficiently, and that investors enjoy high levels of protection.

Socio-economic challenges make the time ripe for this review. The EU regulatory environment should enable the fund industry to develop soundly structured, well-administered collective investments which deliver the highest possible returns consistent with the individual investors' financial capacity and risk appetite while giving them all the necessary

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<sup>1</sup> Directive 85/611/EEC of 20 December 1985 (OJ L 375, 31.12.1985, p. 3) amended, inter alia, by Directives 2001/107/EC ("Management company Directive") of 21 January 2002 (OJ L 41 of 13.2.2002, p. 20) and 2001/108/EC ("Product Directive") of 21 January 2002 (OJ L 41 of 13.2.2002, p. 35) both referred to in the text as UCITS III.

information to evaluate risks and costs. Integrated and efficient European markets for investment funds are of strategic importance: they can contribute significantly to adequate provisioning for retirement; they allocate savings to productive investments; and they can be a force for sound corporate governance.

The analysis presented in this document draws on the asset management expert group report published in May 2004 and subsequent discussions with Member States, CESR members and market participants. This consultations and the detailed analysis of the functioning of UCITS legislation which Commission services have undertaken<sup>2</sup> have highlighted a number of issues which the Commission believes warrant extensive public debate. This Green Paper represents the Commission's first contribution to this debate.

## **1. GENERAL ASSESSMENT**

The UCITS Directive has proved an important first step towards integrated and competitive European markets for investment funds. 28,830 UCITS funds manage €4 trillion. UCITS enjoy wide market recognition inside but also outside the EU.

The use of the UCITS product passport has more than doubled in the last 5 years. 16% of UCITS are true cross-border funds and are winning increasing investor share. However, cross-border UCITS are only beginning to establish themselves as significant players in host country markets.

Viewed from the perspective of overall market efficiency, the sector's potential is not yet fully exploited. The landscape remains dominated by funds of sub-optimal size. European funds are on average 5 times smaller than their average US counterpart. As a result, the fund industry is not able to benefit fully from scale economies – reducing net returns to end-investors.

From an investor protection perspective, there have not been notable financial scandals involving UCITS. UCITS has provided a solid underpinning for a well-regulated fund industry. Recent trends in the industry are, however, changing the risk-features of the business. Outsourcing of operational functions or moves towards open-architecture may entail increased operational risk or conflicts of interest. New fund-types, based on more sophisticated investment strategies, may embody features that are not well-understood by retail investors. The possible implications of alternative investment strategies for investor protection and financial stability remain poorly understood. Furthermore, substitute products, such as unit-linked products or certificates, compete with UCITS for long-term savings. However, they are not necessarily subject to the same level of disclosure and transparency.

The Green Paper examines how well the UCITS framework meets its objectives in this evolving context.

## 2. MAKING EXISTING LEGISLATION DELIVER

### 2.1. Priority actions

In January 2002, the original UCITS Directive was amended in several key respects. The “Product Directive” extended the range of assets in which a UCITS can invest. The “Management Company Directive” reinforced capital and organisational requirements for management companies. It allowed them to passport certain services and introduced a new disclosure document, the simplified prospectus. Since their entry into force in February 2004, divergences have emerged between Member States in how some of the amended provisions should be interpreted and implemented. Funds still encounter difficulties in making use of the product passport.

In recent months, the overriding priority has been to consolidate the UCITS passport and to provide more guidance on investor protection safeguards. In this respect, a crucial contribution is being made by the CESR Investment Management Expert Group. The cooperation and commitment of national supervisors, working through CESR<sup>3</sup>, is central to finding pragmatic solutions to implementation problems.

