Asset management: trends, challenges and priorities for the next legislature

1. Main trends in the European asset management market

1.1 Product trends

The Chair stated that there has been constant growth in the European asset management sector since the financial crisis, despite outflows in 2022 due to the adverse economic situation. The strong EU fund framework, including the UCITS and AIFMD directives, has supported this growth, as it allows a huge variety of products to be developed and sold domestically and also cross-border thanks to the passport. UCITS has also become a global brand. Funds are the easiest way for retail savers to invest in the capital market and to participate in the real economy. Product categories with specific rules have also been created at EU level, such as the European Long-Term Investment Fund (ELTIF), and at domestic level, such as real estate funds.

An industry representative confirmed that trends are positive in the EU asset management market, with stock markets at an all-time high. There is also a strong upside potential ahead. Investment funds only represent 25% of the overall EU investment market, which is relatively low compared to other advanced markets such as the United States, where they account for 60% to 70%. There is strong demand, with investors who are better informed and are looking for investment opportunities that will help them to tackle the changing macro environment. A regulator noted that in recent months there has been more investment into fixed income strategies and, on the equity side, higher investments in the technology sector.

A second industry representative highlighted the growing trends in the areas of sustainability, exchange-traded funds (ETFs) and private assets. Although the focus on sustainability reduced last year, partly due to investors allocating more money to cash and fixed income in response to market events, it is expected to return and remain an important trend going forward. An increasing number of investors also see the benefits of ETFs. This includes synthetic products, which are considered to be more complicated and risky. Measures have been taken to alleviate the risks, such as using multiple counterparties, but adequate controls are necessary. Another trend which started in the US and is now gaining traction in the EU is the launch of active ETFs. These enable investment managers to wrap their active management capabilities in a different instrument and make it available to different client segments. ETF share classes can also be launched within existing mutual funds, which gives investors access to ETFs without having to launch a separate ETF. A third important trend is the democratisation of private markets. Asset managers and regulators are considering how retail investors might access that part of the market, while acknowledging the illiquidity and increased complexity of these products. This would offer multiple benefits, including the fact that these assets are part of the real economy.

A regulator remarked that providing investors with access to new asset classes, such as private assets, real estate or long-term assets, is an important objective that is consistent with the macroeconomic goal of financing the transition.

1.2 Wealth management and distribution trends

An industry representative observed that the asset management industry is also impacted by the ongoing transition in the wealth management sector from a product-centric value proposition to a client centric proposition, with a move from selling products to providing portfolios. This changes completely the way clients are approached. Wealth propositions are also being brought to investors in innovative ways with new online players entering the market.

Three trends in the wealth management industry illustrate this client-centric evolution, the industry speaker explained. The first is a shift towards fee-based advisory solutions that integrate the entire value chain, from the advisor interacting with the client to a central portfolio building team. This approach, which leverages centralised investment strategies that can be either discretionary or non-discretionary, has demonstrated efficacy, yielding lower risk and enhanced performance and a capacity to build scale. It is anticipated that this model will dominate the market in the coming years, regardless of regulatory changes, with many players currently testing new approaches and business models in this area. Some banks are already proposing discretionary portfolio management services from €3,000 in some parts of Europe, which was unheard of 12 months ago. The second trend is the growth of independent wealth managers in Europe. This is a big market in the UK and US, but still only represents 10% to 15% of the EU market. Growth in this market is driven by experienced advisors who previously worked for traditional banks and are now proposing to their customers a more client-centric approach around financial planning and whole-portfolio management. The third trend is accelerating digital distribution. Retail and private banks are investigating how to re-engineer their processes and improve their client front ends to compete with retail neo-brokers that are starting to capture a significant market share. These brokers control 5% of the market and their share is expected to increase to 15% in the coming years.

