EVENT REPORT

EUROPEAN CAPITAL MARKETS INSTITUTE

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The asset management industry has become the object of intense regulatory action in the past five years, with three objectives: safeguard financial stability, stimulate market-based finance and improve investor protection. The European Commission has been at the centre of this process, which it strives to complete before its current mandate ends. This ECMI Seminar will draw the balance between the different regulatory initiatives and discuss their progress with Tilman Lueder, Head of the Asset Management Unit at the European Commission. Among the questions this ECMI Seminar will consider:

- What are the main challenges in the process of EU and national implementation of the AIFMD (alternative investment fund managers directive)? Will it attract or divert fund management activities from Europe?
- Would an EU framework for less liquid funds bring added value to institutional investors? How would it sit within the AIFM and European venture capital frameworks?
- Will any actions follow on shadow banking? How should Europe regulate money market funds?
- Has there been enough ambition and progress on investor protection? What can the EU do to support the single market? Which future for UCITS after the recent consultation?

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Speakers

- Tilman Lueder, Head of Unit, Asset Management, European Commission
- Liam Butler, Head of Hedge Fund Services Europe, Northern Trust
- Simon Gleeson, Partner, Financial Markets Practice, Clifford Chance - London
- Thierry Blondeau, Regulatory Leader, Asset Management, PwC - Luxembourg
- Neil Sweeney, Global Head of Compliance, Aberdeen Asset Management

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Tilman Lueder presented an overview of the different dossiers that are currently pursued by the Asset Management Unit of the European Commission, some already at the implementation stage, while others sill in the legislative process or under consideration. On the main challenges to the implementation of the

AIFMD (alternative investment fund managers directive), Lueder highlighted the successful completion of the network of bilateral cooperation arrangements with third countries that the directive requires for the delegation of activities to non-EU undertakings, both by asset manager and depositary. ESMA (European Securities and Markets Authority) continues to prepare a uniform set of arrangements, which it will put forward to national authorities to sign. It is essential that all national authorities sign, to ensure uniform implementation of the framework and effective sharing of information for supervisory purposes. Failure to do so will in addition send the message to markets that the Union is not preparing for the introduction of the passport for non-EU managers foresee as a second stage in the implementation of the directive.

On the potential regulatory framework for less liquid investment funds, Lueder confirmed that a proposal would be put forward by the European Commission to the Parliament and Council before the end of 2013. The framework would sit distinctly outside the UCITS label and be administered by managers subject to the AIFMD with an additional layer of product rules and a straight forward passport. The purpose of the framework would be to facilitate access to less liquid asset classes under diversification by pooling both investments and expertise. The Commission has not yet decided whether (or on which terms), the funds would be accessible to retail investors but is certain that the redemption profile should be in line with the liquidity of the underlying. The evidence points that, even if retail investors would be excluded, at least in a first phase, small institutional investors would benefit from the pooling of investments and expertise, in a framework that should foster the quality and governance for these vehicles, generating confidence.

On the other dossiers at hand, Lueder explained that the Commission is still assessing any changes to the regulation of MMFs (money market funds), which strives to limit systemic risk derived from the unlimited sponsoring offered by some parent undertakings. On UCITS, the Commission will certainly pursue reform, following the recent consultation. It does not intend however to rush changes but to make sure that the new directive is made to last, while equipping the Commission and ESMA to respond to market changes. In this process, the Commission is particularly aware of the international relevance of UCITS outside the EU and is consulting third-country regulators. The proposal would not come before summer 2013 and may be delayed further in view of the 2014 elections to the European Parliament. These elections may also affect the enactment of the legislative proposal on key information documents (KID) for investment products, as no agreement has been found yet on the scope of the legislation (whether it should include also plain vanilla equities and bonds).

In considering the AIFMD and whether it will attract or divert fund management activities from Europe, **Liam Butler** agreed with Lueder that the July deadline for cooperation arrangements is indeed crucial to the success of the framework. Some managers are already interested in accessing the passport, as they see commercial potential but do not find yet sufficient regulatory certainty. Conversely, these uncertainty is bringing others to a 'wait and see' position. In this respect, activities would benefit from faster national implementation. In any case, compliance with the directive may lead some non-EU managers to abandon active marketing in Europe, as far as the size of their activities would not make it economical to comply, for instance on remuneration and custody. The cost of depositary services under the AIFMD is not clear as many firms have not yet disclosed the incremental fees for the additional oversight functions they will be required to perform. Whether the strict liability standard and reversal of the burden of proof will lead similarly to higher fees remains to be seen too. Competition may lead depositaries to internalise costs, at least partially. According to the European Commission, a monitoring exercise of depositary fees prior to the introduction of the AIFMD, found that fees were not linked to the standard of liability applicable in any given jurisdiction.

In considering the potential framework for less liquid funds, **Simon Gleeson** reflected on the diminishing role of public markets as a net source of gross new investment by companies and increasing relevance of private equity and unlisted vehicles/instruments for innovation and gross capital formation. A framework for less liquid investment funds could help instrument these changes. An EU label could foster confidence among investors and contribute to the success of the framework. It should ensure expertise, governance and diversification but minimise the compliance burden, so as to maximise its attractiveness.

With respect to upcoming legislative action on money market funds (MMFs) **Thierry Blondeau** cautioned against regulatory action that could drive funding away from money market funds into bank deposits, and recalled the experience in Cyprus. It observed that additional regulation for MMFs is nevertheless needed, at least to require additional diversification. Mr. Blondeau explained that the vast majority of stable NAV (net asset value) MMFs in Europe are UCITS and purchased by institutional investors and that awareness about the absence of guarantees in MMFs has much increased since the 2008 financial crisis.

On whether there is enough ambition on investor protection at EU level, **Neil Sweeney** argued that there is far too much ambition regarding product structuring rules while probably too little in the sale process, even though most problems arise at the latter stage. He observed that access to appropriate investment solutions on an execution-only basis (without investment advice) is needed by a large share of investors who cannot afford the cost of professional and impartial advice. In order to preserve the single market, common rules are needed and ESMA should be given a more prominent role going forward. There should also be more certainty and uniformity regarding taxation. On transparency, Mr. Sweeney argued against placing too much emphasis on disclosure of fairly remote risks at the expense of more frequent ones.

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