The investment fund industry
The latest trends in a dynamic market

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Mathieu Maurier, Country Manager for Societe Generale Securities Services (SGSS) in Luxembourg since 1 September, looks at a number of issues currently facing the asset management industry.

UCITS is still unassailable

Few fund structures are held in such high esteem as the UCITS—a product that helped augment Luxembourg's position as a leading European fund domicile and is widely purchased by retail and institutional investors worldwide. Harmonization has allowed the UCITS to flourish within the EU while its strong reputation for transparency and investor protection has seen it succeed on the global stage, acquiring a loyal following in Asia-Pacific and Latin America and turning the structure into a €10 trillion plus industry[1].

Unlike other products, which have struggled to stay competitive, the UCITS has effortlessly evolved in line with market and consumer trends and expectations over the last 30 years. Following growing investor demand for greater portfolio diversification, regulators responded with UCITS III, which expanded the list of eligible assets managers could trade by allowing firms to use derivatives, leverage, and synthetic short positions.

Meanwhile, post-crisis versions of UCITS addressed investor concerns about the asset management industry by imposing new protective and transparency measures: namely, reporting requirements in the form of the KIID (Key Investor Information Document) and a requirement for fund houses to appoint a depositary subject to strict liability for any loss of assets or financial instruments, bringing the rules into line with the AIFMD (Alternative Investment Fund Managers Directive).

Retaining the top spot

The UCITS is not indefatigable, however; it currently faces a number of challenges including the threat of rival passporting schemes emerging in Asia-Pacific and increased competition from low-cost index tracking funds. The framers of UCITS (and AIFMD) have also been criticized—despite repeated standardization efforts—for failing to prevent member state regulators from imposing additional requirements and surcharges on managers seeking authorization.

1. Efama (March 12, 2018) 2017 was an exceptional year for the European investment fund industry, with net assets of UCITS and AIF surpassing the EUR 15 trillion mark

Asset managers at the ALFI Global Distribution Conference in Luxembourg on 25 and 26 September said that gold-plating in individual markets was an impediment to cross-border distribution as it led to higher costs and heightened workloads, as evidenced by data showing that only one third of UCITS are registered for marketing in more than three EU countries.[2] Regulators have listened to the complaints and are making meaningful changes through the Capital Markets Union (CMU).

A proposal from the European Commission in the context of the CMU should homogenize member state marketing requirements, introduce consistency as regards how national competent authorities' fees are calculated, and scrap the requirement for managers to appoint local agents.[3] By streamlining the UCITS registration process, EU regulators hope to make it easier for managers to attract more capital from the cash-heavy retail market in Europe, where savings are suffering because of low interest rates.

Leading the way with new products

EU product innovation is not limited to UCITS and AIFs alone. Luxembourg has enjoyed spectacular success with the launch of its RAIF (Reserved Alternative Investment Funds) and this product is now a key focal point for Societe Generale. RAIFs are a blend of SIFs and SICARs but qualify as AIFs, which means that nearly any asset management strategy may be followed within the bounds of this structure.[4]

RAIFs do not require CSSF (Commission de Surveillance du Secteur Financier) authorization although this lack of supervision is offset by indirect oversight by the AIFM, depositary, and auditor—an arrangement that provides comfort to clients.[5] The flexible structure has facilitated growth, with EY calculating that 200 RAIFs have been launched since 2016,[6] while ALFI estimates that the new product accounts for approximately 5 percent of all AIFs by regulatory regime.[7]

The emergence of the PEPP

Another interesting product development—being instigated as part of the CMU—is the proposed PEPP (Pan-European Pension Product). This initiative seeks to enlarge the EU personal pension market following EC findings showing that just 27 percent of Europeans aged between 29 and 59 have subscribed to a pension product.[8] The PEPP program will promote competition among pension providers, thereby creating more choice for consumers and remedying the current regulatory disjointedness around personal pensions across the EU.[9]

The scheme has strong industry and consumer backing, with savers receptive to the idea that PEPPs will transcend national borders, while providers (banks, insurers, investment firms, asset managers, occupational pension funds) will reap commercial benefits if they become more active in the personal pension market.[10] Given that only 11 percent of EU households invest in funds—versus 43 percent in the US[11]—the PEPP could help consumers accumulate savings rather than remaining wedded to low-interest deposits.

