

Description of CIV Industry

- Presenters

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Topics for Presentation

- Definition
- CIVs and Their Service Providers
- CIV Markets
- Advantages of CIVs
- Recognition of CIVs
- Regulation
- Distribution of Securities of CIVs
- Tax Considerations

Definition

- widely-held CIVs
- owned by large group of retail and institutional investors.
- highly regulated for investor protection
- invest in portfolio securities.
- derive income and capital gains.

CIVs and Their Service Providers

- CIVs are one of many ways in which investment advice and financial services may be provided to investors.
- CIVs typically are organized by financial services firms (including securities firms, banks, and insurance companies).
- The organizing firm often is referred to as the CIV's "manager."

CIVs and Their Service Providers

- CIVs typically have no employees.
- All services are provided by third parties.
- Distribution of CIV shares may occur through affiliated and/or unaffiliated firms.

CIV Management Company

- CIV manager typically will have hundreds or thousands of employees.
- Manager may provide services such as portfolio management and transfer agency (shareholder recordkeeping).
- In some cases, the manager selects other investment professional firms to subadvise part or all of the portfolio.

Unaffiliated Service Providers

- The manager, acting for the CIV, also may hire unaffiliated parties to perform other services.
- These services may include legal services, audit services, tax consulting, custodial services and many others.
- There has been a growth in out-sourcing non-core services.

Distribution of CIV Shares

- The CIV typically will have a distributor related to the manager.
- The distributor typically enters into distribution arrangements with other firms that will distribute CIV shares.
- These other firms may be paid by the CIV, the CIV investor and/or the manager.

Types of CIV Markets

- Two distinct types of markets for CIVs:
 - “Domestic” CIV markets
 - “Global” CIV markets
- Investments could be domestic or international

Domestic CIV Market

- Market in which CIV and essentially all of its investors are domiciled in the same country.
- Reasons for domestic market include:
 - Securities law restrictions on public offering of non-domestic CIVs.
 - Tax considerations applicable to non-domestic CIVs that make them uneconomic (*e.g.*, U.S. passive foreign investment company rules or local tax advantages).

Global CIV Market

- Market in which CIV and significant portion of its investors are domiciled in different countries.
- Reasons for global market include:
 - Regulatory regime designed to encourage global business.
- Desire of managers for a single platform

Global CIV Market

Location of Functions

- Portfolio management: geographically spread, tendency to concentrate round larger financial centers.
- Transfer Agency: back office in CIV domicile, front office where the main investors are located.
- Distribution: where investors are located with distribution support in fund domicile
- Investor servicing: follows distribution

Global CIV Market

Location of Functions

- Fund accounting: at domicile of fund.
- Fund Administration & Regulatory Management: at the domicile of the fund.
- Custody: fund domicile with sub-custody in the source country.

Emergence of CIV Centres within the EU

Policy/Business Drivers

- Business Drivers - Consolidation and Economies of Scale
- UCITS Directive and distribution of CIVs
- EU Single Market for Financial Services
- Regulatory framework
- Freedom of Capital Movement & Business Establishment
- Elimination of Tax Discrimination
- Major Centres Luxembourg, Ireland

Advantages of CIVs

- Facilitates Retirement Security
- Diversification
- Professional Investment Management
- Liquidity
- Cost Effectiveness
- Efficient Reinvestment of Income
- Access to Markets
- Educational Benefits

Facilitates Retirement Security

- Ageing populations
- Impending pensions funding crisis
- CIVs are means to facilitate savings
- Gives investors greater flexibility
- Complements traditional savings media
- Allows periodic savings plans

Diversification

- Diversification is an important financial objective.
 - reduces risk and volatility
- Cost effective diversification is expensive.
 - requires round-lot purchases of many different securities
- CIV investor can obtain diversification with small cash outlay.
- CIVs might hold hundreds of securities.
 - an individual would need at least 20 securities to obtain any measure of diversification

Professional Management

- Portfolio decisions for CIV made by CIV manager.
 - Decisions include which securities CIV holds and when they are bought and sold.
 - Portfolio manager and analysts research securities and anticipate market movements.
- The cost of this professional management is spread over all of the CIV investors.

