FUND FORUM TRADE TALK: Europe question time

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How will Ucits V affect the fund industry? Will emerging market assets rebound? And what asset classes have gained the most inflows this year? **George Mitton** asks the experts.

ASSOCIATION OF THE LUXEMBOURG FUND INDUSTRY (Alfi)
Anouk Agnes, deputy director general

What must Luxembourg do to maintain its position as the leading fund domicile in Europe?
It requires a collective effort by all industry stakeholders. Because fund managers and service providers are sensitive to costs, we have to watch our competitiveness. Finding ways to improve the efficiency of the approval process to allow a high level of agility and to reduce the time to market is an important element. We have to continue to adapt fast to new trends and keep innovating. Finally, we strive to more actively promote our ability to service the most complex products and the most demanding investors and fund managers, be they domiciled in Luxembourg or abroad.

What are the important aspects of the Ucits V rules?
It will significantly increase the protection enjoyed by Ucits investors. They are a key step towards restoring investor confidence in the wake of the financial crisis. The key provisions of Ucits V are: Ucits management companies will be required to establish remuneration policies that are consistent with sound and effective risk management; new rules relating to depositaries concerning liability, delegation and entities eligible to act as depositaries; harmonisation of administrative sanctions.

What are the Markets in Financial Instruments Directive (Mifid) II issues that still must agreed?
Mifid has helped shape the global European investor protection framework while ensuring choice and access to the best products. However, there are issues, in particular implementing rules on inducements and the interpretation of “independent advice”, or the review of the definition of complex instruments. The industry will have to assess how to reorganise distribution and product structuring.

BNP PARIBAS INVESTMENT PARTNERS
William de Vijlders vice chairman
Marnix Arickx, senior project manager

What asset classes have gained the most inflows this year and which products will continue to succeed?
Equities have been very popular, as well as credits. We expect this to continue: the quest for yield continues unabated and business cycle risk as well as systemic risk are low, paving the way for investors to take more risk. Monetary policy will continue to be supportive for risky assets. Moreover, equities will benefit from faster earnings growth.

Are emerging market assets due for a rebound or will they continue to suffer from investors having a low risk appetite?
After the turmoil caused last year by the tapering debate, emerging debt took quite a while to recover, but recently a mix of better fundamentals in some countries, Fed dovishness and an ongoing search for yield have seen this asset class make a comeback.
On emerging equities the picture is nuanced with some countries doing very well in recent months for domestic reasons (India, Indonesia, Brazil, Turkey to name a few) and others lagging behind. This shows emerging equities have become a heterogeneous asset class where country picking is important.

What are the main implications of the newly passed Ucits V directive?
We have found ourselves in a strange world where alternative investment funds have better consumer protection than Ucits funds. Ucits V aims to rectify this situation, all other changes being pushed back to Ucits VI. The most important upgrade to Ucits is the increased depository responsibility including a restitution obligation and extensive monitoring tasks. This will imply a significant workload for the depositaries, and for asset managers, which will have to set up new operational flows. The second key topic is remuneration. The main issue lies not so much in the rules themselves, but in the complexity of managing many different rules within the various regulations such as the AIFMD, CRD and various local laws.

JP MORGAN ASSET MANAGEMENT
Massimo Greco, head of european funds

Are emerging market assets due for a rebound?
Caution about emerging markets is merited – cheap assets can always get cheaper, after all – but we are seeing money returning to emerging markets, and there are more positive catalysts recently, such as the Indian elections. If history is any guide, long-term investors should be accumulating emerging markets exposure at these valuation levels. When price-to-book values have fallen below 1.5 times, the MSCI Emerging Markets Index has historically registered double-digit returns over the following 12 months.

What are the most important aspects of the Ucits V rules passed by European Parliament?
Ucits V is an important development in investor protection, but it doesn't have a significant practical impact on distribution across Europe. The scope of Ucits V is relatively narrow in that it focuses mainly on new custody and depositary rules. In particular, it seeks to play "catch-up" with the AIFMD, which sets out relatively high and tough requirements around custody. It closes the gap and creates a more level playing field between alternative funds and retail funds.

What asset classes have gained the most inflows this year and which products will continue to succeed?
We continue to see growing demand among our clients for so-called outcome orientated funds to answer specific client needs, such as income. Income solutions products were a major theme last year and that continues. We are also seeing significant beta related and asset allocation related flows into European equity products where clients had previously been holding underweight positions. In the fixed income area, clients are positioning for rising interest rate risk, increasingly looking for flexible strategies. In particular, we are seeing activity in absolute return funds and in global unconstrained bond funds.

SOCIETE GENERALE SECURITIES SERVICES
Bruno Prigent, global head

What themes will generate the most discussion?
The Foreign Account Tax Compliance Act (Fatca) and European Market Infrastructure Regulation (Emir) will be top of the "hot topics" list. Effective on July 1, Fatca will impact the entire industry and require costs with no added value for clients. As for Emir, European Securities and Markets Authority (Esma) will be proposing draft regulatory technical standards on the clearing obligation and we are sampling our first experiences on trade repository obligations and exchanges with central counterparty clearing houses.