This work will continue. The focus will be to:

1. Eliminate the uncertainty surrounding the recognition of funds launched during the transition from UCITS I to UCITS III. CESR guidelines have helped to resolve the uncertainty regarding the treatment of ‘grandfathered funds’. It is extremely important that these guidelines are implemented faithfully in a way that ensures the smooth functioning of the passport.
2. Simplify the notification procedure for passporting funds: the contents, complexity and length of the notification phase vary greatly from one Member State to the next. There is a need to streamline procedures and to consider practical mechanisms for resolving questions within the scope of current responsibilities. This may also involve improving inter-administrative collaboration in order to avoid home country authorisation from being contested. CESR has already started work to build up convergence among regulators in this area.
3. Promote implementation of Commission’s Recommendations on the use of derivatives and the simplified prospectus: these aim to improve risk management standards and fee transparency. Preliminary analysis, based on CESR’s review, suggests that, with isolated exceptions, Member State authorities have moved to implement this guidance. Given the importance of these issues, the Commission will push for further progress in crucial areas, such as the disclosure of fees and charges.
4. Clarify the definition of “assets” which can be acquired by UCITS. One of the cornerstones of UCITS legislation is that the fund should invest primarily in liquid financial instruments. The UCITS III left room for different views on whether certain categories of financial instrument could be acquired by UCITS. Legally binding clarifications of asset eligibility will be finalised by the Commission in early 2006, further to article 53a of the Directive.

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Further to Commission Decision 2001/527/EC of 6 June 2001 (OJ L 191, 13.7.2001, p. 43).

**Q1 :** Will the above initiatives bring sufficient legal certainty to the implementation of the Directive?

**Q2 :** Are there additional concerns relating to day-to-day implementation of the Directive which need to be tackled as a priority?

## **2.2. Making better use of the current framework**

Can the existing EU legislative framework be further developed to deal with some of the main structural challenges confronting the EU fund industry – notably improving its competitiveness and responding to changing investor demand? Two areas where further work could be undertaken on the basis of existing legislative framework have been identified.

### *2.2.1. The management company passport*

The possibility for fund managers to establish and operate UCITS domiciled in other Member States is seen by some segments of the industry as the route to greater efficiency and specialisation in portfolio management and fund administration. Such a possibility was invoked by the management company Directive for corporate UCITS. However, due to the perceived ambiguities and the incompleteness of the Directive, these opportunities have not materialised. In particular, concerns have been expressed that splitting the supervision of the fund and its manager between two jurisdictions could compromise the effectiveness of risk controls and investor protection. Before taking further steps in this respect, the Commission wishes to gather further evidence on the extent to which the management company passport can open up significant additional commercial possibilities and to identify related supervisory concerns. On the basis of responses to this Green Paper, the Commission will indicate whether and how effect can be given to the management company passport when it issues its follow-up report in early 2006.

**Q3 :** Would an effective management company passport deliver significant additional economic advantages as opposed to delegation arrangements? Please indicate sources and likely scale of expected benefit

**Q4 :** Would the splitting of responsibility for the supervision of the management company and the fund across jurisdictions give rise to additional operational risks or supervisory concerns? Please describe sources of problem and steps that would have to be taken to manage such risks effectively

### *2.2.2. Distribution, sales and promotion of funds*

A second area which could benefit from clarification is the way in which UCITS are offered, sold or promoted to individual investors. Investors faced with more complex products need better and user-friendly disclosure of performance and charges. There is increased demand for advice on most suitable and best-performing products. Change is also manifesting itself on the supply-side. Banks are gradually opening their networks to third-party funds. This allows them to focus on their core competencies and attract clients seeking “the best product in the market”. Finally, the distribution end of the value-chain is a major cost-centre in the European fund industry (particularly cross-border). Competition and transparency in fund distribution could usefully be brought to bear in the interests of the end-investor. For example the conditions under which a product can legitimately carry the label “guaranteed fund” should be also clarified in order to avoid risks of mis-selling.

The recently adopted MiFID<sup>4</sup> could provide a useful “toolbox”, notably to clarify all duties of care, risk warnings or other obligations that an investment firm owes to a client considering an investment in UCITS. MiFID could also serve as a basis to improve transparency of the distribution process, via its rules on management and disclosure of conflict of interest and on “best execution”.

