

European

IMREN News

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The future of investment management

Throughout the turbulent markets of the recent past, historically successful business strategies had to be changed, and cost cutting became the priority during bear markets.

In future, the industry will face a new environment. Investors will be more demanding about performance and ethical standards, and will need more assurance on risk controls. They will also demand access to a wider range of asset strategies. More importantly, their information and service needs will change. Savings of retired investors will grow dramatically, creating an increasing demand for new pension products and wealth management tools.

Regulatory challenges will grow as regulators reach across borders, and as operations and distribution expand across multiple jurisdictions.

Market forces will reshape relationships. As managers focus on core competencies they will outsource new functions and concentrate on fewer, more valuable distribution partners.

As the industry continues to mature, those managers who aim to maintain high rates of growth and profitability will be required to take on more risk, applying traditional core competencies in new ventures and by acting as principal in new opportunities.

The challenge for the industry will be to structure the organisation for success in the new environment. Strengthening of middle management and breeding an organisational culture where every employee always acts in the best interests of investors will be prerequisites for success.

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In keeping with our clients' growing interest in a more diversified set of asset classes, the investment management and real estate practices have merged at PricewaterhouseCoopers and thus in our newsletter. You'll find increased coverage of alternative assets in this issue, and we welcome your thoughts on future articles.

**Flashline****A stitch in (market) time?**

As stories of irregularities due to market timing have emerged over the past eighteen months, a number of preventative approaches have been suggested including: restricting the number of redemptions in any one period; early redemption fees; and fair value pricing.

This article looks at another, more innovative, way to prevent market timing – the use of “in-kind” redemptions. In-kind redemptions were first used by funds facing liquidity problems, and involves giving redeemers a basket of securities rather than cash. The argument for using in-kind redemptions to deter market timers is that when the market timer exits the fund he/she is left not with readily usable cash but with a basket of securities, some of which may not be easily sold.

While appearing an effective preventative technique in theory, what are the practical implications for a fund looking to adopt in-kind redemptions?

The principal barrier is investor taste - while many Exchange Traded Funds (ETFs) have been making use of in-kind subscriptions and redemptions for quite some time – many very successfully – the investors to whom non-ETFs are being marketed are different. Investors subscribing into an ETF do so fully aware that any subsequent redemption will be in-kind. Investors looking to subscribe into an ordinary mutual fund may not be quite so willing to accept a basket of securities instead of cash.

This particular issue could be avoided. For example, investors could be required to give a fixed number of days notice prior to redemption. If the required notice is not given, the investor can still redeem out, however, they will do so on an in-kind basis - with a basket of securities rather than the cash equivalent.

While the use of in-kind redemptions is possible and may be useful in certain cases, it will not be practical in all cases. A combination of two or more of the techniques may prove more effective to fund promoters in the fight against market timing.

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Fund corporate governance leaps forward

The results of the PricewaterhouseCoopers Mutual Fund Governance Survey 2004 demonstrate an increasing focus by boards of directors of Luxembourg funds on corporate governance management since our 2003 survey.

Nineteen fund promoters of varying sizes from eight territories were surveyed in May 2004; they represent 48% of assets under management in Luxembourg. Funds managed are mainly UCITS distributed in several countries across Europe.

One-third of participants intend to review and/or change their policies regarding board composition, with top new selection criteria: professional experience, complementary set of skills, absence of conflict of interest and independence. This shows the willingness of UCITS' promoters to further enhance the effectiveness of the Board.

Luxembourg fund boards average six members, with a majority of promoter's representatives (which has historically been a CSSF requirement) and some representatives of service providers (i.e. investment manager, central administration agent, custodian and distributors). On average, board members surveyed are on seven fund boards.

Board directors that are employed by the fund promoter or its service providers are generally not remunerated, while more than 80% of independent directors are remunerated. A quarter of these receive more than €20,000 per year per mandate.

A majority of boards now invite the fund's auditor, either once a year or on a case-by-case approach. Over a fifth of participants have appointed, or are in the process of appointing, an audit committee.

Future challenges

Top issues facing boards in 2004 are fund performance, risk management and compliance. All these issues, as well as corporate governance, have increased in importance since 2003.

Two-thirds of boards have already decided on a UCITS III transition strategy. Almost half did not plan to comply with both the profession and the product directives before 2006.

Three-quarters of participating boards have decided on late trading/market timing actions, with risk assessment and monitoring the effectiveness of procedures and controls the preferred actions taken.

Finally, over the next two years, participants believe that fund expenses, fund risk exposures, as well as risk management and internal controls, will be at the top of their agenda. These items are also areas where increased transparency toward investors will be a priority for the board.

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The executive summary of Mutual Fund Governance Survey 2004 is available on www.pwcglobal.com/lu

EU Accession creates real estate opportunities

The expansion of the EU by 10 countries¹ with 75 million inhabitants creates immediate economic impact on the EU accession countries and, importantly, great opportunities for Western European investors, particularly in real estate.

In Germany, with its depressed office market, more than half of German real estate respondents surveyed by real estate consultant DTZ² plan to invest in the new EU countries, with Poland, the Czech Republic and Hungary viewed as the most attractive, followed by the Baltic States, Malta, Slovenia and Cyprus. While office buildings are still the preferred type of foreign investment according to this survey, shopping centres and logistic properties are catching up in these countries. So what exactly is on offer?

Poland, Hungary and the Czech Republic

These three countries have significant similarities in approach, international orientation, concentrated central structure and market developments over the 1990s. However, the gap between Western Europe needs to be kept in mind. The office building stock of Warsaw (2.0 million square metres); Budapest (1.6) and Prague (1.2) compares to 17 million square metres each in Munich and Berlin. Eastern Europe's actual rate of return for office building space for big cities like Budapest and Prague range between 8% and 10%, while other cities including Krakau, Posnan, Breslau and Lodz can reach up to 13% of annual yield. These figures clearly show the market opportunity and growth projections in this sector.

As the biggest accession country, Poland is likely to be the most important in terms of office building inventory and new office space brought to market. The focus has been on the capital city of

Warsaw where half the real estate inventory is city-centre and half in the suburbs. Office building stock has been rapidly increased with 270,000 sqm of office building space implemented, with rents in the range of €21.00 per sqm in the inner city and €14.00 in the suburbs. The current vacancy rate has climbed to about 14%. The amount of warehouse space stock in the Warsaw region is about 974,000 sqm. In the last year, approximately 175,000 sqm have been let for an average price of €4.50 per sqm.


The retail property market, particularly in Poland's city centres, is also developing dynamically, with the arrival of international retailers pushing rents in top locations up to €40.00 per sqm. However, many of the German and West European retailers have now completed the expansion of their businesses in Poland.

While Poland is becoming more decentralised and the real estate market is spreading beyond the capital, in Hungary, Budapest is still the only significant office building market. The high demand in this sector during the late 1990s economic boom caused an overheating of the market, leading to a current vacancy rate in excess of 17%. However, there are still market opportunities for foreign investors. In 2003 about 140,000 sqm of new office space was completed and office stock has increased to 1,600,000 as a whole. The current market rent for office space ranges between €11.00 and €15.50 per sqm, with top location rents at €18.00 per sqm.

