ASSET MANAGEMENT TRENDS AND CHALLENGES

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Looking at some challenges and opportunities of the collective investment sector

Regulations impacting the asset management sector in 2024 include AIFMD II, ELTIF II, the current reconsideration of ESG/SFDR requirements, measures on fund liquidity risk management, the Retail Investment Strategy package, the Markets in Crypto-Assets Regulation (MiCA) and the Digital Operational Resilience Act (DORA). Even though this list of key regulations is not exhaustive, it provides a good indication of priorities of market participants and regulators/supervisory authorities.

These regulations and initiatives pursue some key objectives:

- Increasing the range of financial products available to retail investors, via the notable possible inclusion of alternative investment funds within the offering, such as European Long Term Investment Funds (ELTIFs) for example,
- Ensuring investor protection,
- Managing fund investment risks individually and avoiding systemic risks emerging from the collective investment sector,
- Further strengthening the control frameworks operated by IFMs, with a specific focus on operational and information technology risk management and resilience.

They impact the way how regulators interact with and monitor market participants and their product offerings, by using new and more efficient technology and communication channels to collect, analyse and manage data as a basis for a risk-based supervision. This presupposes the identification of the key risks impacting the collective investment sector, such as liquidity, credit, ESG/sustainability, asset valuation, leverage and information technology risks having been identified as most relevant and still increasing risks impacting investment fund managers (IFMs) and the investment funds they manage.

Market, operational and contagion risks are assessed to remain unchanged for the time being. As part of their prudential supervision, regulators assess and control the internal risk management frameworks operated by IFMs and monitor the emergence and evolution of macro-economic and systemic risks as well as other external risks facing organisations. Considering the latter, geopolitical tensions, the rise of interest rates, economic uncertainty causing volatility, climate change and investor protection considerations have contributed to setting the regulatory agenda, specifically in terms of supervisory priorities adopted at European level in terms of liquidity risk management, asset valuation, costs and fees and ESG/sustainable finance.

Economic and market developments continue to impact asset managers who regularly adjust product designs and investment strategies by putting an even greater emphasis on risk-adjusted returns, in response to increased market uncertainty as well as investor search for yield and need for capital protection. Both institutional and retail investors demonstrate an interest in ESG investments. On the investment side, asset managers more often rely on new technologies to improve their investment process and capability, by creating new products using artificial-intelligence-powered solutions and algorithm-based trading.

On the fund distribution side, asset managers consider the opportunity of implementing new technology to improve the safety and cost efficiency of their operations and cross-border distribution channels: the use of blockchain technologies, the implementation of cyber-security measures and the tokenization of investment fund shares and units just being examples. This is of particular importance in a sector where profit margins from product offerings decrease and where investments are needed at the same time to develop and support business activities and operations. This is to say that the increased costs currently borne by asset managers do not only stem from compliance obligations, and that they are or will be the result from strategic IT investments which are essential to make companies more robust and sustainable in the years to come.

> **Regulatory initiatives are meant to support the offer of new financial products to a wider clientele.**

In addition to leaner and enhanced operational processes, the rationalisation of investment fund ranges and increased cross-border distribution contribute to a targeted international product offering by adopting efficient cost and risk management processes. In this context, the European passport which facilitates investment fund distribution of UCITS and ELTIFs within European members states is crucial to make this type of financial products available to investors and thereby guarantee their access to a variety of investment strategies.

The good functioning of the passport sets the foundation for the success of UCITS as well as for the "retailisation" of alternative investment funds such as ELTIFs. Alternative asset classes, such as private equity, real estate, and infrastructure, are expected to play a more prominent role in investor portfolios, offering diversification and risk-based investment performance. Regulatory initiatives are meant to support financial innovation including the offer of new financial products to a wider clientele in a transparent and safe mode.

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Upcoming priorities: ELTIFs, macroprudential rules and sustainable finance

New Year started with the long awaited entry into application of the ELTIF2 Regulation. ELTIFs represent a real opportunity for retail to diversify their investment portfolio, and have access to more long-term investment options to finance their retirement for example. It is also good news for EU economies as ELTIFs will be a source of long-term financing to support economic growth and the real economy and even the energy transition. The AMF welcomes the domiciliation of ELTIF2 in France.

ELTIFs may become the privileged retail vehicle used to invest in the so-called private markets, which historically have produced a higher yield than investments in public markets. That higher performance let us not forget, was in return of no access to the investment before the end of the fund's life. ELTIF2 tries to reconciliate the higher performance and possibility for investors to access their investments.

