JULY/AUGUST 2023• ISSUE 218 • €40

funds europe

TURNING UP THE TEMPERATURE ON FEES

IS THE EU RIGHT TO STEP BACK FROM A FULL BAN ON RETROCESSIONS?

HIGH YIELD

HIGH YIELD MANAGERS ARE EXCITED ABOUT BB-RATED DEBT – MUCH OF WHICH IS ISSUED IN EUROPE.

MANCOS & SFDR

CONTRACTUAL 'RE-PAPERING' IS NEEDED TO MEET SUSTAINABILITY RULES, AN IRISH LEGAL EXPERT SAYS.

ALSO THIS MONTH...

INDIA ROUNDTABLE, LUXEMBOURG CRYPTO, PRIVATE MARKETS, EM ESG, TRANSFER AGENCY, AND MORE.

CONTENTS

ALSO THIS MONTH...

FUNDS EUROPE IS PUBLISHED BY DEFINITE ARTICLE MEDIA • 5TH FLOOR, 167-169 GREAT PORTLAND STREET LONDON W1W 5PF, UNITED KINGDOM. TEL: +44 (0)20 3916 5974

AUDIT ISSUE CIRCULATION 10,293 AUDIT PERIOD 1ST JULY 2021 - 30TH JUNE 2022 • ISSN 1477-4453 • PRINTED BY BUXTON PRESS

Scrapping commissions

BRUSSELS STEPPED BACK from a complete ban on retrocessions when it recently released a strategy to boost retail investments. Rather than ban all retrocessions – the controversial commissions paid to intermediaries – it proposed to ban them only in some cases (see page 14).

Data has shown fees for 'clean' share classes (which do not have commissions bundled into them) have fallen while their assets have risen. It's a good advert for a commissions ban, surely. But a similar pattern – if not so dramatic – is observed for share classes still paying commissions.

It's commonly thought that banks in Europe are those most opposed to the ban on commissions. Yet investment fund organisations have also opposed banning them.

They say investors may be doing themselves damage if they are influenced too much by costs – and they may still be paying for advice, but paying for it outside of the clean share class they buy into. In other words, the total cost of ownership for a fund is still higher than what is reflected in the quoted fund fee, including in countries with commisson bans.

The issue is complex and data is sparse. Perhaps Brussels is right to hold off from a full ban until better visibility is gained.

Nick Fitzpatrick
Group Editor, Funds Europe

FUNDS EUROPE

Co-publisher & group editor, Nick Fitzpatrick, tel: +44 (0)203 327 5682, nick.fitzpatrick@funds-europe.com • Editorial director, Benjamin David, tel+ 44 (0)203 327 5684, benjamin.david@funds-europe.com • Digital production executive Carol Ribeiro, tel: +44 (0) 20 3327 5680, carolina.ribeiro@funds-europe.com • Journalist, Piyasi Mitra, tel +44 (0)203 327 5690, piyasi.mitra@funds-europe.com • Technology & operations editor, Nicholas Pratt, nicholas.pratt@funds-europe.com • Sub-editor, David Ryan • Art director, Lucy Erikson • Co-publisher & head of business development, David Wright, tel: +44 (0)203 327 5681, david.wright@funds-europe.com • Senior associate director, business development, Alex Lemm tel: +44 (0)20 3327 5678, alex.lemm@funds-europe.com • Associate director, publications & digital, Michael Fennessy, tel: +44 (0)203 327 5685, michael.fennessy@funds-europe.com • Head of digital, Steve Dimitrov, tel: +44 (0)203 327 5687, steve.dimitrov@funds-europe.com • Ad operations executive, Kasia Stawirej-Brzezinski, tel: +44 (0)203 327 5617, kasia.stawirej-brzezinski@funds-europe.com

SUBSCRIPTION

Subscription enquiries: subs@funds-europe.com • Delivery in Europe: €385 • Delivery outside Europe: €495

FIXED INCOME MOVE
INVESTORS LOOK FOR SAFETY

Global and emerging market equity funds saw inflows in June – but bond funds continued to take the lion's share of money as investors sought safety and yield.

Figures from Calastone saw bond funds raise £880 million (€1 billion) of new money, according to the firm's Fund Flow Index.

Money market funds, another place of relative safety and yield, took in £503 million.

On the whole, investors swapped equity, mixed assets and property funds for fixed income and money markets in June.

Equity outflows were £662 million, followed by mixed assets and property.

The firm also reported that in equity sectors, "strong outflows" were seen in the UK, North America and ESG funds.

ECONOMIC PLANS

UK CHANCELLOR UNVEILS REFORM PROGRAMME

IN A SPEECH delivered in London's Square Mile, chancellor Jeremy Hunt has outlined plans to enhance the competitiveness of the UK economy through longer-term reforms.

The aim of the so-called "Mansion House reforms" will be to direct pension savings towards illiquid assets, boost consolidation among smaller funds and increase investments in private companies.

Hunt highlighted the potential impact of directing defined contribution pension funds towards private companies, aiming to unlock investment opportunities for high-growth businesses.

A significant component of his initiative is the "compact", signed by nine major pension providers pledging to allocate 5% of default funds for defined contribution pension savers towards unlisted equities by 2030.

While some experts expressed concerns about the shift towards riskier private markets, others emphasised the benefits of accessing a wider variety of companies, especially as the number of listed companies declines.

Hunt also addressed the unbundling of research costs and expressed a commitment to enhancing transparency in pension investments. He welcomed recommendations to repeal unnecessary EU laws, including the MiFID II rules, in an effort to streamline regulations and foster a more competitive financial sector.

Hunt stressed the importance of collaboration among stakeholders, including the government, regulators and businesses, to achieve a secure and prosperous financial future.

He emphasised the need for open communication, sharing best practices, and learning from international counterparts to shape policies and enhance the UK's position as a global financial hub, with the hope of achieving long-term stability and more competition.

FUNDS

FEDERATED HERMES CLOSES FIFTH PE FUND

FEDERATED HERMES INC has announced the succesful closure of its fifth flagship Private Equity Co-investment Fund (PEC V), raising $486 million (€439 million).

PEC V's strategy focuses on alpha generation and grants investors access to leading growth companies in sectors poised to benefit from long-term global economic trends.

The fund, which surpassed its initial fundraising target of $400 million, received commitments from existing investors such as Local Pensions Partnership Investments (LPPI) and Hostplus, as well as new investors from Europe and Korea, including Samsung Life Insurance. PEC V has already committed to 23 investments, with seven additional investments awaiting approval.

As of March 2023, Federated Hermes GPE has allocated $4.5 billion across 278 global co-investments over its 22-year history.

Peter Gale, the CIO and head of private equity at Federated Hermes GPE, commented: "With the closure of PEC V, we are excited for the next step of seeking to deliver significant cash returns to our investors through investing in growth-oriented and disruptive companies."

FRANKLIN'S NEW FOOD AND HEALTH ETFS

Investment management firm Franklin Templeton has unveiled its latest offerings for European investors with the launch of two new sustainable, thematic exchange-traded funds (ETFs).

The Franklin Future of Food Ucits ETF and Franklin Future of Health and Wellness Ucits ETF join the firm's existing range of sustainable ETFs.

They provide exposure to companies engaged in sustainable practices across the healthcare and food sectors.

COST MANAGEMENT

DISQUIET AT RISING ASSET MANAGEMENT COSTS

A LARGE NUMBER OF INVESTORS are unhappy with aspects of asset management costs, even though fees have been declining, research by bfinance suggests.

Overall, 34% of investors in a survey said there had been an increase in fund servicing costs in the past three years, with ESG costs being a "pressure point".

Bfinance said investors across the globe were "grappling" with cost management challenges due to inflation, heightened ESG requirements and regulation.

Nearly half (46%) said like-for-like asset management fees have declined, but a quarter of them said they had experienced an increase in ad-hoc expenses from asset managers.

Nearly half were dissatisfied with the level of comparability of asset managers' performance fees, market impact costs and ad-hoc expenses.

While 83% of investors said they were satisfied with the transparency of management fees, there were widespread challenges to do with non-transparency and non-comparability across many cost components and asset classes, said bfinance.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE

ESG FUNDS SOAR, IN SPITE OF HEADWINDS

A REPORT FROM PWC LUXEMBOURG shows that the number of ESG funds continued to grow in 2022, even as the global economy faced uncertainty from the Covid-19 pandemic and the war in Ukraine.

The report, the fourth edition of the 'ESG Mutual Funds Poster', found the number of ESG funds increased to 10,154 in the second half of 2022, up from 9,279 in the first half of 2022.

This was driven by strong growth in the number of Article 8 funds. The number of Article 9 funds, which are more stringent, declined slightly in 2022.

The report also found that BlackRock was the top asset manager for ESG funds in terms of assets under management (AuM), followed by Amundi, DWS, BNP Paribas and Goldman Sachs.

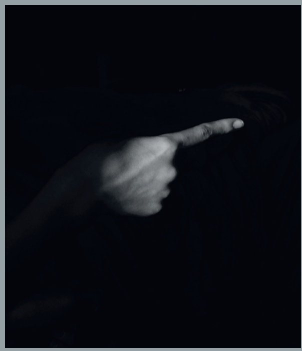
In terms of the number of funds, Amundi was the top asset manager, followed by BNP Paribas, DWS, Eurizon Asset Management and BlackRock.

The report also found that the top EU ESG funds domiciles by AuM as of the end of 2022 were Luxembourg, Ireland, France, Sweden and Germany. For net flows, BlackRock was the top fund in Article 8 and Article 9 funds.

Commenting on the report's findings, Frédéric Vonner, partner and sustainable finance and sustainability leader at PwC Luxembourg, said: "In a context of economic and geopolitical turmoil, the number of ESG funds increased to 10,154 in the second half of 2022, carried by strong growth in the number of Article 8 funds which more than made up for the slight reduction in Article 9 funds.

"The year saw many Article 9 funds being reclassified to the broader Article 8 category due to regulatory uncertainty.

"As the SFDR and other sustainability-related regulations continue to evolve, and as regulatory authorities refine their approach towards enforcing them, asset managers in the EU will have to continuously adapt to the changing regulatory landscape."



MIFID II COST DISCLOSURE

ESMA FLAGS SHORTCOMINGS

The European Securities and Markets Authority (Esma) has released a statement on its 2022 Common Supervisory Action (CSA) and a mystery shopping exercise investigating compliance with MiFID II cost and charge disclosure requirements.

The CSA identified several shortcomings, including varying formats and content of ex-post disclosures across firms and countries, inadequate disclosure of inducements, omission of implicit costs, inconsistent illustrations of cumulative costs' impact on investment returns and disclosure of cost figures only in nominal amounts without corresponding percentages.

Esma's mystery shopping exercise found while most retail clients received pre-investment service information on costs and charges, quality and timing differed across firms.

Esma plans to address these issues with new Q&As and a standardised EU format for cost and charge information. National Competent Authorities (NCAs) will also take corrective actions for regulatory breaches.

ETP FLOW RECORD

HIGH POINT SEEN IN JUNE

Global ETP flows in June 2023 reached a peak for the year of $98.3 billion (€88.8 billion), according to data from BlackRock.

BlackRock's 'Global ETP Flows June 2023' report claimed H1 ETP flows totalled $375.9 billion, surpassing last year's $301.4 billion. At $209.5 billion, equity flows outpaced fixed income's $165.4 billion, with EMEA-listed fixed income ETPs attracting record inflows.

In June, equity flows reached $75.8 billion, while fixed income buying moderated to $26.5 billion, and commodities saw outflows of -$5.1 billion.

US equity inflows reached $45.2 billion, the highest since October 2022, while European equity outflows hit -$4.6 billion, the highest since August 2022.

CONSOLIDATION

INDUSTRY FACES "EXISTENTIAL CHALLENGES"

ONE IN SIX asset and wealth management companies globally is expected to disappear or be acquired by 2027 – twice the normal turnover rate, according to a study by PwC.

The '2023 Global Asset and Wealth Management Survey' highlights the industry's struggle with digital transformation, changing investor expectations, consolidation and 'retailisation'.

In response, 73% of asset managers are considering strategic consolidation to gain access to new segments, increase market share and mitigate risks.

Over 90% of asset managers are already utilising disruptive technologies such as AI, big data and blockchain to enhance investment performance.

The top-ten largest asset managers are projected to control half of all mutual fund assets globally by 2027, up from 42.5% in 2020.

Global assets under management (AuM) fell to $115.1 trillion in 2022, a decline of nearly 10% from the previous year's high. However, AuM is expected to rebound and reach $147.3 trillion by 2027.

The report also highlights the increasing use of AI-driven robo-advisers, estimated to manage $5.9 trillion in assets by 2027.

Private markets are expected to drive growth, accounting for half of asset and wealth management revenues by 2027.

The Asia-Pacific region and emerging markets are predicted to lead AuM growth, while purpose-driven strategies, diversity, equity and inclusion (DEI) and ESG considerations are becoming imperative for the industry.

