THE EUROPEAN INVESTMENT FUND AND THE EVIDENCE OF THE UNDERTAKINGS FOR COLLECTIVE INVESTMENT IN TRANSFERABLE SECURITIES (UCITS) MARKET

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1. Introduction

The objective of the original UCITS directive, which was adopted in 1985 (the “1985 Directive”), was to allow for open-ended funds investing in transferable securities. Undertakings for Collective Investment in Transferable Securities (UCITS) are a set of European Union directives that aim to allow collective investment schemes to operate freely throughout the EU on the basis of a single authorization from one member state. In practice many EU member nations have imposed additional regulatory requirements that have impeded free operation with the effect of protecting local asset managers.

A collective investment fund may apply for UCITS status in order to allow EU-wide marketing. The concept is to create a single market in transferable securities across the EU. With a larger market the economies of scale will reduce costs for investment managers which can be passed on to consumers.

Throughout Europe approximately €5 trillion are invested in collective investments. Of these funds about 70% are UCITS.

2. The European Investment Fund Industry

- Main results for 2006

The year 2006 was a good one for the European investment fund industry with a 14.9% asset growth that pushed assets under management to a new record high of EUR 7,574 billion, EUR 980 billion above year-end 2005 level. Total net assets of UCITS grew 15.1% to reach EUR 5,974 billion at year-end 2006.

The total asset growth can be decomposed into an 8 percent asset increase fuelled by net inflows and a 7 percent increase attributable to market appreciation. In the countries providing European Fund and Asset Management Association (EFAMA) with net sales data, UCITS captured EUR 357 billion in net flows in 2006, compared with EUR 378 billion in 2005. Using estimates for countries for which no net sales data are available, UCITS funds collected positive flows of about EUR 445 billion. Adding up net sales of real estate funds (EUR 5 billion) and special funds reserved for institutional investors (EUR 68 billion), European funds captured EUR 520 billion in new money in 2006. This result compares with EUR 500 billion in 2005.

Following truly exceptional results in the first quarter of 2006, with net sales close to EUR 190 billion, UCITS were hit by the sharp decline in global stock prices that started around mid-May and came to a halt in July. This development triggered a brutal fall in net

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1 “UCITS” is used in this note in the sense of publicly offered open-end funds investing in transferable securities and money market funds, whereas the “non-UCITS” part of the investment fund market groups’ funds that are regulated in accordance with specific national requirements.
sales of equity funds, which recovered in the second half of the year, albeit slowly, reflecting heightened risk aversion among investors.

As for the trends in the European Investment Fund Industry, from the point of view of the net assets by country of domiciliation, the combined assets of the investment fund market in Europe, i.e. the market for UCITS and non-UCITS, increased by 4.2% in the fourth quarter to reach EUR 7,574 billion at end 2006. Compared with end 2005, the total net assets increased by 14.9% or EUR 980 billion.

Three countries (Luxembourg, France and Germany) had a market share of 57.5% at end December 2006. The United Kingdom, Ireland and Italy followed in this ranking.

With EUR 5,974 billion invested in UCITS, this segment of the business accounted for 78.9% of the fund market at end 2006.

### 3. Trends in the UCITS Market

#### Net Sales by Investment Type

Regarding the trends registered by the UCITS, the net flows to UCITS totaled EUR 57 billion in the fourth quarter of 2006, very close to the average net flows recorded in the two previous quarters. Whereas inflows in equity and balanced funds increased to EUR 28 billion and EUR 18 billion respectively, bond funds continued to experience net outflows, albeit at a slower rate (EUR 2 billion compared to EUR 7 billion in the previous quarter). As often in the last quarter of the year, money market funds experienced outflows totaling EUR 6 billion, reflecting seasonal factors. Finally, the net sales of “other” UCITS remained buoyant reflecting strong inflows.

For the year as a whole, UCITS captured EUR 357 billion, from EUR 378 billion in 2005. Inflows to equity funds totaled EUR 135 billion in 2006. Balanced funds also had an excellent year with inflows of EUR 102 billion, up from EUR 61 billion in 2005. Inflows into money market funds increased notably too, in parallel with the rise in money.
market interest rates, the appeal of “enhanced” or “leveraged” money funds as well as prudent diversification among fund investors. In contrast, inflows to bond funds collapsed to EUR 6 billion in 2006, reflecting investors’ uncertainty about bond market developments.

