Priorities for the asset management sector

1. Trends and opportunities in the European asset management sector

An industry representative stated that the European investment fund sector has many strengths and successful frameworks to capitalise on. The Undertakings for Collective Investment in Transferable Securities (UCITS) framework is a global gold standard that has attracted confidence around the world. Exchange traded funds (ETFs) which trade on stock exchanges like stocks represent a significant opportunity. ETFs can be very effective in getting citizens more involved in investing in capital markets, including in line with the objectives of the EU's Retail Investment Strategy (RIS). They are widely recognised as a new vehicle in Europe and many of them are structured as UCITS. Active ETFs are also a new and fast-growing part of the market. The relaunch of European long-term investment funds (ELTIFs) with a reviewed framework, which are designed to foster long-term investment in the EU's real economy by channelling capital towards infrastructure, SMEs and other real assets, should provide additional investment opportunities for retail customers in particular.

A second industry representative added that both institutional and retail clients are reorienting from active to passive strategies using ETFs and hybrid products such as active ETFs. A second important trend is that institutional investors are looking to consolidate their partnerships with fewer asset managers who can provide a broad spectrum of investment capabilities. This will lead to consolidation with larger and more diverse asset managers. A third trend is investments in private markets, especially in private credit loans. Finally, de-accumulation strategies that provide stable income for retirement, while allowing people to continue to achieve capital growth with a more flexible approach during retirement, are another important focus.

A third industry representative noted that the asset management sector in Europe is still a growing market. There has been a significant increase in assets under management in the last 10 years and European asset managers are also leaders in sustainable finance. There is a tendency now towards consolidation and, because fees are constantly decreasing, there is pressure on margins.

2. Fragmentation and competitiveness challenges

An official emphasised that the main challenge facing the European asset management sector is fragmentation. One issue is the insufficient size of the EU players on average. Another issue is the level of fixed costs in the sector, which are higher than in other regions and needs to be reduced. Consolidation, which started after a tough year for the sector in 2022, is part of the solution, but consideration needs to be given to what can be done beyond this to address the high fixed costs. There is also a need for public authorities to think broadly about how to increase the efficiency of the European capital markets, notably by encouraging the industry to move to ambitious projects such as a T+1 settlement cycle.

An industry representative stressed that near-constant regulatory change, as well as regulatory fragmentation across the EU, are a major challenge for the European asset management sector. An industry representative agreed that fragmentation across the European asset management market needs to be reduced. Actions such as avoiding gold-plating and ensuring that there is more supervisory convergence are necessary. It is also important to ensure that the regulatory proposals currently being discussed such as the RIS are not overly complex and treat products in a consistent way. The simplicity and consistency of requirements across the EU have a significant impact on the competitiveness of the European fund sector, which is decreasing. There is only one European asset manager among the top 10 globally. The market share of US asset managers in Europe has increased from 20% 10 years ago to 40%, while the share of European asset managers in the US remains below 2%. It is vital to foster the competitiveness of European actors with further integration at the EU level and ensure a more level playing field at the international level. Europe is one of the most open markets in the world, but this is not the case for many other jurisdictions.

Another industry representative considered that the issue is not the origin of investment managers but how to increase investment in EU firms and EU assets. Both US-led and EU-led managers have been tilting towards the US recently because of the higher returns. Money flows according to offer and demand for capital and can only be directed to certain areas temporarily. The EU has valuable industries and companies, but to attract investment these companies must remain competitive and have the ability to grow, without being burdened by over-regulation.

A policy-maker observed that, despite the declining market share of European asset managers, there is a strong foundation in place with UCITS and the Alternative Investment Fund Managers Directive (AIFMD) directives to drive the sector forward. Other developments and challenges ahead include the shortening of the settlement cycle to T+1 and the need to stay internationally competitive. An industry speaker stressed that any potential reforms to UCITS should be assessed very cautiously to preserve UCITS' status as a gold standard in the asset management sector.

A regulator stated that, in terms of further harmonisation of rules and supervisory coordination, there are already effective mechanisms in place in Europe, such as common supervisory actions and peer reviews. These have worked well during recent crises and have allowed European regulators and supervisors to react quickly and in a coordinated way.

3. Policy priorities for the next political cycle

3.1. Leveraging the role of asset management to finance the European economy

Several panellists highlighted the role of asset management in the Capital Markets Union (CMU) initiative and the potential of the European asset management industry to increase investment in EU capital markets and support the EU's long-term financing needs.

A policy-maker stated that the main objectives of the CMU are to turn savings into productive investment while ensuring that retail investors get adequate returns from their investments and that companies can access the capital they need to grow. Asset managers have a significant role to play in achieving these objectives, however the sector must remain competitive. Following the review of the AIFMD and ELTIF frameworks and the introduction of rules for loan origination funds, the Commission is planning to review the European venture capital funds framework. There is also a need to reflect on broader measures to improve access to market-based funding for innovative companies in the EU, which face too many obstacles to raise capital for their future growth compared to US peers.

