



ROBERT C. GROHOWSKI
SENIOR COUNSEL – INTERNATIONAL AFFAIRS

November 15, 2005

European Commission
Brussels, Belgium

Re: Response to the Commission's Consultation on the Enhancement of the EU Framework for Investment Funds (COM (2005) 314)

Dear Sirs:

The Investment Company Institute¹ is writing in response to the Commission's Green Paper on the Enhancement of the EU Framework for Investment Funds, which reviews areas for improvement in the UCITS Directive. Many of our members actively participate in the UCITS market, and our comments reflect their experiences in organizing, advising, and distributing investment funds in Europe.

We applaud the efforts of the Commission to foster an integrated and efficient market for investment funds in Europe. As the Green Paper recognizes, collective investment funds are, and likely will remain, the very best vehicle for average investors to participate in the securities markets, accumulate wealth, and achieve their most important long-term financial goals. At their best, investment funds offer unparalleled advantages – professional management, broad diversification, liquidity, abundant information, a wide array of choice, and a high degree of convenience and investor service – all at relatively low cost. Improvements in the structure of the market for investment funds in Europe will lead to greater availability and choice of investment funds to the benefit of European investors.

The UCITS Directive has the potential to establish a framework for a pan-European fund market by providing a convenient passport that allows funds to be sold throughout the EU. Unfortunately, as the Commission clearly recognizes, the cross-border ideal inherent in UCITS has yet to become a reality. In practice, the cross-border sale of funds is difficult and expensive, and distribution of funds along national lines still predominates.

In response to the Green Paper, we suggest five ways in which the cross-border market for funds in Europe could be improved:

- Streamline and simplify the notification procedure for passporting funds;

¹ The Investment Company Institute is the national association of the United States investment company industry. More information about the Institute is included at the end of this letter.

- Enhance the usefulness of disclosure available at the point of sale, particularly by allowing funds and intermediaries to rely principally on the Internet for purposes of communicating the required information to investors;
- Enhance the usefulness and comparability of fund advertising materials through the establishment of standardized performance methodologies;
- Streamline the process by which Member States approve marketing plans; and
- Improve the European infrastructure for processing subscription and redemption orders.

We also recommend that the Commission establish a working group to consider adopting a common understanding or definition of “private placement” across the EU. Our reasons for these recommendations and our responses to some of the specific questions in the Green Paper are included below.

Section 2.1 – Priority Actions

The Commission lists four priority areas in Section 2.1 of the Green Paper. In our view, the second priority – simplifying the notification procedure for passporting funds – remains the most important. Member states continue to administer the provisions of the UCITS Directive differently, resulting in substantial delays in completing the notification procedure for passporting funds. For example, in Italy, registering a non-Italian UCITS fund for sale routinely takes six months, rather than the maximum of sixty days contemplated in the Directive. CESR’s work to build up convergence in this area is crucial to the realization of a true EU passport for funds.² We urge the Commission to fully support CESR’s efforts with respect to the convergence of notification procedures.

Section 2.2.2 – Distribution, sales, and promotion of funds

The Commission asks whether greater transparency, comparability, and attention to investor needs in fund distribution materials will enhance the functioning of European investment fund markets and the level of investor protection. The answer clearly is “yes.” We fully support enhanced disclosure to be available at the point of sale to help investors assess and evaluate a recommendation to purchase fund shares.³

² CESR recently issued a consultation paper on this topic. See CESR/05-484 (Oct. 27, 2005).

³ We have expressed concern, however, that point of sale disclosure could have the undesirable effect of creating a disincentive for intermediaries to sell retail investment funds, as compared to other products that are not subject to similar requirements. We would encourage the European Commission to consider the potential effect that its disclosure requirements might have on the sale of retail investment funds as compared to other investment products.

In evaluating possible approaches to point of sale disclosure, the Commission should consider expressly recognizing the use of the Internet. We have urged our own Securities and Exchange Commission to craft disclosure rules that recognize the growing use of the Internet by investors and allow funds and intermediaries to rely principally on the Internet for purposes of communicating the required information to investors. We encourage the Commission to do the same. The Internet is an effective way to provide investors with timely and convenient access to the required information without imposing inappropriate costs and burdens on the sale of fund shares.

Two other issues relating to the distribution, sale, and promotion of funds warrant attention by the Commission. The first is the comparability of performance advertising in the EU. We agree with the Commission that investors and intermediaries increasingly need meaningful performance information. Standardized performance methodologies will provide comparable performance information, which we believe will promote a pan-European market for investment funds.⁴ We therefore urge the Commission to standardize the methodology for computing fund performance across the European Union and require funds that advertise performance to include standardized performance figures.⁵

Second, the Commission should examine the practice by member states of approving marketing plans and consider limiting the time that member states have to grant the necessary approvals. Host countries have the jurisdiction to set marketing requirements. This has meant, in practice, that funds are subject to varied and conflicting requirements relating to advertising and disclosure. The result is an overlapping, duplicative, and inconsistent set of requirements that effectively creates a barrier to passporting funds in the EU.