What are the main issues that must be agreed with regard to MiFID II? What are points of tension?
Mifid II/Markets in Financial Instruments Regulation reform represents the cornerstone in the biggest overhaul of financial markets regulation in the EU. The main affects, which will be addressed through the current Esma consultation, are about banning inducements, independent advice, telephone record-keeping, reporting, suitability and appropriateness assessments, product governance as well as all requirements on pre and post-trade transparency and market architecture**.**

Has the industry implemented the AIFMD?
Work remains to be done with some European countries still working to transpose the directive into national law. Discussions are also in progress with regulatory authorities to clarify some of the information required in the regulatory reports that we will be producing on behalf of our clients. As the impact of AIFMD on our clients is quite broad, one of our main challenges has been applying the regulation to the various client types that fall within the directive's scope. As a depositary, keeping up with the reporting schedule may prove to be an arduous task. We are trying to adapt to our clients' pace of business yet ensuring full compliance by July 22.

CITI
Sanjiv Sawhney, head of global custody and alternative investor services

What themes will generate the most heated discussion?
One trend is the ongoing interest in alternative Ucits, given demands for transparency and liquidity, as well as some uncertainty on the implementation of the AIFMD. However, we may see a re-balance of flows out of these Ucits toward the end of the year as the private fund rules become more settled. Another area of focus is the ongoing organisational changes reshaping on the buy-side against the background of increasingly complex collateral and clearing requirements.

What are the most important aspects of the Ucits V rules recently passed by the European Parliament?
The rules aim to align the obligations of depositaries to a Ucits to depositaries of alternative investment funds. Notable recent developments include the extension of Ucits depositary eligibility criteria beyond credit institutions and Mifid firms as provided for in earlier drafts. The rules also aim to align the remuneration obligations imposed on alternative investment fund managers (AIFMs) to managers of Ucits.
Of significant importance is the reference in the recitals to the application of the remuneration policies and practices to third parties. Finally, the rules aim to harmonise regulatory sanctions across member states, including the provision of detailed lists of breaches of Ucits requirements that will fall subject to regulatory sanction, and lists of sanctions that may be applied.

Has the industry implemented the AIFMD?
There are still a few outstanding items, mostly related to remuneration and marketing. On remuneration, regulators in the UK and Malta issued clear guidelines while other EU regulators are still formulating responses. On marketing, managers with EU domiciled funds will have access to a marketing passport, enabling them to sell across the EU. However, managers with funds domiciled outside the EU will have to navigate the remaining national private placement regimes.

CLEARSTREAM
Bernard Tancré, executive director and head of business solutions, investment fund services

What themes will generate heated discussion?
Upcoming financial industry regulations, such as the AIFMD or Ucits V, will be key topics at this year's conference. The AIFMD has, for example, increased the reporting burden on hedge funds. It will force them to focus on greater efficiency and transparency to comply with new rules on risk mitigation. The ambition of the European Central Bank to extend the scope of Target2-Securities to cover the settlement of mutual fund transactions might also generate discussions.

What are the Mifid II issues that still must agreed?
Mifid II enhances competition in the provision of investment services and strengthens market integrity and transparency. It also introduces organised trading facilities to the Mifid framework, while the original directive only covered regulated markets and multilateral trading facilities. In addition, Mifid II will impose new safeguards for algorithmic and high-frequency

trading activity and additional and reinforced powers of supervision of derivatives markets. Finally, there will be stricter requirements for portfolio management, investment advice and other investor protections.

Has the industry implemented the AIFMD or is there still more work to be done?
It took the industry a while to realise that the AIFMD does not concern hedge fund managers only, but affects all fund managers running non-Ucits funds. We have seen differing levels of preparedness. As the AIFMD will enter into force on July 22, 2014, market players should act now to ensure compliance. The challenge for depositary banks will be to provide a general oversight of the fund's investment activities to keep custody risk in a certain market or a sub-custodian under control. Clearstream has recently launched its domestic markets monitoring report, a first step to increase transparency in the custody chain and help our depositary bank customers comply with the AIFMD.

SWIFT
Olivier Lens, head of funds, Europe, Middle East and Africa

What must the funds industry do to be more efficient?
When it comes to funds order processing, the industry has made great strides towards improving operational efficiency. There is more to do, to eliminate the fax and replace the use of non-standard electronic means of communication with Iso standard communication to facilitate industry-wide operational efficiency, but we are on the right track. The next frontier is to extend automation based on standardised communication to the rest of the flows that make up the lifecycle of a fund transaction – from corporate actions to transfers and beyond. Here the pressure of complying with new regulation has been a real barrier. It has made it challenging for firms to find the time, resources and money to focus on extending operational efficiency.