In the Czech Republic, the increasing GDP through the 1990s impacted the real estate market positively until it peaked in 1999 with top market rents reaching €20.00 per sqm. In the following years the demand for office space settled down on a lower level with a current vacancy rate of 10%. In 2003 about 240,000 sqm of office space was completed bringing actual office building inventory to a total of 1,450,000 sqm. In the last years a market rebound has been registered, again bringing the top location rents up to €20.00 per sqm.

Accession to the EU is expected to have a positive impact on those countries' local real estate market for the years ahead, but no big bang is likely in the next one or two years. Short term, much of the office space demand will be caused by public or EU-authorities or various associations, with the leading markets of Poland, Hungary and the Czech Republic extending their important role. Positive development of real estate markets of the other acceding countries can be expected, creating a number of investment opportunities.

Nevertheless, it has to be emphasised that historic developments of these markets has not been uniform and a differentiated strategy is always recommended.

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¹ Estonia, Latvia, Lithuania, Poland, Slovakia, the Czech Republic, Slovenia, Hungary, Cyprus and Malta.

² Die Welt, 28 April 2004.



Flashline

Islamic finance products multiply

Islamic finance has outgrown its beginnings as a niche market in the Gulf and has quickly spread across the US, Europe and the Far East. In our September 2003 issue, we outlined the pivotal role that property finance has assumed in the Islamic fund industry which is governed by the principles of the Shari'ah including the prohibition of interest-taking and undue speculation. This will sometimes require complex structures which differ depending on the approach taken by the Islamic scholars involved and on whether the investment consists of the development or the purchase of income-producing properties. While real estate continues to be in high demand, the targeting of other asset classes by Muslim investors has gained momentum.

A number of Islamic hedge funds have recently been established and several Islamic private equity funds have started or are being considered. Aircraft and ship leasing funds are being set up and investments in alternative energies like windfarms launched. Cash-flows from the leasing of car fleets are securitised in an Islamically compliant manner through the issuance of "sukuk" certificates.

Several banks offer an increasing range of Islamic products including bank accounts, insurance products and home finance-type Islamic mortgages. In the UK, the first Shari'ah compliant bank obtained a banking licence from the FSA in August 2004. In continental Europe there are also developments in this area.

Shari'ah compliant investment is often considered highly ethical given the nature of the eligible assets (e.g., no investments in the defence industry, alcohol, tobacco, or gambling) and the prohibition of speculative investments. Also Shari'ah law requires that structures should be as transparent as possible. These aspects may also be attractive to non-Muslim investors.

For fund managers considering raising investor money in the Middle East – and there are very substantial funds to be invested – it will certainly pay to become familiar with the key requirements of Shari'ah compliant investments. To meet overwhelming interest from clients, the dedicated PricewaterhouseCoopers Islamic Finance Group has organised frequent workshops, conferences and panel discussions on Islamic finance in Europe, the US, Asia, South Africa and the Middle East.

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Germany: Certainty of treatment for carried interest holders

In July 2004 a new bill passed the German parliament that clarifies how carried interest will be taxed in Germany. This follows a long period of uncertainty regarding the tax treatment of these amounts for German individuals, with the tax authorities maintaining, in the face of strong industry opposition, that the payments should have been fully taxed. Under the new rules, where the carry holder is resident in Germany, only 50% of the carry payment will in certain circumstances be subject to a German tax charge.

Carried interest is a term used for payments to carry holders based on their interest in a fund partnership, entitling them to participate in the profits of the partnership once certain performance targets have been met as agreed with investors. This payment is designed to align the interests of the investors and the fund managers. This mechanism is often used in alternative asset classes especially private equity.

The application of the new 50% exemption is restricted to situations where the fund is categorised as an asset management fund and, hence, disregarded for German tax purposes (*vermögensverwaltend*). A fund must meet (inter alia) the following conditions:

- investments not acquired by debt funding
- portfolio companies' liabilities not guaranteed by fund
- investments to be held for an average period of 3-5 years
- proceeds (generally) not to be reinvested
- fund and its agents not to manage the portfolio companies.

Where the fund carries on a trade (*gewerblich*), the total of the carry will be subject to a tax charge in Germany. While German-based funds will be familiar with these tests, many private equity funds, especially those domiciled outside Germany, may fail to meet these requirements, as these tests do not fit easily with tests applied by overseas tax authorities or current private equity industry practice.

A further limitation to the rules means that the 50% carry exemption only applies to carried interest paid by a fund set up after 31 March 2002. For pre-existing funds, the exemption will only apply to carry paid out of the proceeds of a disposal of shares purchased by the fund after 7 November 2003.

While these changes provide a welcome clarification for German executives, they do not offer the simple advantageous tax treatment that many in the industry were seeking. While most German-based private equity funds will endeavour to satisfy the asset management criteria set out above, most overseas funds will not wish to be restricted in this way. German executives with overseas carry will have to determine the status of the offshore fund before their own tax treatment can be determined, leading to uncertainty for industry players. This complicated tax amendment does not deliver the boost to the German private equity industry that, no doubt, the German authorities intended.



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Optimising outcomes through real estate tax modeling

Increasingly, the complexity of real estate deals, particularly across jurisdictions, makes it difficult to predict the combined impact of relevant tax factors on projected returns. Here Ferry ten Kate explains how the tax leakage simulation model can enable real estate professionals to optimise outcomes and returns.

Tax advice in the real estate industry focuses on advising investors on suitable investment structures which are tax efficient while meeting the investor's commercial goals. However, the traditional approach of static jurisdictional tax information plus interaction of different tax systems means that the consequences of an investment structure are understood only in nominal terms. The investor considers nominal tax rates (transfer taxes, income taxes, withholding taxes, etc.), applicable methods of relief from international double taxation (e.g. tax credits, exemptions), nominal rates of depreciation and capital cost allowance, etc. A crucial further step is needed to translate tax structuring advice into tailor-made cash flow models that show the impact of advice in real figures: IRR, ROI, ETB, etc.

Moving to interactive project-specific information provides more precise information and thus greater transparency. With competitive counterparties, and millions of dollars at stake, this greatly improves negotiating position. Additionally, it enables the investor to optimise and increase returns and better understand the risks at each point in the project. Depending on the type of investor, it may be crucial to see the difference between pre-tax returns at the property level and post-tax returns at fund or investor level.