Olwyn Alexander, global asset and wealth management leader at PwC Ireland, said: "Existential challenges are sweeping the asset and wealth management industry against a backdrop of social, economic and geopolitical disruption."

FIXED INCOME

EUROPEAN INSURERS TURN TO FIXED INCOME

EUROPEAN INSURERS ARE TURNING to fixed income investments amidst inflation and market volatility, according to a Cerulli Associates report.

The 'European Insurance Industry 2023: Meeting Investment Needs' report found that concerns over higher inflation rates and their impact on interest rates and profitability have prompted insurers to focus on fixed income strategies.

Approximately 30% of European insurance firms expect to adjust their fixed income allocations in the next year, and the preferred fixed income options include investment grade sovereign bonds, green bonds and investment grade corporate bonds, the report noted.

It also found that insurers are seeking higher quality in core fixed income assets.

WISDOMTREE LISTS TWO NEW ETFS ON SIX

WisdomTree has listed two new ETFs on Swiss Stock Exchange SIX.

They are the WisdomTree Broad Commodities Ucits ETF (PCOM) and the WisdomTree Enhanced Commodity ex-Agriculture Ucits ETF (WXAG).

PCOM aims to replicate the performance of the Bloomberg Commodity Total Return Index, while WXAG seeks to track the performance of the Morgan Stanley RADAR ex Agriculture & Livestock Commodity Total Return Index.

PHOTO BY - Christin Hume on Unsplash

Too much E, not enough G

BY LIZ PFEUTI

ON THIS GLORIOUS, warm and sunny afternoon, there are three lads erecting scaffolding outside my neighbour's house. Aside from peppering the air with gossip about the latest Arsenal signing – the club overpaid, by the way – they are happily hopping about the rungs and boards like mountain goats.

They've popped round to ours to make sure there's no swifts nesting in the boxes close to where they're building, and are they OK to cut down a couple of branches of shrub? Yes, the bees are done foraging, so it saves me the job.

I'm glad they are keen to protect the environment.

However, there's not a hard hat, glove or harness between them, as they happily toss the bolts and hinges into a plastic tub on the truck, which is parked on the busy main road.

Nosy neighbour that I am, I peeped at the company website to have a look at the health and safety assurances they offer, along with the rules and regulations they should follow when erecting three storeys of boards. There's not much evidence of these decrees being heeded in real life, but it's a relatively small job and they're professionals, right?

The lads had everything up and secured by 4pm, taking their football chat and skilled clambering and fixing techniques away with them. The scaffold looks entirely safe for the roofers to scale next week, to the untrained eye at least. But it's the process and the governance framework that needs closer attention.

It's said it's better to be lucky than good, and this can apply equally to all professions and endeavours. But taking a safe and professional approach to everything from erecting scaffolding to selecting assets for a portfolio sounds to many like the most sensible approach. Equally, I suspect workers up and down the land think that's what they do every day – up to a point.

The scaffold lads worked like lightening and didn't put a foot wrong. They probably assumed – and, with no major incidents reported lately, with good authority – that they didn't have to completely stick to cumbersome health and safety guidelines.

Over almost 20 years, countless fund managers of all stripes have told me that "governance" is implicit and built into their process. It's not something they spend as much time on as, say, environmental concerns, as they only buy good companies.

Great. It's important that someone is really caring about global shifts in climate and biodiversity as closely as those lads worked around our swift boxes. So, I'll be happy to hear that their names as shareholders of all the companies – including the banks – that have collapsed over the past year were false entries on the register? Or, if not, I'd be keen to read about their intensive stewardship efforts to discover what was really going on, not just in the boardrooms but within the activity throughout the company that their investors' capital was facilitating.

I'd also love to hear how managers deal with auditors who fail to adequately do their job. Answers on a postcard to that one.

Governance is not implicit. It doesn't just happen. It needs constant appraisal and work, and should operate like a culture through a firm. By reaching for the headline-grabbing environmental targets and failing to grapple with governance directly, it is not the company directors and fund managers who lose out, it is the lads climbing the scaffolding and the people whose capital has put them there who ultimately pay the price.

There were helmets, gloves and harnesses in the back of the scaffolding truck – the lads just didn't use them. **f**e

Available early June:
www.efama.org

THE EFAMA FACT BOOK 2023

Online version only, free of charge

EFAMA
European Fund and Asset Management Association

THE essential reference for data and information on the European investment fund industry

AT YOUR FINGERTIPS

- Developments in the UCITS and AIF markets since 2012
- Cost and performance of UCITS
- Main investors in UCITS and AIFs
- Long-term trends in the European fund industry
- Net assets and sales of worldwide investment funds
- Detailed reports on key developments in 28 European countries

INFO-BOXES ON KEY REGULATORY FILES

- ESG ratings
- Retail Investment Strategy
- Sustainability preferences and ESG products
- ELTIF 2.0
- Financial stability
- The future of settlement
- Taxation impact on fund strategies

Available for purchase:
- Handy Excel-based statistical package containing:
  - More than 50 historical time series on net assets, net sales and numbers of UCITS and AIFs at the country level
  - Data on the 5 largest asset managers in various European countriescountries.

High yield "lives up to its name"

HIGH YIELD MANAGERS ARE EXCITED ABOUT BB-RATED DEBT – MUCH OF WHICH IS ISSUED IN EUROPE, FINDS **PIYASI MITRA**.

WITH INTEREST RATES RISING, the risk of default among companies paying higher interest rates on their corporate bonds increases. This is particularly the case for issuers in the high yield segment, where rates are currently in the 7-9% area. But there is a window of opportunity for investors in the higher-quality portion of BB-rated firms, according to some fund managers. Investors do not need to sink into the CCC-rated area, which is more risky.

Mark Benbow, high yield portfolio manager at Aegon Asset Management, says the rising interest rate environment has "turned the high yield bond market on its head", meaning investors can now find excellent deals in better-quality companies. Benbow says investors searching for yield have for some time had to accept low yields on corporate bonds, no matter the risk profile. This saw them looking at riskier parts of the market for better income.

"For years, investors have faced the reality of lending to corporates at ever-falling yields," he says. "Now, the high yield market is living up to its name. As rates have shifted higher, yields on high yield bonds continue to increase, even in the higher-quality part of the market."

Low interest rates in recent years kept defaults relatively low. But issuers are now forced to borrow at very high funding rates, notes Benbow, which are "proving painful" for BB-rated companies.

Yet many of these companies, he says, are high quality with "compelling" long-term total return potential, despite the lower rating. "Over the last couple of years, yields have risen significantly for the BB part of the ICE BofA Global High Yield index. In fact, the current funding rates for newly issued bonds are even higher as the index yield includes many short-dated bonds that don't earn all that much more than risk-free."

For new, long-dated funding, the reality is "painful" for firms as they face higher financing costs, but investors gain from the higher coupons. "In this environment, there are attractive opportunities to add exposure to higher-quality companies within the BB segment that offer high coupons and compelling long-term total return potential," says Benbow.

The coupon on Électricité de France is 9.125%. Cruise operator Royal Caribbean pays 8.25%. These are among bonds that he has added to the Aegon portfolio. Another, Ford, pays 7.2%. Benbow says it's "a great time" to be a high yield bond investor. You don't need to chase lower-rated or CCC risk to earn large returns anymore and there is a "clear transfer of wealth" from equity to bond holders.

"If we stay in a higher-for-longer rates environment, we are quite happy to keep lending to companies at these levels. At some point, yields will fall again, but for now, the ball is back in the high yield market's court, providing investors with attractive income and total return opportunities."

"THE HIGH YIELD MARKET IS LIVING UP TO ITS NAME. AS RATES HAVE SHIFTED HIGHER, YIELDS ON HIGH YIELD BONDS CONTINUE TO INCREASE, EVEN IN THE HIGHER-QUALITY PART OF THE MARKET."

Mark Benbow

Amid rising interest rates and record bond issuance, T Rowe Price launched the T Rowe Price Global High Yield Opportunities Bond Fund last year. This has exposure to the US high yield market – the world's biggest sub-investment grade corporate bond market – but also targets a 50% weighting in European and emerging market corporates.

Michael Della Vedova, who manages the fund, says: "Amid bank failures, it has been challenging for companies to obtain debt financing, but these conditions follow a period of record issuance in 2020 and 2021. Issuers could extend maturities out – with the bulk of the maturity walls of issuers coming after 2025 – indicative of broadly strong balance sheets."

Recent interest rate hikes, inflation and low growth have overshadowed credit

AMERICAN MUSCLE – Ford is a US winner for high yield investors.

risk concerns for investors. But this is likely to reverse as investors pay more attention to the strength of company balance sheets, say Della Vedova. Slowing growth will likely put the spotlight on companies' ability to cover rising interest costs. "The refinancing wave of 2020-2021 indicates most firms have healthy cash levels relative to debt on their balance sheets. Borrowing at meagre rates for a long time also allowed them to extend maturities, so many companies don't need to issue bonds this year."

Della Vedova adds that it's important to remember that companies tend to have debt with varying maturities spread over multiple years, so the impact of the rise in interest rates is not immediate – it's spread over time.

Sectors shining

Della Vedova finds value in European cable operators – an attractive industry in terms of valuations and supported by long term trends in media consumption and stable, recurring revenue business models that are important during slow growth. The fund is also overweight to high consumer spending areas such as entertainment and leisure.

In a similar way to Benbow, Kyle Kloc, senior portfolio manager at Fisch Asset Management, recommends investors opt for higher-quality bonds and avoid "very low ratings", like CCC bonds.

"We are underweight cyclical sectors owing to the recessionary outlook, and overweight industries that are better able to withstand such scenarios – and in the high yield segment, we include energy and metals," says Kloc. He adds that he sees potential in industrial metals – especially the likes of copper mines, given the e-mobility megatrend that ensures structural growth in demand.

Ford is a holding for the Pictet-EUR Short-Term High Yield Fund. So are Telecom Italia, Altice France, Softbank and United Group, revealing demand for technology-media-telecom (TMT) issuers. The TMT sector is a defensive choice in making the portfolio recession-resilient, says Pictet Asset Management senior investment manager Prashant Agarwal. "We look for positive catalysts such as Altice France and United Group engaging in asset sales transactions to repay some of these bonds partially," he adds. "Softbank has enough liquidity to repay the shorter bond maturities that we hold in the portfolio. Telecom Italia is the subject of discussions that could see their ownership change, but we expect our bonds held to be repaid or refinanced.

"Ford is a rising star, and we stand to benefit if the bonds are raised to investment grade."

Gerhard von Stockum, co-portfolio manager of the Global High Yield Fund at J Safra Sarasin Sustainable Asset Management, says the fund's holdings in energy continue to benefit from supportive oil prices: "While our overweight position in financials cost us a bit as debt collectors suffered after poor results and cautious near-term guidance, these bonds have started to change momentum, and this sector remains well positioned to benefit from weakening economic conditions." The fund's top holdings include a leading European recycler with "top ESG credentials", specialised energy players, senior debt in an improving European bank, a US-based health insurance provider, a prominent departmental store operator and a diversified Chinese conglomerate with "marquee international assets".

Europe versus the US

At T Rowe Price, Della Vedova points out the importance of Europe to high yield bonds as a means of managing risk. Europe has higher credit quality than the US with more BB-rated companies – 67% in Europe versus 50% in the US.

There is less exposure to traditionally cyclical industries such as energy or metals and mining, and fewer companies rated CCC or below – 5% in Europe versus 11% in the US.

As of March 31, 2023, North American issuers comprise 60% of the global sub-investment grade credit market, with European issuers accounting for 24% of the broad market and emerging market issuers at 17%, Della Vedova notes.

A Neuberger Berman analysis showed that when spreads between corporate bonds and government bonds were at 500 to 600bps, like now, investors have historically generated a positive total return – from coupons and prices – 81% of the time over a two-year investment horizon. "We view the yields on offer today with spreads over 500bps as an attractive entry point despite uncertainties," says Simon Matthew, senior portfolio manager, non-investment grade credit, Neuberger Berman.

Across high yield portfolios, Matthew prefers shorter-duration and higher-quality names, with a bias towards European high yield depending on issuer. This is because the fundamental backdrop looks better than expected.

While further rate rises would impact the cash price of corporate bonds and performance, Matthew thinks it is less of a factor in the current rate cycle.

"The average duration of the high yield market is on the low side – at 3.2 years in the case of European high yield – making the impact more marginal compared to longer-duration investment grade or government bond asset classes. With a yield-to-worst of 7.8%, we would need to see a material movement in rates or widening of credit spreads to result in negative total returns."

Kloc at Fisch Asset Management explains that shorter durations in Europe, and therefore lower sensitivity to rising interest rates, also favour long-term investments in euro high yield bonds.

"Only in terms of liquidity is the US market at an advantage in the event of market stress," says Kloc.

