THE ASSET MANAGER’S PERSPECTIVE ON THE YEAR AHEAD

As we enter 2017, what is the biggest regulatory challenge European asset managers will face?

Dan Hedley: I think the biggest challenge will be to comply with multiple disclosure requirements for multiple audiences that are designed to deliver different policy objectives. It will be challenging for managers to do so in a unified manner that is operationally efficient and useful to our clients and investors.

This year managers will need to finalize standards for communicating fund data to Packaged Retail and Insurance-based Investment Products (PRIIPs) manufacturers invested in underlying UCITS and Alternative Investment Funds, and develop standards for communicating target market data to distributors under the Markets in Financial Instruments Directive 2 (MiFID 2). Luckily, the asset management industry is quite advanced in solving for both directives, although I think we need to pick up the pace under MiFID 2.

MiFID 2 comes into force in Europe on 3 January 2018. What are the areas firms should be most focused on preparing for within 2017?

DH: It seems to me that most asset managers are already in a positive position to solve for the transaction reporting and fee unbundling requirements of MiFID 2. However, product governance requirements and target market assessments will be more challenging to implement. These policies remain subjective and there is not yet industry-wide consensus on how to comply. Fidelity has contributed to a combined industry standard that we hope will be adopted by managers, distributors, and platforms alike. Initial feedback from distributors has been very positive and we are now looking for a place to launch and host our Target Market Matrix.

What is the biggest unopened policy debate?

DH: I would suggest that the biggest unopened policy debate is how policy can help deliver more efficient and effective ways of disclosing fund data to investors and their advisors. Together, UCITS, the Alternative Investment Fund Managers Directive, PRIIPs, and MiFID 2 will require asset managers to generate a set of data points that should be a powerful tool for investors to compare and select funds and hold asset managers accountable for fees and performance.

The problem is that this data often fails to reach investors in a usable format.

Although EU regulation might deliver the holistic view investors need cumulatively, each regulation actually operates in isolation with no one single regulation bringing all data points together for end investors. EU policy also remains stubbornly wedded to paper-based disclosures despite the plethora of research indicating that investors’ understanding and engagement is poor. PRIIPs legislation actually requires a three-sided paper document leaving managers the odd decision about what to do with a fourth blank page.
Whilst the industry has attempted to bridge this gap, we would certainly encourage EU policymakers to help the asset management industry achieve full digital comparability for its investors with an initiative akin to – but moving beyond – FINRA’s Fund Analyzer. This will not only appeal to an increasingly digital-savvy demographic, but will help plug any ‘guidance gaps’ that might open up following MiFID 2’s retrocession policy via automated guidance or even robo-advice. It will also promote competition between products and providers through online comparison, which might go some way towards responding to the Financial Conduct Authority’s Market Study as far as UK asset managers are concerned.

What is the biggest open policy debate?

DH: The biggest open policy debate is still around PRIIPs and the relevance of this regulation to the fund industry. Or, more accurately, the backward step that this regulation might force the fund industry and its customers to take. PRIIPs policy started out well intentioned, seeking to apply the UCITS Key Investor Information Document disclosure standards to a wider array of investment products. However, it quickly deteriorated as policymakers lowered the standard of UCITS to fit the different characteristics of PRIIPs (most notably insurance-based PRIIPs) rather than seeking to raise PRIIPs to the standards of the UCITS disclosure.

PRIIPs policy does not allow the use of past performance data, despite consumer demand. On the other hand, it removes UCITS year-by-year cost disclosure and replaces it with a reduction-in-yield figure that averages costs across the product’s holding period. This not only hides true costs of ownership beneath an average, but denies investors’ visibility into the cost of their holding at any time other than the end of a recommended holding-period set by the PRIIPs manufacturer. PRIIPs transaction costs are also not transaction costs but rather slippage costs between two points in time. Our preliminary analysis shows that these slippage costs can be negative as well as positive (suggesting managers get paid to transact with brokers, which we can assure you is not the case!).

While PRIIPs policymakers seem unwilling to listen to the asset management industry on these points, legislation at least demands a review of PRIIPs in 2019 before UCITS are brought in scope. This offers a real opportunity to test whether PRIIPs has worked, and whether it can work for UCITS going forward. We encourage policymakers not to squander the opportunity by treating the review as a fait accompli. The UCITS industry will not.

There remain some ambitious pan-European regulatory initiatives such as Capital Markets Union (CMU) and the Pan-European Personal Pension Product (PEPP). Do you have faith that these projects will increase participation rates in long-term investment products across Europe?

DH: To be honest, we share some of the industry’s skepticism with regard to the tactical need for the CMU. For example, John Kay suggests the CMU is a solution in search of a problem and that the backbone of the EU real economy – the Mittelstand of family-owned German manufactories – has more than adequate access to funding from local cooperative and savings banks.\(^1\)

Like John Kay, we welcome the strategic shift away from the deposit channel and towards the investment channel as policymakers’ preferred source of funding. We welcome the new form of regulatory dialogue that CMU ushers in, particularly, the fact that policymakers have begun to look at financial services in terms of a trade-off between the social utility market participants can deliver and the risk they represent. The asset management industry is beginning to be recognized as a source of funding equivalent to banks without the systemic riskiness.

We are equally excited about the PEPP for similar reasons. It is widely acknowledged that a third pillar pension provision is needed. We were pleased to see that the recent public hearing on PEPP was well-attended by constituents beyond financiers and regulators. Their attendance acknowledges PEPP’s position within a wider social reform agenda. Clearly, in order for PEPP to be successful, pan-EU tax reform will be required (no small feat), as well as collaboration between asset managers, insurance, and pension providers. Investors’ retirement needs have evolved in a way that demands creative and collaborative thinking from the whole industry, and we look forward to engaging with this dossier throughout 2017 and beyond.

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\(^1\)John Kay, Other People’s Money: masters of the universe or servants of the people, 2015

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