- Net Sales by Country of Domiciliation

In the fourth quarter of 2006, net sales were positive in 11 countries, with Luxembourg, France and the United Kingdom recording the strongest inflows. On the other hand, Germany, Italy and Spain continued to experience outflows in almost all segments of the market.

For the year as a whole, Luxembourg-domiciled funds collected EUR 241 billion, slightly above total net sales recorded in 2005 (EUR 236 billion). Adding an estimated EUR 85 billion of net flows to Irish registered funds, cross-border funds sales represented about 72% of the total industry net inflows in 2006, with a portion of net sales being sourced outside Europe, reflecting the success of UCITS as a global brand and the growth of fund business in Asia.

With total net sales of EUR 106 billion in 2006, France ranked second in terms of net sales, followed by Ireland, the United Kingdom, Finland, Switzerland and Sweden. Among these countries, France reported the highest share of net inflows in equity-linked funds. Balanced funds also enjoyed a doubling of their net sales in France in 2006, reflecting a switch from euro-denominated life insurance investments to unit-linked contracts. Balanced funds fared also particularly well in Switzerland. In the United Kingdom, 2006 saw investors returning to investment funds at levels not seen since the record year of 2000, with continued growth of funds of funds sales.

At the other end of the spectrum, five countries experienced outflows: Germany, Greece, Italy, Portugal and Spain. Italian investors disinvested EUR 9.4 billion from investment funds. Significant outflows from short-term bond and money market funds and investment funds against competition from structured products explained this result. German investors contributed EUR 24.3 billion into UCITS. Finally, in Spain, investors diversified away from bond and money market funds towards bank deposits, as the increased in ECB interest rates affected total returns of fixed-income funds.

- Net Assets by Investment Type

<table>
<thead>
<tr>
<th>Countries</th>
<th>Equity Linked</th>
<th>Bond Funds</th>
<th>Balanced Funds</th>
<th>Money Market Funds</th>
<th>Other Funds</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Italy</td>
<td>589,430</td>
<td>6,499,775</td>
<td>4,004,863</td>
<td>7,612,435</td>
<td>8,381,712</td>
<td>6,113,343</td>
</tr>
<tr>
<td>France</td>
<td>780,470</td>
<td>1,307,310</td>
<td>6,304,261</td>
<td>7,612,435</td>
<td>8,381,712</td>
<td>12,413,045</td>
</tr>
<tr>
<td>Germany</td>
<td>2,141,450</td>
<td>2,359,408</td>
<td>2,241,245</td>
<td>3,109,307</td>
<td>3,236,357</td>
<td>7,967,347</td>
</tr>
<tr>
<td>Spain</td>
<td>420,840</td>
<td>1,305,761</td>
<td>4,458,121</td>
<td>7,612,435</td>
<td>8,381,712</td>
<td>13,967,317</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>11,744,000</td>
<td>9,305,341</td>
<td>2,241,245</td>
<td>3,109,307</td>
<td>3,236,357</td>
<td>20,622,209</td>
</tr>
<tr>
<td>Ireland</td>
<td>1,474,823</td>
<td>1,265,450</td>
<td>3,146,412</td>
<td>6,304,261</td>
<td>6,304,261</td>
<td>13,029,034</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>7,584,000</td>
<td>1,265,450</td>
<td>3,109,307</td>
<td>3,109,307</td>
<td>3,109,307</td>
<td>13,967,347</td>
</tr>
<tr>
<td>Total</td>
<td>15,881,944</td>
<td>15,311,461</td>
<td>10,660,457</td>
<td>13,328,742</td>
<td>13,328,742</td>
<td>68,100,756</td>
</tr>
</tbody>
</table>

Notes: (1) UCITS refers to UCITS funds as well as UCITS-like funds. (2) Including losses of funds from the United Kingdom, Finland, Sweden, Denmark and the United Kingdom, but excluding foreign asset class funds and structured UCITS-like funds. (3) Net sales of non-UCITS-09/2006. (4) Other funds.
Total net assets of UCITS grew by 4.3% in the fourth quarter to reach EUR 5,974 billion at end December 2006, compared to EUR 5,727 billion at end September 2006. Equity funds recorded the strongest increase, followed by “other” UCITS, balanced funds and funds of funds. Mainly due to outflows, net assets in money market funds dropped by 3.3% in the fourth quarter of 2006.