A second industry representative observed that in the US there has been a growth in managed accounts for higher net worth individuals, with the minimum eligibility decreasing at a very high speed. This suggests the type of disruption that could be experienced in the EU over a five to 10 year horizon. Technological innovation, such as artificial intelligence (AI), will accelerate the pace of those innovations.

1.3 Digitalisation and technology trends

An industry representative noted that digital transformation and the use of technology are important trends in the asset management sector. An increasing proportion of tech savvy investors buying products online want to do the research themselves and expect further transparency around products and charges. Serving these clients adequately is important for the growth of the sector.

A regulator highlighted that the ongoing digital transformation in the asset management sector also aims to increase the efficiency and safety of operations and reduce costs. Much progress is being made on digitalisation in the industry. For example, distributed ledger technology (DLT) is being tested to enhance fund distribution. The use of AI for portfolio management and trading is increasing and AI can also help to create new products. The topic of tokenisation of investment fund shares, and securities more broadly, is also emerging. This should contribute to reduce costs and facilitate product distribution.

Existing legal frameworks such as the Digital Operational Resilience Act (DORA) will help to mitigate the risks related with these changes such cyber-risk, the regulator considered. Traditionally, asset management companies may not have been subject to rules as stringent as banks on cyber and digital operational resilience, but this will change. This will also be a new area of work for the supervisory authorities.

2. Competitiveness challenges facing the European asset management sector

2.1 Main aspects to consider for the fund sector

A regulator noted that the competitiveness of the EU fund sector must be considered at different levels. First there is the competitiveness of the EU market vis-à-vis other jurisdictions, which requires conducting regulatory changes with a global perspective. The second level is the competitiveness of fund products compared to other types of investments, which needs taking into account in regulatory discussions. Many assessments focus on the investment fund sector, but the investment universe is much wider. A third level of competitiveness is at the asset manager level in terms of yield provided for investors and profits generated for the asset management company. Technology can play an important role in reducing the costs of the launch of new products and supporting distribution, which may bolster the competitiveness of individual management firms, but investor interests need considering first, as this will eventually drive the competitiveness of the sector.

Another regulator emphasised that the European fund market has many competitive strengths including strong product frameworks, a global brand with UCITS and access to a large savings pool. In addition, technological developments in the market can contribute to improving the management and distribution of investment products and support investment decisions.

2.2 Market fragmentation and divergence issues in the implementation of regulations

An industry representative emphasized that the European fund market is still very fragmented. Despite a slight increase in cross-border funds, 80% to 90% of funds bought by retail investors in the three main fund markets of France, Italy and Germany are domestic funds. There are more funds and share classes in the EU than in the US and the average size of EU funds is smaller. There is moreover a shortage of European asset managers able to compete at a global level with only one European asset manager in the global top 10. Over the past 10 years, the share of European asset managers in the top 30 players of the EU market has decreased from 70% to less than 60% in 2023. In contrast, European players have only a 2% market share in the US, showing an unbalance among jurisdictions in terms of openness to foreign products.

In Europe, this fragmentation is notably due to different national transpositions and divergent interpretations of product rules such as UCITS across the EU, the industry speaker stated. There is also sometimes gold plating by national competent authorities (NCAs). As a result, when passporting a fund to another EU country, it can be necessary to create a dedicated share class, increasing cost and the number of products in the market.

A regulator considered that, overall, Europe has been very successful in cross-border distribution. Products with a critical mass have been launched in a number of jurisdictions and the quality of European products is recognised internationally. Harmonisation efforts however need pursuing.

2.3 Lack of clarity of regulation

An industry representative noted that the lack of clarity of some Level 1 regulation hinders the competitiveness of EU asset managers. For example, the industry is still struggling to define sustainable investment in relation to the Sustainable Finance Disclosure Regulation (SFDR), as this has not been clarified in the Level 1 text. Clarity is also still lacking on some aspects of the ELTIF Level 1 regulation, for example evergreen ELTIFs and article 18.2, on which views differ.

