ASSET MANAGEMENT TRENDS AND POLICY IMPLICATIONS

1. Main trends and opportunities in the asset management sector

A regulator stated that since the beginning of the COVID crisis in March - April 2020 there has been a strong recovery both in terms of flows into funds and performance, with also a growth in assets under management (AUM). The panellists then discussed the main current trends in the asset management market and the opportunities for driving the growth of the sector further.

1.1 Digitalisation

An industry representative explained that digitalisation is a key trend in the asset management sector and is going to have a major material impact on the way that asset managers, wealth managers and financial players across the value chain interact with their clients. Technology now offers the ability to connect various systems through application programming interfaces (API) and the ability to use cloud computing to decrease the overall cost of maintaining a wealth management or asset management system for example. Digital platforms can also be built to serve consumers in a better way than an individual advisor. This does not mean that individual advisors will disappear but their work will increasingly be automated using digital tools, which will increase the potential time that can be spent on actually counselling their clients. Advisors can add their own view of alpha, but their main contribution is to be behavioural coaches and avoid errors or adapt recommendations thanks to their individual understanding of end customers. Another industry representative added that products such as real estate funds can also be digitised with a tokenisation approach. This has successfully been tested by their company.

A regulator emphasized the strong acceleration of digitalisation adoption by retail investors. It was already a trend before COVID, but there has been a paradigm shift since then and there is an increasing number of 'digital natives' in the market. This is both an opportunity and a potential threat if not implemented properly. Digitalisation is an enormous opportunity for the democratisation of financial services and for increasing retail participation in capital markets, but the channels and products for doing so need to be well-designed and with a fair approach.

Another regulator agreed with the previous comments. Rapid digitalisation and innovation based on technology are an opportunity for the asset management sector. The first duty as supervisors is to ensure that this opportunity delivers value for money for investors. Investors should benefit from the same level of protection whatever the medium they use for investing, but that does not necessarily mean that the same rules should apply e.g. to digital and physical channels. It is well known that when a customer uses a digital medium they do not pay the same attention to the information provided for example. Supervisors need to think about how they make sure that accurate information and appropriate advice are provided to customers in a digitalised environment, in order to ensure they get the same substantial level of protection and advice as in a physical context. Many domestic supervisors in Europe have put in place processes to support technological innovation e.g. with a dedicated team which serves as a point of entry for companies who come with a digital project that does not fall naturally into one of the existing boxes of regulation. This will also help regulators and supervisors to shape the way they think about regulation and supervision in the future.

1.2 Value for money and cost reduction

An industry representative noted that a second trend in the asset management sector is increasing value for money for investors through low-cost investing solutions. Their company has globally experienced an increase in the assets managed in lower fee vehicles and a decrease in assets managed in high-fee vehicles, partly driven by the acceleration in indexing and exchange-traded funds (ETFs). Europe however remains far behind the US in terms of the amount of assets managed under these strategies, showing a significant room for progress in this area. Even though asset management fees have decreased on average in the last 10 years, European investors are still paying too much, the industry representative believed. It is not uncommon for investors to pay 2% to 2.5% in total fees. As a result, the investor is taking all the risk, but they have to give around 40% of the returns back to the industry. This is explained in part by the fact that in Europe there has not been a movement to fee based advisory services and low-cost products, so the overall cost of investing has not decreased contrary to the US.

1.3 ESG investing

An industry representative stated that the growth of ESG investing continues unabated. Their company has hit $ 2 trillion AUM (assets under management) in this area in a relatively short period of time. Most of the cash flow of active index is going into ESG-oriented products at present. But there is still a great deal that the financial industry and regulators can do to ensure that investors are provided with relevant information on the ESG impact of their investments.

A regulator noted that at a high level in policy terms the focus on a green digital and inclusive recovery is the right way forward, but for it to be effective, retail investors need to invest in safe products and safe markets that help them to achieve their short, medium and long-term saving and investment goals. A trustworthy environment needs to be created and ESG products need to be implemented correctly with no excesses of greenwashing in particular.

Another regulator agreed that the right level of investor protection is needed in this area. This is in line with the objective of the Capital Markets Union (CMU), which is to make capital markets work for the recovery and bring the investor back to the centre of this project in order to channel more savings into the economy.

1.4 Widening the range of AIF funds accessible to retail investors

An industry representative explained that a growing opportunity from an investor perspective is to widen the accessibility of alternative investment funds (AIF). The Alternative Investment Fund Manager Directive (AIFMD) regime has been very successful, but the market and investor set that it applies to is too narrow. These funds can be passported across Europe under the AIFMD, but only to institutional and professional investors. There is no harmonised AIF framework for retail, which means that it is impossible for managers to market retail AIFs with enough scale. The institutional market has been very successful, but at present there is a growing demand for AIFs coming from retail investors such as high net worth investors and from defined contribution (DC) pension plans, which cannot be answered across the EU because of the restrictions of the AIFMD regime.

