

Perspectives of Collective Investment Undertakings Market

■

Gabriela Anghelache

Ph.D. Professor

Academy of Economic Studies, Bucharest

Cosmin Păunescu

Expert

Romanian National Securities Commission

***Abstract.** The paper presents the main characteristics of the collective investment undertakings, in accordance with the European standards, as well as their prospective evolution in Romania. New elements, appeared post-accession, are highlighted, referring to the structure and management of the collective investment undertakings. Local market is described compared to the European market, with focus on the factors which have impact on its development. Risk management, disclosure and investor protection are the main terms of reference in the management of the collective investment undertakings.*

Key words: investment funds; collective investment undertakings; financial instruments markets; investment policy; market risk; fund assets; portfolio.

■

On the developed financial markets, the collective investment undertakings (CIU) represent one of the main possibilities for investing and saving, both for individuals and for companies. The following factors had a significant influence on the development of the sector: ways of efficient management of the available financial resources of trading companies, professional management for uninitiated investors, access to the hardly approachable financial markets, elimination of the effort to analyze markets for individual investors, fiscal facilities.

Irrespective of the reasons for creating these investment vehicles, a developed collective investment undertakings sector positively influences exchange markets. Institutional investors' presence generates new financial instruments. For example, we can talk about the re-financing of credit institutions through capital market, about initial public offers or capital accruals by new issuances, but we must notice that such operations cannot end up successfully without an available capital on the market.

Moreover, we must not disregard the role of the collective investment undertakings in the development of other sectors/areas of financial markets. Insurance societies (on their own or through their products) and pension funds find in collective investment undertakings an attractive investment instrument in the long term. At the level of banking groups, in the context of a low rate of interest, which does not encourage deposits, financial resources can be efficiently attracted and maintained by

the development of collective investment undertakings. For investment firms, collective investment undertakings represent the clients with the largest turnover.

Besides, the setting up of private collective investment undertakings may be beneficial to the trading companies which were taken over for management, by implementing management projects strictly oriented to their organic growth.

1. Legal impact on the sector development

Current regulations in the domain of the collective investment undertakings have as main reference Law no. 297/2004 on capital market, which, for the first time, made the following classification:

- undertakings for collective investment in transferable securities – UCITS (open-end investment funds and investment companies), harmonized with Directive no. 85/611/CEE for coordination of legal and administrative papers regarding certain undertakings for collective investment in transferable securities – UCITS Directive;
- other collective investment undertakings (closed-end investment funds and closed-end investment companies).

According to the investment policy, there are four main categories of open-end funds. The criteria for this categorization are set out by the European Fund and Asset Management Association (EFAMA):

- equity funds (66% permanent minimum exposure of portfolio);
 - fix income instruments funds (with a portfolio made up of bonds, maximum weight of shares 10%);
 - monetary market instruments funds (with a portfolio made up of fix income instruments and money market instruments, with a maximum period of 1);
 - diversified funds (with a portfolio consisting in different classes of financial instruments).
- the role of the depository as custodian of the financial instruments from the portfolio;
 - high level of transparency/disclosure through regular reports;
 - a simplified prospectus, as a means to facilitate the distribution;
 - free distribution in all the Member States based on the authorization delivered by the Home Member State;
 - supervision carried on by the competent authority from the Home Member State.

Obviously, the use of the name of the category one UCITS belongs in its documents makes it more transparent and facilitates the work of selection of the potential investor.

The institutionalization of this classification or of a similar one may, however, have an undesired impact for managers, who will have to rewrite the propositions in the prospects referring to the investment policy.

UCITS Directive created a common regulatory frame for all entities from Member States. We must consider that UCITS are designed for all types of investors, including those without experience on financial markets. Consequently, the building of the European legislation to the following principles:

- diversification of the portfolio on the risk spreading principle;
- continuous issuance and compensation of participation titles;
- multiple levels of supervision: depository, financial auditor, competent authority;

Even if, legally, the setting up of investment firms, built as joint-stock companies with variable capital, is feasible, there are in Romania only open-end investment funds.

The period 2004-2005 marked the alignment to the European standards through re-authorization of the collective investment undertakings in order to respond to the requirements of the UCITS Directive.