Section 3.1 – Towards a cost-efficient industry

The Commission notes that the European infrastructure for processing subscription and redemption orders is fragmented. As highlighted by the EU Asset Management Expert Group, cross-border processing of fund units is a key issue for the asset management industry.⁶ In 2001, the Institute formed the International Operations Advisory Committee (“IOAC”) to provide a forum for our members to work with the providers of clearing and settlement services and the distributors of investment funds on our common goal of achieving standardization and automation of clearance and settlement procedures for investment fund capital shares in the pan-European marketplace. The IOAC has a continuing dialog with

⁴ For a detailed explanation of our reasons, *see* the attached Institute letter to Niall Bohan, dated May 25, 2005.

⁵ We do not believe that requiring standardized performance figures to be included in advertisements will disturb the home state-host state balance in the current UCITS Directive. Host member states will retain the authority to regulate the marketing of UCITS funds in their jurisdiction. Host states simply will have to require an additional performance figure in fund advertisements that include performance information.

⁶ *See* “Financial Services Action Plan: Progress and Prospects,” Final Report of the Asset Management Expert Group on the Financial Services Action Plan (May 2004).

EFAMA, which, as the Commission recognizes, is working to develop pan-European standards relevant to order processing for investment funds.

The Institute appreciates the Commission's support for industry efforts to develop efficient and safe clearing and settlement systems for investment fund capital shares. We agree with the Commission's instinct that industry should continue to take the lead and that EU policy makers should only become involved in the event of manifest coordination problems or insurmountable regulatory or policy barriers.

Section 3.4 – Europe's alternative investment market

The Commission suggests that it may establish a working group to consider, inter alia, the extent to which a common understanding of "private placement" could facilitate the cross-border offer of funds to qualified investors. We support the concept of a common understanding or standardization of private placement exceptions in Europe because we believe that it could significantly streamline the sale of cross-border investment funds (both UCITS and non-UCITS) to pension plans. Accordingly, we encourage the Commission to establish a working group in this area, but also to ensure that the mandate of that working group is broad enough to consider the benefits of standardized private placement rules to European pension managers.

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The Institute appreciates the opportunity to comment on the Commission's Green Paper. If you have any questions about our comments, please contact me at +1 202 371 5430 or rcg@ici.org.

Sincerely,

/s/ Robert C. Grohowski

Robert C. Grohowski
Senior Counsel – International Affairs

Attachments

About the Investment Company Institute

The Investment Company Institute's membership includes 8,518 open-end investment companies (mutual funds), 663 closed-end investment companies, 148 exchange-traded funds, and 5 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$8.5 trillion (representing more than 95 percent of all assets of US mutual funds); these funds serve approximately 86.7 million shareholders in more than 51 million households.



INVESTMENT COMPANY INSTITUTE

MARY S. PODESTA
SENIOR COUNSEL

May 25, 2005

Niall Bohan
Head of Units for Asset Management
European Commission
Avenue de Cortenbergh, 107
Brussels 1040
Belgium

Dear Niall:

The Investment Company Institute looks forward to the Green Paper on Asset Management due to be published in July, which will review areas for improvement in the UCITS Directive. As discussed with you previously, we hope that the Commission will consider in the Green Paper standardizing the methodology for computing fund performance across the European Union by requiring funds that advertise performance to include standardized performance figures. For the reasons discussed below, we believe a standardized methodology would promote a pan-European market for mutual funds.

Importance of Standardized Performance

Standardizing fund performance information prevents performance claims from being misleading and permits investors to make meaningful comparisons of fund performance claims. Because there are different methods for computing fund performance in the Member States, investors are not able to compare accurately UCITS funds throughout the European Union. Requiring funds to employ consistent, standardized formulae to compute their performance can help to ensure that funds compete in a fair and equitable manner.

In the US, the accessibility of reliable performance information contributed to the growth experienced by the US mutual fund industry since the 1980s. Before 1979, the kinds of information that could appear in mutual fund advertising were substantially limited and funds had little flexibility to advertise performance. In 1979, the Securities and Exchange Commission (SEC) adopted rule changes giving funds greater freedom to advertise, and advertisements containing fund performance information became more prevalent. As funds advertised performance and investors began to use performance claims in making investment decisions, the need for a standard methodology became apparent. The SEC adopted rules standardizing performance figures for money market funds in 1980 and for other types of funds in 1988.

The importance of standardized performance information was recognized by IOSCO when the Technical Committee in May 2004 published its Best Practices Paper on performance presentation standards. The Technical Committee agreed upon three basic principles that can be broadly summarized as follows: (1) advertisements should not mislead; (2) performance

information should be presented for the benefit of the average investor; and (3) performance information should be calculated and presented in a substantially similar manner so that investors can compare funds and not be misled.

In the European Union, these investor-protection goals only can be realized if the performance information standardization is imposed on an EU-wide basis. Under the current regulatory scheme, lack of comparability in performance claims is an obstacle to creating a true single market in UCITS funds.