Dos and don'ts

The year-to-date performance of the Pictet fund has been "strong" in absolute and relative terms, says Agarwal, adding that market conditions have helped investors to identify the stronger firms. Avoiding defaults is a key role for asset managers' credit analysts carrying out bottom-up research.

Paul Benson, head of efficient beta at Insight Investment, says investors should recognise that US corporate high yield and the S&P 500 have produced similar returns over recent years, with high yield bonds offering 40% lower volatility than equities. "Global corporate high yield has outperformed MSCI World and MSCI ACWI this century," he points out.

He adds that the end of quantitative easing has dual implications. "Firstly, greater cross-sectional dispersion amongst companies – separation between winners and losers means a higher potential for alpha for quantitative and fundamental active investors," says Benson. Secondly, he says, "range-bound markets" favour the high contractual income of high yield bonds over equities.

Kloc adds that funds selectors ideally will select managers experienced in multiple credit cycles with sufficient research resourcing. "Understanding a balance sheet is not enough – it is important to have the experience to interpret patterns of firms and management teams to understand how an issuer will react to evolving markets."

Emerging edge

Von Stockum considers selecting oversold emerging market issuers as "good alpha opportunities" as divergence highlights the benefit of diversifying exposure to macroeconomic forces.

Ed Harrold, investment director, fixed income, Capital Group, says "encouraging" returns in 2023 from the firm's Global High Income Opportunities Fund came as both high yield and emerging markets generated "strong income". The fund offers a diversified exposure across local and hard currency sovereign and corporate bonds, and he sees opportunities in local currency debt within emerging markets, partly due to sizeable real-yield differentials relative to developed markets which should protect from volatility. The most value lies in Latin American countries such as Mexico and Brazil where, Harrold says, there were early interest rate hikes to curb inflation and support exchange rates. The Brazilian real and Mexican peso stand out for being among the few currencies that strengthened against the dollar last year.

> "FORD IS A RISING STAR, AND WE STAND TO BENEFIT IF THE BONDS ARE RAISED TO INVESTMENT GRADE."
>
> *Prashant Agarwal*

"Investment grade issuers remain rich relative to similarly rated developed market corporate bonds, whilst cheaper valuations in the high yield part of the market reflect stress with many lower-rated sovereigns close to, or already in, default situations. Hence, it is important to look through market-level valuations signals and take a bottom-up approach to building portfolios," says Harrold. Owning high-yield bonds ahead of a potential recession might make some investors uneasy, but for those with a time horizon beyond one year, investing in bonds with current yields of about 8% has historically offered solid returns, he adds. "A cautious approach is appropriate in the near term, and the value lies in cash-generative companies less impacted by a potential recession, such as BB-rated pharmaceutical and cable companies."

Steve Logan, high yield portfolio manager, PGIM Fixed Income, says he is cautiously positioned on cyclical sectors such as chemicals and autos and overweight on industries such as telecom and grocery retailers. The fund is also exposed to sterling high yield, which remains relatively cheap as it recovers from the sharp sell-off seen after last year's UK mini-budget. Yields are increasingly attractive on an absolute basis, and spreads are currently above the historical average, unlocking value for investors with longer time horizons, he says. In the event of stagflation, spreads and rates have already repriced to some effect – cushioning some of the blow.

In contrast, a recession could coincide with a rate decline, offsetting some volatility in credit spreads. "If rates and spreads move sideways, the sector should generate attractive income, an outcome where rates remain near their peaks, and credit spreads contract may enhance the sector's total return potential," says Logan. He cites the example of 'reverse Yankee' issuers – US-domiciled issuers who issue debt outside of the US in currencies such as sterling or the euro.

"Although the bonds have identical credit risk, the spread differential is driven by a combination of a lack of resources to analyse the breadth of US issuers – prompting many European investors to avoid the opportunity set – and lower liquidity levels in Europe," says Logan.

The firm's 2022 analysis of ten debt issuers in a range of structures in US and European markets revealed that euro offerings were an average of 181bps wider, with some premiums as high as 271bps. **f**e

Does UK RDR show the EU must ban fund retrocessions?

EU FUND MANAGERS REMAIN ENTRENCHED ON FUND RETROCESSIONS, WHILE THE UK HAS TENTATIVELY SHOWN THAT BANNING COMMISSIONS COULD BE HEALTHY FOR THE FUNDS INDUSTRY. BY **NICK FITZPATRICK**.

THE YEARS-LONG QUANDARY about fund costs came back to the fore in the EU when the European Commission adopted the Retail Investment Strategy, which aims to achieve fair treatment for retail investors, in May.

The level of costs and the transparency of how costs are displayed have vexed the funds industry for years – and the temperature on this issue only increases when commissions paid to fund distributors, an intrinsic part of costs in many funds, are thrown in.

The EC Retail Investment Strategy – championed by Mairead McGuinness, Commissioner for Financial Services – once again opens the debate on the murky world of 'inducements', also known variously as commissions, rebates and retrocessions.

The EU will not follow the lead of the UK and the Netherlands by banning inducements completely. Instead, the

MELTDOWN – Turning up the temperature on fund fees.

proposal is for a partial ban. 'Execution-only' products – where no advice is given – are in scope.

The UK industry – where funds are largely distributed by independent financial advisers, wealth managers, digital platforms and banks – banned commissions in January 2013 with the introduction of the Retail Distribution Review (RDR). The Netherlands has taken a similar measure.

In the EU – where the fund distribution landscape is dominated by banks – that resistance is still there, including from organisations representing investment funds.

The RDR introduced 'clean' share classes – share classes absent inducements – and research has found that lower fees and higher levels of assets under management (AuM) have resulted since then for funds with clean share classes.

Fees down, assets up

Back in 2021, Fitz Partners showed that the ongoing charges figure (OCF) for clean share classes in many cross-border European funds domiciled in Ireland and Luxembourg (and which invested in equities) fell by 7% and their assets climbed 86%.

However, over the same period – 2016 to 2020 – it was also shown that share classes that still had distribution costs 'bundled' into them also saw assets rise and fees drop, albeit to a lesser extent: fees fell just 1% and AuM rose 25%.

Whereas the UK and the Netherlands stamped out commissions to distributors, in the wider EU, policymakers opted – through the 2018 introduction of MiFID II – to make fund managers unbundle commissions from other fund costs and be transparent about them.

The EU Retail Investment Strategy resurfaces the issue. After all, a key point is to see that customers are treated fairly. Being in different share classes may mean they are not.

"We've been talking about costs for ages," says Hugues Gillibert in reference to the funds industry. Gillibert is chief executive of Fitz Partners. "I guess the European Commission decided that still not enough was being done."

Big move in pricing

However, the state of costs now is different from 15 years ago, he says. The introduction of stricter regulations around fee transparency as well as market forces have come into play, principally through the rise of cheaper passive funds and the increase in the number of passive products, which forced active asset managers to reduce fees in the name of competition.

"This has certainly worked for newly launched funds but less so for older funds. When we review funds that were launched ten years ago, we see that the average cost has not moved much, depending on the share class. Both retail and institutional share classes are slightly down.

"But for newly launched funds, there has been a big change and the price point is lower," says Gillibert.

He puts this down to the rise of cheaper, passive funds competing strongly with actively managed products, but also to investors having easier access to quoted fund charges.

The data, therefore, may point to a correlation, rather than a causation, between falling levels of fees and the emergence of clean share classes. Nevertheless, the correlation is notable.

"In clean share classes – those with no rebates in them – price points are now very close to institutional share classes [which are generally cheaper], and so the launch of the Retail Investment Strategy could be to do with the fact some people in bundled share classes are not being treated the same as those in clean share classes."

The EC notes that products and services offered to retail investors "often carry high fees and commissions which have a negative impact on their return on investments". In 2021, retail clients were charged on average around 40% more than institutional investors across asset classes, the EC said, citing research by the European Securities and Markets Authority, Europe's financial markets regulator.

> "THESE MEASURES WILL NOT FURTHER INCREASE THE CURRENT LEVEL OF INVESTOR PROTECTION, WHICH SINCE MIFID II IS ALREADY VERY HIGH."
> *Thomas Richter*

"Major disruptive consequences"

Although the Retail Investment Strategy only proposes a ban on inducements for execution-only sales of financial products, even this measure is not appreciated by some of the fund bodies in Europe, including the European Fund and Asset Management Association (Efama) and Germany's BVI.

In a statement following the release of the Retail Investment Strategy, Efama said: "Although the Commission declared it had abandoned its original plan to fully prohibit commissions in the distribution of investment products and insurance-based investment products due to potential disruption to the market, there are many prohibitions to the payment of commissions in the … proposals, and these would still have major disruptive consequences for the European financial sector and consumers' access to investment and insurance protection."

Efama – which delivered its

statement jointly with other finance trade groups – said its comments were "high level" for the time being while other areas of fund regulation were still being assessed.

Also at the time, Thomas Richter, chief executive officer of the BVI, said the BVI opposed the commission ban in respect of non-advised sales, as well as the additional requirements regarding commission-based advice.

"These measures will not further increase the current level of investor protection, which since MiFID II is already very high," he said.

Other research shows how fund charges for investment funds governed by the EU's Ucits regulations have fallen over time. An October 2022 report from ICI Global, a trade body, showed average ongoing charges for equity Ucits fell 19% between 2013 and 2021 (from 1.49% to 1.21%). Fixed income Ucits saw the average ongoing charge decline 31% (from 0.98% to 0.68%).

The research also shows that investors tended to concentrate their assets in lower-cost Ucits, which is a concern for Efama. The body says that the EU retail strategy's "best interest of the client" test "disproportionately focuses on costs" and may lead clients to prioritise the cheapest product over others that could potentially offer them greater value.

"Misleading comparisons"

ICI Global warned against making snap decisions from comparisons between the costs of clean and bundled share classes.

"Retail investors still pay for the cost of distribution even when it is not included in the total ongoing charge. Direct comparisons of average ongoing charges between Ucits share classes that 'bundle' distribution in the ongoing charge with those that 'unbundle' distribution from the ongoing charge can be misleading. In unbundled share classes, retail investors typically pay distribution costs directly out of pocket," ICI Global said in its 'Perspective: Ongoing charges for Ucits in the European Union' report.

In other words, consumers could be buying funds after receiving advice - advice which was paid for seperately rather than bundled into the ongoing charge.

Resistance in the EU industry to the banning of retrocessions is widely seen to be due to the power of the banks, which earn commissions for distribution. But in Efama's view, there is a legitimate question to ask about whether the business models of the UK and Netherlands are superior to that of much of Europe where retrocessions are still widely used.

Like ICI Global, Efama has warned that clean and bundled share-class comparisons could be too simplistic to conclude that clean share classes are cheaper overall.

"The truth is that these charges are lower because they exclude the fees paid by investors to receive financial guidance or advice," wrote Bernard Delbecque, Efama's senior director, economics and research (see *Funds Europe*'s Association Column, February 2022).

Once again, investing in a clean share class might only happen after the investor paid a platform fee or where advice was received - and paid for - seperately, increasing the overall fund cost, even for clean share classes.

Owing to a lack of data, Efama commissioned Fitz Partners to research the topic and found that the share of costs of distribution and advice in the total cost of ownership of an active Ucits averaged 38%. Remarkably, it was the same for cheaper passive funds.

"DIRECT COMPARISONS OF AVERAGE ONGOING CHARGES BETWEEN UCITS SHARE CLASSES THAT 'BUNDLE' DISTRIBUTION IN THE ONGOING CHARGE WITH THOSE THAT 'UNBUNDLE' DISTRIBUTION FROM THE ONGOING CHARGE CAN BE MISLEADING."
ICI Global

Inflationary pressures

There is no doubt that cross-border fund costs have decreased over the past ten years. The question is whether clean share classes are the cause, or whether it's down to better fee disclosures stemming from a number of regulatory initiatives in recent years, and down also to market forces attributed to the rise of passive investing.

But one thing is certain. In the current high inflationary environment, many providers of goods and services are – by definition – increasing prices to cope with the pressures they are under. Though not asset managers, it seems.

Years of consumer and regulatory pressure to lower costs make it very difficult for the vast majority of fund management firms to hike prices now.

Gillibert notes: "Everyone complains about inflation and the fact that businesses are putting up prices - but funds seem to be the only sector where prices cannot be raised!" **f**e

Re-papering for SFDR agreements

IRISH-DOMICILED SUSTAINABILITY-RELATED FUNDS ARE GROWING HUGELY – BUT MAPLES LAWYER IAN CONLON TELLS **NICK FITZPATRICK** MANY FUNDS NEED TO 'PAPER' CERTAIN RESPONSIBILITIES INTO THEIR OLDER FUNDS TO AVOID LEGAL UNCERTAINTY.

SUSTAINABLE INVESTMENT FUNDS are launching at a greater pace across fund domiciles such as Ireland, where about a quarter of funds are now categorised in line with EU rules on sustainability disclosures, according to recent research.