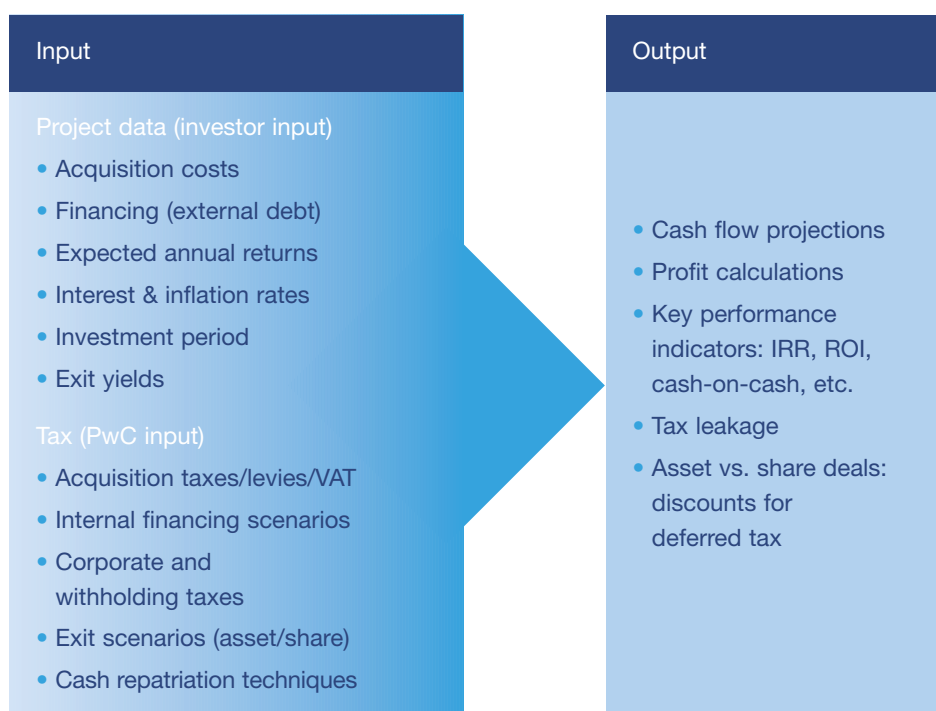
The diagram below shows how the model makes a comprehensive simulation of one or more projected investment and financing structures on the basis of project-specific commercial data. Based on variable investment periods,

the model provides a tailor-made simulation of cash flows going through an investment structure showing extensive computations of accounting profits and taxable incomes at different levels based on local tax regulation, international tax laws and private letter rulings.

What kind of insights can such a model of tax leakage provide? A few examples are:

- Alternative exit strategies, e.g. impact on IRR and ETB of asset versus share deals, taking into account possible discounts for deferred taxation on any built-in gains on exit
- Comparative share/asset acquisition analysis, e.g. calculating possible discounts on the price of shares to achieve a break-even situation between doing an asset or share deal acquisition, taking into account all relevant tax implications
- Optimal financing structure, e.g. comparing internal and external back-to-back financing from different jurisdictions
- Optimal mix of repayment of capital and internal loans to repatriate cash to investors.

Use of this technology enables real estate professionals to visualise and optimise the tax impact, and thus the returns, on their real estate investments. Better information enables better decisions, and can give a competitive edge over less astute counterparties and competitors.





Flashline

Helpful tax change for Belgian new securities

Changes are afoot in Belgium regarding taxes on new securities following an adverse ECJ Judgment regarding indirect taxes on the raising of capital under the UCITS Directives. In response, the Belgian Ministry of Finance has declared that from 15 July 2004, subscribers no longer have to pay either the tax on stock exchange transactions, nor the tax on the delivery of bearer shares, on the issue of new securities.

Consequently, financial intermediaries should no longer withhold either the tax on stock exchange transactions nor the tax on the delivery of bearer shares on the issue of new securities. The same applies to professional intermediaries and the issuing company regarding the tax on the delivery of bearer shares on the issue of new securities. Moreover, the tax could be paid back according to specific conditions provided by Belgian law.

From an investment funds perspective, this tax change applies not just to the issue of new securities but also when the same person switches from shares of one sub-fund to another sub-fund in the same investment company. It also applies to switches within the same sub-fund into other shares to which different dividend rights are attached.

It is now anticipated that the Ministry of Finance will :

- adapt the Belgian law to the ECJ Judgment;
- clarify the statutes of limitation;
- draw up a procedure for repayment of tax in the near future.

However, it is crucial to note that despite this improvement for new securities, the tax is still applicable in other cases (notably the transfer of securities from one investor to another).

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Luxembourg leads with new securitisation law

Luxembourg is building on the experience of other domiciles to optimise its legal and regulatory framework to structure securitisation transactions.

The growing importance and size of the European securitisation market to banks and to commercial companies has prompted European legislators in France, Belgium, Italy, and Ireland to create legal frameworks for that business.

On 22nd March 2004 the Luxembourg legislator issued its new securitisation law which covers all relevant aspects from a civil law, insolvency law, supervisory law and a tax law perspective. The primary objective is to provide a high degree of flexibility and certainty to all companies and investors in Luxembourg and abroad.

The key advantageous components of the law are:

Flexibility: Securitisation can be performed by a corporate entity or by a fund managed by a management company and governed by management regulations. Furthermore, the new law does not foresee any limitations with regard to securitisable assets, e.g. receivables and assets may include car finance loans, home or commercial mortgages, corporate loans, leases, royalties, non-performing loans and future streams of revenue. The transfer of risk can be done in the form of a true sale or on a synthetic basis. The assets and liabilities of the vehicle can be split in different compartments of separate entities which can be liquidated separately without any negative impact on the vehicle's remaining compartments. Securitisation vehicles issuing securities to the public on a regular basis are authorised and supervised by the CSSF. Even the European Central Bank, which the Luxembourg minister of finance consulted on the draft in December 2003, welcomed the flexible framework which allows workable structures at reasonable cost.

High investor protection: The new law ensures a high degree of investor protection, as the bankruptcy remoteness principle separates the securitised assets from any insolvency risks of the originator, the vehicle or the service provider. The law also makes non-petition clauses valid and enforceable. The assets of the vehicle can be divided in different tranches and the claims of different investors can be considered in an order/sequence agreed in the issuance conditions of the bonds (subordination or waterfall provision, limited recourse provision).

Tax neutrality: Securitisation transactions can be structured on a tax neutral basis. Basically securitisation companies are subject to ordinary corporate income tax, while securitisation funds are tax-transparent. Securitisation companies will be taxed based on their profit whereby the commitment to remunerate the investors for issued bonds or shares qualify as interest. The interest payments are not subject to withholding tax in Luxembourg. The securitisation company is exempt from VAT and net wealth tax, and the maximum capital duty is €1,250.

The state-of-the art Luxembourg securitisation law provides an attractive alternative to existing offshore models as well as European possibilities, and is expected to contribute significantly to the continued growth of the European securitisation market.



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Attractive new tax rules for Luxembourg investment vehicles

Luxembourg has been extremely active in 2004, introducing new investment vehicles and adopting applicable tax rules of existing ones to create significant choice and flexibility.

As is well-known, Luxembourg funds are subject to a specific tax regime: they are not liable to income tax but to an annual 0.05% subscription tax computed on their net assets. A reduced rate of 0.01% is available for money market funds/sub-funds and share classes of normal funds dedicated to institutional investors. An exemption is available when a fund invests in shares of another fund liable to the subscription tax.


In 2004, Luxembourg introduced an exemption for money market funds/sub-funds and share classes of funds dedicated to institutional investors. The exemptions also apply to funds used as "pension pooling vehicles", i.e. whose securities are exclusively reserved either for "institutions for occupational retirement provision" (IORP) (Directive 2003/41EC of 3 June 2003) or similar vehicles set up by a single group of companies for the benefit of its employees. (IORP is a new concept broadly corresponding to pension funds). The new law covers thus both internal and external supplementary pension schemes. With the other tax exemptions (no income tax, no wealth tax, no VAT, no taxation of foreign investors, fixed registration duty (€1,250), this constitutes a very attractive tax framework.