As a result, Romanian open-end investment funds may invest on the regulated markets of member states or of non-member states. As the area of investments enlarges, we can witness the issuance of Romanian products, specialized on geographic areas or economic sectors, fact that offers to open-end funds the character of “gate” to a larger investment horizon. In fact, many small investors preferred to enter directly the stock market, encouraged by the growing trend of the last years. The maturity of the local stock exchange and the gain by

the listed issuers of rates that may lead to price multiples will encourage the population to address to the experts of the domain. Therefore, investors will be equally attracted by investment firms which trade on several markets and offer a professional analysis to their clients and by investment funds.

Another new way, which must not be ignored by the management companies, is represented by the possibility of the free distribution of open-end funds on other markets, based on the authorization granted by the Romanian National Securities Commission. In the near future, the local stock exchange will offer good developing opportunities, based on the developing economy. The rhythm of growth of the economy is superior to that of member states, being reflected in the financial results of the listed companies. Romanian funds can therefore compete successfully with funds with longer tradition.

One very important segment of the funds market is represented by the other collective investment undertakings (AOPC). In fact, every Member State has its own AOPC system, the national legal framework being tailored to the local market's tradition and to the needs of national investors.

In Romania, this system began to take shape clearly after the adoption of Law no. 297/2004.

Until that date, we could only talk about investment firms, functioning with respect of the Law no. 133/1996 for transforming Private Property Funds in investment firms and about risk venture

funds regulated by the Government Ordinance no. 20/1998 regarding the setting up and functioning of the risk venture funds.

From their beginning, investment firms played a central role on the Romanian capital market. By their very goal – the transfer of the public property to private property, investment firms proved to be an essential element in the development of a healthy market economy. Investment firms represent important providers of liquidity at the Bucharest Stock Exchange, as well as significant shareholders which can lead to an increase in the number of traded firms, through the listing of the firms from the portfolio.

The legal framework did not encourage the development of risk venture funds.

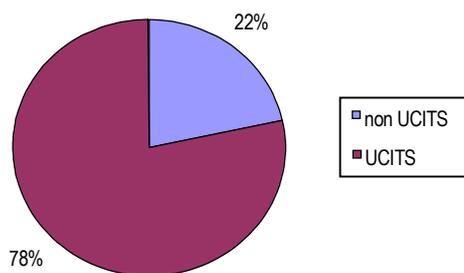
The changes of the regulation in 2004 represented the starting point for the creation of an AOPC system, similar to that from the developed countries. Resources can be collected both through public offer and through private call. Consequently, an AOPC is an attractive investment instrument for the persons who want to take a higher risk. Due to their permissive investment policy, AOPC can actively take part in the management of the firms from the portfolio and adopt long-term investment strategies, with potential high efficiency. The adoption of such strategies can generate a low level of investment liquidity in AOPC. The legal framework is flexible and allows the collective investment undertaking to fix compensation data.

CNVM encourages the development of a strong collective investment undertakings market. Due to the secondary regulation in 2004-2005, new AOPC were created, classified according to their investment policy: diversified, permissive, for qualified investors, restrictive, moderate, guaranteed, specialized in the multiple classes of financial instruments.

2. Size and structure of local and european market

Regarding the structure of the collective investment undertakings market in the EFAMA member states, the most important part is played by UCITS. The explanation is that they address mainly to retail investors and in the European Directives that allow free distribution.

On 30.09.2007, the total volume of collective investment undertakings' assets of the EFAMA member states was of 8115 billion Eur.



Source: www.efama.org

Figure 1. Structure of collective investment undertakings market in EFAMA member states: non UCITS and UCITS

At the end of 2007, UCITS assets were of 257,84 mil. Eur; AOPC (except investment firms) had total assets of 49,19 mil. Eur, and the 5 investment firms - 3108 mil. Eur.

Except investment firms, the local market structure is similar to that of EU member states. The main explanation is that AOPC strongly developed after the adoption of the legal framework during 2004-2005.

The situation reverses if we take into account the assets of investment firms.

The Romanian market is still at an incipient level of development; the activity of collecting financial resources through these investment vehicles is not yet at its true potential.