The amount of Irish-domiciled sustainability-related funds that are newly established has grown by over 40% in the past two years, according to data from law firm Maples Group, which analysed more than 6,400 funds in Ireland.

The firm found that 23% of Irish-domiciled funds are now categorised as either Article 8 or Article 9 funds under the Sustainable Finance Disclosure Regulation (SFDR).

Ireland has €3.74 trillion of assets under administration and is the second-largest cross-border fund hub after Luxembourg, with more than €5 trillion of assets under administration. Ireland and Luxembourg both have ambitions to become 'green hubs' for sustainable investments and Maples' research says the increasing number of sustainable funds in Ireland is consistent with growth in other fund domiciles.

Ian Conlon, a partner in the fund and asset management practice at Maples Group in Dublin, says that the growth in Ireland's sustainable funds sector suggests that ESG funds will reach US$34 trillion of assets by 2026, as predicted by consultancy PwC, with Europe holding half that volume.

"SOMEONE MIGHT SAY THAT 'ONLY' 23% OF IRELAND'S FUNDS ARE SUSTAINABLE, BUT THE REAL POWERFUL STATISTIC FROM OUR RESEARCH IS THAT OVER 40% OF NEW FUNDS THAT ARE BEING ESTABLISHED ARE SUSTAINABLE FUNDS."

Article 9 funds offer the highest level of focus on sustainability, but only 3% of Irish-domiciled funds have Article 9 status and just 15% of those hold investments consistent with the EU's green taxonomy.

"Someone might say that 'only' 23% of Ireland's funds are sustainable, but the real powerful statistic from our research is that over 40% of new funds that are being established are sustainable funds," says Conlon. "I'm very confident in saying that this number will dramatically increase over the next five to ten years."

He argues that the rise in sustainable funds shows that the EU Sustainability Action Plan – introduced in 2018 and now the European Green Deal – is working.

Peter Stapleton, Maples' global ESG lead, adds: "We are quite bullish around the growth of sustainable funds in Ireland" and says that the development of Ireland as a global hub is a core focus of the Irish government's Ireland for Finance Strategy.

Greenwashing caution

Accusations of greenwashing in the UK and EU funds industry have been levelled at firms. Germany's DWS is probably the most well-known example and a wave of caution following greenwashing allegations is thought to be partly behind some fund managers reclassifying their Article 9 funds to Article 8, which have a lower level of sustainability requirements under the SFDR. Morningstar found that some 40% of funds were downgraded by asset managers from Article 9 to Article 8 categorisation in the final three months of 2022.

According to Conlon, greater clarity from the European Commission about the definition of sustainability in April this year will bolster confidence at asset management firms that want to offer Article 9 funds. Even greater confidence will follow the first reporting round next year under the Corporate Sustainability Reporting Directive (CSRD), which will increase transparency about the sustainability of companies that Article 9 fund might invest in.

"We have clients who feel they are more EU taxonomy aligned, but they may be adopting a prudent and sensible approach because they cannot be confident right now based on the quality of the data available," says Conlon.

Who does the papering?

Responsibility for a sustainability-focused fund's compliance with the SFDR primarily sits with the management company – the regulated entity of a fund, known in the industry as the 'ManCo'. In a multi-manager context, which is the prevalent model in the European fund space, it is "crucial that the relevant party responsible for SFDR compliance is identified", Conlon says.

Due to this, pre-SFDR fund management agreements may need "re-papering" to clarify responsibilities. Conlon says it's important that the management agreement in place between a ManCo and a delegate investment manager clearly outlines the responsible party for SFDR compliance.

"If a ManCo did not revisit their management agreements upon the introduction of SFDR, there are potentially gaps that need papering. Otherwise, responsibility for SFDR compliance will default to the ManCo," he says. "So, the impetus for the clarification of these responsibilities lies with the ManCos. When something goes wrong, the parties could become entrenched if they have not contracted who is responsible for SFDR compliance."

The third-party ManCo market – where the management company entity is outsourced – has seen huge growth in recent years, both in Ireland and Luxembourg.

Fund administration firms or legal firms, including Maples, are the main providers of these services.

In its research, Maples found that third-party ManCos manage 35% of all Irish-domiciled funds and in aggregate manage approximately 25% of all Irish-domiciled Article 8 and Article 9 funds. Conlon says these providers were shown to be placing reliance on delegate investment managers for SFDR compliance.

"IF A MANCO DID NOT REVISIT THEIR MANAGEMENT AGREEMENTS UPON THE INTRODUCTION OF SFDR, THERE ARE POTENTIALLY GAPS THAT NEED PAPERING. OTHERWISE, RESPONSIBILITY FOR SFDR COMPLIANCE WILL DEFAULT TO THE MANCO."

Ian Conlon

Website disclosures

More broadly, the Maples report notes that there needs to be a focus on SFDR website disclosure content and location rules – i.e., that the sustainability disclosures are located in the appropriate area of the website that is labelled 'Sustainability-related Disclosures'.

Maples studied the websites of the top 30 managers in Ireland and found a high level of compliance with sustainability disclosures. However, the disclosures were not always located under a dedicated 'Sustainability-related Disclosures' section, meaning finding a firm's disclosures could be "challenging". **f**e

PAPERING OVER THE GAPS – ManCos and investment managers' responsibilities need to be clearly set out.

India: An "obvious choice for global investors"

OUR INDIA INVESTMENT ROUNDTABLE STARTS BY ASKING TWO SEASONED EXPERTS IF INDIA IS THE 'LAST ONE STANDING' FROM THE BRICS PHENOMENON. WE ALSO HEAR THAT INCLUSION OF INDIAN BONDS IN A MAJOR INDEX MAY NOT BE THE DESIRED PRIZE THAT MANY SEEM TO THINK IT IS.

PANEL

PRAVEEN JAGWANI
CEO, UTI International Singapore Pte Ltd

GAURAV NARAIN
Portfolio adviser, India Capital Growth Fund and co-head of equities, Ocean Dial India Pvt Ltd

***Funds Europe* – What is your current economic outlook for India? Do you consider India the "last person standing" of the Brics countries?**

Praveen Jagwani, UTI International – Jim O'Neill, who coined the term Brics in 2001 – an acronym for Brazil, Russia, India, China and South Africa – admitted a decade later that it "doesn't make any sense". The constituent countries are strikingly different in their drivers, and while it seemed like a nifty idea for investing then, the reality is Brics failed to bear the expected fruits.

Russia has demolished its hopes of reintegration with the global economy for a few decades to come. To highlight a recent example, China has emerged as enemy number one with question marks on its stability at the recently concluded G7 meet in Japan. As per Reuters, the G7 summit issued a communique that singled out China on issues including Taiwan, nuclear arms, economic coercion and human

"WHILE IT SEEMED LIKE A NIFTY IDEA FOR INVESTING, THE REALITY IS BRICS FAILED TO BEAR THE EXPECTED FRUITS."

Praveen Jagwani, UTI International

rights abuses, and widening tensions between Beijing and other countries, including the USA.

China is a superpower, no doubt, and will remain a relevant and meaningful player on the geopolitical stage for many decades to come – but will it attract investment flows? Does the world trust China, given its questionable approach to human rights issues, belligerence with neighbouring islands, the Taiwan problem, a massacre of democracy in Hong Kong, people disappearing, and more?

Brazil's re-election of former president Luiz Inácio Lula da Silva has not spelt good news for the country either. Lula's attempts to undo the reforms of his predecessors with flip-flop policies are making the country look like the poster child of all that is wrong with emerging markets.

In sharp contrast, India has displayed consistency in economic policies and political continuity, making the nation a dependable investment destination among other emerging markets. According to Morgan Stanley projections, India is on track to become the world's third-largest economy by 2027, surpassing Japan and Germany, and to have the third-largest stock market by 2030.

India ought to be understood within the framework of CRG – consumption, reforms and geopolitics. Large consuming middle-class and structural reforms by the Narendra Modi government have created a sustainable engine of growth. With a 1.4 billion population comprising 400 to 450 million middle-class people, there is clockwork consumption of everything ranging from FMCGs [fast-moving consumer goods], automobiles, clothing, real estate, luxury items and more. Reforms have merely accelerated this process of adding more people to the middle class, giving the middle class an aspiration, a platform for higher incomes and, subsequently, higher disposable income.

Geopolitically speaking, India became globally relevant ever since Donald Trump started his anti-China rhetoric. A series of incidents have made the world nervous about China as the country doesn't play by the rules of the free world. This is not to say that other countries would completely stop doing business with China, but when they are nervous, fresh money doesn't pour in.

Mazda has shut down its plants in China and Apple is relocating its supply chains to India. Considering the larger context, Western corporations are hunting for a reliable option for relocating their supply chains to manage their business cost-effectively. India is rapidly becoming an obvious choice.

Gaurav Narain, Ocean Dial India – The Brics concept emerged in the 2000s when these were the high-growth, developing economies. Since then, China – the Goliath – has gone on a different trajectory, but time is testimony that every economy is different.

Considering the challenges every economy has faced recently, India has emerged as the shining star of the lot. Long-term prospects and the democratic environment, coupled with its large consumer base, have only improved over this last decade.

Disruptive reforms have been implemented across virtually every sector of the economy under the Modi government since 2014. Along with infrastructural reforms, a prodigious change was the big drive towards digitalisation. Endeavours in this field have given modern India an advantage over the rest of the world, including the West. India's digital infrastructure is at par with, if not better than, the best, government-owned and low-cost.

India took the world by surprise during the pandemic. Recovery and coping strategies worked better than expected because of reforms already undertaken. No corporate or banking issues surfaced when the economy had just closed down. Thanks to the robust digital infrastructure, the government successfully targeted benefits and subsidies in a directed way without affecting the fiscals as it did for the rest of the world.

In a post-Covid world, India is armed with a banking system with non-performing assets at historical lows, well-functioning corporates, a government with relatively healthy financials compared to the rest of the world, and adequate funding to push for the growth of a well-positioned economy.

With worries surfacing over China, India has been getting a lot of incremental business primarily because of two factors. Firstly, it has a large population similar to the massive domestic economy of China. Secondly, several structural obstacles like infrastructure, regulatory environment, ease of doing business and others also got fixed, thanks to various government initiatives.

***Funds Europe* – What are the benefits and risks of investing in India now? Currency impact appears to be a salient issue, perhaps partly driven by foreign institutional investor flows in and out of the country.**

Narain – India's regulatory environment has improved, the fiscal situation is decent, the currency situation is in control, so the government's focus is on sustaining economic growth. Projections from global financial institutions indicate that the country is poised to be the fastest-growing large economy for years to come. Now it is all about employing the younger demographics in the workforce, so everything is targeted towards development and expansion.

This shift has not just taken place at the central government level but also at the state government level. The whole mindset has changed. Gone are the old days of ministers engaged in caste-based politics; the current focus is on employment, development and infrastructure. Thanks to the evolution of the telecom infrastructure, citizens are now better connected and instantly updated about domestic and international happenings. Now it is all about ensuring that growth gets the job done.

In India, almost 50% of any company, on average, belongs to the promoting families. Certain sectors also limit foreign ownership, so as the free float comes down, so do the weights. Hence, India is under-represented in many global indices. China currently represents approximately 30% of the MSCI emerging market index. However, India's share in the emerging market index has jumped quite a bit in the last year or two. It's a matter of time before India gains recognition on that front.

The International Monetary Fund recently highlighted in its 'Stacking up the benefits lessons from India's digital journey' report how India has developed a world-class digital public infrastructure to support its sustainable development goals, with its journey having lessons for other countries embarking on digital transformation journeys. The world's largest biometric ID system, Aadhaar, has helped create a digital infrastructure to disrupt financial services, efficiently economise service delivery systems and boost the start-up ecosystem. Aadhaar was a part of the government's efforts to ensure that every individual had an identity – even if they were illiterate or had no birth certificate. Over two or three years, about 1.3 billion people had a base identity comprising a fingerprint and a retinal scan – all digital. Indian banks and other service providers now use Aadhaar for know-your-customer verification of customers.

Another milestone achieved is the United Payments Interface (UPI), the free digital banking platform that has every financial service provider linked to it. Simply put, it is an instant payment system facilitating inter-bank peer-to-peer and person-to-merchant transactions to instantly transfer funds between two registered bank accounts via mobile phones. Top-tier fintech companies have piggybacked on this revolution to create an environment conducive to financial inclusion across the country. Data shows India accounted for the highest volume of

"PROJECTIONS FROM GLOBAL FINANCIAL INSTITUTIONS INDICATE THAT THE COUNTRY IS POISED TO BE THE FASTEST-GROWING LARGE ECONOMY FOR YEARS TO COME. NOW IT IS ALL ABOUT EMPLOYING THE YOUNGER DEMOGRAPHICS IN THE WORKFORCE, SO EVERYTHING IS TARGETED TOWARDS DEVELOPMENT AND EXPANSION."

