



# Protecting faith in investment fund products

**Mathias Bauer**, President of the European Fund and Asset Management Association (EFAMA) and Chief Executive of Vienna-based Raiffeisen Capital Management, talks to Bob Currie about key challenges facing the asset management industry and important advances that have been achieved by EFAMA and its membership during the recent period of financial instability

The financial crisis experienced during the past 18 months has been tough by any historical standard – and it would be hard to select a more challenging period to serve as President of Europe’s leading representative association for the asset management industry.

Thus, it is with a hint of irony that Mathias Bauer remarks that he took over as EFAMA President in July 2007, just as the symptoms of the impending crisis were beginning to harden and the global

economy stepped into its most severe downside for several decades. Though there is some optimism that the global financial climate may begin to improve from Q4 09 and Q1 10, this thaw in the permafrost is unlikely to arrive in time for Mr Bauer to enjoy spring flowers before his term in office ends this June. Having ushered Europe’s funds industry through some turbulent times, it will be for Bauer’s successor to build on this sound guidance as the investment outlook recovers.



**Mathias Bauer,**  
President of the European  
Fund and Asset Management  
Association (EFAMA) and Chief  
Executive of Raiffeisen Capital  
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### Redemption days

Driven by a deteriorating global economic outlook, Europe's fund management industry has seen sizeable net outflows in recent quarters, with total European fund assets contracting from their peak of €5.5 trillion in May 2007 to €3.9 trillion in December 2008 according to Lipper FERI figures. Total redemptions across European investment funds amounted to almost €300 billion during 2008, with the figure close to €120 billion for European equities funds. Money markets funds were the only category of European investment fund to achieve net positive sales over the 12 months, with the asset class experiencing net inflows of close to €96bn.

Given the storm clouds hanging over the financial services sector, EFAMA's membership – in liaison with the European Commission, the Committee of European Securities Regulators (CESR) and other

2008, it appeared that there was no more than a 50 per cent probability that the Management Company Passport might be included in Level One legislation for UCITS IV," says Bauer. "However, we have now seen these proposals approved almost in their entirety by the European Parliament and that is excellent news for the industry."

Indeed, when the European Commission put forward an initial package of UCITS IV proposals in July 2008, the provision for a Management Company Passport was not included. Several national regulators in Europe voiced reservations about the MCP element, believing that this may create problems for a UCITS Competent Authority in supervising a remote management company. In sympathy with these objections, the Commission adjudged that more time should be granted to ensure that the high standards of investor protection maintained under

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key industry associations – deserves credit for pushing through policy changes that may offer greater efficiency in the way that management companies deliver fund products to target investors in Europe and beyond.

On 13 January 2009, the European Parliament voted strongly in favour of reforms to UCITS directives designed to reduce fragmentation across Europe's investment funds markets and to improve the efficiency with which management companies can manufacture and distribute funds cross-border. Within these reform proposals, MEPs approved the inclusion of a Management Company Passport (MCP), which will allow funds authorised in one EU member state to be managed remotely by management companies established in another member state and authorised by financial authorities in that jurisdiction.

### Uniting behind the passport?

Commenting on these developments, Mathias Bauer indicates that these represent an important milestone in the creation of an effective single market for investment funds. "Looking back to mid

the UCITS directive could be delivered with an MCP in place (see further in FSR, Q4 2008, pp 24-38). To research this point more fully, it invited CESR to canvass opinion from key stakeholders across the European funds industry regarding whether it was feasible to launch an MCP in a manner that would preserve the investor protection 'gold standard' that is a trademark of the UCITS brand.

Subject to this consultation process (CESR delivered its advice to the European Commission on 31 October 2008, recommending that a MCP should be included within the UCITS IV package), MEPs indicated through their positive vote that they are satisfied that it will be possible to open up the single market in investment funds, while maintaining high standards of protection for retail and institutional investors. The resolution was adopted with 589 votes in favour, 28 votes against and 38 abstentions. The directive will now need to be formally approved by the Council. Member States will be required to integrate these changes under UCITS IV into their national legislation by 1 July 2011.

This marks an important stride forward. When in

1985 the UCITS directive extended provision for management companies to market their funds products cross-border under a UCITS umbrella, a fund promoter wishing to distribute in more than one EU Member State was typically required to complete registration procedures in each Member State. This could be a burdensome requirement, which might take weeks to complete in each instance, involving considerable replication from market to market.