Since the end of 2005, total assets in UCITS rose by 15.1%. UCITS assets growth was stronger in 2005 (21.4%), which had been strongly boosted by strong stock market performance. The development in 2006 compares favorably with the average UCITS asset growth observed in the periods 2000-2005 (8.8%) and 2003-2005 (15.9%).

Boostered by their strong performance, equity and balanced funds combined accounted for 56% of all UCITS at end 2006, compared with 52% one year before.

<table>
<thead>
<tr>
<th>UCITS Types</th>
<th>2002(EUR billions)</th>
<th>Change to 2003(EUR billions)</th>
<th>% change in EUR</th>
<th>Change to 2004(EUR billions)</th>
<th>% change in EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>2,222</td>
<td>183</td>
<td>8.2%</td>
<td>163</td>
<td>7.4%</td>
</tr>
<tr>
<td>Balanced</td>
<td>880</td>
<td>30</td>
<td>3.5%</td>
<td>18</td>
<td>20.3%</td>
</tr>
<tr>
<td>Total Equity &amp; Balanced</td>
<td>3,102</td>
<td>146</td>
<td>4.7%</td>
<td>214</td>
<td>16.3%</td>
</tr>
<tr>
<td>Bond</td>
<td>1,251</td>
<td>25</td>
<td>2.0%</td>
<td>25</td>
<td>2.0%</td>
</tr>
<tr>
<td>Money Market</td>
<td>945</td>
<td>-15</td>
<td>-1.6%</td>
<td>-15</td>
<td>2.6%</td>
</tr>
<tr>
<td>Funds of Funds (a)</td>
<td>99</td>
<td>2</td>
<td>2.1%</td>
<td>2</td>
<td>2.1%</td>
</tr>
<tr>
<td>Other</td>
<td>179</td>
<td>10</td>
<td>5.7%</td>
<td>10</td>
<td>20.0%</td>
</tr>
<tr>
<td>All Funds</td>
<td>3,381</td>
<td>100</td>
<td>3.0%</td>
<td>100</td>
<td>3.0%</td>
</tr>
<tr>
<td>(\text{\tiny{Assets in EUR}})</td>
<td>5,727</td>
<td>399</td>
<td>6.8%</td>
<td>2,222</td>
<td>391</td>
</tr>
</tbody>
</table>

(a) Including funds for which no data breakdown is available.

Looking at the development in the leading countries in the UCITS market, Ireland and the United Kingdom recorded the highest asset growth in 2006, 25.9% and 23.9% respectively. Luxembourg, France, Germany and Spain followed in this ranking with positive growth, and Italy with negative growth.

Asset growth was well above the European average in 2006 in Scandinavia, with assets growing by 33.7% in Finland, 25.1% in Sweden and 13.9% in Denmark. Poland enjoyed the highest growth rate (47.6%), reflecting the growing popularity of investment funds, which benefited from transfers of savings from bank deposits. Asset growth was also substantial in Switzerland.

Elsewhere in Europe, Greece, Portugal, Slovakia and Turkey recorded a fall in UCITS assets. Greece-domiciled funds suffered from severe withdrawals from bond funds. In Portugal, the results for 2006 were disappointing in terms of net sales, reflecting increasing competition. Disappointing results in Turkey too, which suffered the strongest setback, due to a sharp depreciation of the Turkish Lira and the ensuing rise of interest rates.
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4. Conclusions

The year 2006 was a good one for the European investment fund industry with a 14.9% asset growth that pushed assets under management to a new record high of EUR 7,574 billion, EUR 980 billion above year-end 2005 level. Total net assets of UCITS grew 15.1% to reach EUR 5,974 billion at year-end 2006.

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<td>44 Finance – Challenges of the Future</td>
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