Gaurav Narain, Ocean Dial India

real-time payments among global businesses, with over 40% of all such payments made through 2021 originating in the country.

According to a report by payment solutions provider ACI Worldwide, data analytics firm GlobalData, and the

Centre for Economics and Business Research (CEBR), India made 48.6 billion real-time payments through 2021 – over 2.6 times higher than China, which is in second place with 18.5 billion real-time transactions. Fintech platforms and banks are using this to democratise the financial system based on the low-cost platform the government has provided them with.

Earlier, banks have been reluctant to service small towns or rural centres due to the costs involved. Today, even a vendor selling fruits on a cart has a simple digital payment system installed. Buyers can scan the QR code in their phone and make payments worth as low as ten cents – no cost to the common man, no cost to the vendor. This simple yet effective system has formalised the economy because one cash transaction is now converted to a tracked transaction. Changes such as this have bolstered confidence in the economy moving to the next level. India's sufficient foreign exchange reserves and stable current account deficit also act as buffers against external volatility.

Jagwani – Historically, global investors generally chose to invest in emerging markets to harness two benefits: higher returns and diversification. Let us consider the 20-year history of equity returns. Emerging markets have disappointed on both counts and neither did they give better returns nor provide diversification. In dollar terms, over the last 20 years, India's equity index has delivered better returns than not just China and MSCI emerging markets but also the S&P 500.

India still offers those twin benefits the world always sought but never got – mainly because India is a domestic consumption-dominated economy and not an export-oriented one. In a world flirting with recession or slowdown at best, relying on external buyers could be tricky. If global trade is declining and commodity prices are going downward, then an economy like India that is self-sufficient, internally driven, and supported by a youthful, growing, middle-class consumption is more dependable.

Despite the benefits, getting the big index providers to give India adequate weightage is a challenge. For example, as a $3.5 trillion economy, India is roughly 2.8% of the global GDP, India's market cap is roughly 2.4% of the global market cap, yet in the ACWI [All Country World Index], India barely occupies 1.4%.

If you look at all the emerging market currencies, except for the Chinese yuan, the Indian rupee has been one of the most stable. Looking at the graphs for the Turkish lira, Brazilian real, the Russian rouble or the South African rand would reveal how volatile those currencies are, but the Indian rupee looks like a safer option. Its historical track record over 15-20 years is an average annual depreciation of about 3-3.5%, which does not seem to be such a big markdown if one is investing in equities.

Considering India's forex reserves are now the fifth-largest in the world, there is a fair amount of certainty around the currency and confidence in the Indian central bank. The view on the rupee is largely shaped by the global view of the dollar. Given the muted outlook for global growth, somewhere between technical recession and actual recession, the dollar is not expected to strengthen this year. In conclusion, we can expect the rupee to be reasonably steady.

***Funds Europe* – JP Morgan has Indian bonds on its watch list for inclusion in the JP Morgan Government Bond Index-Emerging Markets (GBI-EM) indices and could decide on inclusion in 2023. Would this inclusion be welcomed by bond investors? What has India done to elevate the status of its bonds?**

"WHY WOULD ANY COUNTRY SEEK INCLUSION ON A GLOBAL BOND INDEX? THE SINGLE BIGGEST REASON IS TO DIVERSIFY ITS CAPITAL SOURCES, AND HONESTLY, THE INDIAN GOVERNMENT DOESN'T NEED IT AT THIS POINT."

Praveen Jagwani, UTI International

Jagwani – Inclusion of Indian bonds in global indices has been a recurring theme for quite a few years, but one has got to examine what's in it for India. Why would any country seek inclusion on a global bond index? The single biggest reason is to diversify its capital sources, and honestly, the Indian government doesn't need it at this point. The international and domestic flow of savings is adequate to fund all the fiscal expenditures of the Indian government in any given year, so the government is not motivated enough to look for external sources of capital.

I joined UTI 14 years ago and have been aware of the narrative that India is on the verge of joining a global bond index since then. However, I am not holding my breath anymore as I know

"IF YOU ASKED THE CHIEF INFORMATION OFFICER OF A PENSION FUND BASED OUT OF CHICAGO OR STOCKHOLM, THEY WOULDN'T KNOW OR CARE ABOUT THE SETTLEMENT CYCLE A COUNTRY OPERATES WITH. THEY WOULD SIMPLY SAY: 'I WANT A PIECE OF INDIA AND I WANT THIS MUCH.'"

Praveen Jagwani, UTI International

there isn't enough incentive in New Delhi to get this done. When global investors want a piece of emerging market local currency action, then JP Morgan Government Bond Index-Emerging Markets indices are their go-to option. You have countries like Bolivia occupying 5% of the index, and the country is only half the size of New Delhi.

If India were to be included, needless to say, it is going to be fantastic. The inclusion would mean more business for us in helping global investors access Indian bond markets.

The main holders of Indian bonds are Indian pension funds and if bond markets were opened to foreign investors, the mark-to-market volatility would create havoc for the domestic pension system. Indian equity markets are freely tradable for foreigners, which entails volatility seen in markets. Having such volatility in domestic bond markets has little upside for the Indian government. Additional supply of debt capital is not worth the pain of swings in pension balances, so there is no push inherent push to seek external sources of capital for India. However, if India gets included in global bond indices, we would be delighted.

Narain – I would put a slightly different spin on it. The Indian bond market is quite illiquid, and the government has been trying for a long time to bring more liquidity without success. The intent is that once you open up the bond market you will get more liquidity, and in a sense, it will also lower the cost of borrowing for the government and, eventually, the corporate sector. The whole idea is to keep opening up the economy.

Historically, India has always been concerned about the volatility caused by foreign flows, but the central bank is a lot more comfortable with the external environment and the buffers in place today. What happens next would only be a natural progression.

There are some operational issues both parties are stuck on. For instance, the Indian government wants the taxation system to be the same for domestic and offshore investors so there is no discrimination between domestic and foreign investors, placing foreign investors at an advantage. Everything is currently settled in Europe, but the Indian government insists that trade settlement happens in India. This also has more to do with integrating the Indian markets globally – equity markets have been integrated, while the bond markets have not.

***Funds Europe* – January 27, 2023 marked the completion of the year-long changeover in the settlement cycle from T+2 (trade date plus two days) to T+1 and 80% of its equity market capitalisation is now T+1.**

Would this attract more foreign investors who have previously expressed concerns over time-zone differences and consequent trade-matching failures?

Narain – India is one of the few countries in the world which has moved to a T+1 settlement cycle. We moved to a T+2 back in 2003 – a progress reflecting the government and regulator's confidence in our digital systems. The regulators probably thought: "We have a hundred million retail investors, and every transaction is online, so why still work on a T+2 settlement cycle?"

Indian stocks accounting for 80% of the equity market capitalisation moved to the shorter T+1 trade cycle, and the transition has been seamless. We've had no issues in trade settlements, and it's possibly one of the most efficient systems across world markets. After the Indian experience, one could expect the rest of the world to shift to a T+1 settlement cycle.

Jagwani – Any investor who ever wanted to invest in India was never held back by the pre-existing T+2 settlement cycle. Would the business increase because we have gone from T+2 to T+1? Probably not.

These are operational issues and people make investment decisions for the risk-return benefits they derive from global portfolios. If you asked the chief information officer of a pension fund based out of Chicago or Stockholm, they wouldn't know or care about the settlement cycle a country operates with. They would simply say: "I want a piece of India and I want this much." The rest is for the middle-office and back-office teams to figure out. The new system went live in January, but nothing significant has happened to

Indian flows so far. However, a positive outcome of a shorter settlement cycle for the retail investor is that the funds are not blocked, and the systemic risk is lower.

***Funds Europe* – India's first sovereign green bond went to auction recently with no restrictions on foreign investment, so can we expect demand for Indian green bonds going forward? Are there any ESG trends in India's investment industry that you would like to highlight?**

Narain – ESG is growing in India. At the 26th Conference of Parties (CoP26) to the United Nations Framework Convention on Climate Change, Indian prime minister Narendra Modi declared a fivefold strategy — the *Panchamrita* — to achieve this feat.

Panchamrita includes objectives like India aiming to get its non-fossil energy capacity to 500 gigawatts by 2030, reducing the total projected carbon emissions by one billion tonnes by 2030 and achieving the net-zero target by 2070.

In 2021, the Securities and Exchange Board of India, or Sebi, mandated new sustainability-related reporting requirements for the top 1,000 listed companies by market capitalisation. New disclosure would be made in the business responsibility and sustainability report in an upgrade from Sebi's existing reporting framework and a crucial step toward standardising sustainable financial reporting.

The pressure from investors and global companies cannot be ignored. Any company keen to explore business opportunities views ESG as a risk, and the pressures felt in Europe have flown down to India as well because all the large corporates have global linkages today. If you don't meet the standards, that's business lost.

As an asset management firm, we are noticing companies being more proactive, and some of our portfolio companies are using ESG as a positive factor to invest in. They are trying to be ahead of the curve by using ESG to procure more business and generate more investment interest. The challenge is to bridge the gap between what you have disclosed and what is implemented on the ground. Companies are now looking at it from a risk perspective. If you are not on top of your game, you have a business sustainability problem.

Because our investors are mostly European, there's a lot of pressure on the portfolios we manage and advise on. We have started ranking each stock and observed a massive change over the last few years. We look at many small and mid-cap companies without much disclosure now, but they are waking up to the fact that there could be business risks.

The Indian government has raised about $2 billion for the green bond, majorly subscribed by the Indian banks that are required to make disclosures on both the asset side and the lending side. As the disclosures are published, one can position which bank is ahead of the other based on the information available.

Jagwani – India has established an ESG trajectory for itself, led mostly by the regulator and partly by the top multinational corporations. The regulator has mandated specific disclosures starting in 2023 for the top 1,000 listed companies of India. Change is never easy, so kicking and screaming, we'll eventually get these companies to the required level of disclosure and transition.

"PANCHAMRITA INCLUDES OBJECTIVES LIKE INDIA AIMING TO GET ITS NON-FOSSIL ENERGY CAPACITY TO 500 GIGAWATTS BY 2030, REDUCING THE TOTAL PROJECTED CARBON EMISSIONS BY ONE BILLION TONNES BY 2030 AND ACHIEVING THE NET-ZERO TARGET BY 2070."

Gaurav Narain, Ocean Dial India

The problem lies in the lack of coherence on a globally acknowledged definition of ESG. Even within Europe, the Germans and the French cannot seem to agree on its constituents. Do we want exclusion? Do we leave out the polluting companies? Or do we work with them because that's where you might get the biggest bang for your buck?

Even in the USA, ESG has become a highly politicised issue with regulators taking the backseat. In such a global backdrop, it's difficult for a third-world country like India to take a hard stance on anything.

There is opportunity for asset managers if one can demonstrate that a specific pool of money is being utilised for the betterment of climate, conservation of the environment and related activities.

A crucial element missing from the picture is intellectual and philosophical alignment. **f**e

Tactics versus strategy

FUNDS EUROPE TALKS TO CALASTONE'S BRIAN GODINS ABOUT HOW FIRMS CAN DELIVER LONG-TERM VALUE THROUGH TECHNOLOGY CHANGE.

NEXT YEAR MARKS the centenary of the mutual fund. Introduced in the US by MFS Investment Management in 1924 as a way for investors to pool their money in search of higher returns, not much has changed in the intervening 99 years.

While innovation has been evident in other parts of the financial services industry, in terms of new asset classes, banking and trading, the biggest product development in the funds industry has arguably been the introduction of the ETF.

However, this is set to change with the advent of tokenisation – a technology-led development that could have a seismic impact on the funds market and its various participants, says Brian Godins, chief commercial officer at funds network Calastone.

The challenge for those participants is twofold – from a strategic perspective, they must work out how they can remain relevant in a fund market that could see an unprecedented level of change and role evolution.. And from an operational perspective, how do they make the necessary changes to their infrastructure to support tokenised funds without breaking their investment budgets.

This all comes at a time when participants in the funds industry – distributors, asset servicers and asset managers – face some common challenges, says Godins. "They are all under revenue pressure, cost pressure and margin pressure. And they all face the same conundrum – how do you keep your operating costs down whilst driving revenue growth? How do you create this growth without investing a lot of money

PHOTO BY Johannes Plenio on Unsplash

to drive future profitability?"

This conundrum has led firms to pursue a strategy of 'zero cost operations' where there is a desire and expectation to invest more heavily in technology than people, says Godins. However, it has proved exceptionally difficult to separate the two. "You need to invest in both before you yield the benefits of technology and remove the people dependency."

It is a problem that has dogged the investment industry for decades. For example, efforts to introduce automation have been a partial success in that costly, manual processes still persist. A global survey of the state of automation carried out by Calastone found that, despite all the advancements in automation, the fax is still widely prevalent – 60% of firms still have a fax machine for processing parts of the funds transaction chain, just as they did 30 years ago. Yes, there are now digital fax machines, but there is still manual intervention involved.