In a first stage, the Commission services will reflect on the boundary between marketing (UCITS) and sales/advisory services provided to fund investors. In a second stage, a ‘gap analysis’ will examine whether level 2 legislation implementing the conduct of business principles and other relevant provisions of MiFID represent a sufficient and effective basis governing intermediation activities in respect of investment funds. This, however, will have to wait until these level 2 rules are finalised.

**Q5:** Will greater transparency, comparability and attention to investor needs in fund distribution materially enhance the functioning of European investment fund markets and the level of investor protection? Should this be a priority?

**Q6:** Will clarification of ‘conduct of business’ rules applying to firms which retail funds to investors contribute significantly to this objective? Should other steps (enhanced disclosure) be considered?

**Q7:** Are there particular fund-specific issues that are not covered by ongoing work on detailed implementation of MiFID conduct of business rules?

### **3. BEYOND THE EXISTING LEGISLATIVE FRAMEWORK – LONG-TERM CHALLENGES**

The European fund business is undergoing profound structural changes which will have lasting consequences – continuous innovation in investment strategies and products; new forms of business model; emergence of specialised service providers; distribution systems in flux; more discerning investors. Europe needs to ensure that the UCITS framework is capable of representing a viable basis for the successful development of the fund industry over the longer-term while assuring a high level of investor protection. The regulatory environment should enable the industry to provide attractive and soundly-managed products that can compete successfully for investor custom. The following section discusses ways in which the European legislative framework can contribute more to this objective: by creating a European framework to exploit cost-efficiencies and synergies on a cross-border basis; by sustaining investor confidence; by avoiding unnecessary distortion of the competition between substitute investment products; by encouraging the healthy development of onshore alternative investments. However, further progress towards these objectives cannot be delivered within the existing framework. It will require, in some cases, potentially far-reaching adjustments or extensions to existing UCITS legislation. The UCITS review therefore is an opportunity to begin reflections on whether and how some of these broader issues will need to be accommodated by the EU legislative framework in a longer-term.

#### **3.1. Towards a cost-efficient industry**

The existence of too many small funds impedes the EU industry from fully benefiting from economies of scale.

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Directive 2004/39/EC of 21 April 2004 (OJ L 145, 30.04.2004, p. 1) on Markets in financial instruments.

1. Greater consolidation through cross-border fund mergers has been identified by the expert group and others as one route to reducing costs and improving fund performance, although fund managers have been slow to rationalise their product offer even at national level. The UCITS Directive does not prevent cross-border mergers of funds, but neither does it address many of the practical obstacles that may need to be tackled in order to facilitate such mergers. Isolated cross-border fund mergers do take place, but due to the difficulties caused by divergent corporate law and tax regimes, they are uncommon.
2. Fund pooling may offer an alternative route to industry consolidation: this would allow legally separate fund ranges to be collectively managed and/or administered, either by feeding their assets into a master fund (cf. “master-feeder” structures), or by using information technology to allow them to be managed as if they were a single range. However, cross-border pooling is also faced with legal, supervisory and tax barriers, in addition to considerable technological challenges.
3. Fund custody and depositary services could benefit also from further rationalisation. The UCITS Directive requires the management company and the depositary to be located in the same Member State. In the past, proximity and integrated supervision were considered essential to ensure effective performance of fund administration, depositary and custody functions. More recently, a number of stakeholders have advocated greater freedom in the choice of the depositary. As previously noted by the Commission<sup>5</sup>, moving in this direction will require further harmonisation of the status, mission and responsibilities of these actors. The comparative costs and benefits of changes to the legislative framework will need further analysis – not least compared to what can be achieved through delegation and/or sub-custody arrangements. The Commission proposes to examine the implications for effective supervision and investor protection arising from splitting responsibility for supervision of the fund and depositary and asset-custody functions across Member States.
4. The European infrastructure for processing subscription/redemption (fund units) orders is fragmented. This results in high operating costs and operational risks in the transaction value chain. The Commission strongly supports the industry’s ongoing efforts to improve the organisation of fund administration, particularly with regard to cross border arrangements. The Commission’s initial instinct is that industry should continue to take the lead in this respect: EU policy-makers should only become involved in the event of manifest ‘co-ordination’ problems or insurmountable regulatory or policy barriers.