As a product for retail, ELTIFs have to meet in full their liquidity promise made to 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.

This second element is quite relevant in what could be a priority for the next Commission: a macro-prudential framework for investment funds, as part of the Non-Bank Financial Intermediated sector. The AMF believes that a combination of ex-ante requirements on leverage and liquidity (such as the above-mentioned principle in fund structuring), and the effective use of liquidity management tools, in particular anti-dilution tools, could already be the main elements of that framework.

In terms of data, a single comprehensive report, such as the reviewed AIFMD and new UCITS reports, to be shared by securities market regulators and central banks will significantly facilitate the supervision of the sector by both set of supervisors, while reducing operational costs for asset managers.
The last element of the framework could be the creation of a consolidated supervisory approach for large asset management groups. The objective would be, within a supervisory college, to globally assess the appropriateness of the group's risk management framework and have an understanding of the overall risk exposures of the funds managed by the group. This format will continue to foster the dialogue between securities market regulators and central banks to ensure the resilience of the sector.

Another priority should be to simplify and streamline the Sustainable Finance regulatory framework. In particular, we advocate for a review of the Sustainable Finance Disclosure Regulation ("SFDR") with a focus on:

i. the creation of product categories and elimination of articles 8 & 9;

ii. simplification of disclosures to ensure retail investors can actually understand them; and

iii. the elimination of disclosure requirements at entity level.

The AMF has always welcomed the Commission's leading role in developing a regulatory framework that aimed to channel capital to sustainable activities and finance the energy transition. We have to recognise, however, that the current rules do not facilitate retail investors' understanding of product claims on sustainability nor allow product comparability. Furthermore, the ambiguity in the rules have, in some cases, hindered supervisors from fighting and sanctioning greenwashing.

To facilitate the decision-making process for retail, the rules should be clarified and simplified. We advocate for the creation of a limited number of simple product categories relying on objective minimum criteria. These categories will not seek to be labels of excellence for the best sustainable products. Instead, they will ensure a minimum level of contribution to the different objectives of each category. These categories should also be used as a base for the MiFID questions to investors on their sustainability preferences.

As a product for retail, ELTIFs have to meet in full their liquidity promise made to investors.

In order to streamline the framework, the AMF proposes to introduce the same disclosure for all investment funds on how managers integrate sustainability risks in their investment decisions, as well as an assessment of the likely impact of those risks on their products' return. In addition, the funds within any of the categories should make some additional disclosures to justify that categorisation.

Our last proposal for the SFDR review is to use the Corporate Sustainability Reporting Directive as the legal text that regulates the disclosures for entities and to consider SFDR as a regulation only for product disclosures. This will eliminate the overlaps and facilitate the understanding and compliance with both texts.

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Attracting investors: the keys to a thriving investment landscape in Europe

Asset management and collective investment vehicles are fundamental tools that have allowed individuals to deploy their savings efficiently to achieve their financial goals. Europeans however have on average lower participation in financial markets, compared to more mature markets like the US; this might affect, over the long-term, their financial well-being, and overall economic stability.

Yet for citizens to invest, it is key that the European investment landscape remains attractive and conducive to increased participation, across both healthy supply and demand dynamics.

On the supply side, a key strength of the European fund market is its broad offering of a very diverse set of products, instruments and providers. Preserving choice and encouraging product innovation are two key traits of a thriving investment sector.

The EU's regulatory framework plays an important role in ensuring these two attributes. For example, the UCITS regulatory framework serves as a world-class model of a legal vehicle that enables access to a diverse funds universe for retail investors across and beyond Europe, whilst preserving a high level of investor protection.

Similarly in the alternative investments space, the evolution of the European Long-term Investment Fund (ELTIF) Regulation – and all the accompanying level 2 technical standards – will be essential to channel much needed long-term capital to Europe's small- and mid-sized, unlisted companies and democratise retail investors' access to a new asset class with attractive long-term returns, that is mainly being offered to institutional investors today. The rollout of the ELTIF 2.0 framework in 2024 is a positive step. To make sure its potential is fully realised, leaving room for future product innovation, technical standards on redemption terms will need to adequately balance investor expectations and liquidity risk management concerns.

Building investors' confidence, encouraging their participation and stimulating the demand side, is equally crucial. Here, our experience has shown that transparency, ease of access and education are the keys to a thriving retail investment market.