The industry representative added that giving retail investors a wider access to AIFs and related asset classes would support improved investment opportunities and investment in the EU economy. Examination is needed on how AIF regulatory regimes can be evolved in line with the UCITS regime so that the benefits that institutional investors have enjoyed for many years with AIF asset classes can be extended to retail investors. Digitalisation can play a part in this, but a harmonised regime is first needed to allow more AIF funds to be marketed cross-border to retail investors.

A regulator noted that it is important to ensure that the offer to the investor in terms of AIFs is well-designed and safe and that retail investors are offered an appropriate level of protection. Retail investors investing in AIFs should be provided with the same level of protection that they get with UCITS.

2. Policy priorities in the context of the AIFMD and ELTIF reviews

The panellists suggested policy measures for supporting the growth of fund investment in the EU building on the trends and opportunities mentioned above.

2.1 Improving the ELTIF framework and adapting it to retail investment

A regulator observed that European Long-Term Investment Funds (ELTIFs) have many interesting characteristics for investors and for the CMU, providing long-term investment opportunities. However, they have not shown the vitality that was expected since they were launched and the ELTIF framework is now under review. Putting investors at the centre of the CMU project is essential, which means providing them with the appropriate level of protection and the right investment opportunities and conditions. ELTIFs could be a key instrument for developing retail investment, but it needs to be clarified for investors that ELTIFs are different from UCITS, in terms of purpose and investment horizon.

An industry representative agreed that investors should be at the centre of asset management policy initiatives, in order to take into account their needs and make sure that they can obtain a proper return with the right level of protection. Not all AIFs would be suitable for retail investors, but ELTIFs could be a way to provide retail investors with appropriate AIFs. ELTIFs have significant potential but have not really worked to date, as the investment restrictions within ELTIFs make it impossible for managers to deliver a viable return to investors in most cases. The first issue to examine are eligible assets in order to make sure that managers can actually invest capital effectively to deliver a return to the investors which is commensurate with the risks. It would also be beneficial to look at the liquidity provisions of ELTIF in order to provide more liquidity. Currently liquidity provisions are higher for AIFs than for ELTIFs.

A regulator stated that the lack of uptake of ELTIFs demonstrates that the framework needs to be made more effective, while maintaining the original purpose of these funds. There is a case for a recalibration of the type of investments that can be made through this framework, but the very-long-term nature of this investment may mean it is not suited for retail investors in all cases. Increasing flexibility in terms of redemption e.g. around redemption points could be considered, as well as an improvement of the suitability and appropriateness requirements concerning these funds in the MiFID context.

Another regulator suggested that the access to some AIFs should be facilitated for retail investors, as part of the CMU objective to improve access to the capital markets for retail investors. However, AIFs should not be widely opened up to retail investors, given the heterogeneity of AIF funds. The first priority would be to enlarge the investment universe of ELTIFs, which can benefit from access to a retail investor base. Funds that are invested in real estate and mortgage assets for example are good candidates for being reclassified as ELTIFs. The AMF in particular is open to having a discussion on that matter. Its concern will be to ensure that the asset classes eligible for retail ELTIF passports are asset classes that are sufficiently simple and understandable for investors everywhere in the EU. Proposals have also been made in the context of the ELTIF review to reduce the minimum entry threshold of €10,000 per retail investor. The regulator added that providing retail investors who invest in ELTIFs with some degree of liquidity would be appropriate. A solution could be to open up periodic redemption periods during which there would be partial liquidity granted to retail investors.

2.2 Further aligning the AIFMD and UCITS directives

A regulator stated that the AIFMD review should also be used as an opportunity to provide for a better alignment of rules between the AIFMD and UCITS directives. Some differences are relevant since the two directives have different objectives and scopes.

UCITS is a product-related directive whereas AIFMD is a manager-related directive. However there are a large number of managers who manage both AIF and UCITS funds, which means that they are subject to diverging sets of requirements. That is not a desirable situation, so an effort should be made to streamline the requirements of the two directives. Streamlining is needed particularly in three areas: (i) liquidity requirements where AIFMD is more granular concerning the provision of liquidity management tools, (ii) risk management for which there are conflicting requirements between UCITS and AIFMD, and (iii) delegation where the two directives could be better aligned. The possibility of delegation should be maintained because it is very useful for asset managers, but in certain cases delegation leads to a situation where the asset manager that delegates in fact does not have the power to make decisions on investment management or risk management decisions. This is an enforcement issue that needs to be addressed.

Another regulator noted that the European Commission proposals on the review of the AIFMD and ELTIF frameworks should be expected in a reasonably short period of time. AIFMD is a great success story, but some of its features could be further enhanced, such as those concerning liquidity management. There has been a live stress test in the COVID-19 circumstances and the European Systemic Risk Board (ESRB) is examining issues and possible improvements in that area. The AIFMD review is a real opportunity to enhance the availability and the effectiveness of liquidity management tools in particular and to ensure their deployment and use, including by enhancing the internalisation by redeeming investors of transaction costs such as liquidity premia. The regulator added that it would also be to the advantage of everyone if there was a common EU legal framework across the AIFMD and UCITS which governed the availability of additional liquidity management tools, as it would allow having a consistent basis throughout the EU, especially during times of stress. Swing pricing and anti-dilution levies could address issues like first-mover advantage in particular.