As Godins says, the three-letter acronym STP has consequently been interpreted as meaning 'straight to printer' rather than 'straight-through processing'.

To add a further challenge, firms face another conundrum – how to achieve short-term tactical wins without affecting the long-term strategy of reducing overall costs and rationalising systems. "It is about finding a balance. Firms may have a three-year roadmap

"TECHNOLOGY MAKES IT POSSIBLE TO INSULATE RATHER THAN REPLACE LEGACY SYSTEMS. SMART SOLUTIONS ALLOW FIRMS TO FOCUS ON REVENUE-GENERATING OUTCOMES OVER SHORTER PERIODS OF TIME AND WITH MORE IMMEDIATE POSITIVE EXPERIENCES FOR THE CLIENTS."

Brian Godins

for their operations, but very often it is only a three-month plan because of quarterly reporting and the scrutiny of various stakeholders. This has led to a 'tactegic' approach where firms identify short-term tactical wins that drive instant gratification with the challenge of ensuring that those wins align with the longer-term strategy. It is easier said than done," says Godins.

This development can be seen in how firms have dealt with the problem of legacy technology, says Godins. "Previously firms would undergo big, wholesale replacement projects where entire back-office systems would be lifted out or one monolithic, legacy system would be replaced by another. Generally, these projects would underwhelm and underdeliver."

But, thanks to the advent of a technology-led revolution and a more expressive and agile way of thinking, the approach to systems evolution has changed, says Godins. "Technology makes it possible to insulate rather than replace legacy systems. Smart solutions, including the development of microservices and use of APIs, allow firms to focus on revenue-generating outcomes over shorter periods of time and with more immediate positive experiences for the clients."

Calastone has been helping firms to solve their connectivity issues and reduce their frictional costs ever since its inception. The company has sought to capitalise on the industry's relative lack of standards and much-varied operational landscape by automating every step of the trading process for funds and removing firms' needs to make changes to their own infrastructure.

"At Calastone, we thrive on the fact that there is a plethora of bespoke processes, message formats and market nuances," says Godins. "We have that integration quality that can take away the pain for firms. We are a key ingredient embedded in a firm's infrastructure, from order routing through mutual fund event and lifecycle management, enhancing the operating effectiveness and efficiency. It is a community and an ecosystem we are proud of."

Ahead of the game

This community has proved to be a critical benefit for the current revolution facing the funds industry – the introduction of distributed ledger technology (DLT) and the tokenisation of funds. Calastone has been a forerunner in this development, working with the technology for many years and learning about its applicability in asset management.

Four years ago, the company launched its Distributed Market Infrastructure (DMI), with DLT underpinning its core technology stack. Now Calastone has announced a tokenisation project in Singapore involving the Monetary Authority of Singapore and global asset manager Schroders. "We have been ahead of the game in terms of DLT, both in terms of our thinking and usage of technology to drive genuine business opportunities and growth for our clients" says Godins.

"Our core objective is to manufacture and distribute tokenised funds through our DMI. We are tokenising the underlying assets within a fund, meaning that the entire investment process is digital. It is a complete model for creating tokenised investment vehicles. It also changes the end-to-end funds-processing proposition by removing the need for data validation or reconciliation and drastically reducing fund administration tasks. It will take a huge swathe of cost out of the funds process."

This will not happen overnight though, warns Godins. While he hopes that the industry will quickly recognise the benefits of tokenisation, the traditional mutual fund will also be here for some years to come. "So, firms can't just ditch their current set-up. There needs to be the supporting infrastructure for both traditional and digital funds," says Godins.

Consequently, Calastone continues to cater for both traditional and tokenised funds and connecting to the front-ends of a more diverse investor base. "Our goal is to help clients on their tokenisation journey. If they don't have the infrastructure, we can give them scalability and we can give them connectivity and continued access to the same network they have benefited from over the years. We have adopted a co-create model where it is a true partnership where you can listen to and learn from each other."

Unlocking opportunities for institutional investors

IS LUXEMBOURG'S CRYPTOASSET MANAGEMENT SECTOR AN EVOLVING LANDSCAPE, WITH PROMISING OPPORTUNITIES FOR INSTITUTIONAL INVESTORS IN EUROPE? **BENJAMIN DAVID** INVESTIGATES.

THE EMERGENCE OF CRYPTOASSETS has stirred the financial landscape, evoking a range of opinions from enthusiasts and sceptics alike. Within this context, Luxembourg, a prominent European country for investors, has positioned itself as a notable jurisdiction for cryptoasset management.

The second edition of the 'Crypto-Assets Management Survey', commissioned by the Luxembourg House of Financial Technology (LHoFT) and supported by the Association of the Luxembourg Fund Industry (Alfi), sheds light on Luxembourg's potential, presenting institutional investors in Europe with an intriguing opportunity to explore this sector.

Unveiling the potential

The survey results reveal that Luxembourg is gaining increasing recognition as a preferred destination for cryptoasset management. In all, 19% of responders see the country as leading in the cryptoassets space, surpassing powerhouses such as the UK (11%) and France (10%).

Interestingly, an overwhelming 82% of respondents in the survey emphasised the importance of Luxembourg's active involvement in the broader cryptoassets space. This collective sentiment indicates that institutional investors recognise the transformative potential of this asset class. While some enthusiasm has waned, a significant portion of participants (24%) still view cryptoassets as having high investment potential, with 34% considering the potential to be moderate.

According to Nasir Zubairi, CEO of LHoFT, Luxembourg's establishment of a clear legal and regulatory framework that ensures certainty and investor protection is a significant factor contributing to Luxembourg's prominence here. He explains that the Luxembourg government and regulatory bodies have taken proactive steps to understand cryptoassets' unique challenges and opportunities, creating a favourable environment for market participants while exercising caution and prudence.

Luxembourg has also been highlighted in the past few years as nurturing an ecosystem fostering innovation and collaboration. For example, the 'European Innovation Scoreboard 2022' summarised Luxembourg as a "Strong Innovator", with performance at 118.6% of the EU average. Moreover, its performance is above the average of the Strong Innovators as a whole (114.5%). Unsurprisingly, the country has attracted diverse cryptoasset businesses, including exchanges, custodians and fund managers. Zubairi also says that Luxembourg has been successful in bringing together industry players, facilitating dialogue and addressing the evolving needs of the cryptoasset sector.

Challenges as opportunities

The survey also highlights perception challenges facing the broader adoption of cryptoassets in Luxembourg, including concerns related to market infrastructure maturity, volatility and anti-money laundering risks.

Gildas Blanchard, head of industry affairs at Alfi, explains that regulatory clarity is one of the critical tools to address those challenges. Financial innovation is a "chicken-and-egg situation," he adds, and in the context of virtual asset funds, he says that Alfi is convinced that regulatory certainty is "fertile ground" for product innovation. "The survey highlights some positive evolutions on this topic at the EU and national levels. This is the result of an open dialogue between the industry, including trade bodies, and the regulator. As an illustration, the publication of the FAQs on Virtual Assets by the CSSF brought additional clarity."

He says the regulatory framework

COIN BASE – A survey by LHoFT suggests that Luxembourg is increasingly seen as a leading destination for cryptoasset management.

PHOTO ON UNSPLASH - Cedric Letsch

82%

The percentage of survey respondents who emphasised the importance of Luxembourg's active involvement in the broader cryptoassets space.

Source: Luxembourg House of Financial Technology can always be improved, and this is "at the heart of the ongoing dialogue with regulatory bodies".

For Zubairi, the varying perceptions of investment potential in cryptoassets can be attributed to several factors. Firstly, the inherent volatility of cryptoassets creates uncertainty and apprehension among investors. Price fluctuations and market unpredictability lead to cautious attitudes, especially among the traditional finance sector in Europe, where there is a "razor-sharp focus" on stability and risk management.

He explains that until the regulation on Markets in Crypto-Assets (MiCA) is "fully implemented", regulatory uncertainty and concerns around investor protection will continue to affect perceptions. "As we identified in the survey, there is still a lack of broad and deep knowledge about cryptoassets in the traditional finance sector, and education is key to developing attitudes and the right strategy."

However, some of the confusion comes from the frameworks themselves, explains Alfi's Blanchard, who says that clear and consistent regulatory frameworks are "key" to developing financial innovations.

MiCA, among other legislative initiatives, contributed to reducing interpretation uncertainty and enhanced clarity on the requirements. This additional clarity "facilitates innovation and the development of virtual asset-related operational models", explains Blanchard. In addition to MiCA, he says that it's germane to highlight the progress made on the DLT Pilot regime and the Blockchain III law in Luxembourg.

Crucially, there is a collaborative point to highlight involving regulators and industry stakeholders to address market infrastructure maturity, volatility and anti-money laundering challenges and enhance Luxembourg's position as a cryptoasset management hub, according to Zubairi. "There is already significant dialogue and active collaboration across the private and public sectors through various industry associations such as Alfi and the ABBL (Luxembourg's banking association) as well as through our work at the LHoFT."

Discussions focus on four points:

- Enhancing market infrastructure for cryptoassets in asset management by standardising protocols, improving liquidity and fostering participant interoperability.
- Mitigating price volatility through collaborative efforts, developing risk management tools such as cryptoasset derivatives and volatility indexes for risk hedging.
- Maintaining high AML and KYC standards for cryptoasset firms in Luxembourg, ensuring compliance with international regulations and addressing challenges through ongoing dialogue.
- Promoting industry awareness and knowledge through educational initiatives, workshops, seminars and training programmes to enhance Luxembourg's reputation as a responsible cryptoasset management hub.

Industry experts have also flagged media coverage and public sentiment towards cryptoassets as impacting sentiment towards the sector. Negative narratives – such as security breaches, fraud or market manipulation incidents – impact investor confidence, explains Zubairi. "Obviously, the sector suffered several shocks in the 2022-23 period: foremost, the collapse of FTX. There is still much work to be done, and thus there is an opportunity to build a robust and trustworthy infrastructure that will take the industry forward. It is critical that people in the finance industry address these concerns, work to enhance transparency and educate themselves and investors about the potential benefits and risks associated with cryptoassets."

"AS WE IDENTIFIED IN THE SURVEY, THERE IS STILL A LACK OF BROAD AND DEEP KNOWLEDGE ABOUT CRYPTOASSETS IN THE TRADITIONAL FINANCE SECTOR, AND EDUCATION IS KEY TO DEVELOPING ATTITUDES AND THE RIGHT STRATEGY."

Nasir Zubairi

Carolane De Palmas, a crypto and financial content expert at ActivTrades, shares a similar viewpoint, highlighting the importance of embracing a sundry-like approach to regulation. "To create a supportive ecosystem that attracts major players and investors, Luxembourg should collaborate with regulators and industry stakeholders by focusing on establishing a clear regulatory framework," she explains, adding that such a move would develop industry standards and best practices.

She also stresses the importance of promoting education and skills development, fostering market infrastructure development, engaging

in international collaboration and encouraging public-private partnerships, "as well as supporting overall crypto adoption in the country".

Interestingly, approximately one-third of respondents to the LHoFT survey consider regulations, such as MiCA, a critical factor for the industry's development of a well-defined regulatory framework that promotes innovation while ensuring investor protection.

Indeed, De Palmas explains that implementing regulatory frameworks is "essential" for the widespread acceptance of cryptoassets. "These regulations bring transparency, security and trust to the industry by setting clear rules and standards for issuers, service providers and trading platforms."

These regulations ensure fair competition and provide a stable environment for market participants, in her view. "Regulatory frameworks safeguard investors, maintain market integrity and enhance financial stability," she adds, "and by fostering responsible growth and attracting institutional investors, these regulations play a vital role in the long-term development and maturity of the cryptoasset industry."

Untapped potential and outlook

The survey findings suggest that a significant proportion of respondents (39%) believe the global cryptoassets market is still in its early stages, presenting untapped potential. Moreover, 33% anticipate an inflection point, signalling broader adoption and maturity.

Zubairi points out that institutional investors must consider several factors to ensure informed decisions about participating in the cryptoasset market, including regulatory compliance, risk assessment, market infrastructure, due diligence and transparency, market research and portfolio diversification.

By evaluating these considerations, institutional investors can align their strategies with their risk appetite and objectives, ostensibly paving the way for a sustainable and successful integration of cryptoassets into their portfolios.

Luxembourg's proactive approach to regulation, coupled with its growing ecosystem and collaborative efforts, positions it as a prime destination for institutional investors looking to explore the promising opportunities in the cryptoasset management sector in Europe and beyond. **f**e

"TO CREATE A SUPPORTIVE ECOSYSTEM THAT ATTRACTS MAJOR PLAYERS AND INVESTORS, LUXEMBOURG SHOULD COLLABORATE WITH REGULATORS AND INDUSTRY STAKEHOLDERS BY FOCUSING ON ESTABLISHING A CLEAR REGULATORY FRAMEWORK."