During the year, in legislation separate to that applicable to funds, Luxembourg also introduced two new types of investment vehicles aimed at international investors:

- Securitisation funds and companies (see related article p6) and;
- SICAR, investment companies in venture capital and private equity.

These two new types of vehicles are in principle liable to income tax and could thus benefit from the double tax treaties, however, specific mechanisms are used to minimise the income tax or even bring it down to zero. More precisely, securitisation funds are tax transparent, securitisation companies could deduct from their taxable basis their commitments to remunerate investors, and SICAR benefits from an exemption on income and capital gain arising from their investments. Additionally, other attractive features are foreseen: no wealth tax, no VAT, fixed registration duty (€1,250), no subscription tax, no taxation in Luxembourg of foreign investors.

This gives promoters and investors a comprehensive choice of investment vehicles in a friendly tax environment. Often there are a variety of vehicles which could be used for the same project, and the pros and cons of each type should be weighed. Additionally, depending on its regulatory regime and investment policy, it could happen that a vehicle of one category invests in a vehicle of another category. It's good news for promoters and investors, but requires more consideration as to the optimum structure in each case.

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Flashline

China beckons

From the 11th of December 2004, as required by its WTO commitments, China will allow foreign firms investing in fund management companies in China, through Sino-Foreign Joint Ventures, to own up to 49% of the company.

In Sino-Foreign Joint Ventures, foreign partners contribute technical assistance and personnel and thus the true amount of capital invested is likely to be much more given the manpower and systems provided by most foreign fund managers to their mainland counterparts. There are currently eight Sino-Foreign Joint Venture Fund Management Companies operating in the Chinese market with many more currently proposed or in the pipeline for approval.

The investment funds sector in China is experiencing remarkable growth with assets under management increasing ten fold, to approximately RMB200 billion (approx. €19.6 billion), since the introduction of the regulated funds regime by the China Securities Regulatory Commission ("CSRC") in 1997/98.

At the end of 2003, there were 54 registered closed-end funds and 50 registered open-end funds in operation, and by March 2004 there were 49 registered fund management companies, with more expected. China has already introduced the Securities Investment Funds Law, effective 30 June 2004, designed to promote rapid development of the funds sector with a regulated environment.

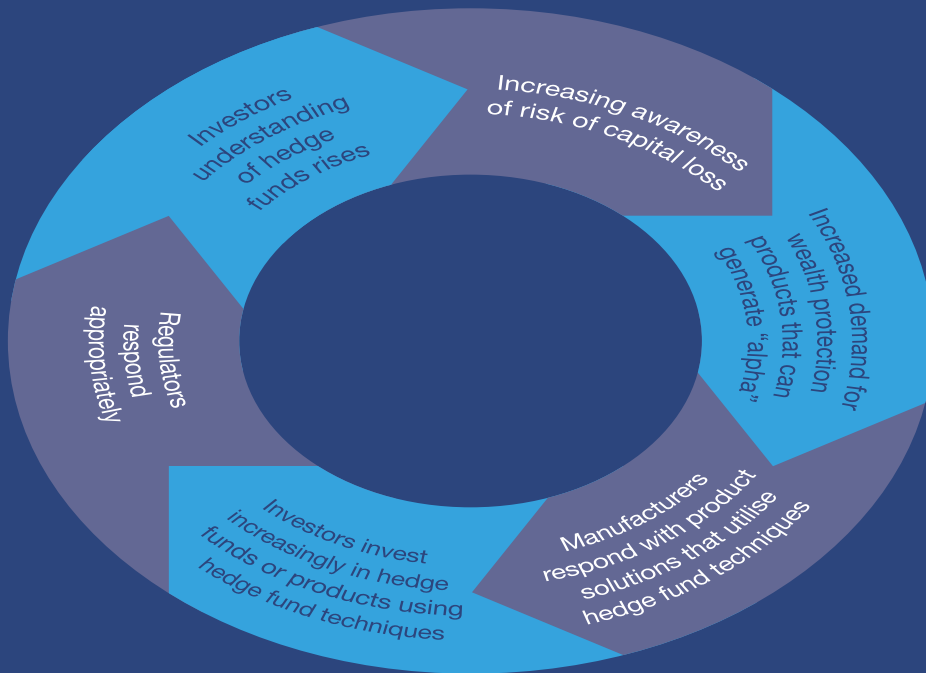
The new Funds Law gives a clearer and more detailed legal framework for foreign firms investing in fund management companies. The minimum registered capital of a fund management company is RMB100 million (approx. €9.8 million), with the principal shareholder required to have registered capital not less than RMB300 million (approx. €29.4 million).

The new Funds Law has helped create a more transparent environment for the establishment of Sino-Foreign Joint Venture Fund Management Companies. With the advent of the new WTO commitments, the time may never be better to consider setting up operations in the Chinese market.

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European hedge fund regulation and distribution moves on

Developments in the European hedge fund marketplace are continuing apace in a virtuous circle:



- Stock market crashes of recent years have focused investors' minds on the lack of capital protection offered by many traditional investment products, with an increasing awareness of the concept of "alpha" and the potential for achieving positive returns together with capital preservation.
- As manufacturers seek to develop products that offer investors solutions to their investment needs, hedge fund investment and risk management techniques are increasingly forming part of the mainstream investment management process, although the "hedge fund" label is often absent from the resulting products.
- This blurring of the boundaries between traditional and hedge fund products has caused regulators to acknowledge that the penetration of hedge fund styles is unstoppable, and regulators are accepting that hedge fund techniques can be appropriate for "mass affluent" and/or retail investors.

Interestingly, discussion has commenced at a European level on the possibility of creating a pan-European regulatory regime to accommodate alternative investment vehicles such as hedge funds. However, despite these moves, national regulators have different appetites for changing their existing rules. Fiscal authorities, with the notable exception of Germany, have generally been less quick to respond than product manufacturers and regulators.

Regulation is typically less well-developed in the ten EU accession countries, and with fewer old rules to unscramble, regulators may have greater flexibility in determining appropriate regulatory frameworks. Administrators setting up in these countries are likely to be cost-competitive and, with the ability to embrace the latest technology, they are in a strong position to challenge the existing traditional centres for hedge fund administration.

The US is moving towards the European model of closer regulation of hedge fund managers, with larger managers soon likely to be required to register with the SEC. Regulation in the traditional offshore "tax havens" is also tightening, partly as a competitive response to onshore regulatory developments and also in connection with managing their reputations as territories that are fully supportive of global efforts to fight the proceeds of crime.

The hedge fund industry must continue to use its influence to shape the future regulatory environment and hence the destiny of the industry in Europe. An appropriate and flexible regulatory regime remains vital for competitiveness with the US and increasingly Asia, so it is paramount that the inevitable rule changes are not imposed by regulators without consultation with the industry. Industry initiatives, such as the development of "Sound Practices" guidance, and participation in dialogue with regulators through industry associations, demonstrate that the industry takes its profile seriously. Looking forward, the industry should consider setting voluntary standards in such areas as valuations (see article on p.9) and fund corporate governance to supplement the increasing oversight of operational risk management by European regulators.

