

## ASSET MANAGEMENT TRENDS AND REGULATION



### RODRIGO BUENAVENTURA

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(CNMV)

### Making the single market for funds work even better

The proposed amendments of the AIFMD, UCITS and ELTIF directives developed by the European Commission, pursue several meaningful goals. Firstly, to contribute to the main objective of the Capital Markets Union (CMU) through the stimulation of the collective investment schemes and thereby the improvement and development of European stock markets, making them more attractive, efficient and safe for retail investors. Secondly, the improvement of liquidity management regarding AIFMD and UCITS, providing common tools in all jurisdictions and thus, in situations of a high market volatility, providing an efficient and effective response to concerns about the protection for investors and the systemic risks.

Risks associated with liquidity management have been at the forefront of the regulatory debate, namely at the FSB level. Some think that funds

contain an inherent instability factor that puts at risk financial markets when dire times come. I disagree. There is nothing risky embedded in funds, with the exception of CNAV MMFs, which is different from any other investment portfolio (including banks' portfolios). It all depends on how they are managed and supervised. Funds do not owe money to others, so regulating them as banks, with capital requirements, is a completely flawed approach. Leaving MMFs aside, there are ways to manage and supervise funds that minimize financial stability risks.

The CNMV, has been traditionally very active in the supervision of appropriate tools to manage redemptions in times of market stress and lack of liquidity, trying to avoid conflicts of interest between outgoing investors and those who maintain their investment. We have published guidelines in 2021 on fund liquidity management for the entire management industry as well.

#### The UCITS framework has been a success, though some tweaks could make it even better.

The third of the common goals is to improve supervision by establishing a harmonised reporting regime to national authorities, including the details of individual portfolio positions. The supervision based on the detailed knowledge of the assets of fund portfolios - at an ISIN level of each fund- has been carried out in Spain, with a monthly frequency, since 1990. It has allowed an extremely effective and close supervision, being able to analyze abnormal returns, non-eligible assets or compliance with limits and coefficients, among other issues. For NCAs, having position-level information is an essential tool to improve fund supervision. And this is again linked with the financial stability perspective. For instance, it allows the supervisor to anticipate liquidity tensions based on significant market events before they arise. It improves the monitoring of financial stability risks and represents a next level in the supervision of funds. I consider that the new harmonised reporting regime, is a key aspect to improve both the single

market of funds and the monitoring of financial stability risks.

The promotion of the ELTIF products is also laudable, insofar as it has been an instrument with a little success among the European investors. The amendments pretend to make a more flexible regime, not only with technical and operational details, but also by including a mechanism as a "secondary market" for the crossing of possible purchase and sales offers of the ELTIF "shares" among investors. The mechanism could allow an exit before maturity, though actual liquidity will be probably scarce.

The recent report by the Court of Auditors of the EU is a welcome perspective on the UCITS market. However, it is somehow critical with regards to the achievement of a single market for funds, the limited realization of the benefits linked from the promotion of cross-border activities and the profits that these could give to the investors in terms of lower rates due to greater competition. The conclusions may be valid in small countries and where, as a general rule, the collective investment industry is less developed. But this is not the case in medium-sized and large countries, like Spain. In large markets, there is a true single market for UCITS, with significant choice of domestic and imported products. Funds truly promoted by foreign providers reach close to 45% of market share in Spain, proving that the single market works. So called round-trip funds are absolutely residual in Spain.

I think that the UCITS label has been a true EU success and only minor tweaks are needed. Among them, the new reporting regime to NCAs and the new liquidity management tools stand out.

Investors may not yet be able to fully reap the benefits of cross-border activities as a result of some obstacles and drawbacks. The solution to these obstacles has been tackled through the cross-border distribution of funds package that came into force a year ago, which requires some more time for a fully-fledged evaluation.



## MICHAEL MCGRATH

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### Evolution & not revolution: Council's position on the AIFMD framework update

Over the course of the first half of 2022, member States discussed the European Commission's legislative proposal that formed part of the November package of measures to boost Europe's capital markets with the aim of stimulating the real economy and facilitating post COVID-19 growth. Under the French Presidency, Council reached an agreement on a review of the AIFMD, and the consequential updates to the rules applicable to UCITS. This General Approach will now guide the Czech Presidency on behalf of the Council in the trilogue discussions with the European Parliament over the coming months.

Member States, throughout the Working Parties, sought to ensure that the developments built on the effective AIFMD framework which has provided high levels of investor protection while also facilitating EU Alternative Investment Fund market integration. It was important to preserve that which has proven to be solid and to limit

the focus for change to areas where improvements were required.

