Enhancing the role of asset management in the financing of the EU economy

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David Wright

Ladies and gentlemen, I would like to begin our exchange of views with Patrick Thomson who is the Chief Executive Officer, EMEA, for J.P. Morgan Asset Management. He has been in the firm from 1995, and has a vast experience of the asset management industry in Europe. We are going to talk about the role of the asset management industry in Europe, how it is evolving, and particularly how he would like the industry regulatory environment to change as we move forward.

Patrick Thomson

David, thank you for the introduction. It is a delight to be here. In summary, when we think about what asset management does and what the industry actually does, it does a couple of very important things. One, it helps savers meet their own goals in retirement, or their own personal goals. Two, it provides capital to companies. And so when you think of that in a European context I would say that actually under the UCITS framework the asset management sector has been very successful in meeting the goals of its customers, which of course is what we are here to do. I think the predictability and the consistency of the UCITS framework has really helped asset managers and their customers understand the role that asset managers play in providing capital to companies and to infrastructures for a societal benefit, but we also of course give a return to our customers, which allows them to grow their capital over time and keep the purchasing power of the capital.

In summary, I think the European asset management industry and the way it is regulated can generally been regarded as very successful, and I submit as evidence of that the fact that pension funds all around the world in Chile, in Singapore and in other parts of Asia now adopt the UCITS framework which, in essence, is a success.

David Wright

But do we have a genuinely competitive and integrated European market for asset management? One often hears about fragmentation related for example to marketing rules, is that a major issue?

Patrick Thomson

I would say that generally speaking and from the perspective of one of the largest cross-border providers of mutual funds in Europe, the EU fund framework is a huge competitive advantage when you look at other markets, compared for example to Asia, which is a very fragmented market. Each market has its own regulations about products and services in Asia, so relative to that I would actually say Europe has got a significant competitive advantage.

That having been said, there are clearly areas where rules could be improved in Europe. There are some challenges in terms of the way that we have to describe our products, if you think of the PRIIPs regulation that clearly does not meet customer needs and requirements. That is a real challenge. Generally speaking regulation has good intentions, and the way that the regulation is created is usually through consultation with the industry and then rules are made. However in some cases, some of those rules have unintended consequences, and I would submit PRIIPs as possibly one example, whereby you are given information which is very complex to digest.

David Wright

Besides tackling the unintended consequences of PRIIPs, what else is on your wish-list for the incoming Commission regarding EU regulation?

Patrick Thomson

The one ask I would have for the incoming Commission is to build on the success of UCITS, which was built up over 30 years. It is a very stable, consistent, understandable and pragmatic set of rules. They are not perfect, no rule is, but they allow people both inside and outside the EU to have confidence that when they put their capital in the hands of an asset manager that manages UCITS products, that capital will meet the goals that are stated by the asset manager in a sensible and safe way, so that the investor is actually protected.

The UCITS experience also indicates that consistency and predictability over time help to build investor confidence. Our advice would be not to tinker too much with existing regulations that work well. The same goes for MiFID II and AIFMD which is under review.

David Wright

I agree UCITS is a major achievement and this example should be followed in other areas such as pensions. What more could be done to capitalize on the success of UCITS?

Patrick Thomson

The one request I would have to the Commission is to continue to listen to the industry. When the industry actually makes a point around something like PRIIPs then it is worth listening to that.

Another example might be delegation of portfolio management. Delegation of fund management services, which is where your portfolio managers might sit in a different geography to the client or to where the fund is registered, is a fundamental principle in the supply chain of asset management. This has nothing to do with Brexit or third-country regulation. If investors want an exposure to Japan or to the US, then the people managing those assets need to be as close as possible to that market. That notion of delegation is incredibly important for the continued success of the asset management industry.

David Wright

Do you see any major changes happening in the European market with Brexit or other on-going evolutions?

Patrick Thomson

What will happen with Brexit is very difficult to anticipate, but I would say that the asset management industry is prepared. More generally, the industry continues to see Europe as a very successful source of both capital and investment. One example is infrastructure. Europe has been over the last few years a fantastic place both in terms of a place to invest in infrastructure projects and of regulation and organisation of the market, which are very sensible.

Also, we are increasingly seeing European citizens interested in investing in infrastructure themselves. That is a result particularly of the very low levels of yields that we are currently in. What is happening to government bonds at the moment is quite remarkable. Fifteen 10-year government bond yields are now negative, and over twenty others have negative yielding assets somewhere along the curve.

If you think about that, and you combine that with the very low levels of returns on deposits for European savers, that presents a tremendous challenge to the asset management community to be able to generate income or capital growth on those assets, which is why the asset management industry has begun to look at different asset classes. Infrastructure is a perfect example of this because it is a very predictable, inflation protected, sensible investment that actually delivers a societal benefit to European citizens, increasing productivity and efficiency of the European economy. I think those different factors combine to make Europe continue to be a very successful place to invest.

David Wright

Patrick, at the European and global levels there is much talk about fund liquidity risks and possible run risks associated with mutual funds and ETFs. Is this a major concern?