The remainder of this letter sets forth our ideas on how the Commission could create a standardized methodology for UCITS performance.

Standardized Performance for UCITS Funds

We strongly recommend that the Commission require UCITS funds that advertise performance to provide performance information using a standardized methodology with respect to computation, currentness, and disclosure. If presentation of performance data were standardized, investors would be able to rely on the veracity and fairness of performance information provided in UCITS sales materials and to compare performance information among funds.

Although our long term view is that the UCITS Directive eventually should be amended to eliminate the prerogative of host Member States to regulate marketing of UCITS funds, our current proposal would not deprive Member States of imposing their own methodology for calculating performance. Under the current regulatory framework, host Member States have the authority to regulate marketing of funds. We propose that the Commission require an additional standardized performance figure if funds present performance information using a formula developed or approved by the competent authorities of the Member States. The additional figure would promote comparability across the EU without disturbing the current authority provided to host Member States.

Calculating Standardized Performance

We recommend that the Commission require funds that advertise fund performance to include total return. Total return is the sum of all fund earnings plus any changes in value of assets reduced by all expenses accrued during a measuring period. This figure is not affected by whether investment growth derives from income or capital appreciation or when income is distributed. The methodology for computing total return also does not require complex accounting judgments or rules. (To demonstrate the relative simplicity of a total return requirement, we have attached, for your information, a copy of the total return formulation used in the United States.)

For calculating standardized total return, sales charges and fund expenses accrued during the appropriate measuring period (which includes all recurring fees that are charged to all shareholder accounts) should be deducted. This requirement assures that potential investors are adequately informed of the existence and effect of the fund's fees and expenses on their investment.

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May 25, 2005

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To provide a non-misleading presentation that promotes comparability, total return should be computed over a sufficiently long period of time to provide a picture of fund performance over a business cycle, typically ten years. We suggest that the Commission require the presentation of performance over several periods – *e.g.*, average annual total return for one, five, and ten years – rather than aggregate total return over ten years. A single figure aggregating return over ten years produces large numbers that are not comparable with returns on other financial instruments that are measured on an annual basis.

Importantly, presenting average annual returns over various periods, *e.g.*, one, five, and ten years, permits investors to see fluctuations in performance. The presentation of historical performance helps investors appreciate that mutual fund performance quotations indicate past performance – not a promised return.

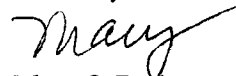
Finally, to prevent investor confusion about mutual fund performance claims and, in particular to insure that investors do not think these figures represent a promised return, UCITS advertising performance should disclose that these figures represent historical performance and that the principal value of an investment in the fund will fluctuate. To insure that investors can use performance advertising to compare UCITS, the rules also could require that the total return figures receive equal prominence with any non-standardized performance quotations in fund marketing materials.

* * * * *

We would welcome the opportunity to speak with you in more detail about our proposal for requiring funds that provide performance data to include standardized performance. As explained above, we believe that this additional requirement would not disturb the balance in the current UCITS Directive that provides the host Member States with the authority to regulate marketing of UCITS funds in their jurisdiction. The additional figure that would be required in fund advertisements would permit investors to compare funds across Europe and ensure comparability of performance data throughout the European Union. Only true comparability of UCITS can bolster investor confidence and facilitate a single EU market for UCITS funds.

If we can provide any other information regarding our proposal, please feel free to contact me at (202) 326-5826 or at podesta@ici.org.

Sincerely,



Mary S. Podesta
Senior Counsel

Rule 482 of the Securities Act of 1933 governing Advertising by an Investment Company (*Only relevant sections are included.*)

d. *Performance data for non-money market funds.* In the case of an open-end management investment company or a trust account (other than a money market fund referred to in paragraph (e) of this section), any quotation of the company's performance contained in an advertisement shall be limited to quotations of:

3. *Average annual total return.* Average annual total return for one, five, and ten year periods, except that if the company's registration statement under the Act has been in effect for less than one, five, or ten years, the time period during which the registration statement was in effect is substituted for the period(s) otherwise prescribed. The quotations must:
 - i. Be based on the methods of computation prescribed in Form N-1A (§§ 239.15A and 274.11A of this chapter) . . .;
 - ii. Be current to the most recent calendar quarter ended prior to the submission of the advertisement for publication;
 - iii. Be set out with equal prominence; and
 - iv. Adjacent to the quotation and with no less prominence than the quotation, identify the length of and the last day of the one, five, and ten year periods.

4. Determine the ending redeemable value by assuming a complete redemption at the end of the 1-, 5-, or 10-year periods and the deduction of all nonrecurring charges deducted at the end of each period. If shareholders are assessed a deferred sales load, assume the maximum deferred sales load is deducted at the times, in the amounts, and under the terms disclosed in the prospectus.

5. State the average annual total return quotation to the nearest hundredth of one percent.

6. Total return information in the prospectus need only be current to the end of the Fund's most recent fiscal year.