There are different levers to support a transparent, easily accessible funds market. Beyond regulation, which has certainly helped create cost transparency and reduce barriers to investing, Wealth Managers play a fundamental role. They support the retail investor journey and help savers to find investment solutions to support their immediate needs, their long-term goals and financial wellbeing.

Transparency, ease of access and education are the keys to a thriving retail investment market.

In addition to traditional Wealth propositions, Execution Only and Digital platforms have played a pivotal role in encouraging European investors' participation, in recent years. They offer a broad range of products with low barriers to entry, intuitive interfaces, and a low cost, democratising access to products and portfolio solutions. These platforms also encourage regular and long-term investment programmes, that benefit not just citizens but also contribute to the economic resilience of Europe. For example, in recent years, Exchange-Traded Funds (ETFs) and ETF savings plans, have catalysed the interest of new investors, facilitating the shift from saving to investments. Often, such platforms also provide end-investor with educational material, and absorb trading, custody, and execution fees to minimise total cost of ownership. At end-September 2023, an estimated 7,6 million ETFs savings plans had been subscribed to in Europe – an encouraging number that is expected to quadruple by 2028.

For these propositions to continue to grow and attract new investors, it is crucial that the regulatory framework continues to preserve and support their economic viability, while preventing conflicts of interest in proposing solutions to end investors.

In conclusion, fostering an ecosystem that supports innovation in the investment industry is crucial for positioning Europe as an attractive destination. The regulatory framework must enable innovation and contribute to increasing the attractiveness of the European funds market. ELTIF serves as an example of how regulation, technology, and product design can align successfully. It is important therefore that existing and upcoming regulatory frameworks focus on supporting scalability and the use of technology so that investment vehicles can be adopted increasingly by investors, at a lower cost. As investor participation grows, maintaining a broad offering with ease of access will be vital for the sustained attractiveness of European investment vehicles.

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A thriving EU investment fund sector is needed for a self-sustaining Capital Markets Union

Ahead of the next European Commission's mandate, and with the legislative agenda pausing during the European elections, it is a good time to consider what role the EU investment fund sector can play in the next phase of the EU Capital Markets Union project. A lot has been said and done in the past years on CMU but its central goal has still not been fully grasped: that of incentivising savers to invest in capital markets as they plan for their future. A thriving investment fund sector can offer two key solutions: it can represent a channel for long-term risk capital, and it can act as a means of empowerment for retail investors and savers. Let's start with the latter.

ETFs saving plans have been the perfect example, and a very popular one, of how our industry can continue to innovate and drive long-term wealth accumulation among new investors and outside traditional distribution channels. Germany has been at the epicentre of a considerable growth: from a mere 150 thousands saving plans in 2014, the market has surpassed 7 billion at the end of 2023, for a combined EUR 15 billion of savings volume. Consistent growth is expected to remain strong in the coming years, reaching EUR 64 billion of new investments by 2028[1]. These plans have been popular especially among younger investors, who resort to neobrokers in their investment process, driven especially by the low costs of execution. The result is that, thanks to digital wealth platforms, retail investors can become self-directed investors and their savings are turned into new investments, thus bringing more capital into EU financial markets.

This continues the long tradition of ETFs as a vehicle that has democratized the way investors access capital markets. Looking ahead to future developments, index funds and in particular ETFs, continue to be characterised by a high level of innovation, further increasing investor choice and market accessibility. ETFs are evolving rapidly and their latest transformation is characterized by "actively managed ETFs", with a growing number of traditional active funds managers converting their mutual funds structures in ETFs. This responds to a demand from investors for lower fees and the ability to access more frequent portfolio updates compared to the more traditional mutual fund wrapper.

The development of the retail markets in Europe should be further encouraged, especially by considering ways to increase retail investors' access to ETFs at the point of sale. Here the Retail Investment Strategy should play a key role in supporting retail participation through these emerging ETFs trends, especially by safeguarding the low-cost execution models of digital engagement and distribution channels. The Retail Investment Strategy can also be an opportunity to build on the positive developments that we are seeing in local capital markets. Replicating these best practices across the EU would create a virtuous circle of investors participation in financial markets, fostering a bottom-up approach to capital markets integration.

At the same time, the fund sector can help in maintaining a steady flow of long-term capital into European private markets. The EU has a strong track-record in creating well-regulated and attractive investment fund structures, as demonstrated by the UCITS and AIFMD regimes, but has so far been less successful when it comes to facilitate investors access to private markets. In this regard, the promise around the revival of the ELTIF structure must be followed through in legislation, with simplification and ease of accessibility being key for increased visibility, liquidity and uptake of the product.