**Q8:** Is there a commercial or economic logic (net benefits) for cross-border fund mergers? Could those benefits be largely achieved by rationalisation within national borders?

**Q9:** Could the desired benefits be achieved through pooling?

**Q10:** Is competition at the level of fund management and/or distribution sufficient to ensure that investors will benefit from greater efficiency?

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Communication COM(2004) 207 from the Commission to the Council and the European Parliament of 30 March 2004.

**Q11:** Which are the advantages and disadvantages (supervisory or commercial risks) stemming from the possibility to choose a depositary in another Member State? To what extent does delegation or other arrangements obviate the need for legislative action on these issues?

**Q12:** Do you think that on-going industry-driven standardisation will deliver fruit within reasonable time-frames? Is there any need for public sector involvement?

Once account has been taken of the responses to this Green Paper, the Commission will create an expert group to further research the main sources of inefficiencies in the EU fund industry outlined above. This work will also consider the feasibility and effectiveness of possible facilitation measures.

### **3.2. Maintaining high levels of investor protection**

The UCITS Directive establishes several lines of defence to protect investors. In terms of investor protection, the record to date has been satisfactory. However, new risks are emerging and market expectations are changing. There may be need to consider reflections on a more comprehensive risk-based approach to investor protection.

The revised investor protection safeguards provided by UCITS III should be given time to prove themselves. CESR will also work to build up convergence among the European regulators regarding the prevention of conflicts of interest and the investor protection safeguards for UCITS managers as revised by articles 5f and 5h of Directive 2001/107/EC. However, the Commission feels that, with its reliance on formal investment limits, UCITS may struggle in the longer term to keep pace with financial innovation and more complex distribution systems. This could mean undertaking a more systematic assessment of the main risks that arise at each stage in the fund industry value-chain. Given the stated ambition of the industry to become the investment vehicle of choice for the retail investor, the Commission will work continuously to reinforce investor protection safeguards. Ongoing work of the IOSCO Standing Committee on investment management may provide a starting-point for further reflection on these issues in a European context.

**Q13:** Does heavy reliance on formal investment limits represent a sustainable approach to delivering high levels of investor protection?

**Q14:** Do you think that safeguards – at the level of the management company and depositary - are sufficiently robust to address emerging risks in UCITS management and administration? What other measures for maintaining a high level of investor protection would you consider appropriate?

### **3.3. Competition from substitute products**

As the debate on the European legislative framework for UCITS evolves, it will be important to consider the wider asset management landscape. UCITS compete with many other products for the private savings of European investors. Products, such as unit-linked life insurance or certain structured products, replicate some UCITS features. They are, however, subject to different regulatory or tax treatment and are sold through different sales processes. In some Member States such competing products enjoy wide acceptance. The Commission is concerned that this different regulatory treatment may distort investment decisions. It believes that it would be a retrograde step for investors if UCITS disclosures were scaled back as a result of regulatory competition.

**Q15:** Are there instances resulting in a distortion of investor's choice that call for particular attention from European and/or national policy-makers?

### 3.4. Europe's alternative investment market

The alternative investment industry – comprising hedge funds and private equity funds – is here to stay. It offers new diversification benefits for asset managers, the promise of higher returns for investors and can boost overall market liquidity. However, alternative investment strategies are more complex, and may involve higher risks for investors than mainstream UCITS.

#### *Alternative investments*

- Private equity funds entail a long-term commitment to investments involving an active participation in their management. However, private equity funds are faced with additional tax complications and most funds structures are not mutually recognised in the different Member States.
- Hedge funds use a broad array of techniques and instruments (such as short-selling or leverage) often not available to more traditional forms of collective investment schemes. Hedge Funds may represent a source of counterparty risk for financial institutions which lend to them. Although they are not currently regarded as a significant source of systemic risk because of their relatively small size and modest, collateralised use of leverage, their fast growth and perceived lack of transparency give rise to growing concerns regarding their impact on the markets. Regulators are currently focused on strengthening their ability to assess aggregate exposure of the financial system to hedge funds.

