The asset management industry's primary duty is to the investors

INTRODUCTION

Ladies and Gentlemen, Good afternoon,

I am delighted to join you here at this annual conference organised by the International Centre for Financial Regulation, an organisation with a rising profile that I understand acts as a catalyst for dialogue, thought leadership and scholarship in the critical field of financial regulation. We need it.

The topic I am going to address today is « the asset management industry's primary duty is to the investors ». I will take a European perspective when addressing this fundamental issue on behalf of the asset management industry.

The financial crisis had many causes – including those on which public attention often focuses. The related regulatory reform agenda is well known and has been led for the most part by the G20 debates. It covers a full range of issues, with a focus on systemic risks: supervision, capital requirements, liquidity, hedge funds, derivatives, credit rating agencies, remunerations etc.

If all those reforms are important, it is however crucial that we focus on the ones that are more vital than others

Indeed underlying these high-level issues – and sometimes political, the asset management industry believes that there are fundamental and strategic issues that need to be prioritised: those include the need to focus further on investor needs and to develop long-term savings in Europe.

Post the financial crisis we have a collective duty to put back the tens of millions of investors at the centre: we need to move **from an industry-centric to an investor-centric approach,** to ensure the alignment of interests along the value chain, that our fiduciary duties are met and maintain a high level of trust and confidence with investors.

To highlight my point I would like to quote the following sentence from the G20 Pittsburgh meeting a year ago: "far more needs to be done to protect consumers, depositaries and investors against abusive market practice and promote high quality standards". My question being: in the light of what we have practically experienced in the asset management industry over that period, are we doing this effectively?

To that extent as the asset management industry we need to look at:

- The key lessons learned from the crisis
- How to respond to those lessons
- What can we do more and how can we engage further with legislators and regulators to formulate our responses

I. Taking the investor perspective: some concrete examples/ key lessons learned from the financial crisis – to ensure further industry focus on investor needs

1) High volatility in flows, which revealed a need for a long term perspective at investor level

The volatility of flows in asset management products reached during the crisis levels at odds with the long-term nature of most asset management products.

- Redemption rates in cross-border funds reached levels close to 100% at the peak of the crisis (which is 3 times higher than in the US for instance).
- Full long-term outflows have not yet completely come back to the European industry, notably in core asset classes (e.g. European equities)

Case of European equities (Source Lipper FMI): Since the end of 2006, AuM in European equity funds (out of all European-domiciled funds) have dropped from Eur 550bn to about Eur 340bn. Their relative share of funds has also dropped from 9 to 6%. Overall outflows have totalled Eur 63bn since beginning of 2006.

How can we explain those trends?

- Absence of regulatory environment for distribution mechanisms

- Needs in terms of distribution and quality of advice/ **banks in Southern Europe**

- Need for a long term perspective when investing

- Absence of simple and homogeneous solutions across Europe to enable investors to meet their long-term investment goals, incl. retirement needs

- Financial education

- Solvency II

2) Competition from other products: the lack of level-playing field

More and more investment solutions have been marketed to retail investors at the same point of sale, with the same content packaged in different wrappers and sold to the same investor.

- Unfair competition with structured notes: in 2007 for the first time, structured note issuances were higher than fund flows (about Eur 300bn vs flows for funds of about Eur 100bn)
- Stiff competition from short-term banking products after the liquidity crisis
- Continued lack of level-playing field in insurance and other long-term wrappers

3) Failure to meet product features, in particular liquidity

Best illustrated by challenges in money market funds

- Challenges in enhanced money market funds further to the “subprime” crisis in the midst of 2007: €70bn of net outflows in august and September 2007, mostly from institutional investors; 12 funds were closed for a short period and 4 liquidated in Europe
- Panic after the Lehman bankruptcy on 15 september 2008 and closure of the Reserve Primary fund in the US, with fear of contagion to European funds (in particular for « stable NAV »). This triggers massive net outflows with more than €100bn of net outflows in Europe in the next 6 weeks that followed (until end of october), in particular for« stable NAV » (representing more than 50% of outflows)

What did those challenges highlight?