The Commission concluded that AIFMD had largely achieved its original objectives and that the overall approach should be evolutionary, with targeted amendments progressed to modernise the framework to reflect market developments since 2011.

Ireland, home to a vibrant fund and asset management industry, actively participated in the Council discussions. We sought to ensure that the cross-border model and the openness to global expertise and services was preserved in line with our support for the CMU. We also recognised that greater harmonisation is desirable in certain areas to improve the resilience of investment funds and enhance the single market.

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#### Liquidity Management Tools (LMTs)

The Council agreement emphasised the need to enhance the ability of fund managers to deal with liquidity pressure in stressed market conditions. The General Approach stresses that this can be achieved by providing for a common set of Liquidity Management Tools (LMTs) available to Fund Managers and by ensuring harmonisation in this area. Recent events, including the Russian invasion of Ukraine, are testament to the need to ensure that fund managers are well equipped to effectively deal with instances of financial turbulence.

#### Loan Origination Funds

Ireland was one of the first EU member States to introduce a domestic regulatory framework for this activity. The establishment of a basic EU framework, such as proposed in the Council text, will support a more efficient and effective internal market in relation to this activity. These funds play an important and positive role in a well-diversified financial system. Such funds complement bank-based funding and supporting the real economy. The

need for an effective EU framework for Loan Origination by investment funds encompassing governance and risk management is clear to see. This is an example where the existing AIFMD framework needs some modernisation in light of recent developments. In addition, the legislative proposal is further strengthened by proposing a new limitation on leverage and by adding a prohibition on AIFMs from managing funds designed with an "originate-to-distribute" focus.

#### Delegation

The current delegation framework in AIFMD has worked well and remains one of the key pillars supporting the EU's cross-border investment market. Our framework allows Fund Managers to benefit from cost savings, utilise expertise in specific markets and access global trading capabilities through delegation while being subject to strict control, oversight and accountability by those funds' national regulator in compliance with EU rules. The Council agreed that it was crucial to ensure that any changes made do not undermine the global funds model or contradict our agreed goal of deepening the EU Capital Markets Union. At Council we have further clarified the rules, and the need for increased transparency and supervisory cooperation in this area. We wish to achieve these adaptations to the framework while avoiding the creation of letterbox entities and ensuring appropriate regulatory oversight. To this end, the Council introduced minimum substance requirements and new reporting requirements on delegation arrangements allowing for improved supervision of the application of the EU regulatory framework.

#### Access to Depository Services

Finally, the Council discussions also sought to build upon the Commission's proposal to allow for cross-border access to depository services under strict parameters. The final Council position of placing additional safeguards in this area is a pragmatic compromise.

#### Conclusion

The AIFMD has proven to be a European success story that continues to fulfil the stated objectives of providing robust investor protection and addressing systemic risks. Furthermore, the importance of the AIFMD brand cannot be overstated. Therefore, it is heartening that the Council General Approach seeks to build upon this integral aspect of the EU's global fund offering - it will be important that the post-trilogue text safeguards this framework.



## RIMANTAS ŠADŽIUS

Member - European Court  
of Auditors (ECA)

### No true single market for investment funds yet – the EU auditors' view

As the Union's independent external auditor, the European Court of Auditors (ECA) not only assesses the implementation of the EU budget, but also the performance of EU institutions and bodies in reaching their objectives. In our recent audit report, we assessed EU efforts to develop a Single Market for investment funds, facilitating cross-border business, ensuring a high level of investor protection as well as consistent and effective funds supervision.

The Single Market should provide increased and fair competition, uniform investor protection, more choice for investors and less administrative burden on asset managers through uniform rules. As a result, it should lower costs for investors and enable more cross-border risk sharing. Most stakeholders generally consider the EU's regulatory framework a success story, especially as a quality standard abroad. However, we found that so far there is no true Single Market benefitting investors in the EU.

The EU's regulatory framework for investment funds mainly consists of

Directives. While they set a minimum standard to follow, they are unable to create a level playing field. Indeed, diverging national rules usually come on top of the transposed provisions of Directives. On the other hand, Directives very often mean a higher administrative burden and significant delays in implementation. Just think - it took long eight years to fully transpose the AIFMD in all Member States. How many years are we ready to wait for the present review of the AIFMD and UCITS to complete? We conclude that Regulations would be a better and more efficient tool to achieve legislators' objectives, especially in a fragmented area like financial services.