A self-sustaining Capital Markets Union must rely on deeper sources of long-term risk capital, and this cannot ignore a further development of the pension markets in Europe through the realisation of European initiatives, such as the Pan-European Personal Pension Product, and the promotion of best practices at Member State level, as for example the implementation of auto-enrolment which can drive up pensions savings and increase investable capital.

For a thriving fund sector the EU must build on digital distribution channels and investor-friendly products.

To conclude, it is also important to continue fostering among investors a high degree of confidence in markets and in the fund sector. Regulatory initiatives should be careful in not framing the sector solely as a source of risk, nor should they make it the target of specific additional macroprudential regulation. In the past years, both regulators and fund managers, have been undertaking extensive efforts to increase the resiliency of the sector, ensure investor protection, and reduce the risks of propagating shocks throughout financial markets.

However, a sense of balance must not be lost, and over-restricting the financial intermediation capacity of investment funds can come at the price of preventing the positive added value that the sector offers to the economy in terms of financing opportunities. If anything, Europe needs more capital markets, not less.

1. *ETF Savings Plan Market in Continental Europe, published by extraETF Research, September 2023.*

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The EU has an opportunity to 'walk the talk' on capital markets

The upcoming European elections offer a useful opportunity to reflect on the progress made over the past decade under the EU's Capital Markets Union (CMU) agenda.

To date, the EU's efforts to develop a true single market for capital have done much to develop the regulatory framework governing market functioning and transparency, public listing, supervision, and, of course, investment management and product innovation.

However, while household savings and investment rates in the Euro area are trending slightly above pre-pandemic levels[1], they have remained lower in recent years than in other developed economies including Australia, Japan, S. Korea, Switzerland, and the United States[2].

With the EU's green and digital transition plans estimated to cost around €645bn per year through the next political cycle and beyond[3], and as public spending remains under pressure, it is clear that more needs to be done to mobilise private capital in Europe.

So, as policymakers begin to consider the next steps for progressing the CMU agenda, appropriate attention must be given to implementing policies that are truly effective in:

- engaging and empowering a more diverse investor base in Europe;
- fostering a more proactive culture around long-term investment and retirement planning;
- facilitating greater participation in both public and private markets; and
- maximising the visibility and attractiveness of investment opportunities in Europe.

Making meaningful progress towards these goals is essential and will require EU policymakers to 'walk the talk' on developing capital markets.

For example, we commend the European Commission's efforts to coordinate Member States' initiatives to improve citizens' financial literacy, and to develop financial competence frameworks for citizens jointly with the OECD. We believe that such initiatives can truly be brought to life through the institution at Member State level of financial health checks where citizens are encouraged to assess and understand their financial health at key stages in their life, in much the same way as they do in relation to their physical health, and to plan accordingly.

Improving citizens' financial literacy will enhance their ability to take positive action in relation to their longer-term financial health, whether it be saving for a rainy day or life after retirement. As highlighted by EIOPA[4], citizens are having to take greater responsibility for their long-term financial health, so policymakers must provide appropriate mechanisms to empower them.

In this regard, policymakers should seek to improve the availability of and access to best practices in relation to auto-enrolment savings plans at Member State level, as identified by the European Commission[5]. If closing the pensions gap remains "top of the agenda", as EIOPA states, effecting positive change in this policy area represents a necessary step forward.

Further, as citizens look to make their money work harder over the longer-term, it is also vitally important that Europe gets its investment offer right. This includes, in our view, ensuring access to a broad range of investment opportunities and vehicles, including private market assets such as corporate credit and real estate, in a manner which ensures an appropriate level of protection while offering exposure to potentially higher returning assets.

The EU's recent legislative review of the ELTIF Regulation was certainly an improvement in this regard. However, some regulatory implementation issues remain to be resolved, including in relation to fund strategy and distribution, in order for the ELTIF to truly maximise its potential for all investors. In short, in order to 'walk the talk', the EU's political ambition regarding the development of a true single market for capital – and all of its component parts – must be matched by regulatory reality.

Right-sizing the ELTIF Regulation represents one opportunity from the current political cycle to achieve this objective. Similarly, from a public markets perspective, ensuring the effective roll-out of a consolidated tape of record for market data that supports end-investors, and improves the transparency and attractiveness of EU capital markets, is another.