EFAMA has long seen this to be an obstacle to the creation of a single investment funds market for Europe, believing that when the regulatory authority in one EU Member State has verified that a fund is compliant with the UCITS directive, then this approval should be upheld by regulatory authorities in other Member States. This passport

advanced under UCITS IV will see the UCITS 'Simplified Prospectus' replaced by a short Key Investor Information (KII) document. As the title suggests, this will summarise key information on a fund's economic content and risk profile, presenting this in a concise and digestible way to the retail buyer. This marks a departure from the so-called Simplified Prospectus under UCITS III, which was often far from simple, in some cases stretching to 20-25 pages, and which prompted many differences of interpretation from Member State to Member State regarding which information should be included. Subject to KII guidelines, investors will now be provided with a quick and accessible summary of the primary information that they require to guide them in selecting funds that are suitable for their investment horizon and risk appetite.

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status will expedite the registration process for new funds and will improve the efficiency of cross-border distribution. Subsequent to the plenary vote of the EU Parliament on UCITS IV, EFAMA is pleased to see progress in this area, such that it may require little more than 4-5 days, once approval has been granted in the fund's domicile, to register a fund for sale in another market.

Mr Bauer is quick to praise the work done by CESR in liaising with national regulators across Europe in building support for this reform agenda. Five Member States (namely, Ireland, Luxembourg, Poland, Slovakia and Slovenia) voted against CESR's Advice that the MCP should be included in UCITS IV proposals, believing that there was need to increase local substance to ensure the legal status and function of the UCITS and to protect standards of local regulatory oversight. "The fact that UCITS IV proposals, including the MCP component, have achieved strong backing from MEPs confirms the importance accorded to CESR, and the flexibility shown by national supervisors and key industry associations in working through politically challenging and sensitive situations in order to find a collective solution," says Bauer.

Alongside the above, the package of reforms

To assist the investor in making effective comparison across fund products, EFAMA has played an active role alongside the European Fund Classification Forum in developing a European Fund Classification system for investment funds. This will provide a common benchmark and language for fund comparison, enabling transparent comparison of investment funds on a pan-European basis. The classification is managed by FundConnect, which was chosen as classification administrator in a joint venture with CCLux, a subsidiary company of the Luxembourg Stock Exchange. The results of this analysis are publicly available on the FundConnect and EFAMA Websites.

### **Lessons from the Economic Crisis**

We have noted that the European funds industry has witnessed sizeable net outflows as the fall out from the global economic crisis has percolated through to retail and institutional investors. But how did the scale of these redemptions measure up against what senior industry figures might have anticipated? Mathias Bauer believes that the level of fund outflows has far exceeded what many could have predicted at the start of 2008. This dramatic level of redemptions, he suggests, reflects a panic reaction to falling markets and to doubts

materialising in investors' minds concerning the resilience of the financial system. In a number of European countries we have seen sharp relocation of investment away from capital markets products into bank deposits – and this gained momentum as some state governments took the decision to issue state guarantees for investor deposits.

On the positive side, it seems possible – though by no means certain – that this scenario may gradually start to reverse during the latter months of 2009. As interest rates paid on deposits continue to fall, investors may begin cautiously to rebuild their exposure to equity and selected fixed income funds in search of more attractive rates of return. But there can be little doubt that investor risk appetite will remain conservative for some time to come – and many will wait until they believe that the market has moved past the bottom of the cycle before they begin to re-establish their exposure to real assets.

Though some institutional investors may avail of the flexibility and cost-efficiency offered by exchange-traded funds (ETFs) to build their core exposure in times ahead, Mathias Bauer is confident that investment funds will remain the vehicle of choice for the majority of European retail investors keen to build balanced exposure to global capital markets at moderate cost. The economic crisis has been painful for all concerned. However, an encouraging signal to emerge from this period of financial instability is that the UCITS regulatory framework has proven to be resilient and, in essence, a point of stability as a tempest has raged around it.

This said, the crisis has illustrated that the European funds industry will need to tighten its risk management procedures in a number of areas – particularly by improving its understanding of liquidity risk and how this can shape the dynamics of investment markets. A number of fund companies have suffered through being forced to trade through a highly illiquid market – with investors in high-yield bonds, asset-backed securities or in some areas of the money market finding this out to their cost. As we reflect on lessons from the credit crisis, Bauer believes that asset management companies will need to reinforce the systems they have in place for monitoring changes in liquidity and for ensuring consistency of fund valuation across illiquid and hard-to-value securities. EFAMA has started initiatives in both areas to improve harmonisation in these matters throughout Europe and to develop best practice standards.