Liquidity

- An individual's investment in a CIV is highly liquid (providing flexibility for investors).
- CIV shares typically are redeemable upon shareholder demand at a price equal to the CIV's net asset value ("NAV").
 - NAV is calculated by dividing the net value of the CIV's assets by the number of CIV shares outstanding
- Some CIV shares trade on stock exchanges.

Cost Effectiveness

- CIVs are very cost effective.
 - particularly for small investors.
- Significant economies of scale are provided.
 - CIV fees -- including those for management, recordkeeping, custody, and audit – are spread ratably over all CIV investors.
 - Portfolio transactions are effected in large round lots, providing significant cost savings.

Efficient Reinvestment of Income

- CIVs permit investors to stay fully invested in the markets.
 - CIVs reinvest in the markets the cash they receive as dividends, interest and gains from their portfolio securities.
 - This significantly enhances return in the long-term.
 - Most investors could not efficiently re-invest on this basis.
- Shareholders may choose for CIV distributions to be automatically reinvested in additional CIV shares.

Access to Markets

- CIVs offer access to certain markets that may not be obtainable by most individuals.
- Some markets are restricted to qualified investors.
- Transaction costs in certain markets can be prohibitively expensive for small investors.

Educational Benefits

- CIVs educate investors about:
 - investing fundamentals and investment returns
 - the value of personal savings, and
 - meeting long-term goals.
- Information about these issues presented in:
 - offering documents and other disclosures
 - annual reports, and/or
 - accompanying educational materials.

Recognition of CIVs by Governments

- Governments generally facilitate and encourage CIVs because:
 - CIVs facilitate efficient individual savings
 - Individual savings will be more important, as a supplement to public resources, in meeting the needs of ageing populations
 - CIVs are efficient providers of capital for source-country investment

CIV Market Impact

Total investment by CIVs was:

US\$21.76 trillion

as of December 31, 2006

CIV Market Impact

- International diversification of investment portfolios is becoming more significant.
- *Examples:*
 - Almost 20% of all equity assets held by US CIVs are issued by non-US companies
 - Almost 30% of assets of UK CIVs are invested outside the UK
 - More than one-third of the assets of Japanese funds are foreign securities
 - Assets of Lux, Swiss and Irish funds are predominantly invested outside their home domicile.

Regulation

- Highly regulated CIV activities include:
 - Operation of CIV itself
 - Distribution of CIV shares to investors

Restrictions on Investments

- Concentration restrictions
- Control restrictions
- Prohibitions or restrictions on certain investments
- Limitations on leverage

Service-Provider Regulation

- Regulation of CIV manager
 - Standards of care (*e.g.*, fiduciary status)
 - Prohibited transactions (*e.g.*, self-dealing)
 - Calculation of net asset value
 - Financial statement audit
- Regulation of custodian
- Regulation of transfer agent

Regulation of Unit Distribution

- Many jurisdictions require the delivery of a disclosure statement (*e.g.*, prospectus).
- Standardized disclosures often are required.
- In some jurisdictions, the disclosure statement is reviewed by the regulator.
- CIV sales are effected through regulated entities subject to “know your client” rules.

Distribution of shares

- CIV shares may be distributed through many distribution channels.
- Direct share purchases are effected between the ultimate investor and the CIV or its transfer agent/paying agent.
- Indirect share purchases are effected through one or more intermediaries (*e.g.*, securities firms, banks, and insurance companies).

Intermediary Holdings

- CIV shares acquired through intermediaries often are registered at the CIV level through nominee/street name accounts for several reasons.
- Intermediaries view a customer's identity as highly valuable proprietary information.
- Intermediaries net their customers' purchases and sales each day and effect only a net purchase or a net sale each day in the nominee account.

Intermediary Holdings

Intermediaries know
their customers.

CIVs know
their intermediaries.