Carolane De Palmas

Monaco hears of major asset management trends

INDUSTRY LEADERS AT THE ANNUAL FUNDFORUM EVENT IN MONACO IN JUNE LISTED SEVEN MAJOR TRENDS AFFECTING THE FUNDS INDUSTRY. **PIYASI MITRA** REPORTS.

DURING THE 2023 IMPower FundForum in June, one panel focused on the most important transformational trends for end customers and stakeholders in the wealth and asset management industry.

Hermin Hologan, a wealth and asset management leader at EY, highlighted several trends shaping the investment management industry.

Hologan, who chaired a panel discussion, shared data from the World Health Organization, Coinbase and *The Economist* that projected significant developments in demographics, healthcare costs, investor demands for ESG data, asset movement by millennials and women's ownership of wealth.

Among the supporting statistics he noted were estimates that by 2030:

- There will be 1.4 billion people aged 60 and older;
- Healthcare costs will increase by 64%;
- More than 50% of investors will demand ESG data;
- Millennials will be more than twice as likely as boomers to move assets; and
- Women will own 55% of the world's wealth.

Hologan highlighted technology, energy, sustainability, ESG investing, product innovation, cost transformation, private markets, ecosystems and talent management as trends shaping wealth and asset management today.

PHOTO BY Reuben Rohard on Unsplash

He emphasised the role of technology as a business and operational accelerator, the increasing importance of ESG investing, product innovation driven by changing investor preferences, the transformative power of cost management, the opening of private markets to a wider investor base, the growing significance of ecosystems and the adaptation of talent management to new work models.

Sustainability spreads

Commenting on Hologan's observations, Stefanie Drews, president of Nikko Asset Management, highlighted the increasing integration of sustainability into investments in Asia. She drew inspiration from the sustainability-focused regimes in Europe and mentioned that Hong Kong and Singapore are now implementing their own sustainability-focused initiatives.

Pete Cherecwich, president of asset servicing at Northern Trust, provided insights into the investment landscape, stating that 40% of new funds launched last year were private market funds. He noted that private markets continue to gain momentum, particularly in the private credit sector, which is growing slower than private equity.

Darko Hajdukovic, group head of new primary markets at the London Stock Exchange Group, acknowledged the challenges of access to private markets investment but said society needed healthy private markets for the overall health of public markets. He said the London Stock Exchange was working on solutions for private markets and aims to create a seamless transition between public and private markets by providing capital to private companies.

Fadi Abuali, CEO of Goldman Sachs Asset Management (GSAM), disputed the notion that private equity is dwindling, calling it an interesting asset class that has performed well during periods of high inflation and volatility since the 1970s and 1980s. He pointed out that bid-offer spreads are shrinking, creating attractive opportunities, and predicted an interesting time for private equity in the next 12-18 months.

Regarding sustainable investments, Cherecwich at Northern Trust emphasised the importance of "doing the right things" and highlighted that the London Stock Exchange had facilitated carbon-neutral investments by setting standards for companies.

GSAM's Abuali highlighted the long-term relevance of ESG, irrespective of political views, which are becoming fractious. He said there was growing interest in social bonds and green bonds, particularly in sectors such as housing, healthcare, education and the green energy transition.

Drews emphasised that talent management is about creating an environment that fosters good performance. She provided examples from Nikko AM, where working from home and language learning had been facilitated.

Growth dynamics

A further panel at the Monaco event explored growth dynamics and strategic challenges faced by global asset managers and boutiques in the US, Europe and Asia.

Moderated by Richard Bruyère, managing partner at Indefi, the panel brought together CEOs from top-flight global asset managers, boutiques and specialist players.

The session began by addressing the rapid growth of ETFs compared to mutual funds. Jim McCaughan, chairman of Polen Capital, identified "producing products that clients want to buy and can buy" as a key driver of growth, alongside investment performance.

Jonathan Krane, founder and CEO of KraneShares, noted the increasing prevalence of model portfolios to ETFs, particularly in the wealth management and private banking sectors, where advisers use them as tactical investment strategies. He also highlighted the growing trend of asset managers partnering to create model portfolios for joint distribution, predicting further cooperation in the future.

Contrary to the notion that traditional mutual funds will become obsolete, Orla Foley, principal and global head of relationship management at Brown Brothers Harriman, argued that they still have a place in the industry. She emphasised the importance of delivering value for money, choice, and exceptional service and user experience to investors.

Alexandra Altinger, CEO of J O Hambro Capital Management for the UK, Europe, and Asia, underscored the significant role played by Ucits, which provide a common framework for different jurisdictions. She highlighted Ucits' relevance in the post-Brexit environment, where reciprocity and equivalents are embedded in the Ucits structure.

"IF AN INVESTOR WANTS SOMETHING CUSTOMISED, THEY CAN BUILD IT THROUGH ETFS, BUT OTHER THAN THAT, UCITS SHOULD BE THE VEHICLE OF CHOICE."

Stefanie Drews

Drews, of Nikko AM, also took part in this panel and emphasised the need to understand clients' wants and provide solutions in a manner independent of specific investment vehicles. She said that Ucits are here to stay and will remain the dominant vehicle. "If an investor wants something customised, they can build it through ETFs, but other than that, Ucits should be the vehicle of choice."

She shared examples of her company's use of AI for language translation, highlighting how language is no longer a barrier and emphasising the value of leveraging talent and connectivity.

The panel also addressed ESG issues. Drews praised the EU's Sustainable Finance Disclosure Regulation (SFDR) for promoting convergence between Asian and European standards. Krane mentioned impact investing as a long-term theme within ESG, highlighting the growing focus on carbon credits.

In Japan, the launch of a new fund scheme was seen as a game-changer. Drews anticipated a surge in this space, with a variety of products catering to diverse needs, while passive investing is also expected to gain traction.

When it comes to geopolitical influences, Altinger stressed the need to strike a balance between scaling up and preserving the autonomy and unique identity of individual brands when expanding into new locations. **f**e

PRINCIPALITY - Growth dynamics and strategic challenges were among the issues discussed in Monaco.

IMAGE ON UNSPLASH - Airam Dato-on

70%

The amount of SDG and Paris-aligned capital that needs to go to developing countries. Currently, 80% of global financial assets are in developed countries. This leads to a $2.5 trillion investment gap.

Source: OECD, Morningstar, Credit Suisse Research, UNCTAD

The gap in the emerging market

THERE IS STILL A HUGE NEED FOR ESG INVESTMENT IN EMERGING MARKETS, BUT COMPANIES THERE ARE RESPONDING TO VARIOUS SUSTAINABILITY AND SOCIAL NEEDS. WHAT'S MORE, REPORTING IS IMPROVING TOO, FINDS **PIYASI MITRA**.

A CONVERSATION AROUND environmental, social and governance (ESG) investing in emerging markets versus that in developed markets would be like comparing apples with oranges because ESG appears much more embedded in developed market companies.

While International Monetary Fund data shows that emerging markets account for two-thirds of global greenhouse gas emissions, other data shows that a higher percentage of companies in developed markets have strong levels of ESG risk management, according to Nicolo Bragazza, associate portfolio manager at Morningstar Investment Management. The figure – revealed by comparing the developed market Morningstar DM TME Index with the emerging market Morningstar EM TME Index – is 64%, compared with 32% in emerging markets.

Corporate governance is a challenge within emerging markets because many notable companies are owned by, or have links to, governments. This may lead to decisions that prioritise political goals rather than shareholder interests.

"A static approach to ESG issues may penalise companies on their path to business improvement," says Bragazza.

According to Claude Brown, a partner at law firm Reed Smith, corruption and political instability also continue to pose challenges: "Each potentially exposes asset managers to reputational and financial risk. Additionally, interaction and possible tension between E, S and G make impact investing a challenge due to the collateral risks involved."

For investors with insufficient data and disclosures, there is an underlying fear that data scarcity or opacity may mask significant problems, adds Brown.

Also, good governance doesn't always gain wide traction. This is because of cultural differences between emerging countries and ESG investors.

"If the investing policy intends to be uniform across the portfolio, cultural differences can reduce the pool of investable countries, increasing the portfolio's concentration risk," says Brown.

Catriona Macnair, an emerging markets investment director at abrdn and lead portfolio manager for the asset manager's Article 9 emerging markets SDG [sustainable development goals] equities strategy, says investors need to research emerging market companies for visibility about who is behind the business. Investors need to know the extent of the backers' voting powers and understand the alignment of management incentives with minority shareholders and the degree of independent oversight.

Relying on third-party external data providers is not enough in emerging markets, says Macnair. Data can be "backwards-looking" with narrower coverage for small-cap names.

According to Macnair, almost 15% of the holdings in abrdn's Article 9 emerging markets SDG strategy are not covered by MSCI, a major provider of ESG data.

But given the boom in passive money flows, many of which will use quantitative screens based on MSCI scores, there are lots of opportunities for active ESG or UN SDG-aligned investors willing to undertake due diligence and legwork themselves in a bid to unearth less well-known names where sustainability disclosures are patchy or where there is no MSCI coverage.

> "IF THE INVESTING POLICY INTENDS TO BE UNIFORM ACROSS THE PORTFOLIO, CULTURAL DIFFERENCES CAN REDUCE THE POOL OF INVESTABLE COUNTRIES, INCREASING THE PORTFOLIO'S CONCENTRATION RISK."
> *Claude Brown*

"A key consideration is the proximity of emerging market corporates to pressing fundamental global problems such as deforestation, poverty and climate change," says Macnair. "Disruptive technologies, deployed cost-effectively, have the potential to solve these problems profitably and transform lives."

Just transition

Juliana Hansveden, emerging market sustainable equities portfolio manager at Ninety One, thinks there are more sustainability-driven growth opportunities in emerging markets than in developed markets. Some of the thematic

IN THE MARKETPLACE - Developing countries and ESG investors sometimes have cultural differences.

opportunities are financial and digital inclusion, decarbonisation and healthcare.

She says also that clients in emerging markets look for the same opportunities as clients in developed markets, especially as growth opportunities and sustainability are linked to emerging markets.

However, some emerging market companies will also have more exposure to social issues than to governance or environment. For instance, manufacturing, materials or mining involve disruptive work that impacts local communities, explains Hansveden. The lives of local farmers may change when a company sets up new facilities near agricultural fields and there is a risk that the water supply gets polluted. Yet importantly, companies that run themselves sustainably – which implies sustainability risk management – should be less exposed to regulatory sanctions, reputational damage, consumer opposition, talent loss and other threats to long-term success, says Hansveden.

One of the strongest features for ESG in emerging markets is falling renewable energy infrastructure costs. These make it easier for a large section of emerging markets to bypass the building of electricity infrastructure based on fossil fuels and allow them instead to meet energy demand through clean energy generated by wind and sun, points out Andrew Ness, co-manager, Franklin Templeton Emerging Markets Sustainability Fund.

The International Energy Agency's projection is that global solar power spending will hit over $1 billion a day or $382 billion a year, while investment in oil production will stand at $371 billion.

China, India and Brazil have announced climate-aware ambitions, including legislation to limit emissions, says Ness. "Emerging markets are home to many companies providing solutions that address environmental problems," he adds. The solar supply chain, battery electrolyte production, EV supply chain and semiconductors are all investments in the Franklin Templeton GEM Sustainability Fund.

However, challenges for power are not just about power generation, but also distribution, says Brown at law firm Reed Smith. Despite abundant sources of renewable energy in emerging countries, the essential infrastructure is frequently lacking. "The population is often sparsely distributed with poor transport infrastructure, making construction and installation of a decentralised power grid hard. In others, there are highly concentrated population nodes which are not only at significant distances from the renewable sources but make safe, localised energy distribution within high-density urban areas costly and time taking," says Brown.

As ESG inflows increase, there is more pressure for investors to find opportunities. "This, in turn, is producing more sophisticated impact modelling. However, the data issue remains, hindering the transition from exclusionist strategies to activist ones," adds Brown.

But setting up alternative power sources cannot be carried out in isolation. "Those engaged in fossil fuel-based power generation in emerging markets need to be redeployed if investment in sustainable energy aims to avoid adverse social consequences."

Renewables rule

ESG investments in India have primarily been into the renewable energy sector, with green shoots in low-carbon sectors such as green hydrogen, across listed and unlisted spaces, points out Shantanu Srivastava, sustainable finance and climate risk lead (South Asia), at the Institute for Energy Economics and Financial Analysis (IEEFA).

"A major tailwind for ESG investors in

> "EMERGING MARKETS ARE HOME TO MANY COMPANIES PROVIDING SOLUTIONS THAT ADDRESS ENVIRONMENTAL PROBLEMS."
>
> *Andrew Ness*

India includes the government's clean energy ambitions providing opportunities in a sector ranking high on ESG credentials," he says. The capital market regulator, the Securities and Exchange Board of India (Sebi), has also rolled out a mandatory regime – the Business Responsibility and Sustainability Reporting Standards (BRSR) – for the top 1,000 listed companies in the country.

