EFAMA

European Fund and Asset Management Association

CHALLENGES FOR INVESTORS AND THE INVESTMENT FUND INDUSTRY IN EUROPE

Keynote Speech by

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Thank you for the very kind introduction and for the privilege of delivering a keynote speech at this prestigious event organized by the CMVM.

I am most grateful for the opportunity to share with you some of our views on the challenges faced by investors and the investment fund industry in Europe.

Today I would like to focus on three main challenges:

1. Firstly, the challenge of increasing retail participation in capital markets
2. Secondly, contributing to the transition towards a more sustainable economy
3. And finally, maintaining the UCITS Directive & AIFMD as globally recognized gold standards

As is so often the case, with challenges come opportunities - and it is important that the public and private sectors work hand in hand to address these challenges and seize the opportunities that arise from them.

So let me start with the first of these three challenges:

Increasing household participation in Capital Markets

It is commonly accepted that the European financial system is still very much “bank-based”, as opposed to “market-based”.

This is reflected in the structure of the financial position of European households, who keep a large share of their financial wealth in bank deposits. At the end of 2019, this share was 37.5%, or 11.6 trillion euros.

This is a huge amount and is one of the reasons which explains the important role banks play in the funding of companies and in the financing of government debt.

We all understand the benefits of more developed capital markets when it comes to the access to finance, risk transfer, monetary policy transmission and investment opportunities, and we probably all support the Capital Markets Union initiative of the European Commission. We certainly do.

But there is one thing that gives us a real cause for concern. And that is, while many people do manage to save for their old days, their assets by and large sit in bank deposits. This comes with a huge opportunity cost and may also give rise to potential social unrest in the future given the difficulties that an increasing number of people are expected to have to make end meets once they are retired. A real pensions time bomb.

EFAMA has made some calculations to illustrate the opportunity cost associated with having too much of your savings sitting in bank deposits.

During the 2008-2019 period, European households saved an additional 4.1 trillion euros in bank deposits. Now, if they had saved only one half of that amount in deposits, and invested the other half in an equal mix of equity and bond funds over that same period, that original 4.1 trillion figure would have been a staggering 1.2 trillion euros higher by the end of last year.

In its recently published revised CMU Action Plan, the European Commission recognizes this problem and the absolute necessity to foster increased retail participation in capital markets. Not surprisingly, the report from the High-Level Forum on CMU had arrived at the same conclusion.

We fully support the HLF recommendations and the renewed Commission's efforts to address the problem. However, we believe that those efforts will not be effective unless Member States also take appropriate measures at national level.

Simply put: There is an inherent limit to what can be achieved at EU level when it comes to getting households to invest more of their savings into markets. A lot more needs to be done at national level, and by the Member States themselves. In a report we published in early September, we analysed the investment behaviour of households across 25 European countries.

The analysis highlights huge discrepancies between countries.

For instance, in four countries (the Netherlands, Denmark, Sweden and the UK), households are holding less than 30% of their financial wealth in deposits, while it is more than 70% in three other countries (Greece, Cyprus and Bulgaria). In Portugal, the share of deposits in household financial wealth (excluding unlisted shares) was 64% last year.

Also, the vast majority of EU households do not invest in capital market instruments. In Portugal, according to the latest ECB Household Consumption and Finance Survey, only 4 percent of the population directly owns listed shares and only 2 percent of the population directly owns investment funds.

A number of drivers can explain why so few EU citizens invest in capital market instruments. This includes risk aversion, lack of financial literacy, preference for real estate investments and the perceived generosity of the existing welfare systems.

Against this backdrop, EFAMA has made several policy recommendations to the European Commission, which focus on financial literacy, pension policies and tax incentives, Admittedly, these are three areas for which Member States have more competence than the EU.

I can only encourage you to read our report which you will find on our website Time does not allow me to present all our recommendations. For this, I will highlight just three of them:

1. Our recommendation that Member States promote auto-enrolment for occupational pensions and grant the pan-European Personal Pension Product (PEPP) the same tax relief as is granted to national personal pension products;

2. Our recommendation that Member States ensure that their taxation regimes do not treat investment products as less suitable long-term savings products for retail investors compared to capital-guaranteed insurance products; and that they see to it that households understand that nominal guaranteed products offer no protection against inflation.