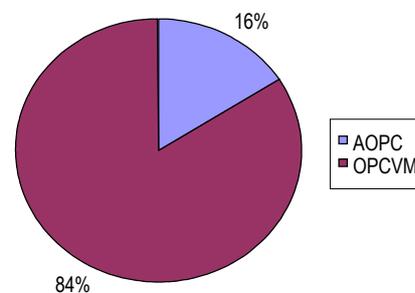
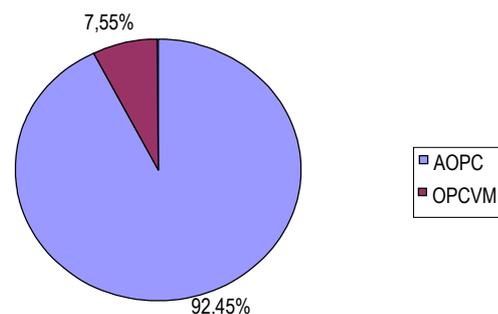


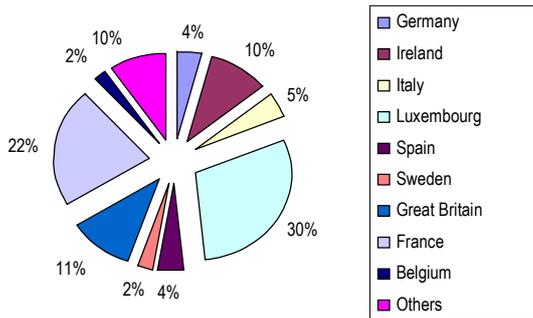
Figure 2. Structure of Romanian collective investment undertakings market (except investment firms): UCITS (OPCVM) and other collective investment undertakings (AOPC)



Source: www.unopc.ro

Figure 3. Structure of Romanian collective investment undertaking market (including investment firms): OPCVM and AOPC

In order to analyze the possibilities and the means of growing of the local UCITS market, we must notice the structure of the European market.



Source: www.efama.org

Figure 4. UCITS market structure:

The country's area and its economic development do not necessarily represent the main factors for the development of collective investment undertakings. Ireland, for example, is surprising with 10% - market share and Luxembourg with 30%.

Luxembourg is an example of success in the field. The first collective investment undertaking was founded in 1959. The national regulation anticipated UCITS Directive, because since 1983 the necessary background for investment firms was created (SICAV). Through rapid implementation of the Directive, Luxembourg brought a competitive advantage for authorized UCITS which had access to free distribution before UCITS from other Member States. From the fiscal point of view, SICAV do not have to pay taxes on capital gains, being imposed only an annual tax which varies between 0.01% and 0.06% out of their assets.

Due to fiscal advantages and expertise accumulated in the field, Luxembourg is the country which attracted the most the establishment of UCITS from many Member States. Management delegation or distribution facilitation systems are used, like, for example, transfer and payment agencies, with the role of keeping investors' evidence in the states subject to the distribution.

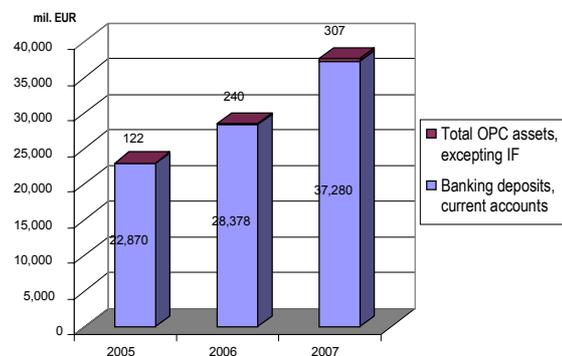
Ireland is a country with a remarkable evolution in the domain of collective investment undertakings. Fiscal regulation exempts non-resident investors from profit tax or capital gains for investments in UCITS.

The perspectives of the Romanian Collective investment undertaking market are tightly connected to the creation of an unique, functional market.

3. The potential of local market

The potential of local market can be illustrated comparing the total assets of collective investment undertakings and the total value of banking deposits, deposit certificates and current accounts to credit institutions.

Collective investment undertakings' assets are less than 1% of the total savings kept in credit institutions. As development rhythm, the growing of the investment in funds surpassed that of the savings through credit institutions, in 2006 as compared to 2005 (97% compared to 24%), but the tendency was not in the same direction in 2007 (27% as compared to 31%). We cannot talk yet about a reorientation of investments from banking deposits to funds' market.