Divergent national regimes carry the risk of regulatory fragmentation which could hamper the development of these businesses. As this industry develops, and particularly if European retail investors become more exposed to alternative investments, there will be a growing need for a coherent and enlightened European approach to this sector.

Taking account of responses to this consultation, the Commission will establish a working group to study whether a common regulatory approach can facilitate the further development of European markets for hedge funds and private equity funds. This could also look at the types of action that could be most helpful in overcoming barriers to their cross-border development. This work could consider, inter alia, the extent to which a common understanding of 'private placement' could facilitate their cross-border offer to qualified investors.

**Q16:** To what extent do problems of regulatory fragmentation give rise to market access problems which might call for a common EU approach to a) private equity funds; b) hedge funds and funds of hedge funds?

**Q17:** Are there particular risks (from an investor protection or a market stability perspective) associated with the activities of either private equity or hedge funds which might warrant particular attention?

**Q18:** To what extent could a common private placement regime help to overcome barriers to cross-border offer of alternative investments to qualified investors? Can this clarification of marketing and sales process be implemented independently of flanking measures at the level of fund manager etc.?

### **3.5. Modernising UCITS law?**

Experience has highlighted the difficulties encountered in adapting UCITS provisions to changing market realities, and ensuring their consistent implementation. The UCITS Directive testifies to the dangers of trying to regulate highly technical issues through first level EU legislation. Some commentators, including CESR, have urged a recasting of the Directive along the lines of recent EU securities legislation – namely functional and principle-based first-level legislation supplemented by scope for detailed implemented law and reinforced supervisory cooperation (Lamfalussy approach). However, recasting UCITS legislation in this way would not be a cosmetic exercise: it would involve choices as to the drafting of overarching principles to be retained in first-level legislation and the scope and content of decisions to be determined through comitology based law. It would therefore entail substantive and institutional ramifications. This would call for careful preparation and full-blown co-decision procedure. Should views crystallise in the future around the need for such changes to the UCITS legislation, the Commission believes that the occasion should be seized to restructure the Directive along the lines of the Lamfalussy approach.

**Q19:** Does the current product-based prescriptive UCITS law represent a viable long-term basis for a well-supervised and integrated European investment fund market? Under what conditions, or at what stage, should a move toward principle-driven, risk-based regulation be contemplated?

## **4. CONCLUSIONS**

UCITS has served as the focal point for the emergence of a successful European fund industry. The UCITS legislation – with its product passport and strong retail investor ethos – has facilitated this outcome. Despite these developments, there is a perception that UCITS entails missed opportunities and can be improved. However, there is no compelling case for fundamental legislative overhaul at this stage. Instead the focus should be on exhausting the possibilities offered by the current legislative framework.

In view of the strategic importance of the sector, there is a need for wide-ranging reflection on the future direction of the EU framework for investment funds. Should some of the structural concerns identified above materialise, far-reaching action will be required to ensure that the vast European fund sector will be equipped with the right tools, and that European investors enjoy a high level of protection, as they enter the next decade.

Responses to this consultation, as well as regular discussions with relevant stakeholders and further preparatory work within the Commission will be taken into account for the determination of eventual follow-up measures. Orientations for action to enhance the UCITS framework will be then announced in early 2006. To the extent that legislative actions may come under consideration, they will be subjected to extensive ex-ante consultation, impact assessment and cost-effectiveness evaluation.

Responses to this consultation should be sent by 15 November 2005, to the following email address: [markt-consult-investmentfunds@cec.eu.int](mailto:markt-consult-investmentfunds@cec.eu.int) Responses will be placed on the Commission's website – unless there is an explicit request to the contrary. As part of the follow-up to this Green Paper, the Commission will publish a feed-back report summarising the respondent contributions in early 2006.

