Portugal Country Report

1. Economic and Financial Background

Table 1: Key Economic Indicators			
	2009	**2010**	**Jun-2011**
Population (million)	10.6	10.6	10.6*
GDP (EUR billion)	168.6	172.7	n.a.
Real GDP growth (%)	-2.5	1.3	-0.6* **
Inflation rate (%)	-0.9	1.4	2.94
Unemployment rate (%)	10.1	11.1	12.4*
Stock market capitalisation (EUR billion)	172.4	132.7	134.1
Stock market capitalisation (% of GDP)	102.3	76.8	n.a.
Bond market capitalisation (EUR billion)	31.4	0.7	71.8
Bond market capitalisation (% of GDP)	18.6	0.4	n.a.
Household gross savings ratio (%)	10.9	9.8	n.a.
Household financial wealth (EUR billion)	209.2	212.1	n.a.
Average per capita financial wealth (EUR)	19,644.83	19,934.70	n.a.

Sources: INE – Portugal; Euronext Lisbon; Banco de Portugal
* - Data as of March 2011.
** - Year on year rate of change.

Portugal found itself, throughout 2010, in the middle of the sovereign debt crisis, with investors being very suspicious of the capability of the Country to honour its debt compromises and demanding very high interest rates to buy Portuguese sovereign debt.

This happened following the financial rescue asked by the Greek and the Irish Governments and as a consequence of the long term accumulated State Budget deficits and high level of indebtedness of the Portuguese Economy, both in the Public Sector and also on the Private Sector.

The Portuguese Government was forced to take several austerity measures in order to strengthen budget consolidation and to control the growth of public debt, seeking to honour the commitment to reduce the deficit to less than 3% of the GDP by 2012.

Private consumption reduced and the growth of the economy (1,4%) was mainly driven by exports that benefited from a strong economic recovery in several countries, such as Germany, or even emerging markets, with which Portugal has close commercial links.

The difficulties in accessing credit extended to the private sector and a large number of companies were forced to close or to implement cost reduction plans. The combination of these two factors led unemployment to levels never experienced in the recent past decades. At the end of 2010, unemployment stood at 11.1%, which compares with 10.1% observed in 2009.

This entire environment had a negative impact in the Portuguese Stock Exchange that registered one of the worst performances in Europe.

In 2011, the economy's external financing conditions worsened significantly in a context of political instability and uncertainties regarding temporary and permanent financial assistance mechanisms in the European Union. The rating agencies successively downgraded their ratings on the Portuguese Republic, as well as those of the Portuguese banks and several non-financial corporations. At the beginning of April, heightening pressures on Portuguese public and private debt made the Portuguese Government'S request for international financial assistance inevitable. As a result, in May financial assistance was granted by the international partners – the European Commission, the European Central Bank and the International Monetary Fund – to support and implement an ambitious reform programme, with the aim to correct external and internal imbalances and boost potential growth and employment.

2. Data on Funds under management and portfolios

Table 2: Net Assets by the Fund Industry in Portugal (EUR billion)					
	2007	**2008**	**2009**	**2010**	**Jun-2011**
Home-domiciled UCITS	21.703	10.454	11.572	8.759	7.829
Home-domiciled non-UCITS	14.508	14.586	16.891	16.970	16.306
Total AuM	36.212	25.040	28.463	25.729	24.135

Table 3: Net Assets by Fund Type (EUR billion)					
	2007	**2008**	**2009**	**2010**	**Jun-2011**
UCITS:	**21.703**	**10.454**	**11.572**	**8.759**	**7.829**
Equity	3.307	1.110	1.569	1.543	1.437
Bond	7.574	3.357	2.606	2.002	2.116
Balanced	1.463	0.912	0.901	0.903	0.865
Money market	6.120	2.985	3.988	1.857	1.131
Fund-of-funds	1.507	0.703	0.599	0.526	0.448
Other	1.733	1.388	1.908	1.930	1.831
Non-UCITS:	**14.508**	**14.586**	**16.891**	**16.970**	**16.306**
Real Estate Funds	10.449	10.698	11.232	11.492	11.252
Other	4.060	3.888	5.659	5.478	5.054
Total	**36.212**	**25.040**	**28.463**	**25.729**	**24.135**

Table 4: Number of Funds					
	2007	**2008**	**2009**	**2010**	**Jun-2011**
Home-domiciled UCITS	212	207	192	191	195
Home-domiciled non-UCITS	283	317	346	359	372
Foreign funds registered for sales	1,576	1,726	1,729	n.a.	n.a.
Fund launches*	65	64	52	39	35
Fund liquidations*	8	22	20	24	11
Fund mergers*	6	13	18	3	7

* Includes only Home-domiciled Investment Funds. For June 2011, it refers to the events occurred during the first half of 2011.