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Hedge fund valuations: an art or a science?

For the impressive success of the hedge fund industry to continue in a business where reputation is everything, consistent and accurate valuations are of paramount importance.

Hedge fund valuation issues are more far-reaching than for traditional mutual funds, and valuations range on a wide spectrum of quantitative/qualitative and objective/subjective factors. In examining the issues and responsibilities in hedge fund valuations, this article will focus on three hotly debated areas: counterparty versus model valuations, liquidity, and stale prices.

Which is more appropriate and more reliable – counterparty quotations or model valuations for positions held? Both have positive and negative aspects, and both need to be considered in a valuation.

Counterparty valuations are model valuations, but with less transparency on the models and inputs being used as the counterparty is simply providing the final value. Counterparty valuations raise concerns about reliability – whether it is provided by a knowledgeable trader or a more junior employee removed from daily trading activity and whether it is biased based on the counterparty desk's own position in the instrument. Consistency of the models and inputs being used and the timeliness of the valuation quotes being provided is very important, with more and more hedge funds now seeking daily indicative NAVs. However, as the counterparty is often the party with whom the position's valuation must be agreed and closed out ultimately, their valuations should not be ignored, but nor are they likely to be sufficient as the single source.

With model valuations, a standard industry model should be used whenever possible. If an in-house model is used, it should be independently tested, benchmarked and calibrated to industry accepted standards to ensure consistency of approach. The source of inputs, their reliability and their consistency has to be assessed.

Industry information is improving with the advent of consensus data, but there is still a good deal of subjectivity involved. For example, is there sufficient historical information on recovery rates in the dot com industry to be reliable? There should be standards or guidelines for price overrides. Finally, there is the issue of the black box – if the knowledge and understanding of the model is with one or two people can the valuation be assessed for reliability? This is where the combination of counterparty valuations and model valuations can highlight either errors or blatant misrepresentation and/or fraud by providing at least a benchmark to each other.

Liquidity is always an issue but particularly with certain strategies such as convertible bonds, CDOs, distressed debt and emerging markets. If a quoted market price is available, the use of liquidity discounts is actually inconsistent with most generally accepted accounting standards. However, many practitioners believe that liquidity discounts are necessary to reflect true fair value. This has resulted in some funds having two NAVs – a trading NAV and a reporting (GAAP compliant) NAV. The trading NAV incorporates liquidity discounts, considering the size of the position held versus both the total amount of the investment in issue and the average daily trading volume. Some managers recognise that their purchase/sale of a large position can move the market and influence price, so using market value is not considered true “fair value” in these instances.

Taking liquidity to its extreme brings the issue of stale pricing. How old is stale? The SEC states that “if an exchange or market on which a security is traded does not open for an entire trading day,

and no other market prices are available, a security price is deemed ‘not readily available’ and requires the use of fair value procedures.” This insight into the regulator's way of thinking may come to bear on hedge fund managers over time. There does not appear to be a commonly accepted definition in the hedge fund industry, with many variations in different hedge fund managers' pricing policies. It's not unusual to find the latest traded price being used as the default price, even though it can be up to three months old with no indicative valuations since the valuation point obtained! This is an area where some hedge funds could enhance procedures by addressing them in their pricing policies and implementing a mechanism for board approval and oversight.

So in the debate of art versus science, in the world of valuations, science is the valuation process and structure, while art allows the element of judgement and subjectivity to creep in. Overall the valuation process should be as scientific as possible to enhance consistency and reduce the level of subjectivity. Certain instruments will always require some artistic flair, but as far as possible the pricing process should be documented and consistent to keep that artistic flair in check!

Hedge fund valuation is a complex area, posing many industry challenges. The starting point should be consensus on the definition of valuation with the next step pushing the valuation process to be as scientific as possible. The end goals are to minimise the areas of subjectivity and achieve consistency in an increasingly complex valuation environment.



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Flashline

UCITS III: the headache of cross-border promoters!

Harmonisation of cross-border distribution of UCITS is one of the top priorities of CESR's Expert Group on Investment Management, which in April 2004 took over the Contact Committee's mission, but not much decisive came out of its first meeting, leaving each country free to apply its own approach and interpretation of UCITS III. Pending further guidance at the European level, certain countries, such as Spain and Italy, seem to be toughening their position, particularly toward incoming UCITS I vehicles.

In the last two months, regulators of three countries have been particularly active in providing guidance. Firstly, Belgium has advanced in its UCITS III implementing legislation: the bill of law is now in final form, and publication is pending the issuance of some practical guidance in the "*Arrêtés Royaux*". Secondly, Italy has moved towards a consultation, led by Consob and Banca d'Italia, on certain aspects of the UCITS III Directives. Lastly, German guidelines on the contents of the simplified prospectus of a *Sondervermögen* have been issued.

However, the coming into force of new local rules does not imply that cross-border selling of UCITS is easier. On the contrary, the current or planned marketing and/or product range strategy for most promoters could be jeopardised by the uncertainty surrounding some UCITS III provisions and by unexpected change of mind by regulators.

While passporting of UCITS III products with a "grandfathered" management company had seemed acceptable for all (the French AMF has finally officially confirmed its position), Italy has surprised the industry by suddenly refusing this concept. Registration of foreign UCITS III funds without a simplified prospectus (e.g. the Irish IFSRA tolerating its absence until 2005) is also still an issue in France, Spain and possibly Luxembourg. The same reluctance would also apply to foreign mixed-funds (with both UCITS I and UCITS III sub-funds) in at least 8 countries.



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German InvTA: Chance and challenge for UCITS funds

In December 2003, Germany passed the Investment Tax Act (InvTA), effective from 1 January 2004. In abolishing major tax discrimination of foreign funds, the InvTA provides the opportunity to enter the German market on a large scale. Equity funds will be a particularly tax attractive investment alternative for institutional investors, with about €50 million expected to go from Special Investment Funds to mutual funds due to the enacted IFRS accounting principles.

The "transparent" fund introduced by InvTA passes on significant tax benefits to German investors, giving them a very favourable after tax return compared to investing directly in the fund's assets. The major benefit is the complete tax-exemption of capital gains from securities and derivatives available for private investors and for institutional investors as long as these capital gains are accumulated by the fund. There is also a 95% or 50% tax exemption of dividends and capital gains from equity. In contrast to the transparent fund, investors in a "non-transparent" fund will be subject to taxation on a lump-sum basis incurring the risk of a considerably higher tax burden. Investors are taxable on all actual distributions plus 70% of the appreciation in the value of the share during the calendar year, but at least on 6% of the last redemption price of the calendar year, irrespective of whether the fund's NAV increased or decreased during the year.

The transparent fund status, however, can only be obtained by complying with a sophisticated set of tax data disclosure and publication requirements. Also, the tax data must be approved and certified by an auditor or tax adviser via a tax certificate confirming that the data has been determined in accordance with the rules of German fund tax law.