What themes will generate the most heated discussion at this year's conference?
This is no surprise, but the topic generating the most debate at this year's conference will be regulation. The impact of regulatory change on costs is an issue for firms of all sizes. Swift's role is to support the funds industry in reducing costs and increasing operational efficiency.

What are the most important aspects of the Ucits V rules recently passed by the European Parliament?
Ucits V aims to increase investor protection by defining precisely the tasks and liabilities of all depositaries; establishing clear rules on the remuneration of Ucits managers; and implementing a common approach to how core breaches of the Ucits legal framework are sanctioned. Swift can help the community achieve compliance with Ucits V with cash and securities settlement and reconciliation messaging and Swift's funds solution, which provides direct communication and messaging services for investment managers.

DEUTSCHE BANK
Angus Fletcher, head of market advocacy, global transaction banking

What are the most important aspects of Ucits V rules?
Aligning Ucits to a great extent to the AIFMD has been a good development as it allows fund services providers the opportunity to serve both clients (AIFs and Ucits). We also noted that the liability requirements on the depositary are now stricter, effectively making the depositary the "policeman" responsible for investor protection.

What are the Mifid II issues that still must agreed?
The recently published consultations alone have a size of more than 800 pages. We have only begun to digest the documents and need to further analyse the potential impact but it appears that some elements of the segregation requirements under Ucits and AIFMD have found their way into the consultations. While this might be a good thing we will have to consider if a "one-size-fits-all" approach across all kinds of businesses will be helpful to achieve greater investor protection.

Has the industry implemented the AIFMD?
Ten months after the AIFMD went live, the hedge fund industry appears to be moving to a one-stop-shop model, where administration, custody and depositary services are provided by one main service provider. One might assume that prime brokerage would be a natural fit to the concept of getting multiple services from one partner. However, the current discussion about separation of banking services might make such efficiencies somewhat impossible. Some open questions remain. One of them is what differentiates an open-ended AIF from closed-ended AIFs. While a definition is on the table, the European Parliament has requested an extension of its scrutiny period. Also, we still need clarification on the level of segregation required between AIF and non-AIF assets.

FUNDSQUARE
Olivier Portenseigne, chief commercial officer

What themes will generate heated discussion?
Mifid II and its inducement policy will affect the cost structure of the distribution model and will force a further supply chain review, most probably towards direct-to-consumer models. Another interesting topic may be the distribution of alternative investment funds.

These funds will become gradually more acceptable to the market thanks to the higher level of standards and controls, although the other side of the coin is distribution compliance and its associated costs. However, distribution of alternative funds can benefit from all the efforts already done for Ucits, and the alternatives industry will be able to leverage on existing structures and players to start on more efficient distribution models.

What must Luxembourg do to maintain its position as the leading fund domicile in Europe?
The Luxembourg fund access model was a cornerstone for the success of the Luxembourg marketplace and it allows Ucits products to be distributed globally. This model can be further enhanced to allow even more cross-border market penetration, by reaching out to new frontiers and client segments. However, further efficiency is expensive and benefits in straight-through processing are less evident individually for each fund supply chain participant.

How is fund distribution evolving in Europe and what are the main challenges faced to achieving a more efficient ecosystem?
The fund distribution value chain will need to be reassessed with a view to revealing all its associated hidden costs. In addition, there is the need to assess the fund supply chain and the redundancy of different tasks and costs amongst intermediaries.

Doing this is the only way to improve the existing distribution model and to understand the need for a more collaborative approach to create better efficiency and value allocation around the entire chain.

EUROPEAN FUND AND ASSET MANAGEMENT ASSOCIATION
Peter De Proft, director general

Are you in favour of the recent European agreement on packaged retail and insurance-based investment products (Prips)?
Efama has always been in favour of the Priips initiative and we believe this is a significant step forward in protecting investors. It will contribute to achieving a level playing field in the disclosure of key information to investors. As currently adopted, certain products will or could be left out of the scope of PRIIPs and Efama believes further work could be done in this area.

Is the financial transaction tax (FTT) inevitable?
The EU FTT continues to be uncertain for these reasons.
The UK’s action against Council Decision 2013/52/EU authorising enhanced cooperation has been rejected by the European Court of Justice as premature (ie not brought against an

adopted directive). The UK may see this aspect as a validation of its legal challenge. Other actions could follow the adoption of the directive.
The council also allowed enhanced cooperation on FTT for 11 countries. However, on May 6, Slovenia did not join the statement on FTT. As unanimity is required for the adoption of the directive, Slovenia's position could be decisive and furthermore other countries, particularly the smaller ones, might have second thoughts.

Has the industry implemented the AIFMD?

The industry has spent enormous resources on being ready, but there is still more work to be done. The upcoming AIFMD reporting requirements loom as the next big project. One example for this is that there are many data fields that are hard or nearly impossible to fill out by the asset managers because the information is hard to acquire or its calculation does not make sense. On the other hand, because of lack of experience, even regulators are struggling to provide support and answers to asset managers in answering those questions.