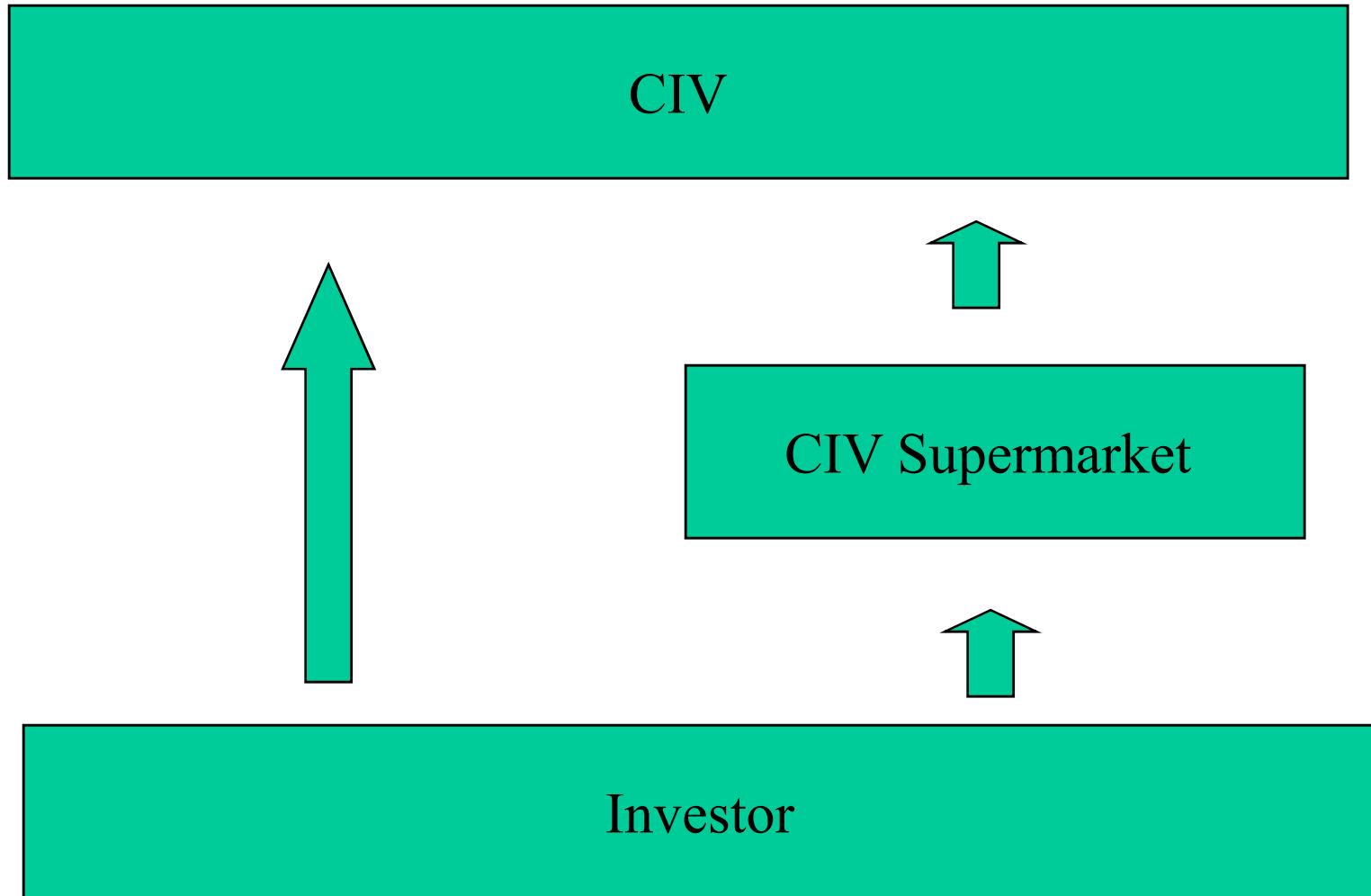
Changing Shareholder Base

- Whilst investments in a CIV are typically long-term, a CIV's shareholder base may change every day -- as new shares are issued and existing shares are redeemed (or as shares trade on an exchange).
- Because of nominee accounts -- where only the net purchases or sales for a given day will be reflected in such an account -- a CIV will not even know the change in its underlying investors.