A. From January 1, 2010 through December 31, 2010

Frightened by the poor performance of the Portuguese Securities Market and by the uncertainty of the economic environment, Portuguese investors fled away from Investment Funds, into what were considered by these investors, safer havens such as bank deposits and financial insurance products that guarantee the amounts invested plus a minimum return.

Investment Funds also suffered from more aggressive campaigns by banks that tried to attract new deposits in order to compensate for their difficulties in financing in the International Money Markets.

UCITS Funds were severely affected by the conditions described above. Throughout 2010, Assets under Management reduced more than 24%, to 8.8 billion Euro, the lowest value observed since 1993.

The reason behind this drop is, once more, the exit of investors. Total outflow registered in 2010 exceeded 2.9 billion Euro, meaning 104% of the observed reduction.

There are several possible causes for this exit. The main ones are related with the need to use this money to compensate a reduction in the income (because of high unemployment rates) and with the search for safer investments, namely insurance products and bank deposits.

The low returns provided by Money Market Instruments and the volatility observed in the debt securities Markets explain why the Money Market Funds and Bond Funds were the categories of Funds that registered the higher falls (53.4% and 23.2%, respectively).

Other UCITS, which consists almost entirely of Flexible Funds, is the only UCITS category that has been showing consistent positive growths over the recent years. The freedom to make adjustments among the various asset classes is greatly appreciated by managers and one that savers value as a driver of results.

Because of the good behaviour of Real Estate Funds, Non-UCITS Funds were able to maintain their upward trend in what concerns Assets under Management.

At the end of 2010, total Non-UCITS reached 17.0 billion Euro, an increase of 0.5% when compared with last year. Since 2006, average annual growth stands at 6.6%.

A greater demand for Open-ended Funds, explain most of this performance. These Funds grew 4.8%, in 2010, which compensate the 3.2% decrease in Other Non-UCITS.

Despite the decrease in the Assets under Management, the number of active Funds registered the highest value in the history of Portuguese Investment Funds Market (550).

The trend in the number of UCITS Funds accompanied the evolution in the respective Assets under Management, with one Fund less than in 2009. Portuguese investors and also the Management Companies continue to favour Non-UCITS Funds. At the end of 2010 there were 359 active Non-UCITS Funds, 13 more than at the end of the previous year.

The increasing number of Fund liquidations reflects mainly the fact that a large number of Funds, especially Guaranteed non-UCITS Funds, reached the end of the period for which they were initially constituted.

The two trends combined – reduction of Assets under Management and increase of the number of active Funds – have an obvious negative effect on the average fund size. The Median size reduced globally and for most of the Fund Categories. It's worth noticing that this median size is very small, preventing Portuguese Funds to achieve more cost effective economies of scale.

B. From January 1, 2011 through June 30, 2011

Total Assets under Management reduced 6.2% during the first half of 2011, with UCITS-Funds being the most affected registering a decrease of almost 10.6% in the period. Of these, Money Market Funds were particularly affected and fell by over 39%. The low rates of return provided by these products and, especially the increasing competition from bank deposits help to explain most of this trend.

From the categories of UCITS Funds, only Bond Funds were positive, registering an increase of 5.7%. All the other categories were negative in the first half of 2010, penalized by the depreciation of assets price or by investor divestment or both.

Non-UCITS Funds also registered a decrease, of 3.9%, due to a reduction either of Real Estate Funds (of 2.1%) and of Other Funds (7.7%).