The EU's political ambition on capital markets must be matched by regulatory reality.

The bigger picture, however, is ensuring that such holistic policymaking is carried through to the next political cycle and in the development and, crucially, implementation of the CMU 3.0 agenda.

Being effective in engaging and empowering investors, facilitating access to wide-ranging investment opportunities, and increasing the transparency and attractiveness thereof – in particular opportunities in the EU – is the only way policymakers will develop a true single market for capital in Europe and, more broadly, attract the private capital required to fund the bloc's wider green and digital transition plans to the benefit of its citizens.

1. *Eurostat, Jan 2024*
2. *OECD, Jan 2024*
3. *European Commission, Mar 2022*
4. *EIOPA, Nov 2023*
5. *European Commission, Nov 2021*

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Developing long-term investment products is key to finance the European economy

At the heart of the European Union (EU) capital markets lies a pressing challenge, where a significant portion of long-term savings remains locked in unproductive deposits, accounting for 44%[1] in 2022. This weighs on European economy, not only by limiting companies' access to diversified funding sources, but also because savers' earnings are not optimised. To address this enduring situation, the EU must develop - or improve - policies in key areas of persisting barriers. This is essential to efficiently support long-term investments along with mobilising more private financing towards the green and digital transitions.

Among these main barriers is the fragmentation of the European market. Despite the flows of EU legislations and the numerous initiatives of the European Supervisory Authorities, there still remain too many divergent applications and interpretations among Member States, together with gold-plating practices, that hinder the confidence of market players. This could be rationalised, through better harmonisation and coherent interpretation of EU legislation. Furthermore, asset managers are still required to duplicate many functions in different Member States, in order to comply with the requirements of local supervisors. This creates additional burden and costs that go against the objective of encouraging more cross-border operations, and should be tackled. For instance, the concept of European group could be recognised, with the establishment of a single set of rules applicable to these EU groups to avoid unnecessary costs and delays.

It is also essential to foster more engagement of retail investors in capital markets, along with more long-term investments in EU companies. The precondition for this is developing financial education, all the more in the European context of predominant risk aversion. Financial literacy allows individuals to make informed financial decisions and better plan their future, and is thus a prerequisite for enhancing their participation in capital markets.

The second condition is to maintain easy access for all European citizens to effective and affordable advice, to support them in their investment decisions. In the context of current discussions around the Retail Investment Strategy (RIS) proposal, it is essential for the EU to avoid impairing the current distribution model by banning retrocessions, and avoid the unwanted consequences experienced in the UK, where the 2013 total ban on inducements resulted in insufficient access to advice for the vast majority of retail investors.

There still remain too many divergent applications and interpretations among Member States.

The third condition is to foster long-term investment products. The RIS also regrettably introduces a primary focus on costs, to the detriment of any other qualitative criteria or characteristics of the products that are essential for the long-term interests of retail investors. This cost-centric approach would lead to a reduction in investment products offer and especially those with ESG characteristics, which are built on enhanced expertise. In this respect, the European Long Term Investment Fund (ELTIF) is a great example of product that can be distributed to retail investors and gives them access to long-term investments. However, ESMA has recently proposed[2] level 2 measures forcing a high level of liquidity requirements, which will penalise the return on investment, but also limit the pool of investment channelled towards long-term projects.

When setting the priorities for the new political cycle, it is essential for the Capital Markets Union's success that the EU focuses on rendering regulation consistent, developing pan-European investment solutions to finance increasing retirement needs. The support of tax incentives to steer savings in these directions is an additional important element to be considered.

Redirecting retail savings towards local businesses requires also competitive European market players, which in turn need regulatory stability and consistency. Given that predictability is important for both businesses and investors, it is essential to preserve the rules that have already proved effective, such as the UCITS framework.

Last but not least, adopting coherent legislations all along the investment chain, in which asset managers operate, is essential for efficient financial markets and investors' confidence. As such, some areas of the financial market ecosystem are still insufficiently regulated. This is the case in particular of non-financial data - notably needed to meet growing regulatory constraints. In this regard, the current proposal to unravel the legislative framework applicable to the vast majority of benchmarks, including ESG benchmarks, is a point of concern.

Addressing these issues effectively would strengthen the financing of a sustainable growth of the European economy and develop its strategic autonomy, as well as ensure that both EU businesses and citizens benefit from it.

1. *EFAMA Fact Book 2023*
2. *ESMA final report on ELTIF Regulatory Technical Standards – 19 December 2023*