### Enhancing the UCITS framework – Proposed steps

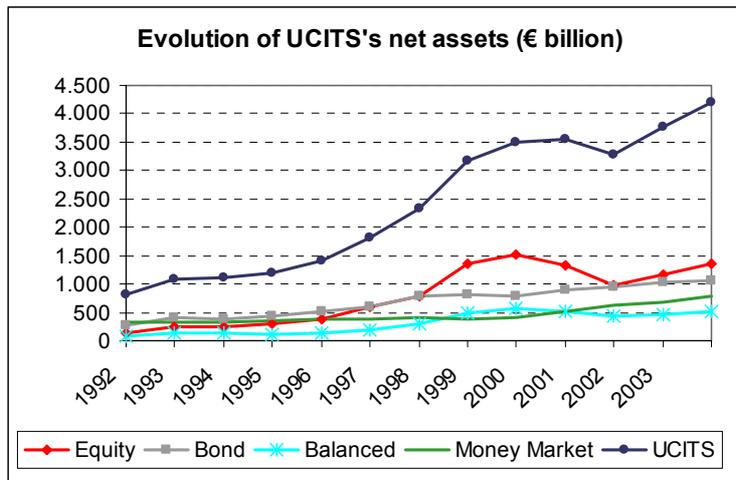
Topic	Action	Proposed dates
UCITS review process	Consultation process :  Feedback report on the public consultation; COM statement on follow-up actions :	July/Nov. 2005  Feb/March 2006
<b>1. Priority actions</b>		
Clarification of UCITS eligible assets	Adoption of implementing legislation	March/April 2006
Recommendations on Derivatives and simplified Prospectus	Publication of definitive assessment of Member State implementation (CESR and COM)	Autumn 2005
CESR Guidelines on transitional provisions	Interim report on national implementation	Autumn 2005
Notification procedures	CESR Guidelines for the notification procedure	Autumn 2006
<b>2. Building on the current framework</b>		
Management Company passport	Analysis of conditions needed to facilitate effective functioning of management company passport (for corporates)	Early 2006
Fund distribution, sales, promotion	Assessment of the articulation between UCITS and MiFID :  Gap analysis of MiFID level 2 measures :	Early 2006  Mid 2006
<b>3. Long-term challenges</b>		
Cross-border mergers/pooling	Work of specialist forum group	Winter 2005-Summer 2006
Investor protection	Analysis of risks and risk controls in European investment fund industry (CESR and COM): Monitoring of IOSCO work; launch and publication of Commission studies	
Alternative investments	Work of specialist forum group	Winter 2005-Summer 2006

## Annex

### OVERVIEW OF THE UCITS MARKET

UCITS legislation has provided the foundations for the development of a successful European fund industry. 20 years after the adoption of the original UCITS Directive, 28,830 UCITS funds manage €4 trillion representing over 70% of the assets under management by the EU investment fund industry as a whole. Assets managed by UCITS are growing rapidly (some 4 times over the last 10 years). This industry has a strong presence in all of the 'old' Member States and is gaining ground in many of the new Member States. In some Member States, over 20% of the adult population have invested in funds. UCITS also enjoy wide market recognition outside the EU (namely in Asia and South America).