3. Key Trends in flows and assets under management

Table 5: Net Sales by Fund Type (EUR million)					
	2007	2008	2009	2010	1st half 2011
UCITS:	**-4,594.6**	**-8,699.7**	**544.6**	**-2,930.4**	**-904.9**
Equity	97.5	-923.3	104.1	-40.1	-58.4
Bond	-2,231.9	-3,731.2	-680.7	-602.1	69.9
Balanced	91.2	-377.8	-57.8	-23.7	-31.9
Money market	-2,130.0	-3,112.7	969.3	-2,143.3	-742.8
Fund-of-funds	-553.6	-585.7	-160.0	-110.2	-73.1
Other	131.8	31.1	369.8	-10.9	-82.7
Non-UCITS:	**758.5**	**3.7**	**1,741.5**	**-89.9**	**-476.9**
Real Estate	n.a.	n.a.	n.a.	n.a.	n.a.
Other Funds	758.5	3.7	1,741.5	-89.9	-476.9
Total	**- 3,836.4**	**-8,695.9**	**2,286.0**	**-3,020.2**	**-1,381.7**

A. From January 1, 2010 through December 31, 2010

The reduction of the amounts invested was essentially the result of negative net sales. The figures for Real Estate Funds are not known but as far as Mutual Funds (UCITS and Non-UCITS) are concerned, total divestment (3,020 million Euro) outbalances the total reduction in Assets under Management.

Although all UCITS categories registered negative net sales, in 2010, the outflow from Money Market Funds (2.1 billion Euros) and Bond Funds (0.6 billion Euros) is worth mentioning as it represents almost 94% of total divestment.

As with UCITS Funds, the reduction in Assets managed by other Non-UCITS was caused by negative net sales that totalled 90 million Euro, although, in this case, the reduction was also consequence of negative performance of the underlying assets.

B. From January 1, 2011 through June 30, 2011

The first half of 2011, showed that investors continue to divest from investment funds. Throughout this six months, there was an outflow of 1.4 billion euro, which represents more than 86% of the total reduction of assets under management.

Money Market Funds continued to be the most affected, registering more than half of the negative net sales observed in the period. As explained above, these Funds have been under heavy competition with bank deposits, banks offering relatively high rates to attract new clients and new money.

4. Product developments

Nothing to report.

5. Regulatory and self regulatory developments

5.1. Preparation of the implementation of the UCITS IV

In view of the approaching date for the implementation of the Directive 2009/65/EC of the European Parliament and of the Council, of July 13, which co-ordinates the legislative, regulatory and administrative provisions in respect of some Undertakings for Collective Investment in Transferable Securities (UCITS), APFIPP organised several initiatives and work during the last months, with the aim to analyse the package of legal and regulatory provisions and prepare the process of the transposition to the Portuguese law.

For this purpose, was also set up a Working Group, to assist the work of the Association's Mutual Funds Technical Committee in this area, which studied the Level I and Level II measures.

Since the transposition has not yet occurred, UCITS IV will continue to be a central item in the agenda of the Association, in a first stage to proactively monitor the process of implementation of the new provisions in Portuguese law and afterwards to help its Members in its adoption, seeking, as and where necessary, to obtain from the supervisory entity clarification in respect of any doubts and questions that may arise.

5.2. Classification of Special Investment Funds by APFIPP

Given the increasing number of Special Investment Funds, a type of Non-UCTS Funds authorized by Portuguese Regulation, and their heterogeneity in terms of investment policies, APFIPP decided to make some adjustments in its classification, dividing this Fund Category into more homogeneous categories (in accordance with their characteristics, objectives, investment policy and investment strategy):

- Equity Special Investment Funds;
- Bonds Special Investment Funds;
- Absolute Return Investment Funds;
- Money Market Special Investment Funds;
- Short Term Money Market Special Investment Funds;
- Mixed Special Investment Funds;
- Real Estate Special Investment Funds;
- Other Special Investment Funds.

These methodological adjustments came into effect on November 1, 2010, the inclusion of the Funds in the new sub-categories taking place in January 2011 following the monitoring of the classification in respect of November and December.

5.3. Taxation

A. State Budget for 2011

Some of the most relevant changes introduced by the State Budget for 2011, in the field of the Investment Funds activity, were the following:

After the elimination, in the State Budget for 2010, of the tax benefits enjoyed by Closed-ended Real Estate Funds in respect of Municipal Tax on Property (IMI) and Municipal Tax on Property Transfers (IMT), the State Budget for 2011, reintroduced the exemption of those taxes for Closed-ended Real Estate Funds subject to public placement.