3. And, our invitation to the European Commission to use KPIs to measure progress made at national level and to incentivise Member States to take actions to support the future financial well-being of their citizens. To that end, we are proposing a specific KPI to assess the progress made in fostering retail investments in capital markets.

I referred earlier to the new CMU Action Plan of the Commission. We are supportive of the 16 high-level actions included in the Plan, including the Commission's objective of making the EU an even safer place for individuals to save and invest for the long term. For that to happen however, we need to empower citizens to make adequate, well-informed, investment decisions. And this requires an improvement in the

quality and consistency of disclosures to retail clients. The obvious starting point for doing this is to fix the well-documented flaws of the Key Information Document of the PRIIP Regulation.

While I am ordinarily full of praise for the work of the EU institutions, this endless PRIIPs saga is reflecting extremely poorly on the EU institutions. The UCITS KIID is well functioning and it is critical to ensure that the flaws of the PRIIPs KID are remedied before it applies to UCITS on the first of January 2022. The clock is ticking. We are calling for an urgent review of the PRIPPs level 1 text and an extension of the UCITS exemption until such a time as this review is completed.

The second challenge I would like to focus on this morning is the necessity to contribute to the transition towards a much more sustainable economy.

European institutions and the financial sector both share the same urge for ambitious and effective policies to promote sustainable growth, and for an inclusive economic recovery.

Asset managers play a fundamental role in accelerating the transition towards a more sustainable economy.

In addition to channelling funds towards environmentally and socially sustainable projects and holding investee companies to account, asset managers continue to drive a fast pace of innovation in the development of new products and strategies for ESG investment.

The demand for such products is ever increasing, and green finance is definitively becoming mainstream.

European institutions have been proactive in addressing sustainability challenges and have developed a detailed regulatory framework that we hope will set the standard for other jurisdictions to follow.

From the start, the investment management industry has been fully committed to the objectives of the Sustainable Finance agenda.

Taken together, the initiatives stemming from the 2018 action plan have the potential to

- reorient capital flows towards sustainable investment
- address the risks from environmental and social issues; and
- foster transparency and long-termism in the financial industry.

However, many of these proposals were developed in parallel and some inconsistencies and gaps have since emerged.

To succeed, it is essential to make the new rules work in practice, in a well-sequenced, consistent, and coordinated manner.

There is also a strong need for better disclosures from investee companies. The insufficient availability of meaningful, reliable, comparable, and public ESG data is an impediment to the realisation of the full potential of sustainable finance.

Initiatives such as the review of the Non-Financial Reporting Directive, or the disclosures requirements under the EU Taxonomy Regulation, will help narrow the ESG data gap that currently limits the development of sustainable finance.

The initiative to establish an EU Single Access point, as part of the new action plan on CMU, is also a welcome development and one that EFAMA has long been advocating. It will provide investors with

seamless access to the relevant financial and sustainability-related information from investee companies. It also has the potential to address the failures in today's market for ESG data.

Other initiatives to harmonise standards and labels might also help reduce fragmentation across Member States, while helping clients in their investment choices. This is the aim of the EU Ecolabel for retail financial products. It is important, however, that the criteria set by the Commission strike the right balance between the strictness of the label's criteria, that give it credibility, and ensuring a sufficiently large pool of eligible investment opportunities, to allow for diversification and protect investors' savings.

The new set of transparency requirements are also a fine balancing act. Next year, asset managers will start disclosing information on how they integrate sustainability risks in their investment decision-making, and how these decisions affect sustainability factors.

These rules are a cornerstone of the EU Sustainable Finance framework. They are intended to:

- enhance comparability and trust for end-investors;
- hold market participants accountable; and
- avoid greenwashing.

These are all objectives that we fully support.

However, to achieve these objectives, the information provided must be clear, comparable. And, and again it must be backed by solid and reliable data coming from investee companies.