A regulator agreed that a lack of clarity of some rules makes it difficult for market players to comply and for supervisors to verify compliance.

3. ELTIF Level 2 regulatory technical standards

A regulator noted that ELTIF is an opportunity to establish a strong new brand in the fund market. These vehicles should be promoted to retail investors but with a prudent approach, given the lack of liquidity of the underlying assets, including real estate and private assets, and their exposure to the macroeconomic climate. ELTIFs have to meet in full their liquidity promise made to retail investors. This requires an appropriate balance between the liquidity offered and the holding of liquid assets. The higher the redemption frequency offered to investors, the higher the liquid assets ELTIF should hold. This is the basic principle of fund structuring that i) will ensure that retail will receive their proceeds as promised; and ii) reduces the chances that ELTIFs will have to sell assets at a substantial discount in times of stress or only meet redemptions partially.

Another regulator considered that ELTIF has potential in terms of retailisation of alternative products. However, getting the Level 2 regulatory technical standards (RTS) right is essential, as ELTIF 1 did not work as intended. Discussions around the RTS are ongoing, creating some uncertainty in the meantime. These discussions must end soon to avoid jeopardising the product's chances of success. Cross-border distribution will also be an important factor in the success of ELTIFs.

An industry representative suggested that investors need access to a broad range of investment vehicles and opportunities, including private market assets such as corporate credit and real estate, to get a better return in the longer term. This access should be provided in a way that ensures an appropriate level of protection. The EU's recent legislative review of the ELTIF Regulation is an improvement in this regard. However, a pragmatic approach to the regulatory framework and technical standards is needed to seize the opportunities of these funds. This includes solving some regulatory implementation issues in relation to fund strategy and distribution. These products are complex to launch and expensive to seed. They are also long-term oriented investment vehicles, so a stable regulatory approach is also essential.

4. Further actions needed to enhance the competitiveness of the EU fund sector

4.1 Implementing a competitiveness check of new regulations

An industry representative stated that strong and competitive European players, notably in the asset management sector, are needed to build a real capital markets union (CMU). One way of fostering this could be to carry out a competitiveness check of new regulations based on solid impact assessments of the European Commission's proposals but also of the amendments made by co-legislators, to ensure that the measures do not have negative unintended effects in terms of competitiveness for the European financial industry. For example, the shortening of the securities transaction settlement cycle to T+1 that is currently being assessed creates new challenges for European financial players, including for the buy-side. The way this rule is transposed in the EU should take account of the fragmentation of the European post-trading market and notably the presence of multiple CSDs. The review of the benchmark regulation is another example where impacts on EU industry players need considering. Buy-side players are using an increasing amount of data and indexes and that has a cost. A further idea could be to provide the European Supervisory Authorities (ESAs) with a clear mandate to integrate competitiveness implications in their regulatory work.

4.2 Encouraging retail engagement in the capital markets and retirement planning

An industry representative noted that, while household savings and investment rates in the Euro area are trending slightly above pre-pandemic levels, they have remained lower in recent years than in many other developed economies. With the EU's green and digital transition plans estimated to cost around €645 billion per year through the next political cycle and beyond and as public spending remains under pressure, it is clear that more needs to be done to mobilise private capital in Europe. As policymakers start to consider the next steps for progressing the CMU, attention must be given to policies that are likely to engage and empower a more diverse investor base in Europe and foster a more proactive culture around long-term investment and retirement planning. The Retail Investment Strategy (RIS) proposal which can contribute to this objective must be finalised. The measures proposed to improve citizens' financial literacy, and to develop financial competence frameworks for citizens jointly with the OECD are particularly important. One way of putting them into practice could be through the institution at Member State level of financial health checks, encouraging citizens to assess the robustness of their financial planning at key stages in their life and to adjust it if needed.