- Needs in terms of product liquidity and quality - Need for product quality regardless of the sophistication and proliferation of complex instruments used by fund managers

- Investor information needs to be enhanced: transparency, clarity and simplicity will never be enough

- Need for transparency in areas such as the nature of underlying assets, risks, costs
- Clarity and simplicity : investors can be challenged by the complexity of product choice and design
- Fund naming and classification needs to be improved

II. POTENTIAL FOR ACTION / WHERE MORE CAN BE DONE FOR THE INVESTORS: BEYOND THE REGULATORY AGENDA, NEED FOR INDUSTRY'S LEADERSHIP AND LONG-TERM FOCUS

1) Strengthening of distribution and further focus on investors

- **Know your client:** the industry must take action to bridge the distance that exists between the asset manager and the end investor due to growing distribution intermediation
- **Improve the quality of advice and transparency of activities at the point of sale.** Potential actions include:
  - Disclose the nature of distributors' services: there is an opportunity to improve MiFID as to ensure investors can have a comprehensive view on the advice they are receiving (such as distributors' duties to the client, basic criteria and process for selecting products…)
  - Ensure full disclosure of all cost items and the principles of remuneration arrangements – the investor should understand exactly what he or she is paying in order to make better informed investment decisions
  - Develop standards for advisor education and competence (advisor certificate)
  - Consider granting investors the right to withdraw from an investment decision, with a view to reimburse a portion of the transaction fee

  These additions would ensure effectiveness and extend the impact of PRIP.

- Empowering consumers through better investor information and financial education

- Investor infirmation: UCITS has already got high standards but more to be done through the implementation of UCITS IV (Key improvement in sight: KID)
- Clarity: more needs to be done in the field of classifications: establish a European-wide fund-type classification with regard to portfolio holdings (take further the work of the EFCF)
- One area where our industry can contribute further is financial education of investors and advisors

2) Need for level-playing field

- In today's market environment, a cross-sectoral/ horizontal approach in regulation is required for the retail financial services industry at distribution level
  - Need to harmonise distribution standards: different investment product categories have different transparency and selling rules
  - Need to roll out PRIPs (Packaged Retail Investment Products)
  - Scope of PRIPs could be extended to capture the full universe of substitute investment products
- Opportunities for level-playing field as well:
  - At product wrapper level (such as retirement vehicle)
  - At tax level

➡**Further level-playing field means more competition and choice for investors**

3) Need for enhanced product features

Notably through improved operational management (such as Risk management procedures, valuation rules etc…)

But with « New UCITS »: are we going too far?

- Consequence of the extension of the eligible assets of UCITS
- Need for the industry to react and set some limits

… but also through cost efficiencies

- Need to ensure further cost efficiencies - notably reflected in the level of fees in Europe vs US – a study from Lipper showed the relatively higher TERs prevailing in Europe vs the US, such as for Equity funds (TER of 1.78% for a European equity fund in Europe vs a TER of 0.81% for a US equity fund in the US)
- Some Already known prior to the crisis:
  - Deliver on UCITS IV/ efficiency of the implementation of the efficiency package (in particular need to generate economies of scale average fund size in Europe is about Eur 110m Compared to Eur 0.8bn in the US)
  - Industry initiatives (fund processing)
  - Value chain approach: no additional layers of fees

4) Need to develop long-term vehicles in Europe

- Retirement plan level: potential to increase the consumer-friendliness of long-term investments by introducing a personal retirement plan that has consistent certification standards across Europe (with basic requirements in terms of transparency, choice, transferability/ portability, flexibility, cost efficiency and safety)
- Product provider level:
  - Need to develop superior products which are suitable for the long-term and target investors
  - Give all PRIP providers equal access to the development of retirement plans in order to foster competition for the best investor solutions

CONCLUSION

— Our reputation as an industry is key and we should ensure that we continue to leverage on 25 years of collective work in Europe which has now resulted in one of the biggest success of European financials services (UCITS), to the benefit of investors

— We therefore now more than ever need to focus further on investors and what can make a concrete and practical contribution to investors, moving from an industry-centric to an investor-centric approach.

— Rather than being solely reactive, our industry needs to be much more pro-active, faced with a regulatory agenda that has become very heavy (G20 priorities) – and not always prioritised around investors' needs

— Success will require collective efforts from the various stakeholders of the financial services industry, adopting a sector-wide approach and getting the right balance between regulation and self-regulation will be key