The Single Market is based on passporting, which allows asset managers to operate cross-border funds. However, this only led to concentration of funds domiciles in a few Member States and the so-called "round-trip" funds, and did not ensure real integration. Nearly 70% of funds held in the EU continue to be focused on domestic markets and are sold by domestic asset managers. In addition, in Eastern Europe to date markets remain far less developed. Consequently, we need to create powerful incentives for true cross-border funds and their EU wide distribution.

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ESMA's main task is to ensure the equal and just application of European rules across all Member States. However, we found that in practise, ESMA has to rely a lot on the goodwill of national authorities, when it comes to sharing information or participation in convergence tools. As a result, the Agency is not sufficiently aware of the actual level of convergence. Nevertheless, ESMA found various divergences, which it was often not able to address despite significant efforts over many years. For instance, ESMA was unable to overcome differing views on the extent of delegation and enforce common standards. Thus, the Commission had to include this topic in its AIFMD review proposals.

Despite ESMA's efforts, the quality of funds supervision differs between Member States and enforcement measures remain rare. We found

that while ESMA helped national authorities to better identify risks and incompliances, it struggled to persuade them to follow-up on regulatory breaches. We observed that national authorities are generally reluctant to use formal supervisory powers, even in case of clear breaches of law.

The level of investor protection is generally high in the EU. This is important, as households are key investors into funds, either directly or indirectly via insurance and pension providers. Nevertheless, some issues exist. For instance, it remains difficult for investors to compare products and to gain a reliable overview of available funds and their respective costs. We recommend developing a tool to allow investors to compare funds, very similar to the idea of the European Single Access Point. Another growing concern is greenwashing as ESG ratings and tools are currently unregulated and unsupervised. Investors, relying on these ratings, are usually not aware of this fact.

The supervisory reporting for investment funds needs improvements. While a comprehensive system for MMFs exists, there is no harmonized reporting regime for UCITS, and the one for AIFs lacks granularity. In light of numerous on-going crises, we also highlight the need for better data and for more work to understand and address possible financial stability risks in the funds sector.

As the next step, we recommend the Commission to perform a comprehensive fitness check and to propose significant changes to the current framework. We are convinced that currently proposed minor revisions, despite addressing relevant issues, will hardly achieve the key objectives of the Single Market and the Capital Markets Union. We also recommend to change ESMA's governance structure in order to ensure efficient and consistent supervision of the market in the interest of the Union.



## CHRISTOPH BERGWELER

Chairperson of the Board of Directors - J.P. Morgan

### Unlocking EU's retail investor potential requires open and competitive markets

Unprecedented global events have spurred a rapid evolution in the asset management industry over the past two years – from green and digital transitions to increased engagement by citizens with their finances. Such significant changes can be a driver for strengthening the investment culture within Europe and, provided markets remain open and competitive, offer investors an optimal opportunity for investment success.

European citizens stand ready to benefit from greater economies of scale and the potential for better returns if EU policymakers work to foster greater retail participation by ensuring access to a wide range of suitable investment opportunities. Sustainable investing and digital developments offer, for example, a catalyst for potentially turning more savers into investors. At the same time, to ensure the best possible investment outcomes for these investors, Europe should seek to expand the set of suitable products on offer, while preserving the great

foundations for retail investment built through the considerate development of the UCITS ecosystem.

Looking at noteworthy industry developments, it's worth taking a moment to first reflect on the growth of sustainable finance; for example, since 2019, the level of green finance raised in European capital markets has more than doubled, reaching €311 billion. The possibility of steering capital towards enabling companies to transition has attracted new participants to the markets. We are encouraged by the recent focus of policymakers on supporting the transition of parts of the economy that are not yet green but have the potential to be, which has not been the case to date. In addition, as climate risk is a global matter, we strongly recommend international alignment of standards. While the EU should be commended for elevating climate risk to the forefront of the international agenda, a globally coordinated response is the only way to facilitate the green transition.

Second, digital developments have made the process of investing more simple and less costly, and have helped to improve transparency. Innovations in automation and artificial intelligence have also given firms the opportunity to provide products and services tailored to the differing needs of investors. We encourage the EU to harness the potential of increased digitalisation, while engaging with international partners on globally consistent rules and creating proportionate regulation which ensures a sufficient level of investor protection.

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**Greater retail participation by ensuring access to a wide range of suitable investment opportunities.**

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Third, largely thanks to the easier and more seamless access to financial services, there has been an increased interest in investing. However, to engage a significant proportion of Europeans for their financial future in a meaningful way, the EU needs to ensure that the investing public has access to a broad range of products suitable to their needs. For example, the European ETF sector has continued to grow steadily, with over €1 trillion last year. When also considering the growth of active ETFs, European investors now have the opportunity to benefit from

a range of cost-effective products that may better suit their investment needs.