*UCITS enjoy wide market acceptance*

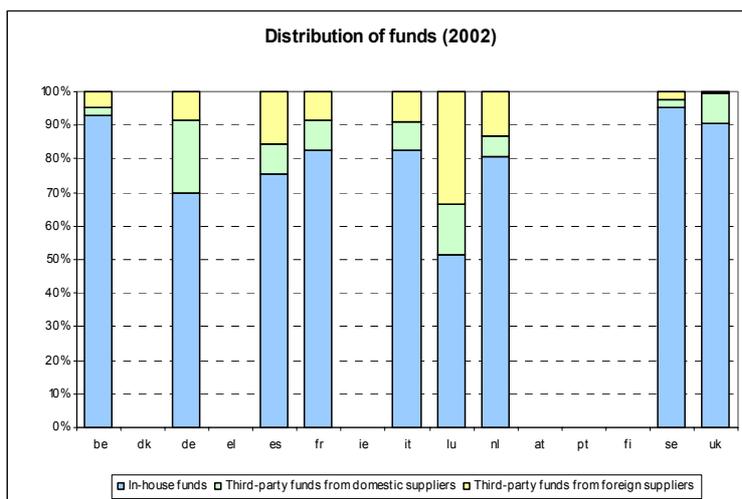


The UCITS Directive has proved an important first step towards integrated and competitive European markets for investment funds: it has been the catalyst for the growth of an industry which is increasingly investing and competing on a cross-border basis. At present, less than a fifth of all European UCITS (in terms of number of funds) are true cross-border funds in that they are sold in more than one country other than that of the sponsoring parent company. However, as shown in the table below, the number of cross-border funds has increased more rapidly than the total number of funds over the last years. Their assets under management are also growing at a fast pace: net sales of cross-border funds represented more than 60% of the total industry net inflows in 2004.

*...with increasing cross-border penetration*

	End-98	Mar 2001	End 2002	End 2003	Change (98-03)
X-border funds	2,287	3,260	3,750	4,529	98%
X-border notifications	11,338	22,791	26,966	26,030	130%
Total no. of funds	20,069	n.a.	28,459	28,149	40%
X-border/total funds	11%	n.a.	13%	16%	41%

Despite the increase in the number of notifications and the sales of cross-border funds, the market share in most host Member States is often small. Despite recent years' move towards open-architecture, the range of products on offer remains biased towards national providers. National distribution networks remain dominated by local players. Most European third party funds (TPF) distributors are "semi-open" with 33% of them offering less than 5 TPF and only 6% putting in their list of products more than 49 TPF. In addition to this, 46% of fund distributors do not offer even one TPF. Consequently, competition is limited and investors do not necessarily have access to the best funds in the EU market.



Viewed from the perspective of overall market efficiency, the facilitation of cross-border fund offer has not yet delivered an optimally functioning European fund market. The number of funds is considerably higher than 10 years ago. This reflects the rapidity with which managers have reacted to new trends and the needs of increasingly demanding investors. For instance, products such as guaranteed funds have recently enlarged the range of investment opportunities for UCITS investors. The end-result is that the landscape remains dominated by funds of sub-optimal size which are on average 5 times smaller than their average US counterpart. Fund managers and administrators are not able to benefit fully from scale economies – reducing net returns to end-investors. Estimates indicated that if EU funds could attain US funds' average size, annual cost savings of € 5bn could be achieved.

*Lack of market integration translates into higher costs for investors.*

From an investor protection perspective, there have not been notable financial scandals involving UCITS in Europe. UCITS has provided a solid underpinning for a well-regulated and generally well-managed industry. The investment limits, capital requirements, and organisational controls on asset segregation and safe-keeping, disclosure obligations or the oversight responsibility of depositaries introduced by the Directive have been important contributing factors.

*No notable financial scandals so far...*

<p>Recent trends in European fund industry are changing the risk-features of the business. Changes in the organisation of the business, such as outsourcing of operational functions or moves towards open-architecture may entail increased operational risk or conflicts of interest. New fund-types, based on more complex or sophisticated investment strategies, may embody features that are not well-understood by retail investors. The possible implications of alternative investment strategies for investor protection and financial stability remain poorly understood. Furthermore, substitute products, such as unit-linked products or certificates, compete with UCITS for long-term savings. However, they are not necessarily subject to the same level of disclosure and transparency. This may call into question the levels of disclosure and investor protection promoted by UCITS.</p>	<p><i>... but business is evolving and current trends may accentuate certain risks to investors.</i></p>
<p>The accompanying Commission staff working document provides an extensive treatment of these issues. To further improve our understanding, the Commission is sponsoring further research to evaluate the degree of integration of European fund markets; to assess whether there are as yet unrealised efficiency gains that could be achieved through cross-border competition or a more rational pan-European organisation of the market; and to study evolutions in the risk-features of European asset management business.</p>	