An official suggested that the CMU may be close to a turning point. Much progress has been made in improving the capital markets framework, with a number of key reforms such as the AIFMD, UCITS, ELTIF and MiFIR reviews now in the implementation phase. There is strong political momentum around the CMU, following the publication of a series of reports on the future steps of the CMU and the Letta and Draghi reports. The Eurogroup, the European Finance Committee (EFC), the Financial Services Committee (FSC) and ESMA have also been working on proposals to strengthen the CMU. Building trust between policymakers, regulators, industry and investors is also essential to encourage more investment in capital markets and to achieve the objectives of the CMU, as long-standing habits need to be changed.

An industry representative agreed that the CMU might be at an inflection point, given the strong momentum surrounding the project. The MiFIR review, in particular, which seeks to enhance transparency in European capital markets, is expected to have a substantial impact by facilitating best execution and reinforcing investor confidence in European markets.

3.2. Encouraging European households to engage in the capital markets

An industry representative stated that European citizens have too much of their savings in low-yielding savings accounts. Encouraging more retail investment into the capital markets must be a key objective of future policy work at the European level. A policy-maker agreed that a greater proportion of the savings of European citizens needs to be invested in the real economy and noted that the Commission is reflecting on further measures to boost retail participation in EU capital markets.

An official concurred that there is a significant reservoir of household savings to be tapped in order to develop capital markets, but this requires changing the current habits of savers. To encourage investors to become more involved in the capital markets, it is necessary to increase financial literacy and also to help savers gain practical experience in investing. One of the proposals put forward in the recent report from Christian Noyer on the CMU[1], namely the creation of a product label based on common criteria at European level, could contribute to this. This label would identify investment products within existing ranges that are likely to support long-term retail investment and invest predominantly in European assets, in return for favourable tax treatment in their home country. This type of instrument could encourage retail investors to invest more in capital markets and gain investor experience. In the current fragmented policy landscape, a common approach to tax incentives, building on existing product offerings, seems more likely to be adopted. It could also be more sustainable over time, which would also help to attract retail investors.

A second industry representative suggested that moving more savings towards investment in the capital markets requires a cultural shift as well as education. People must get more comfortable and knowledgeable about investing. Ease of access to investing is also important for retail investors. ETFs can play a significant role in this regard, as they are a simpler product. This is the way the market is evolving in the US, where passive products have now overtaken active ones, and Europe is also starting to follow that trend. Increasing the access of retail investors to private markets and implementing auto-enrolment strategies, in particular for Pillar 2 pension schemes, are further opportunities to consider. Retail investors also need to have confidence in the market. That starts with investor protection, which is not necessarily about having more rules but about having clear and consistent rules. There is also the need for fair and orderly markets across the EU, which the MiFIR review measures should contribute to achieve.

A third industry representative stated that around €700 billion of additional investment is required each year to finance the green and digital transitions in Europe. The growing trend of passive investment with ETFs has positive aspects but also has some downsides, notably as regards the allocation of savings towards the financing of the European economy. For instance, it is important to realise that the MSCI World Index is investing more than 70% of portfolios in US equities, which is higher than the share of the US stock market in terms of global market capitalisation, which is around 40%. This is why the French Finance Ministry's report on the future steps of CMU proposes a harmonised European product label that includes tax incentives for products investing predominantly in European assets.

1. Proposals for a Savings and Investments Union – Developing European capital markets to finance the future – Report drafted by a committee of experts chaired by Christian Noyer April 2024.

3.3. Enhancing supervision at the EU level

An official observed that in several reports published on the future steps of CMU, and also in the Letta and Draghi reports, the enhancement of EU-level supervision is considered as a key priority to further integrate the EU capital market, promote a single rulebook and increase efficiency. The present supervisory set up is quite costly for global and European players operating across the EU, and also consumes a great deal of time, money and resources on the supervisory side.

An industry representative stated that moving towards pan-European single supervision must not be seen as a solution to all CMU problems. The result might be a single supervisor with multiple supervisors below, and the persistence of fragmented regulations, if there is insufficient power at the European level and ability to align regulations and supervisory approaches. To make this change, a shared understanding among European stakeholders of the goals that are aimed for and sufficient trust that they may be achieved are needed.

3.4. Focus on value for customer rather than costs

An industry representative recommended that in the context of the RIS, European policymakers think in terms of value for investors and not just price or costs. In the UK there have been some policy missteps. A charge cap was imposed on defined contribution pension plans. This immediately priced all future defined contribution master trusts to the cheapest, which is not necessarily what brings most value to customers. The active managers that continue to grow in Europe are those that provide investors with sufficient value. It is also important to be aware of the unintended consequences of regulation. In the UK, the retail distribution review (RDR), which was implemented in December 2012, aiming to set new standards in the distribution of retail financial services products and clarify the advice market, has led to roughly 85% of UK citizens getting no financial advice at all. Access to advice must be preserved, as it is essential to encourage savers to invest and help them meet their long-term financial goals.

Another industry representative agreed that the RIS approach should not put at risk the ability for retail investors to continue to benefit from appropriate advice. Some reports on CMU have suggested promoting simpler products or creating a new EU label for simple products. However, the most valuable and appropriate products for customers are not necessarily the simplest. It would be better for them to be advised on the best products to invest in. Price controls should also be avoided in the value for money measures of the RIS. Competition and transparency are more effective tools for achieving this objective. Tax incentives should also be improved to encourage European savers, who are generally risk averse, to invest more in capital market products.