More broadly, the growth of the UCITS fund market has been exponential, turning this fund structure into a flagship European product. Its' global success has been enabled by a robust framework, including the ability to utilise international talent and expertise from across the globe, through delegation, whilst maintaining a very high standard of investor protection. We welcome targeted efforts to achieve better convergence in this area, while cautioning against overly prescriptive rules that do not serve the best interests of investors. This may also cause avoidable uncertainty among investors in EU funds, both European and international, thereby adversely affecting EU competitiveness.

In addition, to further strengthen long-term investing, the EU should seize the opportunity to move the ELTIF from a niche product to a mainstream, trusted structure. Adding clarity and flexibility to investment rules, while also simplifying retail distribution rules, has the potential of transforming the ELTIF into a vehicle of choice for long-term investing. It is positive to see that the restrictive nature of certain provisions in the original framework is currently being reconsidered, without compromising other key elements.

If Europe is to unlock the potential from increased retail investor interest and fulfil its ambitious goals for the long-term funding for the transformation of its economy, it needs to ensure that its capital markets remain open and competitive. It is an opportune time to further strengthen the attractiveness of the UCITS brand, by preserving the current model of distribution, and develop investment vehicles such as ELTIFs into a world-leading framework for long-term investment. It would be remiss of both industry and policymakers not to seize such an opportunity.



## STÉPHANE JANIN

Head of Global Regulatory  
Developments and Public  
Affairs - AXA Investment  
Managers

### How to ensure a true Single Market for EU fund investors?

As recognized by the European Court of Auditors earlier this year, the current EU regulatory framework for investment funds has allowed for facilitating the development of the Single Market to the benefit of investors.

The multi-decennial, step-by-step process of adoption and amendments of the UCITS Directive, the AIFM Directive, the ELTIF Regulation and complementary pieces of EU legislation has been, and is still, a reasonable way to build that framework. Many practical tools were set up: cross-border marketing of UCITS and AIF funds; cutting-edge and safe design of UCITS funds (recognized now as the global golden standard by non-EU investors and firms); attempt to provide for cross-border retail funds invested in EU real economy assets (ELTIF).

From this product management and offer perspective, the current AIFMD/UCITS and ELTIF Reviews will secure further benefits to investors. First by ensuring clearer rules for fund management (e.g. regarding portfolio

management delegation or loan-originating funds in the context of the AIFMD Review; wider scope of eligible assets regarding ELTIFs). But also in allowing easier access by investors (typically in the case of ELTIFs, by repealing the current minimum threshold of investments). Additional pieces such as the Cross-Border Distribution of Funds legislation were also helpful, e.g. in clarifying the notion of pre-marketing at EU level. In fact, the main remaining obstacle to allow for a complete Single Market vis-à-vis EU investors does not lie in the regulatory framework as such, but in the taxation one: for instance regarding ELTIFs, as long as principles on tax transparency are not agreed by Member States, full EU-wide diversification of invested real assets across several Member States will be deterred. We understand the wish by Member States to keep knowledge and control on taxpayers and national sources of tax revenues. But solutions should be found as soon as possible by improving tax neutrality across European jurisdictions, in order not to hinder the development of the Single Market for investment funds.

From another perspective, what is also critical is to make the EU fund industry more competitive vis-à-vis those based in other regions, to offer the best products at the best prices to both EU and non-EU clients. The cost of regulation plays its role here. Over decades, data clearly demonstrate that the market share of EU-based fund managers vis-à-vis their US-based peers is regularly decreasing.

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#### Avoidance of new red tape should remain a central underlying parameter.

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Positively, we have taken note that recently the EC has proposed three actions which will save costs for EU fund managers. First, in the context of the Digital Operational Resilience Act (DORA), as users of cybersecurity service providers we asked for and obtained a better legal protection vis-à-vis them. Second, regarding the EU DLT Pilot Regime, we were pleased to see taken on board our request to include UCITS funds. Third, the current EC's initiative for potential legislation on ESG Data Providers shows that we were heard too – although we keep asking for a wider action vis-à-vis Data Providers beyond ESG ones. Those three initiatives will be sources of cost savings for EU fund managers and their

clients, and EU institutions must be thanked for that.

