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Keynote Address
Future challenges for fund managers

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Ladies and Gentlemen,

I am very pleased to have been invited by AIMA to give a keynote speech at this event. I think this is an excellent opportunity to provide you with some thoughts on the outlook for the asset management sector from a supervisory perspective. Of course this comes at extremely challenging times for all of our lives and the challenges go well beyond the financial sector.

The events linked to the pandemic that spread across the globe since the beginning of this year are a game changer for most of us and it is crucial to reflect on the recent experience also from a more narrow regulatory perspective and specifically in the asset management sector. Steven Maijoor, the Chair of ESMA, has last week spoken about some of the lessons to be learned from the crisis. Giving attention to these topics should ,however, not come at the cost of neglecting other very important developments that are occurring in the asset management sector.

This is the reason why I will spend only a few words on the Covid-related events, looking at them from an ESMA perspective, and then move rapidly on to two other topics that I am conviced are also very important for the future of the asset management sector (and beyond): (i) delegation, in light of the looming end of the Brexit transitional period and (ii) sustainable finance.

Before I get to those important topics, I would like to share with you a couple of reflections on the Covid experience so far in the funds' sector, from an ESMA perspective. First, I would like to stress the substantive coordination efforts deployed by ESMA in order to ensure exchanges among national competent authorities (NCAs) across the EU on market developments and supervisory risks. This was done with a particular focus on liquidity issues in the asset management sector. Indeed, on one side we fostered exchanges among NCAs on the use of liquidity management tools (LMTs) which helped monitoring across the EU the overall situation in the sector. On the other side, we acted upon a recent recommendation from the European Systemic Risk Board (ESRB) and coordinated a focused supervisory exercise with investment funds exposed to less liquid asset classes (corporate debt and real estate assets) to assess their preparedness to potential future adverse shocks.

This leads me to the second point that I wanted to make on this topic. At this stage, what we saw is that overall the majority of the sector managed to maintain its activities adequately, while facing unprecedented pressure - last March in particular. This view is based, for instance, on the fact that the global amount of fund suspensions at EU level was quite modest back then. However, I should stress that there are also worrying signals. Certain segments of the EU MMF sector faced acute stress and – although the relevant funds did not suspend – they showed deficiencies that deserve further scrutiny. Morevover, the findings of the supervisory exercise that I mentioned a moment ago evidence that there are a number of shortcomings in the way liquidity is managed in certain segments of the asset management sector. This deserves further action: first and foremost by asset managers who need to promptly address any misalignement between their funds' investment strategies and redemption policies; secondly, by NCAs who need to keep monitoring and actively supervise the funds under their jurisdiction.

I will stop here on this topic on which Steven Maijoor already extensively spoke last week and for more detail on our work related to the ESRB recommendation that I referred to earlier, I invite you to read the report that we published last week[1]. I will now move to the two main themes that I announced earlier.

Delegation in asset management in light of the Brexit challenges

With just over one month to go until the end of the UK's transition out of the EU, I believe that it is important for me to give again some visibility and attention to some of our Brexit related activities. As of 1 January 2021, UK financial firms will no longer have unfettered access to the EU's single market. This is an inevitability and something that will not be affected by the ongoing trade deal negotiations. While this is certainly a big change, firms have now had four years since the UK referendum to prepare for this

[1] Available at : https://www.esma.europa.eu/sites/default/files/library/esma34-39-1119-report_on_the_esrb_recommendation_on_liquidity_risks_in_funds.pdf.

moment and we expect that all firms are now ready to face this new reality. On ESMA's side, we have been supporting the work of NCAs to get ready and undertaking EU level preparations.

For example, for the past three years we have been addressing supervisory convergence risks with respect to the treatment of authorisation requests by UK firms to EU27 NCAs in the context of the UK's withdrawal. With the large increase in relocations of asset managers, investment firms and trading venues from the UK to the EU, ESMA established a Supervisory Coordination Network (SCN). In this network, we discussed the relocation of firms, activities or functions into the EU, before actual authorisation decisions are taken by NCAs. Throughout these three years, we held discussions on 250 relocation cases. Doing this, I believe, really contributed to ensuring high levels of consistency in authorisation standards across the EU.

This network also supported the gathering of data that allowed ESMA to identify trends in the behaviour of relocating firms and contributed to raise awareness in NCAs on risks associated with the relocations. For example, ESMA observed that investment managers often make use of large-scale delegation arrangements and that Brexit will likely make delegation to non-EU entities more pronounced. I will speak more about this point shortly.