In line with these priorities, Raiffeisen Capital Management (RCM) has conducted an extensive review of its risk management systems, working to ensure that these are appropriate to the risk challenges that the crisis has presented, "In applying an enterprise risk management approach to our company-wide exposure, we have substantially reviewed the contractual and legal arrangements that we have in place with parties with which we do business, and the credit risk exposures to which we may be subject in dealing with those counterparties," says Bauer. "As part of our regulatory reporting obligations to the local market regulator, the Austrian Financial Market Authority has conducted a detailed appraisal of our risk management systems and has found these to stand up well under stress conditions."

### **Rebuilding confidence**

*FSR* asked Mathias Bauer, as Chief Executive of Raiffeisen Capital Management, what he believed to be the principal challenges facing his company as we advance through the early months of 2009. "Undoubtedly the most immediate challenge is to rebuild the trust of investors in investment fund products, both in the retail and institutional investor segments," he responds. This is a common theme that applies universally across the asset management industry at the current time. In practice, RCM, and each and every other fund provider or distribution outlet, must fulfil its individual responsibilities to regenerate investors' faith in investment fund products.

For management companies selling funds to the institutional customer, Mr Bauer believes that a priority is to retain the high levels of safety and transparency attached to UCITS funds, while continuing to attend to the specialised needs of different categories of institutional buyer, whether this be pension funds, insurance companies, wholesale banking firms or other customers. For management companies targeting the retail buyer, an appropriate move may be to offer a narrower range of simple, transparent and flexible products that are accessible to the retail investor at attractive levels of pricing.

In Europe, roughly 60-65 per cent of RCM's assets under management are held by institutional investors, with many looking to benefit from the company's expertise in managing funds investing into Central and Eastern Europe. "At RCM, we believe that the key is to remain as close as possible to the investor, ensuring that we provide

regular and transparent explanation regarding why the crisis has come about, how this will impact their investment portfolios and how we can help them to manage the associated risks. In doing so, we are providing regular feedback to the investor on the state of the global economic cycle and how we expect this to unwind. We believe it important to provide reassurance to investors that they are on the right track and that they should retain their trust in investment funds."

In planning for the future, RCM retains an interest in building the global reach of its product distribution. It has been working closely with its parent bank to broaden its investor base in the Middle East, as well as to extend its distribution coverage in the Asia-Pacific region, particularly at this stage by reaching out to local private banking clients. This initiative is already in progress in Singapore and will continue in Taiwan and Hong Kong in coming months.

When asked to identify the most noteworthy achievements since July 2007, Bauer points to two factors. The first, understandably, is that Europe's funds industry has brought UCITS IV before the European Parliament and has seen this resoundingly endorsed by MEPs, including provisions relating to the Management Company Passport. Second, he highlights the Association's wise judgement in selecting Peter de Proft as its Director General. De Proft, previously Chief Executive of Fortis Investments Belgium, has brought great energy and expertise to the DG function, playing a crucial role in promoting public policy that serves the best interests of Europe's asset management industry and its sizeable constituency of investors around the world.

Undoubtedly, there is unfinished business that will exercise future EFAMA Presidents after Mathias Bauer completes his two-year term. An enduring priority for Europe's investment funds industry is

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As an industry organisation, EFAMA has been active in promoting UCITS distribution into the Asia-Pacific, Middle East and South American regions. During his term as EFAMA President, Mathias Bauer has travelled widely in promoting the merits of the UCITS brand, including visits to Hong Kong, Singapore and Taiwan as part of an EFAMA roadshow designed to strengthen links with regulatory authorities and industry associations in these jurisdictions.

### **Industry commitment**

While he is modest in speaking of achievements pushed through by EFAMA and its members during his term as President, it is hard to overlook the positive role that EFAMA has played as a representative association in guiding management companies through some of the toughest economic conditions in living memory. And, in doing so, it has contributed to shaping policy amendments that are destined to provide a more efficient framework for the cross-border distribution of UCITS funds.

the need to establish a level playing field, whereby regulatory standards applied to UCITS are consistent with those applied to substitute products with comparable economic content. The European Commission has issued a Call for Evidence and will publish its findings in a White Paper during Q2 2009. For EFAMA, this process confirms that the Commission recognises a need to adapt its legislation to ensure consistency across product areas. Ultimately, this will extend the access of retail investors to flexible and cost-efficient products that deliver high standards of investor protection. EFAMA holds the view that the high standards of transparency and safety extended under UCITS should be applicable to substitute products, thereby ensuring that the major achievements secured under UCITS are retained and extended to all products available to the retail investor. "In short, the principle that underpins UCITS investment is investor protection and, on this basis, it has developed to be one of the most flexible and appropriate savings vehicles for a large number of investors in Europe," concludes Bauer. ■