Helping EU citizens to prepare for their retirement is also essential, the industry speaker stressed. Addressing the tax aspects that hinder the establishment of pan-European private pension products, revitalising the PEPP (pan-European personal pension product) and developing auto-enrolment schemes should all be part of the next CMU agenda. The financial industry should also change the way it approaches retirement issues. At present retirement is considered as a moment of change in people's lives rather than a part of an overall journey. Product innovations to better support customers throughout the phase of asset accumulation and after they have retired need to be further explored.

A second industry representative noted that ETFs can play an important part in achieving the objectives of the RIS and increasing the participation of retail investors in the capital markets. Low-cost investment models via digital channels involving ETFs should be taken advantage of in particular. These developing trends should be appropriately considered in future legislation including in the RIS proposals. More generally, future legislations should leverage the potential of the asset management sector to drive the CMU forward and to ensure a steady inflow of long-term capital into capital markets. This requires maintaining a high degree of investor confidence in the sector. The strong EU fund frameworks should contribute to this. Much has also been done in recent years to increase investor protection and also enhance the resiliency of the sector and reduce spill-over risks. Going forward, a balanced message must be delivered about the risks posed by the asset management sector, taking into account these measures, in order to preserve investor confidence.

A third industry representative suggested that the wealth management sector also has an important role to play in attracting more retail investment. This requires adapting the advisory process to focus it more on long term financial planning and on building an appropriate investment portfolio, than on the sale of products. It also requires empowering advisors further to have financial planning discussions with their customers and regulations that foster such approaches. This will help to better answer investor needs and also facilitate investment in ELTIF products that are better suited as a component of a portfolio than as standalone products.

4.3 Fostering more consistency and stability in the European regulatory framework

An industry representative stated that more convergence is needed in the interpretation of rules for legal and marketing documentation across Member States. ESMA has a key role to play in this area. Regulatory stability should also be an objective. Care should be taken before changing any rules on UCITS at Level 1, as this is a gold standard that must be preserved. However, supervisors should have the ability to adapt rules to changes in the market in an agile way if needed. The possibility for ESMA to issue real no action letters should be considered in this perspective.

A regulator agreed that there must be a degree of regulatory stability in the EU. Its is expected that new regulation will be introduced in a more staggered way during the next political cycle, after relatively intensive legislative work during the current legislature. However, new policy or the review of existing policy will also be needed to improve the regulatory framework and adapt it to market evolutions. For example, reviewing SFDR is a priority as it has produced completely unexpected results. That would also contribute to resolving the issues around the heterogeneity of rules applying to marketing material. There is also a structural weakness of the single market in the way that supervision is conducted. The various supervisors across the EU all act in good faith but have different traditions and national views, which leads to a fragmented approach. Supervisory convergence and coordination between supervisors must be enhanced, as has been suggested in the RIS proposal.

Another regulator noted that effective mechanisms are in place that allow NCAs and supervisory authorities to exchange views, notably in crisis situations. There are sometimes divergences in views, but these are discussed and collaboration has been successful in many instances. There are however some areas where a more harmonised approach is needed to make the single market work from an asset management perspective that need to be further explored, based on feedback from the industry.

4.4 A more consolidated approach to asset management groups at EU level

An industry representative suggested that group structures should be better recognised and taken into account in the regulatory and supervisory framework in order to allow a streamlining of processes and foster more industry consolidation at European level. When a function is delegated from one entity to another, the fact that this takes place within a European group with a parent company supervised by an NCA based in an EU Member State is not taken into account at present. The subsidiaries of asset management groups are considered to be completely different management companies and entities.

A regulator noted that, as a side effect of the single market, the structure of asset management groups has changed significantly. Firms typically have teams in various European countries and funds located in other countries. Insufficient coordination between the relevant NCAs in this context might create inefficiencies and complexity for market participants. A more consolidated approach to supervise the business of large pan-European asset managers should be introduced, although this will require finding an appropriate balance between national and European-level responsibilities for supervision.