Finally, on Brexit, I would also like to highlight that over the past few years ESMA has been addressing, across the whole of its remit, the many challenges that have arisen linked to this momentous change. These have ranged from the recognition of UK CCPs to allow them to continue to provide clearing services for the duration of the 18 month equivalence decision, or making preparations for the transfer of supervisory responsibilities from ESMA to the UK FCA for certain Credit Ratings Agencies, Trade Repositories and Securitisation Repositories. I would specifically like to mention that ESMA has also recently clarified the scope of the EU Share Trading Obligation (STO) to minimise disruption for EU investment firms after the end of the transition period. We are happy to see that the UK FCA followed our statement on this, outlining their approach, which avoided overlapping EU-UK STO obligations and averted potentially adverse effects for market participants.

Moving to the AIFMD review, the European Commission's review comes at an important time for fund regulation in Europe, partly if not only due to the impact of Brexit. ESMA has gathered practical supervisory experience on the functioning of the AIFMD since it was first applied, and shared these experiences with the Commission in a letter we published in August.

We chose to devote particular attention to the area of delegation and substance requirements. The issues raised in our letter draw on previous ESMA work, in particular the 2017 ESMA Opinion to support supervisory convergence in the area of investment management in the context of the United Kingdom withdrawing from the EU ("Brexit Opinion"). We also issued Q&As on delegation and discussed in ESMA's SCN hundreds of Brexit-related relocation cases that I was referring to earlier. The objective of the clarifications we suggested in our AIFMD advice letter is to ensure that the key legal requirements on delegation and substance are clear and unambiguous.

I want to emphasise upfront that ESMA fully acknowledges the benefits of delegation in terms of enhancing efficiency and scale as well as getting access to more specialised investment expertise. We are therefore aware of the importance of delegation arrangements for the fund industry and the need to keep an open global model and avoid creating unnecessary barriers.

While acknowledging the benefits, we should also recognise the increased operational complexities and supervisory risks that come with large-scale delegation arrangements.

In this context, the existing AIFMD legal text already states that investment management functions delegated shall "not exceed by a substantial margin" the functions retained by the authorised AIFM. Given the key importance of this legal requirement, we have invited the European Commission to further specify this concept ("substantial margin") to ensure greater legal certainty for the sector and supervisory convergence amongst NCAs.

In our view it is important to ensure that entities that are authorised and supervised in the EU remain ultimately in charge of the key business functions and decisions. This also requires to implement and maintain sound governance and control mechanisms in the EU entity including rigorous due diligence and delegation monitoring processes.

To this end, it is important to emphasise that ESMA fully acknowledges that delegation is (and to our mind should remain) permitted under the AIFMD and UCITS rules. We are not asking for a complete overhaul of the AIFMD substance requirements but the clarification of the already existing legal text.

In addition to this, our letter emphasised the need to ensure that all AIFs are subject to consistent regulatory standards, irrespective of the regulatory status or location of the delegates. This is particularly important in case of delegation to non-EU entities which might be subject to different regulatory standards. We see merit in giving further consideration to this issue to ensure that AIF investors always benefit from the regulatory safeguards laid down in the AIFMD and that these safeguards are not lowered (and put at risk investor protection) through inappropriate use of delegation arrangements.

Finally, the UCITS element should not be forgotten here. Since the UCITS legal provisions on delegation are significantly less granular compared to the newer AIFMD rules, there would also be merit in giving further consideration to improving the consistency between the two regulatory frameworks that govern the fund sector. A stronger alignment would enhance investor protection for UCITS investors and reduce operational and legal complexity for market participants with dual licenses and also for NCAs in their supervisory activity.

This is the context within which we believe the Commission should clarify the rules in both AIFMD and the UCITS Directive.

As you will be aware, the Commission launched its public consultation in October seeking the views of stakeholders on how to ensure a more effective and efficient functioning of the EU alternative investment funds market. The consultation includes questions to stakeholders consistent with the matters addressed in the ESMA letter. Once this consultation process closes in January next year, it will be for the Commission to determine how to take this forward in light of the feedback received and to make the appropriate proposals for legislative amendments. We, at ESMA, will continue to work closely with the Commission during this time and stand ready to provide further advice based on the supervisory experience on the ground.

The ESG agenda

I would now like to move to the second main topic of my remarks today - sustainable finance, which is another key priority for both ESMA and the EU. The financial markets are evolving with investor preferences shifting towards sustainable financial products, and with sustainability factors increasingly affecting the risks, returns and value of investments.