ESG takes center stage

Investors—especially millennials—are increasingly choosing to invest with asset managers with proven ESG strategies and track records. ESG is integral to asset management and we have seen a shift towards sustainable investing at institutions, beginning firstly in the Nordic countries, and subsequently spreading to France, the UK, Switzerland, and Japan. ESG strategies are a key tool when it comes to attracting millennial investors, who will receive a large transfer of global wealth in the next few years.
As ESG is interpreted and applied differently across institutions, asset managers need to provide very bespoke solutions on a client-by-client basis. ESG investing has noticeably matured, moving beyond excluding unethical companies from portfolios to encompass active engagement whereby asset managers use their voting rights to reform shortcomings in corporate behavior and enhance sustainability standards.

The EU—through its Sustainable Finance Reforms—is also nudging asset managers towards ESG. While attitudes to ESG are famously diverse, the EC is looking to create a standardized definition. Creating fixed terminology for ESG would provide transparency to investors and simultaneously spare managers from having to fill out multiple ESG questionnaires from clients in different markets, all with conflicting views on sustainability.

Asset servicers can help managers with ESG. Depositary banks, for example, are increasingly developing services to ensure managers running ESG strategies are sticking to the terms of their investment mandates. Depositaries and trustees will also be able to support managers by providing investors with ESG reporting, which is another requirement contained in the EC's proposals. By embracing ESG, asset managers can broaden their market appeal to underserved younger investors looking to deploy capital.

Bringing distribution into the digital sphere

Attracting younger, more digitally savvy investors will also require major changes to distribution practices. Distribution has, until recently, remained somewhat resistant to digitalization, and this weakness means that the process of buying and selling fund units continues to be highly manual. However, disruptive technologies such as artificial intelligence (AI) and blockchain are being increasingly used in customer onboarding and KYC/AML checking, which has the potential to make distribution far more seamless.
In addition, the industry is giving serious consideration to robo-advisors, or automated investment platforms. This technology allows investors to select funds for their portfolios using smart devices, shaving off transaction costs and effectively disintermediating the traditional IFAs and wealth advisors. Robo-advisory is a fast-growing

market, having accumulated more than US$200 billion in assets,[12] chiefly because it provides a much easier path for tech-smart younger investors to buy funds.

Despite this, robo-advisors have a checkered performance record, with studies showing that the recommended products have failed to beat industry benchmarks.[13] Nonetheless, experts at ALFI say that more data is needed before people can reach a firm conclusion on the intrinsic worth of robo-advisors. Others also believe robo-advisors will pivot away from simply following an index towards more active management, in what would be a major development, and a potential challenge to existing fund managers.

Asset management in 2019

The UCITS—along with the fund domiciles that support it—is growing, buoyed by steady product innovation and solid regulation. ALFI, for example, estimates that the UCITS could enjoy a compound growth rate of 5 percent over the next three decades, potentially quadrupling its AUM to €42 trillion by 2048.[14] However, the asset management industry faces a number of challenges from technological disruption and Brexit over the next 12 months. The fund industry has no choice but to respond and evolve.

To the point :

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- Leading the way with new products: Luxembourg has enjoyed spectacular success with the launch of its RAIF
- PEPP: A product in the making: Another interesting product development is the proposed Pan-European Pension Product, an initiative designed to enlarge the EU personal pension market
- ESG becomes real: Capturing millennial investors can be done through ESG strategies
- Disruptive technology such as artificial intelligence, Blockchain, robo-advisors and automated investment platforms are being increasingly used in the industry

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