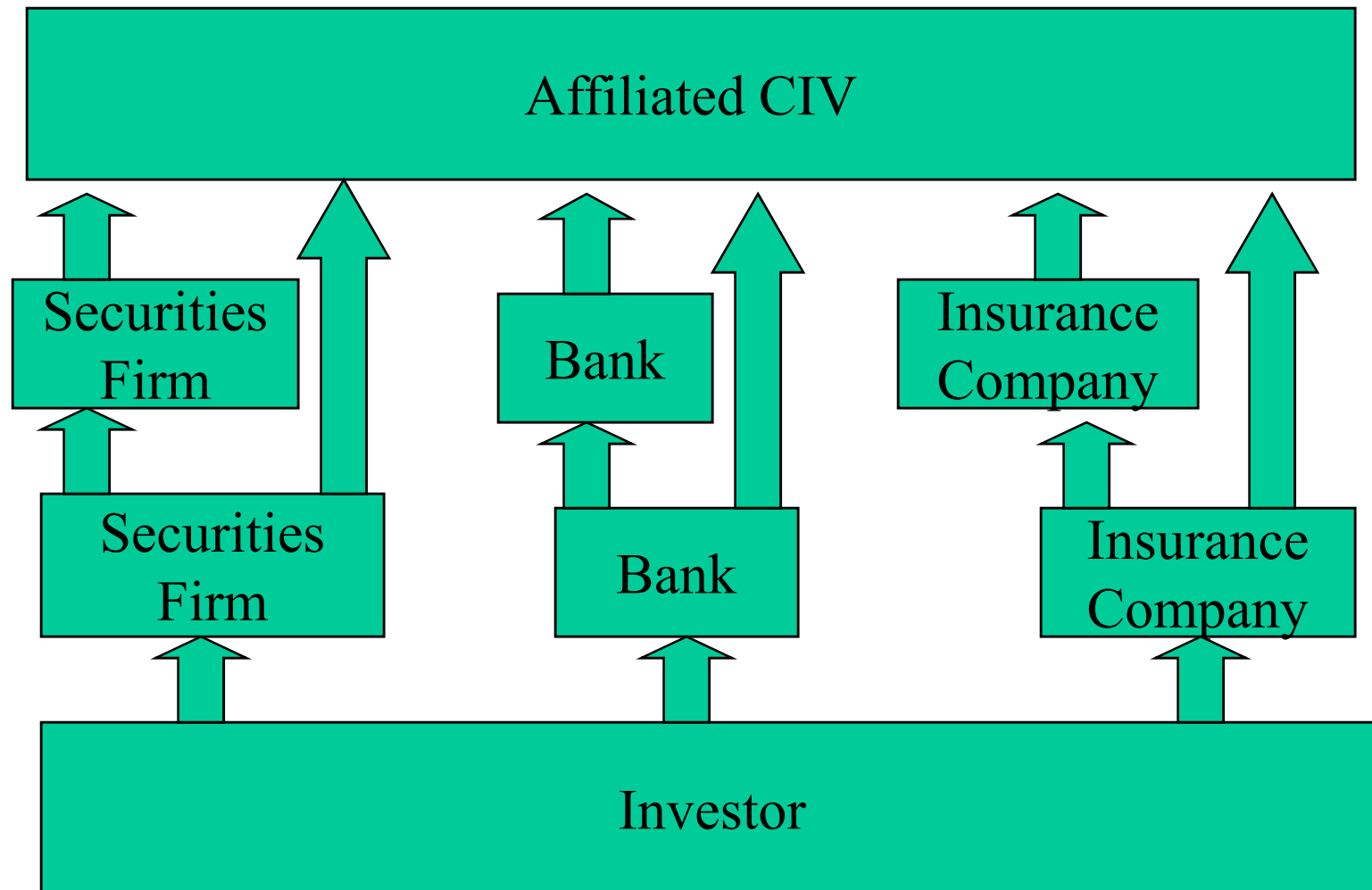
Distribution Channel Illustrations

- The following charts illustrate:
 - the “direct” investor distribution channel
 - “indirect” investor distribution channels
 - the “fund of funds” structure
 - the flow of funds between an investor, a CIV, and the issuer of a security