Source: www.unopc.ro, www.bnro.ro

Figure 5. Total assets of collective investment undertakings, except investment firms and banking deposits

The growing potential is reflected by the index Total assets/PIB. If we consider Poland, Hungary and Czech Republic we can say that the doubling of the assets of the collective investment undertakings is an easily reachable goal. An argument in this sense is represented by the evolution of the developed countries during 1996-2006. In 1996, the indicator was 35% in France, 16% in Great Britain, 19% in Germany.

Table 1

Country	Total assets/GDP (%) 2006
Romania	2.97
Czech Rep.	5.40
Poland	14.19
Hungary	14.32
Germany	47.37
Great Britain	48.32
France	91.96
Ireland	482.00
Luxembourg	6531.43

Source: World Bank (GDP), EFAMA (Fund Assets), UNOPC.

4. Possible evolutions of the regulatory framework at european level

The Directive regarding financial instruments markets (MiFID), that standardizes different types of requirements: operations of intermediaries, execution of transactions, categorizations of clients according to their investment experience, as well as disclosure and reporting post-transaction requirements excludes from its field the UCITS. UCITS are mentioned according to their quality by clients of an intermediary, so they are classified as eligible counterparty (therefore they can choose a higher level of protection). UCITS are mentioned as well as regarding the relation between client and intermediary. In order

to provide portfolio management services or investment advice, the investment firm draws up an adequacy test to its client. Information is obtained about: investment objectives, financial state, knowledge and experience. The denial of the client to transmit the information will lead to the non-providing of the investment service or to the limitation of the advice given by the investment firm.

In the situation of the services of buying and selling of financial products, the investment firm makes an appropriateness test, which evaluates the way how the client understands the risks he assumes by entering a transaction. Many participation titles issued by UCITS are non-complex financial products; in this case, the test is not necessary.

For the management of individual accounts, the investment firms are applied a series of provisions regarding the relation with their clients, the execution of transactions and reporting.

The UCITS Directive brings a series of provisions which must be concretely implemented in the national legislation. One of the most important provisions is that referring to risk management, resulted from the transactions with derivatives. The recommendation of the European Commission no. 2004/383/EC contains a series of principles of uniform evaluation of the market risk. As regards the UCITS with a sophisticated investment policy, we recommend to apply the VaR method, which sets the maximum loss in a period of time, with a certain assumed degree of trust. Besides, stress test measures the effects of the extreme movements of the market.

At this time, we cannot talk about a unification of the methods of risk assessment of the investments made by UCITS at European level. However, risk management represents a complex and actual issue and a means of investor protection and improvement of trust in this type of investment.

A series of changes in the European regulations will reconfigure the current structure of the European market: the replacement of the simplified prospectus with a standardized document (Key Information Document), the management by a management company of authorized UCITS in different Member States. The possibility of using the mechanism of the private investment for cross-border distribution of participation titles issued by other collective investment undertakings is also considered.

In our opinion, the development of Romanian collective investment undertakings can be influenced by a series of factors, as follows:

- the introduction of a fiscal regime, favorable to the investment in such vehicles;
- the identification of legal and operational mechanisms that allow for the delegation of the management firms' functions (like, for example, back-office activity), in order to improve costs;
- the use of the free distribution of UCITS in Member States;
- the enlargement of the investment geographic area of collective investment undertakings;
- the development of financial products related to the funds evolution: unit link, structured deposits;
- the introduction of new types of collective investment undertakings (for example real estate).

Last year's increase in the number of collective investment undertakings proves the growing investors' confidence in their capacity to assure similar performance to other investment opportunities.

References

Anghelache, Gabriela (2004). *Piața de capital. Caracteristici, evoluții, tranzacții*, Editura Economică, București

Anghelache, Gabriela, Nan, S. Badea, D., Ioacără, A. (2005). *Reglementări actuale pe piața de capital*, Editura Economică, București

A consumer's guide to MIFID – Investing in financial products, CESR februarie 2008
Comisia Națională a Valorilor Mobiliare, Raport de activitate 2006

Council Directive of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to

undertakings for collective investment in transferable securities (UCITS) (85/611/EEC)
Commission Recommendation 2004/383/EC of 27 April 2004 on the use of financial derivative instruments for undertakings for collective investment in transferable securities (UCITS)

White Paper on enhancing the single market framework for investment fund, Comisia Europeană 2006

www.bnro.ro

www.cnvmr.ro

www.unopc.ro

www.efama.org