Thus, the tax certificate central to the InvTA causes an unofficial German tax audit, since the entity confirming the tax data is liable for incorrect figures to a maximum amount of €1 million per certificate (i.e. per share class). To avoid increased costs for the approval and certification, a systematic evaluation of the tax figures is essential and needs to cover all relevant transactions. In many cases, the fund administrator will have to adapt its system to the German fund tax rules, the earlier the better. The position is not aided by the proposed significant amendments to the "transparent" taxation procedure as contained in a draft law announced in July 2004. Even if the amendments are not adopted into law, the continued uncertainty is unhelpful to those who need to develop systems capable of handling the transparent fund requirements.

Achieving the transparent fund status is crucial for foreign funds to attract German investors and to make this investment tax efficient. Despite the challenge of having to cope with the new German tax obligations, the introduced tax benefits for German investors offer the chance for foreign fund managers to make substantial headway with their products in the growing German fund investor market.



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CAD is dead: long live RBCD (and it's good for asset managers)

In the summer, for reasons best known to themselves, the European Commission, changed the name of the Capital Adequacy Directive to Risk Based Capital Directive (or Capital Requirements Directive) (and ISD to MIFID – the Markets in Financial Instruments Directive or FIMD – Financial Instruments Markets Directive, which it isn't).

Once past the taxonomy the substance can be considered. For asset managers the answer is nothing of significance changes. The main test for capital adequacy remains the Expenditure Based Requirement and the "CAD waiver" from consolidation, although substantially redrafted, and certainly more explicit appears to have predominantly the same effect as before.

Not all countries were happy with the retention of the waiver, so it may come under attack in Parliament or the Council. In any event implementation is unlikely to be much before early 2007.

Non-EU parents

Of more immediate concern is the implementation next year of the Financial Groups Directive. This is of particular relevance to asset management groups with parents outside the EU/EEA. Their EU regulator will be required to take a view as to whether the parent's regulator imposes equivalent regulation. It is not entirely clear what happens if the answer is that it does not.

Key considerations for asset managers

- Do you have a non-EU/EEA parent?
- Do your UCITS funds delegate functions outside the EU?
- If operating under the "CAD waiver", will the new text continue to allow you to do so?

Dealing on own account

Where the RBCD has changed in the most recent Commission proposals is for those firms who occasionally deal on own account but only so as to satisfy a customer order. Under the original proposals they would have been caught by the full weight of the new risk-based proposals and a substantial, and largely unjustified, increase in capital would have resulted.

Following consultation, the Commission has followed the analysis set out in PricewaterhouseCooper's impact study on the earlier proposals and has created a set of limited circumstances in which these firms may deal on own account but would not be subject to the €730,000 minimum capital requirement.

For firms with large trading books the earlier proposals are largely unchanged but there is a joint Basel/IOSCO working group looking at some of the disputed definitions.

UCITS

Of course, the latest UCITS Directive has its own minimum capital levels. For most, apart from self-managed funds, these start at €125,000 and if the funds under management exceed €250mn, the capital rises at the rate of 0.2% of FUM up to a maximum of €10mn. Except that the old ISD test of one quarter of fixed expenditure (EBR) has also to be applied and the higher of the two calculations taken. For most, the EBR test will bite.

Delegation of UCITS functions

Extra-territoriality has raised its head under the Financial Groups Directive. It occurs also under UCITS, where

delegation outside the EU requires the competent regulator to take a view as to whether the function that has been delegated is subject to equivalent supervision. This is already causing headaches for some.

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In addition, it seems that the Spanish CNMV will no longer register new sub-funds created after 13/02/02 in a UCITS I "grandfathered" fund, a position beyond the French and the Italian ones, which refuse UCITS I sub-funds launched after 13/02/04!

Equal caution surrounds national views on the use of derivatives. The EU Commission recommendation on derivatives (published 27 April 2004) seems to be followed by all with now unrestricted use of currency derivatives and maximal global exposure of up to 200% of the NAV (+10% via borrowings). However, products selling uncovered derivatives or using OTC derivatives to get the return of hedge fund indices or commodity indices would receive differing treatment from state to state, with some regulators accommodating previously prohibited "exotic" investment policies under the new rules.

In that context, CESR's recommendation(s) will be welcomed!

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Flashline

**EU Savings Directive:
Implementation postponed**

In June, the European Union Council of Economic and Finance Ministers ("ECOFIN") agreed a delayed start date for the implementation of the Savings Directive. The Directive provisions will now apply to interest payments made from 1 July 2005. This delay was agreed after the Council concluded that Switzerland would be in a position to apply equivalent measures by 1 July 2005.

From then, paying agents in EU member states (and other territories) making cross-border interest payments to EU individuals will be required to report information to their domestic tax authorities or, for paying agents in Austria, Belgium and Luxembourg, to levy a withholding tax on such payments. These rules will apply equally to paying agents resident in the 10 countries that joined the EU on 1 May 2004 and those resident in non-EU Member States including Switzerland, Liechtenstein, San Marino, Monaco and Andorra, and all relevant EU overseas dependent territories, such as the Channel Islands, Isle of Man and the Caribbean dependent territories.

Some member states have already formally revised their national implementation timescale: e.g., the UK Inland Revenue have announced that the first reporting period for UK paying agents will be from 1 July 2005 to 5 April 2006. UK paying agents may need to notify the Inland Revenue by 15 April 2006 of their liability to make a report which should be delivered to the Inland Revenue by 30 June 2006.

Paying agents with EU clients will need to be able to identify all reportable interest payments; produce relevant required information in relation to payees; and generate required reports for the Revenue authorities for payments after 1 July 2005. However, the new customer documentation rules requiring paying agents to obtain and verify relevant information in relation to new customers have been in effect since 1 January 2004.

With EU and national preparations for the Savings Directive still proceeding apace, it is clear that paying agents need to act to ensure that they fully understand the impact the Savings Directive will have on their investors and also their business.

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Pension funds: stay in control

In June 2004, PricewaterhouseCoopers merged their Dutch investment management and pension fund groups, with Sonja Barendregt-Roojers also becoming chairman of the latter. Here she discusses how the complex pension fund market in the Netherlands and elsewhere requires a multi-competency approach.

Dutch pension funds, many of which are internally managed, are considered among the most sophisticated in the world. Increasingly they have been embracing advanced types of finance, going beyond low-risk investments to equities and derivative products. The trick is to limit risk within this new investment profile as much as possible. This will be supervised strictly by the newly-merged Dutch supervisory authority.

Pension fund managements are becoming more professional, with increased emphasis on pension fund governance. The question "how do we stay in control?" is more and more dominant. This also applies to smaller pension funds, which often outsource implementation; however, the responsibilities remain the same: for policy, for implementation and also for reporting. Increasingly companies in the Netherlands as elsewhere are switching to a defined contribution arrangement. This is not, as is often argued, because of international reporting rules or in anticipation of IFRS, but because they want to be able to manage the volatility.