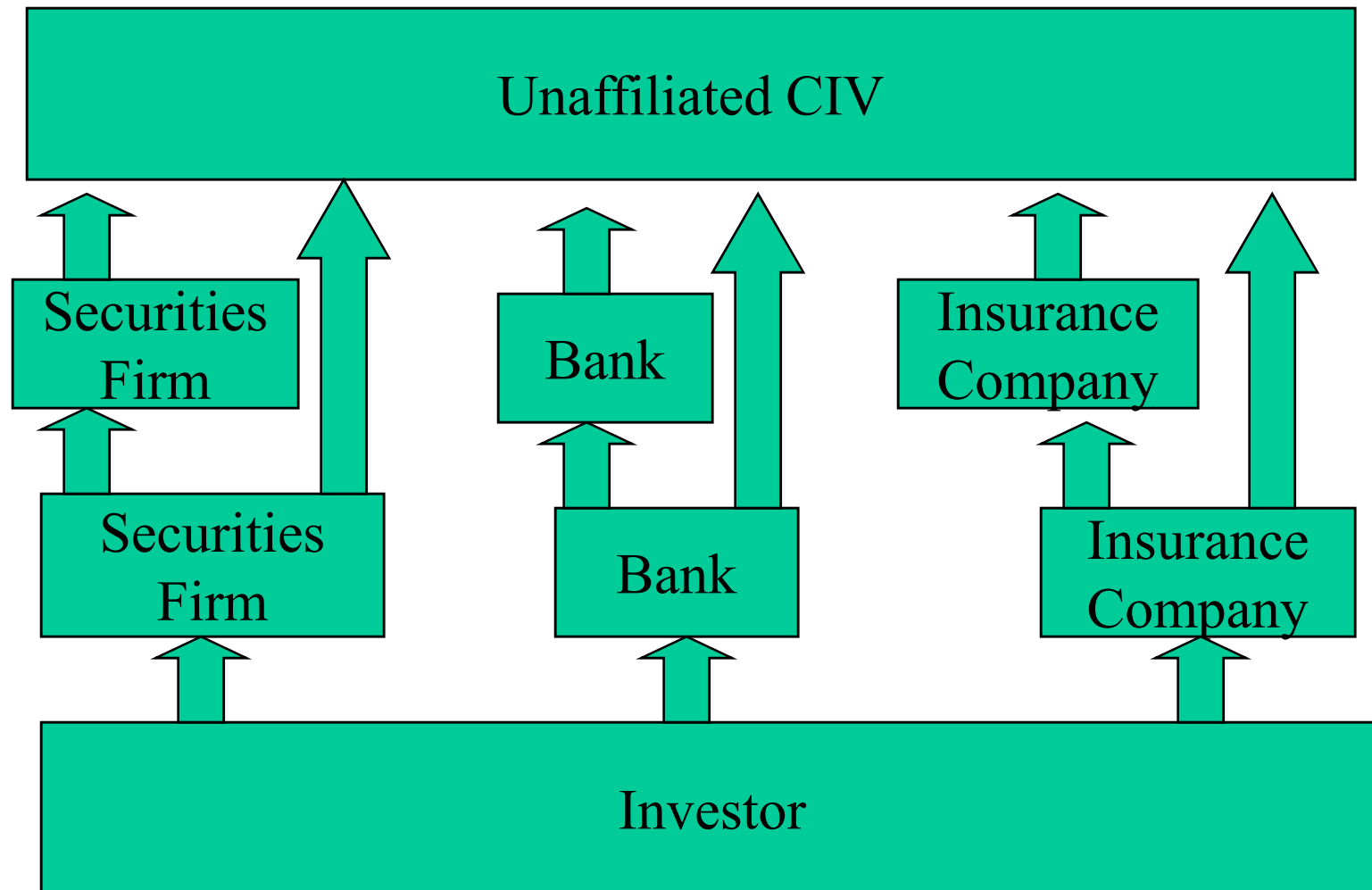
“Direct” Investor



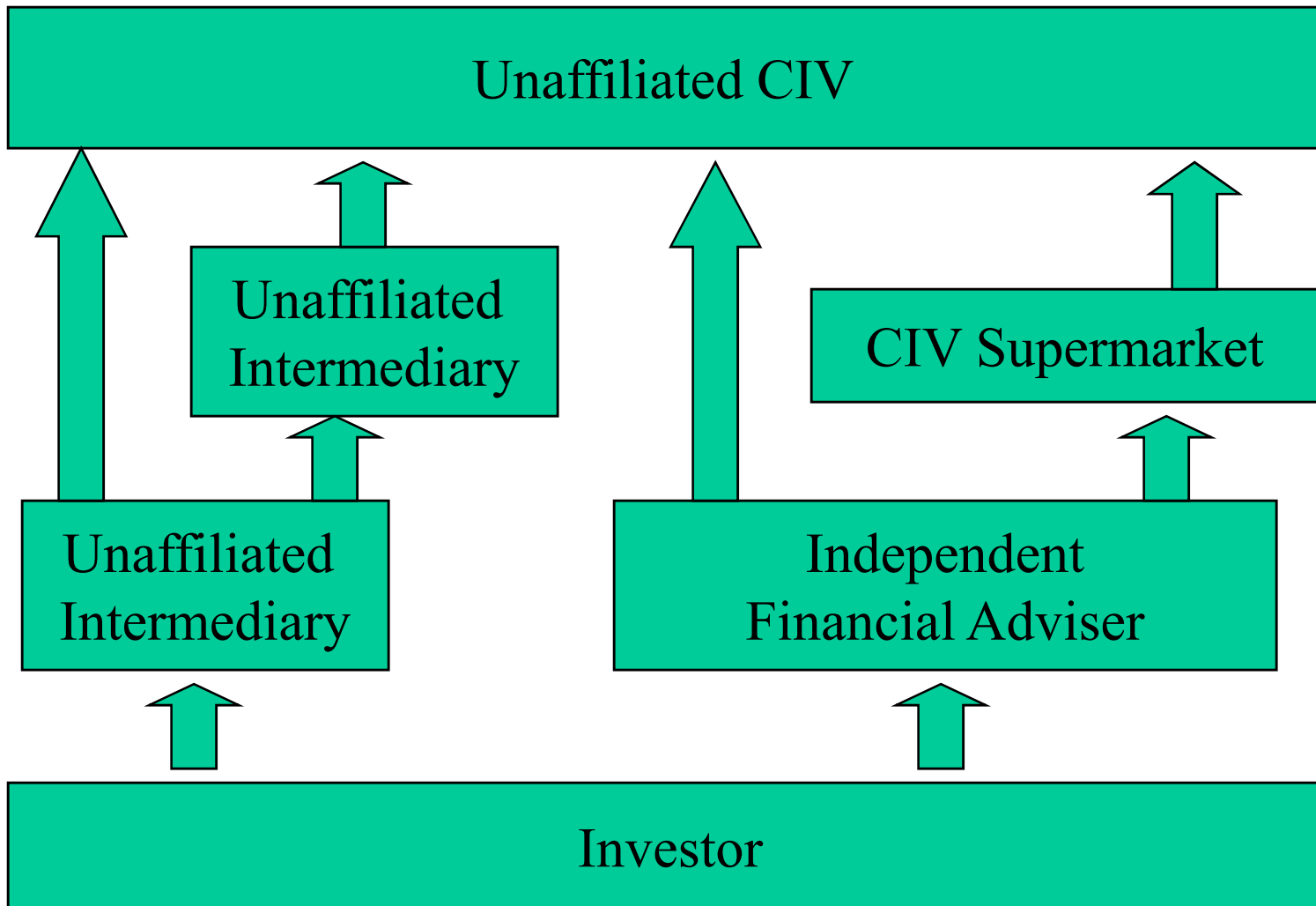
“Indirect” Investor -- Adviser With Affiliated CIVs (Part 1)