The industry is advocating for a phased approach to disclosure requirements, looking to ensure the flexibility needed to implement the new set of rules gradually and effectively. Regulators need to maintain a realistic and pragmatic approach. It is in everyone's interest to ensure that the proposed rules deliver on their objectives.

It is also important to encourage governments to do their part, which includes the issuing of sovereign green bonds. Many EU member states have yet to do this. This step is important not only to green the economy and to finance infrastructure projects but also for institutional investors who need access to a broader green bond investment universe.

We hope that the Renewed Sustainable Finance Strategy, due in November, will aim to address some of these points and will represent a new leap forward to strengthen Europe's leadership in this field.

Let me turn now to my third and last challenge which is to preserve the conditions that have led to the recognition of UCITS & AIFMD as globally recognised standards.

The UCITS and AIFMD regimes are among the EU's greatest successes in financial services regulation. These two directives, combined, regulate asset management activities very comprehensively, while allowing managers the flexibility and freedom to manage funds in the best interest of their clients, and to take advantage of investment opportunities and innovations.

This applies especially to UCITS. Since 1985, the regime has undergone numerous adaptations, enhancing the comprehensiveness of its rules, but also contributing to its world-wide success as an investment product distributed globally. The latest of these was concluded as recently as June last year, promising to remove existing cross-border barriers to fund distribution within the EU.

As you know a number of reviews are expected to come our way in the near future, including AIFMD, UCITS and ELTIFs .

The AIFMD review is expected next year, and the Commission's consultation is actually due in a few weeks. We share the Commission's stance that AIFMD represents a significant pillar of CMU and has created an internal market for AIFs, by reinforcing the regulatory and supervisory framework for managers of alternative funds in the EU. AIF managers are now operating with greater transparency for supervisors and investors alike, helping building confidence and trust in financial markets.

While further improvements can be made in terms of reporting, to help monitor and mitigate macro-risks which may stem from the activities of AIF managers, we favour an approach that would deliver synergies, and allow supervisory authorities to access funds' reporting which is already being provided to central banks. We therefore see no need for a complete overhaul of an already comprehensive reporting regime.

The continued success of UCITS and AIFs should not be taken for granted, in light of developments in some third country jurisdictions.

And yet this continued success is a *sine qua non* for the further development of the Capital Markets Union and indeed for the participation of our industry in the post Covid-19 European economic recovery. Every effort should therefore be made to maintain the UCITS Directive and AIFMD as gold standards. This can be achieved by understanding what the key success factors have been and by ensuring that they remain intact.

One such factor is undoubtedly the delegation model.

For decades, asset managers have relied on the best expertise available to manage their portfolios in the interest of their investors. For a global industry like ours, it is imperative for portfolio management to be able to continue to be carried out from non-EU jurisdictions, allowing portfolio managers to be in the local market, close to local market supervisors, and to participate in the corporate affairs of investee companies there registered, so as to offer the best possible investment outcome for their investors. Any attempt to restrict the outsourcing of portfolio management functions to entities based in non-EU domiciles, along with many other critical functions in a management company's value chain, risks jeopardising current delegation practices beyond repair.

To counter any possible shortcomings in the way delegation agreements are currently authorised and monitored, we would advise against a full-fledged and likely disproportionate legislative review. Instead, we would recommend that ESMA makes full use of the tools it now has at its disposal.

I would have liked to conclude my address with a positive reference on the very strong resilience of our industry in light of the recent Covid-induced market stress but by now I am probably completely over-running.

I shall therefore stop here knowing that I will anyway take part in the *"Financial stability and the capital markets"* panel discussion this afternoon.

I would like to thank again the CMVM for this kind invitation and I would also like to congratulate Gabriela Figuereido Dias on her recent re-appointment as Chair of ESMA's Investment Management Standing Committee. She really has been doing a fantastic job in that capacity.

We very much look forward to engaging with the upcoming Portuguese Presidency of the Council of the EU and wish Portuguese authorities every success in that important role.

Thank you for your attention.