The requirement to be in control highlights the importance of operational risk management, as pension funds seek to obtain and apply the wide knowledge needed. To manage and advise well requires competence in compliance, actuarial knowledge, employment terms, IT systems and operational risk management. To be in control comprises everything from investment risks to communication with participants. Also needed is a working knowledge of fiscal issues such as VAT and what activities come under corporate tax; all factors requiring broader knowledge by management supplemented by specialist advice.

Over the coming years, investment management will assume greater urgency, with increasing use of hedge funds and alternative investments, usually participations in non-listed enterprises. This comes at a time when pension funds have more and more compliance and regulatory burdens, both on a national and European level.

European legislation such as the 'Bolkestein Guideline' on pan-European pension funds will have many consequences. There are still too many barriers, particularly to fiscal and supervisory harmonisation, for the establishment of true pan-European funds. However, possibilities are arising, e.g. asset pooling or mutual investment funds, and many large clients are considering setting up pan-European elements, e.g. centralising the management, while observing national features and regulations.

The new Dutch pension act, European legislation, valuation at market value under IFRS: all these developments will require more professionalism and knowledge from pension fund managers. Small pension funds with less than two hundred participants are likely to place everything under insurers. Large pension funds may struggle to find enough qualified managers, given the increasing responsibilities. PricewaterhouseCoopers' multi-disciplinary approach now supplements national and European pension competence with crucial investment management expertise to ensure pension fund clients are always in control.



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Does IFRS apply to my fund?

As is well-known, the EU issued a regulation in 2002 (EC/1606/2002) (the “IAS Regulation”) which requires that EU listed companies prepare their consolidated financial statements using IFRS for financial accounting periods beginning on or after January 1, 2005.

The question, which the remainder of this article tries to address, is whether or not IFRS applies to Funds.

Firstly, let’s look at the IAS Regulation in detail. There are three conditions, which have to be met before it applies in the first place:

1. The entity must be governed by the law of an EU Member State;
2. The entity must be required to prepare consolidated accounts; and
3. The securities of the entity in question must be listed on a regulated market of any Member State within the meaning of EU Directive 93/22 on investment services.

If any one of those requirements were not met then the IAS Regulation would not apply. In many cases, funds in the EU will not be required to prepare consolidated accounts and as a result many funds would not have to apply IFRS based on the EU Regulation.

Previously, we referred to the fact that the IAS Regulation applies to EU listed companies. What about a fund, which has not been established as a company? Funds can be established in a number of different forms other than as incorporated entities in many jurisdictions. In an interpretation issued by the EU in November 2003 the EU commented that companies are defined by the Treaty of Rome, Article 48 (ex Article 58) as follows:

“Companies or firms’ means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.”

This is an open question and legal opinions may be required in some jurisdictions to determine whether particular forms of entities are companies as defined in the Treaty.

Assuming that your fund does not meet the three conditions for applying IFRS as laid out in the EU Regulation, it may still be the case that the fund has to apply IFRS. That is because of the “Member State Option.” The IAS Regulation gives Member States the option to extend the requirement to apply IFRS. These extensions could apply to:

- The annual accounts of the companies that have to apply IFRS for their consolidated accounts;
- Other companies not covered by the IAS Regulation, to prepare their consolidated accounts and their annual accounts under IFRS.

The regulations and legislation in each Member State are different in this regard.

The table below summarises the position in a number of EU Member States for 2005 (based on current information).

Notwithstanding the fact that many funds will not be required, either by the IAS Regulation as it currently stands or by the extensions that some Member

States may make to the IAS Regulation, preparers of fund accounts cannot afford to ignore IFRS because:

1. Certain funds are dedicated funds which are fully owned by a major institution which has to prepare consolidated financial statements under IFRS. Therefore, the administrative agent of the dedicated fund will have to prepare some sort of IFRS reporting for consolidation purposes of the institution;
2. As more and more accounts will be prepared in IFRS and users of accounts may come to expect to receive IFRS compliant financial reporting even in cases where this is not required by any regulation;
3. Convergence between local GAAP and IFRS will result in IFRS, just over a longer (and thus more expensive and harder to manage) period;
4. Local regulators may seek to create a level playing field between listed consolidated investment products and funds that have many similar characteristics but which are currently outside the scope of the regulation by having them apply IFRS.

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How are specific countries dealing with IFRS Regulation extensions for investment funds?			
Country	Listed (statutory)	Private (consolidated)	Private (statutory)
Belgium	No	No	No
France	No	No	No
Germany ¹	No	No	No
Ireland	Permitted	Permitted	Permitted
Luxembourg	Permitted	Permitted	Permitted by special committee approval
Netherlands	Permitted	Permitted	Permitted
UK	Permitted ²	No for unit trusts	No for unit trusts

¹ Answers given refer to UCITS compliant funds. For funds with a corporate structure, e.g. private equity funds, IFRS will be permitted when the proposed amendments to the local GAAP are released. ² Permitted for listed investment trust companies.

Offshore funds: Welcome changes but discriminations still remain

The UK Finance Act introduced changes to the UK distributor status rules for offshore funds. These rules enable investors in offshore funds that distribute the majority of their income to be subject to tax on disposals as capital gains rather than income.

In overview the changes were designed to simplify the regime, while preserving the fundamental elements of the scheme. The headline changes are:

- Individual sub-funds, or share classes within sub-funds, are now able to obtain distributor status. This will facilitate the inclusion of both accumulating and distributing investment options within one umbrella fund.
- Most of the investment restrictions have been removed. The only remaining restriction is a limitation on investment into non-distributor status funds of 5% of the fund (or share class) assets.
- There are changes to the methodology for calculating the UK Equivalent Profits Test, which are intended to more closely align the UKEP number with the income as shown in the fund's accounts.

These changes have broadly been welcome by the fund management industry: the requirements of the offshore fund rules having previously resulted in the proliferation of fund ranges across Europe, with many asset managers forced to establish one umbrella fund range for European distribution, and a separate umbrella fund with Distributor Status certification, for marketing into the UK. Following these UK changes, many asset managers are starting to examine the possibility of rationalising European fund ranges, perhaps by launching a distributor status share class within their main fund range, and merging the Distributor status fund range into this share class. While this should deliver immediate costs savings to managers by reducing product duplication, should managers in fact use this opportunity to

fundamentally reassess their fund ranges? There are several aspects that managers may wish to consider, including:

- The optimum fund domicile for the asset manager and investor. The choice of fund domicile can be a complex decision. Factors such as availability of local service providers, regulatory regime, taxation treatment of the fund and investors all should be considered.
- UCITS III offers the possibility of new investment freedoms and an obligation to update fund documentation. Would it be preferable to consider changes to a fund range in one exercise, rather than contact investors with successive waves of changes?
- Over time investment styles and preferences change. Some sub-funds may no longer be of interest to new investors or in fact overlap in investment objectives with other funds. Would existing investors in these funds be better served by a fund merger to create a fund with the critical mass to deliver improved investment performance?

Although the changes to the rules outlined above are to be welcomed, they remain discriminatory under EU law for the following reasons:

- Unless offshore funds (or under the new rules, sub-funds or share classes in sub-funds) obtain distributor status, investors are taxed under a less favourable regime compared to UK investors in domestic funds.
- Funds will still have to undergo onerous tax compliance procedures in order to achieve tax treatment for investors

equivalent to investment in domestic funds. This additional burden is in itself likely to be regarded as discriminatory by the European Court of Justice (ECJ).