The sum of eligible deductions from tax liabilities made on account of tax benefits became subject to a maximum limit, in function of the taxpayer's taxable income. This measure has limited the benefits that individuals could enjoy by investing in special investment instruments whose main purpose is saving for retirement (like Pension Funds and PPR - Savings Retirement Plans which one of the forms that can assume is Investment Funds).

The penalty applying in cases of early drawdown of amounts invested in PPR - Savings Retirement Plans was change, corresponding now to an added amount of 1% of the amount paid, to the taxable amount for the year in which this payment occurred. In the past, deducted amounts were added to the taxable amount of IRS in the year in question, with an increase of 10 %, for each year or fraction of a year since the right to making a deduction was exercised.

B. Financial Assistance of EC, ECB and IMF

Against the background of the structural challenges facing the Portuguese economy and contagion from the sovereign debt crisis in other euro area countries, financial conditions facing the Portuguese sovereign and banks led to the granting, last May, of financial assistance from the European Commission in liaison with the European Central Bank and the International Monetary Fund.

This programme of assistance foresees a wide range of tax measures to be implemented in phases by the final quarter of 2014, most of which should come into effect in 2012.

6. Corporate Governance – Major Developments

On July 2010, CMVM, the Portuguese Securities Market Supervisor and ISP, the Supervisor of Insurance and Pension Funds, issued a joint Recommendation in order to incentive Investment Funds and Pension Funds to exercise their shareholder rights diligently at the General Assemblies of the companies in which they invest.

It provides some guidance on the situations in which the participation in the General Assemblies is expected or, at least, highly recommended.

The Recommendation also includes guidance on the content of the document with the policy for exercising the voting rights, namely the criteria to determine when and how to exercise the voting rights in relation to specific corporate issues.

7. Fund Governance

In 2010, for the first time, in compliance with Law 28/2009, of June 19, Investment Fund Management Companies were forced to disclose on their annual accounts the remuneration policy of the management and audit bodies and also the annual amount earned by each of the members of these corporate bodies.

8. Other major issues and developments

In 2010, APFIPP began working on a proposal for a new tax regime for the Real Estate Funds, since it considers that the present tax framework is disadvantageous when compared with other vehicles having exposure to real estate investment, a situation that may reduce the competitiveness of this industry in Portugal. Since Real Estate Funds constitute a collective savings vehicle subject to supervision, audits and control, and that they channel the funds received to the real-estate sector, developing and promoting it in a transparent and rigorous manner, it is believed that these characteristics ought to be defended and should continue to be an option for investors in Portugal. The proposal was recently presented to the Government, consisting in maintain the current tax regime for the Real Estate Funds of the contractual type and create a new regime for the recently approved Real Estate Funds of the corporate type.

The promotion of savings, especially savings for retirement continues to be one of the issues on top of APFIPP’s agenda. Regarding this issue, two initiatives have been undertaken. The first consists of the construction and disclosure of a savings barometer, jointly with one of the most repute Portuguese Universities. The barometer is design to monitoring the evolution of savings and to encouraging greater awareness among people of the need to save and, at the same time, to drive forward the activity of the various parties involved, in the launch of measures leading to an increase of this important variable.

The other consists of implementing a Certification of Responsibility for Retirement. The aim of this initiative is not to assign quality to the Funds or Management Companies, rather to contribute to encouraging companies and other organisations to promote retirement benefits for their workers and also to distinguish the Defined-Contribution Pension Plans funded through Pension Funds, whose characteristics correspond to those considered good market practices.

In the field of the training activity promoted by APFIPP, a total of 12 training courses were undertaken in 2010. The themes covered include several matters on Real Estate Funds' activity, Income Tax Obligations, prevention of money laundering, GIPS 2010, IAS 19 and Social Security Contributions Code.

During 2011, another 7 training sessions have already taken place, covering topics such as Taxation of Real Estate Funds and Mutual Funds, Information duties of the Management Companies, Conflicts of Interest, FATCA and Management of risk and internal control within the management of Pension Funds.