However, regarding fund legislation as such, in order to secure the competitiveness of EU-based fund managers and funds, avoidance of new red tape should remain a central underlying parameter. As an example, in the current AIFMD/UCITS Review, the wish by some Member States to introduce an EU-wide Reporting by fund managers to their National Securities Regulators – potentially applicable to each of the existing 33,000 UCITS funds – would be a bad signal: since ECB Regulation 2013/38, we have had to provide the detailed inventory of each of those 33,000 UCITS funds already to National Central Banks on a regular basis. The risk – and related buildup and running costs – of an additional reporting to securities regulators on the same UCITS funds cannot be taken. Instead, we suggest that national central banks share with the national securities regulators the data they have already been receiving from us for almost ten years.

That UCITS reporting simple case demonstrates the current big room for improvement regarding cooperation between securities regulators and national central banks. Even if from a mere securities regulators' perspective, the main objective remains to transfer progressively more powers from NCAs to ESMA over time, in parallel the transversal cooperation between banking bodies and securities ones is critical and should be facilitated (including through some EU measures, e.g. the compulsory sharing between central banks and securities regulators of our current UCITS fund data reportings). The price of insufficient cooperation between regulators and supervisors should not be paid by asset managers.



## MIRELA AGACHE DURAND

Chief Executive Officer -  
Groupama Asset Management  
& Vice-Chair - AFG

### Succeed in the sustainability transition

At a time of urgency for climate issues, the European institutions engaged those past years an impressive work, with notably:

- in June 2020, the adoption of the EU taxonomy defining the main criteria for the economic activities to be considered as 'sustainable',
- in March 2021, the entry into force of the Sustainable Finance Disclosure Regulation (SFDR), aiming at improving transparency in the market for sustainable investment products
- last February, the publication of the proposal of the European Commission for a Directive on corporate sustainability due diligence (CSDD),
- last June, a political agreement reached between the European Parliament and the Council of the EU on the Corporate sustainability reporting directive (CSRD).

Those texts represent only the first step towards an EU sustainable framework. A tremendous effort is also made to 'translate' their political objectives into concrete action.

In the context of CSRD, the European Commission mandated EFRAG as

technical advisor to provide the draft European Sustainability Reporting Standards ('ESRS'). Those standards are crucial as they will, for all economical and financial players, establish operationally the ambitious EU political framework in the wake of the green deal. They will also have to reflect EU political will to standardize sustainability reporting and to spread the EU norms towards international standard setters.

We welcome the work of EFRAG which allows for the harmonization of this new reporting. Yet, the framework remains extensive and very complex to implement. In order to ensure the ability of all stakeholders to meet the upcoming requirements, we believe that exposure drafts should be simplified. In addition, the challenge will be to ensure a reporting done at a sufficient level of granularity to meet the information needs of investors, yet without overburdening companies.

#### International cooperation is key for enhanced comparability on sustainability disclosures.

In this context, we fully support the concept of 'double materiality' introduced by the European Commission and the EFRAG. This European concept is key and will allow a company to determine which information is material in the context of its activity. Nevertheless, to allow its effective implementation, we believe that it should be further clarified and illustrated. Practical guidance should be provided, first to be better understood and implemented by companies. Second, to gain weight at the international stage.

AFG is supporting the principle of 'rebuttable presumption' which allows a company to report only information that is material to its activity. Yet, it should be reminded that as investors, asset management companies face many obligations related to sustainable finance and therefore need tangible information from their counterparts to comply with these requirements. Consequently, we believe that the principle of 'rebuttable presumption' shouldn't apply to all SFDR Principal Adverse Impact indicators (PAIs) mandatory and optional and to certain climate-related information such as net-zero scenario, forward-looking

information and decarbonization plan. This information is essential for asset management companies to be able to finance their counterpart in full knowledge.

Interoperability and consistency between the different regulatory frameworks must be a priority. At this stage, we acknowledge some differences between ISSB, SEC and EFRAG framework. The framework proposed by EFRAG, which we support, is much broader and accurate than frameworks proposed by the ISSB and the SEC. Indeed, EFRAG considers the Environmental, Social and Governance aspects in their globality, whereas the ISSB and the SEC only focuses on climate matters. In addition, EFRAG rightly introduces the notion of double materiality, absent from the other frameworks which only focuses on financial materiality. We also call the ISSB and the SEC to take into consideration the work of EFRAG and notably certain information such as SFDR PAIs.

We are convinced that success of the sustainability transition lies into international cooperation. In this regard, we support the ISSB initiative to set up a working group of jurisdictional representatives (including notably the SEC and the European Commission) to establish dialogue for enhanced comparability on sustainability disclosures.

The reality is that we are all stakeholders – investors, industry, NGOs, consumers, citizens – experiencing a sustainability revolution that will transform thoroughly our current economical and financial paradigms.