Patrick Thomson

Different factors need to be considered. One is that we are possibly coming to the end of a nine or ten year period of economic expansion, which means that asset prices have risen a great deal. This is a very cyclical industry. A contributory factor is central bank action; the world is awash with money through quantitative easing, so of course liquidity is incredibly important to our clients.

Another issue is that we are potentially entering a long phase of low interest rates that may be more worrying than liquidity. This may be similar to what Japan has experienced over the last 10 years, where there is now talk of "low-for-longer" and "low-for-ever", as was mentioned in a previous session of the Forum. We may just be at the starting point of this in the euro area, so monetary policy response and the implication of that policy response is actually a very grave concern for long-term investors.

In this context, I think it is very important that regulators do not overprescribe on liquidity. Let us remember that over 30 years since their creation UCITS funds have weathered various crises, which is a very good validation of the way the UCITS regulation has been built over time. What is very important is that regulators and asset managers work together on this topic, and that asset managers demonstrate that they understand liquidity and its implications both in stable and difficult market conditions.

One could argue that the most liquid investment would be short-dated treasuries, government bonds, or potentially bank deposits. However, bank deposits do not give you the return that you need in order to meet your retirement provision, so you have to take a balanced view on both risk as an investor and also liquidity. There should be parts of a portfolio – a pension fund, for example – that can very well be invested in illiquid assets that provide a superior return over time.

You mentioned ETFs. We want to be able to provide our clients with as much choice as we can, which means that rules in this area should not be over-prescriptive either.

David Wright

Another representative of an asset management company mentioned in a previous session that there has been a completely unambiguous move in the industry for five years towards thinking about sustainable investment and green finance. Do you agree with that?

Patrick Thomson

Yes. This is the one of the most exciting evolutions in the European market. It is not a fad; it is here to stay. You only need to look at what happened this summer with the civil action and unrest around climate change in many of the major capital cities to know that this is absolutely foremost in the minds of voters, and voters, of course, are our clients. People increasingly want to know what we are doing with their money for retirement, whether it is invested in companies in a sustainable way, if the way that these companies generate returns is sustainable… We need to be able to respond to that. I would further make the point that customers are moving faster than the industry and the regulators are. And I think Europe is in an extraordinary position to take a leading role in determining – not unlike it did with UCITS – a sensible set of policies that the industry can then use to derive products that meet these customer needs.

I am very excited about that opportunity, because I think Asia and the US are a long way behind. Europe has a leadership position in terms of the description or taxonomy of this type of investing, which covers many different fields in many different areas. Having a consistent description about what sustainable investing actually is, is essential. Asia and the US have large pools of capital, so that also represents a huge opportunity for capital to come into Europe and for European policymakers to take the lead on describing the nomenclature and the way that we should think about investing sustainably.

David Wright

When we talk about ESG everybody talks a lot about the E (environment), but they do not talk too much about the S (social) and the G (governance) aspects. Have you got teams of people looking at the social and governance policies of these institutions, or is it all environment?

Patrick Thomson

We look at it relatively holistically, but I think you have hit on a really interesting issue, which is why I think people are now veering more towards the description of sustainable finance. If you talk to US investors about the 'S,' let alone 'G' aspects you are going to get quite an adverse reaction generally, although some of them are now beginning to accept the notion of the impact on the environment and the degree of sustainability around the economic footprint of businesses. Many also consider that this is not the role of investors but of governments. Being very precise and careful around these descriptions will help build a degree of consensus around what these sorts of solutions should look like.

Sustainability is a huge opportunity and a huge goal, which we really do see as a significant advantage. The one ask I would have however around ESG is again not to be overly prescriptive in terms of excluding various activities, investment methods, processes and opportunities, just to reach some sort of purist interpretation of what E, S and G might mean. For example, there are different standards of governance around the world, and so one has to be careful.

David Wright

Finally, Patrick, how important is technology for the fund industry? Can major changes be expected on that front?

Patrick Thomson

Technology is an important factor. There are different applications of technology, but as an investment manager we are particularly excited about what technology can do in terms of helping us deliver better products faster, quicker and cheaper to clients. I think there is also an important role for technology in simplifying the delivery of products to consumers and in the provision of information in digestible formats. We see this in different markets, where more and more customers use their banking apps for example. The banking app we have in the US is one of the most popular financial apps. It is consulted by customers five, six or seven times a day. You get a high degree of confidence and interaction through this, and if we can do the same in the investing sphere, getting people to look on a mobile app at how their savings for their retirement are doing and how well it is working for them, you get better familiarity with investment. That will build confidence and ultimately lead to better investor education and more informed investors, which is a good thing for Europe overall.

The whole continuum of services needs to be considered including robo-advice Technology is disrupting our business but also providing improvements to consumers. You only need to look at what is happening in China and look at the extent of the digital footprint around savings products there to see the power of that. It would be a great outcome for the European Commission to help support that.

David Wright

Patrick, a great pleasure to see you here. Thank very much for your insight.

Patrick Thomson

My pleasure. ■