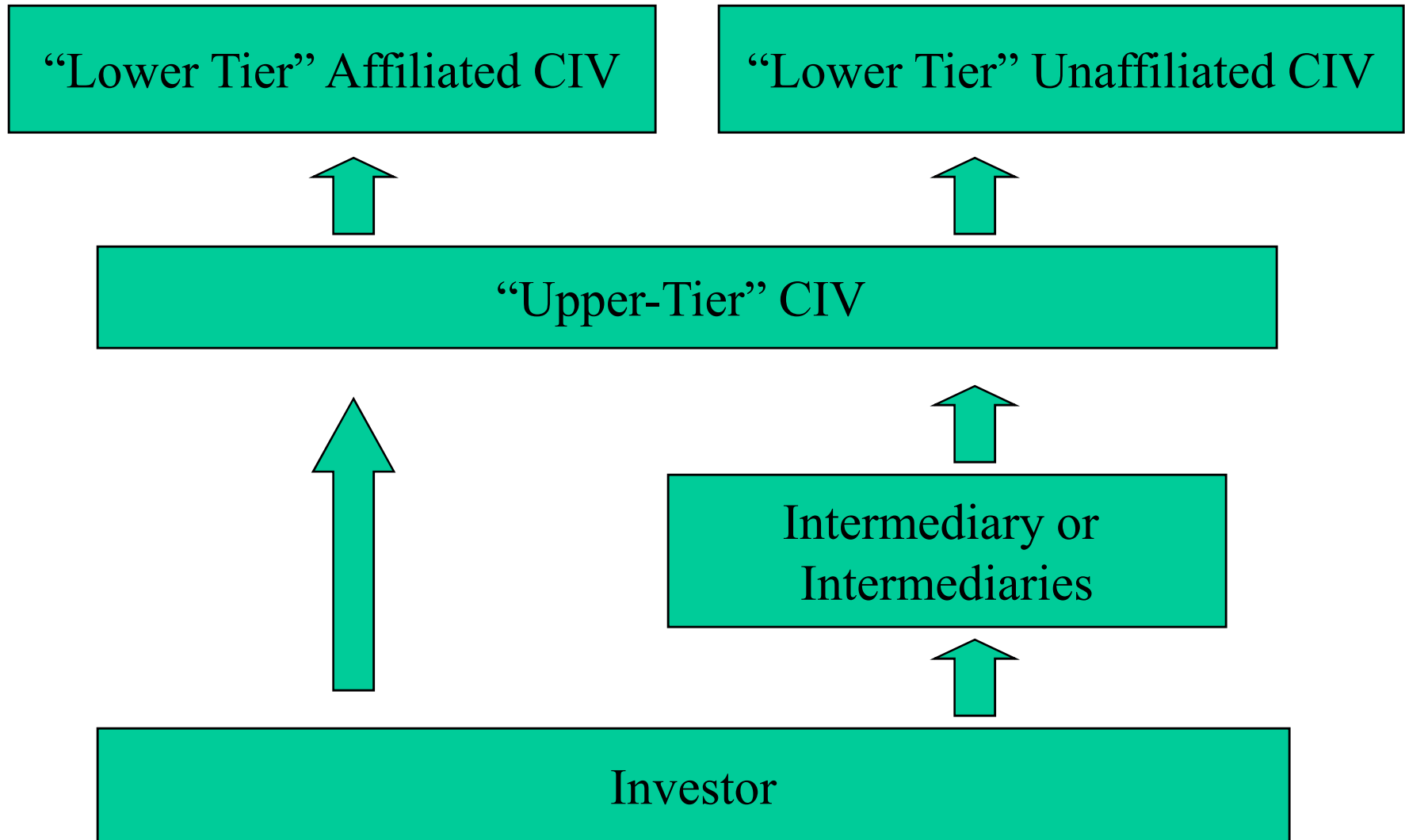
“Indirect” Investor -- Adviser With Affiliated CIVs (Part 2)