The regulator emphasized that delegation is a challenging issue, but if done properly it can bring advantages of diversification and specialisation in the asset management industry. It can also assist in reducing costs and creating efficiencies, but it is very important to ensure that there is high-quality, substantive oversight and control by fund management companies who delegate portfolio management activities. There is a case for improving the requirements regarding delegation in the AIFMD and harmonising them with the UCITS framework, but the focus should be on effective oversight, requiring fund managers to have sufficient resources and competencies to manage effectively and control their delegates.

2.3 Tackling inducements

An industry representative considered that the inducements policy should be revisited as a result of digitalisation and increased levels of consumer interest in investing. Inducements in the asset management space are not very productive because of their lack of transparency for investors. More can be done to educate investors, improve cost disclosure and facilitate access to advice at a lower price, taking advantage of digitalisation. The future is going to be towards digitalisation, which will allow a reduction of costs across the entire value chain and more transparency in the asset management industry across Europe. In the UK and the Netherlands there has been a positive impact of banning inducements and it is hoped that this trend will develop in the EU.

A regulator stated that supervisors need to make sure that a degree of advice is readily available for all types of customers in a context where financial advice will probably be increasingly charged to the consumer through fees. Unsophisticated customers will not pay for financial advice, therefore care must be taken that advice remains available to all customers.

The industry representative acknowledged the concern expressed by certain regulators that reducing inducements may lead to some investors not benefitting from any advice because they are not ready to pay for it specifically. However, fee-based advice is now dominant in the US and there is no evidence that getting rid of inducements in the UK has created any advice gap. In the US this evolution happened because of competitive dynamics, but the competitive dynamics in Europe are not robust enough to make this happen. Regulatory intervention is therefore required in order to push the market along. There is also an opportunity to encourage the use of digitally-based advice that could be across a sliding scale from basic, simple advice all the way through to sophisticated financial planning, thus contributing to achieving the objectives of the CMU. Their organisation already has a direct to consumer advice platform in the UK, and will be opening one in Germany within the next few months.

The industry representative moreover stressed that retail investors can be relied upon to be a significant source of long-term invested capital. When there is market disruption it is usually the larger institutional investors and the chief investment officers of larger organisations that make bad behavioural mistakes with respect to investing, not retail investors. For example last year there was a ‘dash to cash’ during the early part of the COVID crisis, which did not come from retail investors, but from larger institutional investors who are the ones who should receive curbs on their ability to move in and out of investment vehicles at will.

2.4 Enhancing supervisory convergence and coordination

A regulator considered that greater supervisory convergence is needed to foster the build up of the single market in the asset management sector. The main priority is to clarify the cases where there are overlapping requirements and uncertainty in the responsibilities of the supervisory authorities of the asset manager and of the funds when are domiciled in different jurisdictions. An ESMA letter from August 2020 underlined that there was a degree of uncertainty and sometimes a degree of overlap between the responsibilities of various supervisors in the asset management sector. Work is needed to clarify this and to make sure that there is a good degree of coordination between supervisors.

A proposal made by the French AMF would be to recognise the role of a lead supervisor for each asset manager in the context of the review of the AIFMD. The lead supervisor would be responsible for supervising all the activities of a given manager and would have access to the information that is provided to the supervisors of all the funds of the manager. The idea is to foster greater cooperation and information sharing between supervisors without putting into question the respective role of home and host supervisors.

2.5 Providing an EU loan origination fund framework

A regulator suggested that loan origination AIFs could be a great success on a pan-European level if a framework was put in place. A number of EU countries already have domestic frameworks for such funds including Ireland, Germany, France, Spain, Italy, Portugal and Malta; Ireland for example has about 61 loan origination funds with around €7.5 billion AUM. A pan European framework would produce a level playing field, efficiencies and economies of scale in this area, which would favour a diversification of sources of funding and be beneficial for investors.

Another regulator stated that there are concerns from regulators and macroprudential authorities on possible risks arising from loan origination funds. However, it was noted that loan funds are important instruments in providing funding to the firms, also in cases where traditional funding sources (like banking credit) is not possible, and so the regulator asked whether the appropriate mitigation mechanisms and instruments are in place to address those risks and make loan funds a reliable source of funding.

The first regulator agreed that there needs to be an appropriate balance of risk and benefits. Looking at the different regulatory requirements in the existing domestic frameworks shows that there is sufficient experience now to put together a framework at EU level with the right balance of opportunity and risk in order to make loan origination funds a quality addition to the AIFMD framework.