- In order for distributor status to be granted, offshore funds will still need to pay cash distributions. In contrast, investors in domestic funds are taxed on income of the fund, whether distributed or accumulated.

This remaining discrimination is particularly disappointing as it follows a long period of consultation with the investment management industry; indeed, at the outset the Revenue said that it wished to bring forward a regime that met the UK's obligations under the EU treaty. Alas this seems to have been a bridge too far, with the result that some discriminatory aspects remain. Given that it has taken the Revenue two years to come back with something that is still discriminatory, it would seem that the only way to change matters would be for fund management companies or investors to invoke their rights under the EU treaty which may entail a trip to the ECJ (although the European Commission could presumably be approached to take the case instead using their powers under Article 226 of the Treaty).



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Product provision: a missed opportunity

Have wealth managers fully come to grips with the challenges in delivering best of breed products to an ever more demanding client base? And can they afford it?

In an in-depth analysis of “Product provision: a missed opportunity” following on from the 2003 PricewaterhouseCoopers Global Private Banking/Wealth Management Survey, “the impact of rapid product development on middle/back office and regulatory compliance” is the most widespread cost concern among wealth managers worldwide.


Open product architecture has liberated wealth managers to offer more product, but brings with it issues in client relationship manager effectiveness, reporting, information systems and profitability. Should the asset management department continue to be the driving force for wealth managers, or should some or all of it be outsourced? Many perceive asset management as their differentiator (hopefully their clients do as well). However, over the next three years, increasing numbers of wealth managers, particularly in North America, hope to differentiate themselves with their family office services, raising the question as to whether family offices are clients or competitors for wealth managers.

Numerous regulatory changes such as the European Savings Directive and legislation to prevent money laundering and to ‘know your customer’ have a major impact on product design, as does taxation (with cross-jurisdictional tax particularly challenging). Tax expertise is now as crucial as investment expertise for credible wealth management solutions. Many clients are consolidating portfolios and moving assets from low-tax jurisdictions, while products may no longer be best sourced from home jurisdictions but internationally. A major flaw in new product development is not integrating systems and compliance and

taxation implications into the new product development process, whether products are in-house or third party.

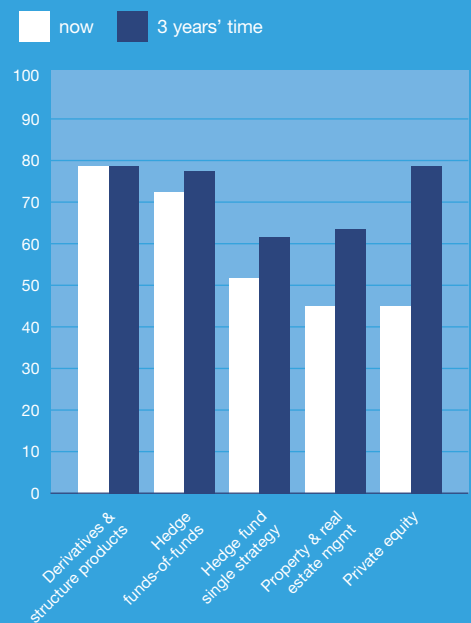
Wealth managers are embracing alternative investment products over the next three years (see table right) with striking increases expected particularly in private equity (going from 45% to 79% offering) and real estate (from 45% to 63%). Hedge funds, particularly funds-of-funds, are also seen as demonstrable value-added products. Derivatives and structured products would be further examples of important building blocks in providing client solutions. Wealth managers have focused on high fees and stickiness of these (relatively illiquid) assets; but complex products also carry greater due diligence requirements and have increased reputational risk in how they are sold, how they are managed (even if externally) and how they are accounted for with regulatory, compliance and even IFRS implications for the wealth manager.

There is a very real danger that service and advice to clients (and the wealth managers’ reputation) will actually deteriorate if wealth managers only focus on putting products on the table. It is the use of cost-effective delivery and integration of products which will be key to determining the winners and losers in the battle for clients and profitability.

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Additional information on our website: www.pwc.com/globalwealthsurvey

Alternative asset products offered by wealth managers now and in 3 years’ time



Flashline

Irish improve f-o-h-f regulations

Following consultation with the industry and taking account of international developments, the Irish Financial Services Regulatory Authority has made significant amendments to the regulations for funds of hedge funds in Ireland. Non-UCITS Notice 25 “Funds of unregulated funds schemes” was revised and reissued on 24th June 2004. The changes came into effect immediately. This notice applies to retail fund-of-fund schemes which propose investing more than 10% of their net asset value in unregulated schemes.

Specifically, a minimum subscription requirement of €12,500 has been dropped. In addition, a restriction on investment in target funds has been increased from 10% of net asset value to 20% of net asset value. The investment restrictions have also been simplified considerably, with a series of previous requirements now removed and replaced with the single limit of not more than 20% in a single target fund.

The regulatory framework for fund-of-funds in Ireland, taking account of the amendments above, compares favourably with other jurisdictions, in particular jurisdictions such as Germany and Luxembourg, where there is no minimum subscription requirement. Investment concentration limits in both jurisdictions are also comparable to the revised 20% limit above. The revisions have been welcomed by the industry in Ireland.

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European asset managers speak with one voice

Last year the European Commission established four groups of industry experts covering banking, insurance, securities and asset management. The groups reported in May.

The asset management group's recommendations were remarkable for their attack on practical, rather than theoretical, issues. If implemented, the efficiency gains would be clear and measurable. The unanimity of the group was also the first time the industry has spoken with a single voice. Their recommendations include:

Simplified fund registration

Despite the theoretical harmonisation of the UCITS Directives there are still barriers to registration. "Some authorities – deliberately or inadvertently – use the registration process to create unnecessary administrative and operational barriers to cross-border business." The group recommends simplification, harmonisation and, eventually, mere notification to a host state.

Easier cross-border fund mergers

It is near impossible to merge funds cross-border, yet were it possible the

efficiency of the industry would be greatly improved. The group calls for legal and fiscal barriers to be dismantled and for legislation to assist fund mergers.

Effective single passport for UCITS management companies

The latest amendments to the UCITS Directive seem to allow cross-border management companies. But few national regulators agree. Since their presence would aid efficiency the group argues for them, via new legislation if need be. Regulators had been wary of the degree of regulator co-operation required, but CESR now addresses this.

Freedom of choice of depositaries

Again, efficiency would flow if funds round Europe could use a single depositary. This requires standardisation of requirements for depositaries.

The group also called for changes in the areas of:

- standardisation of fund-processing protocols
- cessation of discriminatory tax treatment of foreign funds
- introduction of a suitability test for advice
- further work on fund governance and the management of conflicts
- initiatives on investor education.

Some recommendations were as much for the industry as the Commission. Many will be worked on by CESR in coming months and years. They will have lots to do, but if they succeed the European industry would at last gain the single funds market the UCITS Directives promise, but do not deliver.

Do not hold your breath.

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