A policy-maker commented that it would have been good if active management and advice, as it is currently provided, had widely resulted in high net returns and value for money for EU consumers, but evidence of this is limited. It is important that customers are offered a wide range of products, including simple and less simple ones.

3.5. Prioritising the implementation of the measures adopted

An official stressed that as a new political cycle is about to begin in Europe, it is important for policy makers, regulators, market participants and other stakeholders to reflect on what has been achieved and to fine-tune the measures adopted before new policy proposals are made.

An industry representative agreed that it is important not to overburden the industry with many new regulations without first implementing those that have already been adopted. It is necessary to reflect and absorb what has been done and possibly improve existing rules before proposing new ones, in order to make steady progress without confusing market participants.

4. Addressing financial stability risks

An official stated that the EU fund sector has held up reasonably well in recent crises, but some new issues may emerge that need to be grappled with. Before developing new tools to mitigate risks, it is necessary to ensure that existing ones, which are already quite extensive, are used to the fullest extent. The efficiency of supervisory processes also matters. The Central Bank of Ireland, for example, has been quite proactive in this area and has intervened when needed, using tools such as article 25 of AIFMD to establish a specific macroprudential framework for property funds. Actions have also been led in combination with ESMA and some NCAs in the area of sterling denominated liability-driven investment (LDI). It is also important to avoid applying a one-size-fits-all approach to the non-bank financial institution (NBFI) sector, because that label covers many different products such as UCITS, money market funds and hedge funds that pose different risks and are regulated in different ways.

A regulator agreed that the primary focus should be on using existing tools in the most effective way. Access to liquidity management tools (LMTs) has been extended in the context of the AIFMD review. These tools have been used in the market for 20 years, but the CCSF has published in a recent paper on macroprudential measures that further guidance is needed for their use in terms of selection, notification, calibration and timing, and how to put them into operation. The main responsibility for activating these tools, as a general rule, should lie with the investment manager, and not with national or European-level supervisors. There could be instances during a systemic crisis where a different approach might be needed, but that should remain exceptional.

As part of the current review of the eligible assets directive, the regulator suggested a systematic review of liquidity at the asset level and to avoid a presumption of liquidity for some assets. It is also important to enhance the data on leverage. Ensuring effective data reporting at the right frequency with adequate reporting templates that are consistent across the EU is also essential.

A policy-maker emphasized that while there is a strong focus on competitiveness, financial stability is essential for a viable and trustworthy market. To support stability, the LMT toolbox has been enhanced and harmonised across the EU, and supervisory reporting has been strengthened.

Ongoing discussions focus on effectively identifying emerging vulnerabilities, monitoring systemic risks, and evaluating the adequacy of the macroprudential framework for NBFI, which includes investment funds. A targeted consultation on this topic is currently underway. The objective is not to revisit areas recently reviewed by co-legislators, as regulatory stability is important, but rather to pinpoint potential fragilities. Some specific areas demand attention. One is money market funds (MMFs), where significant work has been undertaken at the international level and key reforms have taken place in some non-EU markets. Another area are short-term asset markets that MMFs invest in, which may require targeted adjustments, although they are functioning relatively well.

5. Addressing the impacts of digitalisation and tokenisation

An industry representative noted that technology such as blockchain and AI present significant opportunities for the asset management sector. Industry must embrace technology to engage with customers more effectively, and digital solutions can help customers to understand the products they are investing in, the related risks and consumer protection measures. Technology can also support regulatory and supervisory approaches.

A regulator observed that tokenisation is progressing in the fund sector. Some firms are now tokenising assets and funds in order to reduce costs and add value for clients. From a regulatory perspective, tokenisation of funds is essentially the use of different technologies to perform the same activity. Regulators regulate activities, not the underlying technology, and act in a technology-neutral manner, so the same rules should apply regardless of how the activity is performed. However, a number of laws on blockchain and distributed ledger technology (DLT) have been enacted in Luxembourg to provide a regulatory and legal basis for the use of blockchain for financial activities. Guidance has also been provided by the CSSF, via a dedicated white paper, to help stakeholders identify risks associated with the use of blockchain and implement mitigation measures.

Digitalisation efforts should be industry-led, rather than driven by regulation, although regulators and supervisors can act in terms of risk mitigation and data standardisation. The Digital Operational Resilience Act (DORA), which is currently being implemented, addresses information and communication technology (ICT) risks. It requires ICT risks to be mapped and mandates ICT risk management and governance measures. Further regulation in this area does not appear necessary at this stage. In terms of standardisation, reporting is an area where improvements can be made to move towards common standards at the European level. Technology will also change the way supervision is conducted. It is becoming increasingly data-driven and supervisors need to keep pace with technological developments in this area.

An official agreed that technology regulation should be neutral and activity-based. It is, however, important to ensure that the regulation is also future-proof and can adapt to evolutions of the underlying technology.