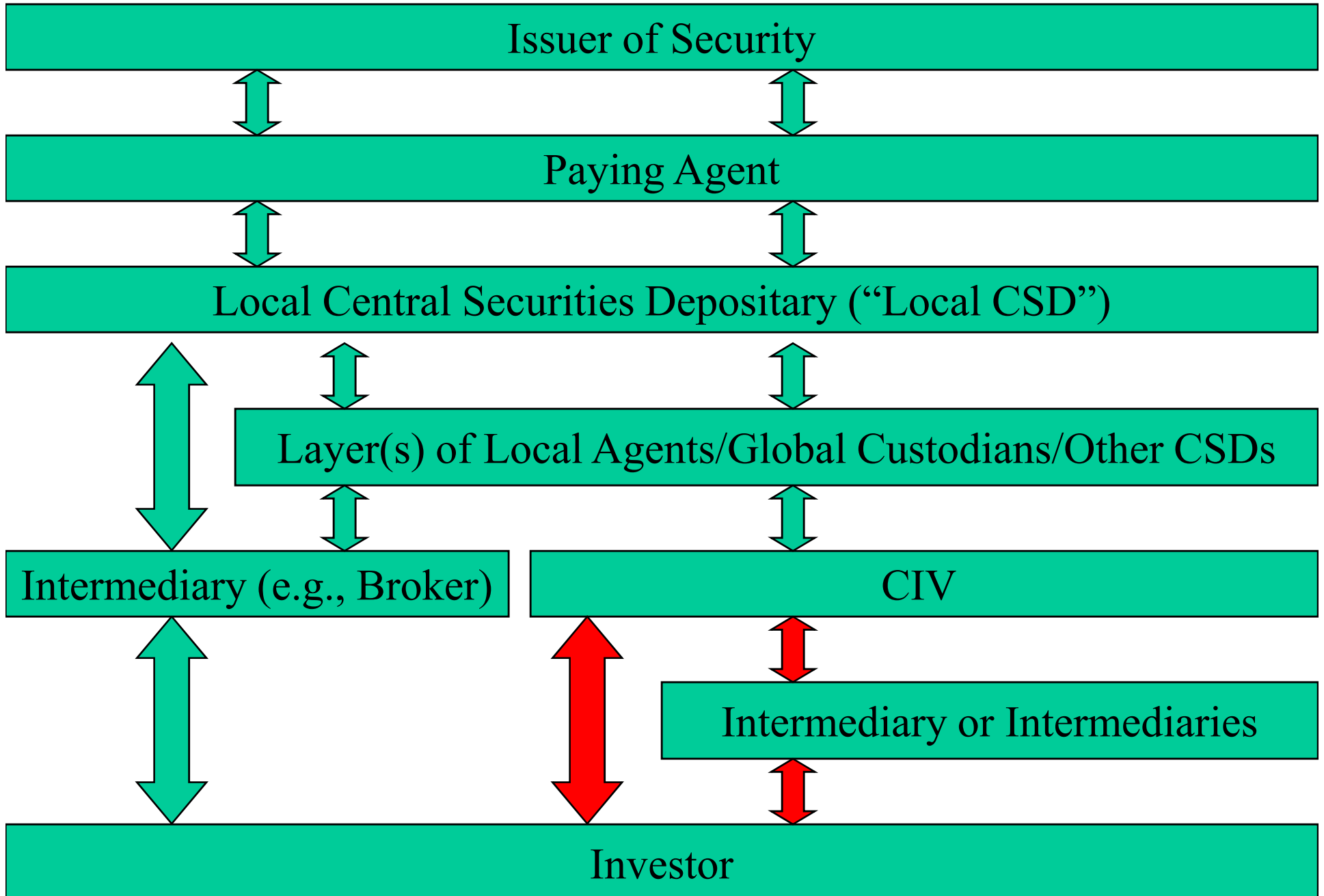
“Indirect” Investor -- Adviser Unaffiliated with CIV



Fund of Funds



Flow of Funds to/from CIV & Security Issuer



Explanation of Slide

- Green (lighter shade) arrows represent flow of funds to and from security issuer.
- Red (darker shade) arrows represent flow of funds to and from CIV.

Tax Considerations

- CIVs are generally designed to prevent an additional layer of tax.
- This result occurs, with some exceptions, regardless of the CIV's legal form.

Tax Considerations

- A CIV's net asset value includes amounts expected to be received (receivables).
- NAV forms the basis for subscriptions and redemptions of units.
- If CIV expects to receive withholding tax benefit provided by treaty, NAV will include tax reclaim receivable.
- Because of NAV impact –
CIVs need tax certainty!

Tax Considerations

- Important distinction must be made between
 - income and gains *received* by a CIV on its portfolio investments and
 - amounts *distributed* by a CIV to its shareholders

Tax Considerations

Specifically:

- income and gains *received* by the CIV assume the characteristics ascribed by the source country; while
- Amounts *distributed* by the CIV
 - first assume the characteristics ascribed by the CIV's country of establishment (for establishment-country withholding tax purposes)
 - and then assume the characteristics ascribed by the CIV investor's country of residence (for residence tax purposes).

Tax Considerations

A second important distinction is –

- the difference between:
 - the value of the CIV's shares, and
 - the shareholder's right to the CIV's income and gains

Tax Considerations

Specifically:

- while the value of the CIV's shares includes the value of income and gains earned by the CIV,
- a CIV shareholder generally has no right to receive the income and/or gains until the CIV declares a distribution.

Tax Considerations

- Thus, if an investor sells shares before the distribution is declared, the investor is not entitled to the distribution
 - even though it may include moneys earned by the CIV during the investor's period of CIV shareholding.
- Conversely, if an investor buys shares before the distribution is declared, the investor will be entitled to the distribution
 - even though it may include moneys earned by the CIV before the investor's period of CIV shareholding.

Questions?

THANK YOU!