As ESMA has competences cover the entire investment chain, it is in a unique position to support the growth of sustainable finance while contributing to investor protection, orderly and stable financial markets.

Sustainable finance is therefore a strategic priority for our organisation, reflected in the new, and reinforced, mandate to incorporate sustainability considerations into our activities, based formally on the revised ESMA Regulation, and as we have highlighted in our recent Strategy on Sustainable Finance.

For example, in the context of ESMA's risk analysis reporting in the Trends, Risks and Vulnerabilities (TRV) publication, we now also incorporates ESG indicators. Furthermore, future climate-related stress tests are planned.

We are also busy pursuing supervisory convergence of national practices, focusing on preventing greenwashing, misselling and fostering transparency and reliability of non-financial reporting. One important way ESMA pursues this supervisory convergence goal is by organising exchanges on supervisory practices among NCAs, where recently for example we have focused on ESG funds' authorisations.

The work that we have undertaken alongside our EBA and EIOPA colleagues, to deliver technical standards under the sustainable finance disclosure regulation (SFDR), therefore fits squarely into ESMA's commitment to sustainable finance. The aim of the disclosure regulation and of our technical standards is to combat green washing by ensuring that the increased demand for sustainable products is met by sound disclosures on how environmental or social characterstics are achieved in practice by a particular product.

Furthermore, the introduction of rules for financial firms to disclose principal adverse sustainability impacts of their investment decisions is a ground-breaking transparency initiative at European level.

We were pleased that so many organisations, including AIMA, responded to our consultation paper on draft technical standards. It is clear that the adverse impact reporting framework in particular generated significant reactions. Here I would like to stress that we remain committed to delivering a framework for adverse impact reporting that is meaningful and comparable.

The indicators for adverse impact that we developed in the consultation paper were designed to underpin the rigorous reporting envisaged by the Level 1 text. However, we have taken note of the substantive feedback we have received, in particular with regard to data availability. We will be revising the technical standards to take this into account. Stakeholders particularly commented on the number and type of indicators for principal adverse impact. While many industry representatives argued that the consultation paper contained too many indicators, the ESAs' approach was supported by NGOs. Unfortuately, our job has not been made easier by the fact that there were widely varying suggestions from stakeholders on which indicators to emphasise. We are currently reflecting on all the feedback received.

We are also grateful for the responses we received to the separate survey on product templates – the technical feedback will help the ESAs conduct appropriate calibrations to the technical standards and templates. To respond to some of the commentary on the templates, it is important to remember that we are trying to design a set of disclosures that have to cover very different types of products and have to be included in various underlying disclosure documents. This means that we have to try to strike a balance between comprehensibility and comprehensiveness of the disclosures. In brief, the disclosures you would want to design for inclusion in a PEPP KID would look very different to the disclosures that you would design to be part of a fund prospectus.

The final report by the ESAs is due by the end of January 2021. As is well known by now, the application date of the technical standards under the disclosure regulation will be delayed, but the obligations stemming from the Level 1 regulation must be applied according to the original schedule starting from 10 March 2021. The timely application of the Level 1 regulation is necessary due to the urgency of addressing climate change disclosures in the financial sector. We very much appreciate the operational challenges of the application of the provisions without the accompanying technical standards fully in place. We hope to be able to communicate shortly on the exact date of the application of the technical standards and on what the supervisory expecations will be in the “interim” period.

The ESAs are also aiming to launch a consultation paper in January 2021 on additional taxonomy-related product disclosures stemming from empowerment given to the ESAs by the Taxonomy Regulation. This consultation paper will seek feedback on proposed transparency rules for how taxonomy-related products must disclose their taxonomy alignment.

So as you can see, ESMA is actively committed to play its role in sustainable finance, both by working on the technical disclosure rules and by integrating sustainability in our risk analysis and supervisory convergence work.

Conclusion

Ladies and Gentlemen, the two main areas that I touched upon in my intervention today evidence I think how challenging the times ahead are for all of us (regulators, industry and wider investors’ community). This is even more true when being conscious that these challenges have to be faced while in the immediate future we still have limited visibility on whether and when the pandemic will fade away.

However, I believe that we have no other choice but to face these challenges head-on. And tackling these issues in the right way also provides new opportunities, both to enhance investor protection across the EU and more generally to support and promote sustainablility, which is so important for all of us around the globe.

Thank you for your attention.