Sebi has issued guidelines for green debt securities for domestic issuers to wade off any greenwashing risks. India's central bank, the Reserve Bank of India, has also recommended disclosure by banks in line with the Task Force on Climate-Related Financial Disclosure, says Srivastava.

He adds: "To address mis-selling and greenwashing in ESG schemes introduced by Indian asset managers, Sebi has introduced measures such as mandating ESG schemes to invest at least 65% of assets under management in listed entities where the assurance on core BRSR and third-party assurance and certification by the board of assets managers on compliance with the objective of ESG schemes are undertaken, among others."

An official green taxonomy is much needed. "Compliance is largely in the purview of the reporting entity, and the BRSR also doesn't require disclosure of detailed transition strategies by currently high carbon-emitting companies," says Srivastava. "Also, government policies have historically focused on decarbonising the power sector, and new policies are only now emerging for other hard-to-abate sectors. For some of the larger institutional investors, such as the insurance and pension sector, the investment regulations are prohibitive of investment in clean energy technologies."

Saurabh Trivedi, research analyst at IEEFA, recommends that Sebi continues strengthening its ESG frameworks to address greenwashing and increases the ESG-labelled bond issuances in local currency. "An Indian green taxonomy should introduce investment guidelines for the wider green sector like green hydrogen, battery storage, energy efficiency and other sustainability projects," he adds.

There will be pressure on corporate boards to showcase their ability to effectively manage ESG issues, including but not limited to climate change, human rights and social issues. Biodiversity and natural capital sectors are likely to attract the interest of the Indian investor community in times ahead, Trivedi says.

Currently, Federal Bank Limited is the only bank in India to discontinue financing new coal projects. Still, Trivedi is hopeful that more banks will start establishing divestment policies against climate-risky sectors.

Brown points out that social investing, particularly impact investing, fares better in emerging markets than governance, as health and education tend to be more neutral objectives. However, impediments to virtuous investment strategies are genuine. "One only has to look at reproductive rights, non-gender-oriented education or underage-related employment to see some of the pitfalls," says Brown.

Environmental-led investing is less complex because international financial institutions, development finance institutions and multilateral development banks apply rigorous environmental standards on their investment and aid, says Brown, which exposes emerging markets to environmental criteria, monitoring and reporting in a manner that "dwarfs" comparable requirements for S and G projects.

"This makes them better placed to respond to private investment in the environmental space because the infrastructure is there and understood."

Power access struggle

Parts of many developing nations struggle with power access – a factor prioritised over investing in green alternatives. Abrdn invests in both themes. "We invest in Energuate, the providers of electricity in rural Guatemala, with dedicated capital expenditure towards increasing access to electricity from the current 90% to 99% by 2032," says Sam Bevan, investor director and portfolio manager of abrdn's Article 9 EM SDG Corporate Bond Fund.

The fund also invests in CMI Energía, a renewable power operator across Central America, including Guatemala. Abrdn's focus is on decarbonising grids within the electricity-generation space.

Bevan suggests "storytelling" around sustainable investment be more acute in emerging markets, given these markets' focus on reducing inequalities.

Opportunities lie in investing in companies providing healthcare access for 50% of the global population still waiting for it, financial services to the 1.7 billion unbanked population, or upping telecommunications' 30% penetration in the sub-Saharan region, for instance.

Working in the realm of fixed income, Bevan argues first-mover advantage can drive alpha. Barclays data shows only 6% of emerging market debt corporate bonds is ESG-aligned, compared to 30% in euro corporate bonds. Demonstrating how improved ESG and sustainability perceptions can lead to bond outperformance, Bevan cites the improvement in Tower Bersama's rating, from a B to an A, in abrdn's two-and-a-half years of engagement with the company. This move led to the compression of spreads in Tower Bersama bonds.

"THE SHIFT IS NOW AWAY FROM A CORPORATE SOCIAL RESPONSIBILITY PERSPECTIVE, TO DEMONSTRATING THE POSITIVE OR NEGATIVE IMPACT OF PRODUCTS AND SERVICES."

Sam Bevan

Nascent market

Macnair points out that of more than 700 emerging market equities funds, only about 20 fall under Article 9 – illustrating that the ESG asset class in emerging markets is still nascent in comparison with developed markets. But disclosure among emerging market companies is improving, she acknowledges – ranging from supply chain audits to avoided emissions, and to the number of new pharmacies opened within South Africa's townships.

Technology, media and entertainment and telecommunications companies have been at the forefront, says Bevan. Citing Helios Towers – a pan-African telecom tower infrastructure company, which provides in-depth reporting on connecting rural areas – he adds: "The shift is now away from a corporate social responsibility perspective, to demonstrating the positive or negative impact of products and services." **f**e

Private markets growth signals the return of the human factor

TIKEHAU CAPITAL'S THOMAS FRIEDBERGER WARNS THE EUROPEAN INVESTOR SUMMIT THAT GROWTH IN THE NEXT DECADE WILL BE SLOWER – BUT IT'LL BE MORE SUSTAINABLE AND LESS LEVERAGED.

THE INCREASED INVESTMENT in private assets is a cause for optimism as it will herald a return of the human factor in asset management and a more sustainable risk and return ratio.

However, if asset managers are going to capitalise on this development, they will need to maintain their investment discipline and attention to detail and establish a physical presence in various local markets.

These were the conclusions reached by Thomas Friedberger, Deputy CEO of Paris-based alternative asset manager Tikehau Capital, who was speaking at the European Investor Summit held by Societe Generale Securities Services in Paris in June.

Friedberger's optimism comes amid a number of headwinds facing private markets, such as inflation, interest rate hikes and geopolitical uncertainty. But while it is likely that there will be a much slower rate of growth in the funds industry over the next two decades, it will be more sustainable and linked to the real economy and should therefore be welcomed, said Friedberger.

"It is evident to me that the economic model we have employed since the end of World War II, which is based on infinite short-term growth is not sustainable," said Friedberger. "It has had a negative effect on biodiversity, climate change and wealth inequality and created financial bubbles."

"FOR ASSET MANAGERS, ONLY THE MOST DISCIPLINED WILL OUTPERFORM THE MARKET. YOU NEED TO BE PLUGGED INTO LOCAL ECOSYSTEMS, HAVE OFFICES EVERYWHERE YOU INVEST, AND THE ALIGNMENT OF INTERESTS WILL BE MUCH MORE IMPORTANT THAN BEFORE."

Thomas Friedberger

There have been some fundamental changes to the global economy and investment world since the pandemic, said Friedberger. One being the acceleration of globalisation and an extended period of low interest rates which had allowed companies to over-optimise – be that tax efficiency, production costs, thin capital buffers, or just-in-time global supply chains.

Resilience

As a consequence of these changes, wealth creation in the coming decades will be more dependent on resilience, said Friedberger. "Globalisation has revealed some weaknesses, as evidenced during the pandemic and there will be much slower rates of growth in the next one or two decades. However, this will be much more sustainable growth with less leverage."

In addition to more sustainable growth and an end to financial bubbles, there will be a return of the human factor to private market investing with returns driven more by alpha than beta and value creation more dependent on stock-picking than asset allocation, says Friedberger.

"In private debt you are often the sole lender to a borrower or issuer. This forces you to have a constant dialogue with the issuer and to anticipate issues and restructure accordingly. This creates financial value. This is the same in real estate when you know your tenant, you can foresee issues."

The greater emphasis on the human factor in the private markets of the future will have competitive implications for firms, says Friedberger. "For asset managers, only the most disciplined will outperform the market. You need to be plugged into local ecosystems, have offices everywhere you invest, and the alignment of interests will be much more important than before. Attention to detail will also make a significant difference."

Friedberger's views and sense of optimism are shared by a number of other alternative asset managers similarly invested in private markets. That said, there is a mixed picture when it comes to the various asset classes within the private markets that will benefit the most from an estimated $2 trillion in dry powder destined for the private markets.

Real estate slowdown

As stated by Marco Belletti, CEO of Italian asset manager Azimut, the real estate market has seen a slowdown in certain sub-sectors and geographies but, according to Paolo Rizzuti, Head of Private Markets and General Manager of the pension fund of the banking group Banca, this is not a U-turn in the demand for private assets, but just a change in the cycle as property owners wait for better market conditions.

Infrastructure is seen by Peter Veldman, Deputy Group Head of Fund Operations at EQT Group, as a natural hedge for the current market conditions, while private equity is also seen as attractive. The credit market also holds some opportunities for non-bank participants, said Veldman.

But it is the impact of private market investments on the real economy that could prove to be the most effective driver of inflows, according to Alexandre Pieyre, Head of EDF Invest, the private equity arm of the French energy company. "It is about climate change – our investments in infrastructure and real estate have an impact, especially where we are refurbishing buildings with green technology – converting brown assets to greener assets in order to meet Paris Agreement targets," said Pieyre.

This is also helping to broaden the investor base to include, in addition to institutional investors, alternative investors and HNWIs. "The 60/40 allocation model is over. Institutional investors have seen private assets as supportive and complementary to a diversified portfolio for quite some time, and this is now coming to a more diffuse base," said Rizzuti.

In addition, more companies are going private for longer, as it allows them to grow without the short-term pressure of quarterly earnings. For example, the number of listed companies in the US has halved since the collapse of Lehman Brothers and the start of the 2008 financial crisis. So, it is not just that private markets are here to stay, but that the growth will accelerate over the next decade at the expense of the listed market, said Rizzuti. **f**e

87.5%

The number of limited partners that intend to increase their private market ESG investments over the next two years, according to a survey.

Source: PwC Luxembourg

Institutional investors move headlong into ESG

BENJAMIN DAVID EXPLORES THE TRANSFORMATIVE SHIFT OF INSTITUTIONAL INVESTORS TOWARDS ESG INVESTING IN PRIVATE MARKETS, HIGHLIGHTING ITS RISE, THE DEMAND FOR ENHANCED REPORTING AND THE POTENTIAL FOR A SUSTAINABLE FUTURE.

INSTITUTIONAL INVESTORS, INCLUDING limited partners (LPs) and general partners (GPs), are undergoing a transformative shift in their investment philosophy as they increasingly prioritise environmental, social and governance (ESG) considerations. This emerging trend towards an 'ESG or nothing' approach is gaining traction across private markets, according to a report entitled 'GPs' Global ESG Strategies: Disclosure Standards, Data Requirements & Strategic Options' by PwC Luxembourg. As the momentum behind ESG builds, a significant majority of institutional investors are planning to cease non-ESG private market investments by 2025.

Growing commitment to ESG

The report surveyed 300 GPs and 300 LPs, highlighting a solid commitment to ESG among institutional investors. Interestingly, 87.5% of LPs surveyed expressed their intention to increase their private market ESG investments over the next two years, with over a third targeting increases of more than 20%. This growing trend indicates institutional investors' recognition of the potential for ESG-focused investments to deliver sustainable returns while aligning with their values and expectations.

Olivier Carré from PwC Luxembourg explains that long-term value is becoming more self-evident here. He says institutional investors can meet the evolving demands of LPs and contribute to a more sustainable and responsible investment landscape by minimising risks and positioning themselves to unlock the long-term value creation potential.

"While opportunities and challenges vary greatly from region to region and asset class to asset class, the key message remains the same: rethink the status quo and view your operations and licence to exist through an ESG lens," he says.

Sustainability manager Charles Van Tuyckom from Morrison & Co emphasises the widespread adoption of ESG approaches and policies among industry managers. He notes, "Managers without an ESG approach and policy are extremely rare." Van Tuyckom underscores the longstanding importance of good governance and commercial sustainability in private market investment.

He further stresses the significance of quantifying and reporting these aspects to investors in a clear and meaningful manner, stating, "Quantifying and reporting ESG aspects to investors transparently and effectively are the fundamental change we see developing, driven by investor interests and recognition of the importance of ESG risks and opportunities." According to Van Tuyckom, the transformative trend towards ESG is driven by the increasing recognition of ESG risks and opportunities, as well as the growing interests of investors.

This aligns with the perspective of David Duffy, CEO of the Corporate Governance Institute, who suggests that ESG investing is fundamentally about "responsible investing". Duffy points out that investors now believe their investments should create value and reflect their values. He affirms that ESG investments are not inherently riskier than those in firms that do not embrace ESG. Investors are witnessing growing evidence that they don't have to compromise good returns for good deeds.

Unlocking value through enhanced reporting

Interestingly, institutional investors are willing to pay higher management fees for significant improvements in GPs' ESG data reporting. The report reveals that 66.6% of LPs surveyed are willing to accept higher fees if it leads to more transparent and comprehensive ESG

BLOSSOMING – The 'ESG or nothing' approach is gaining traction across private markets.

reporting from their fund managers. Nearly 45% of LPs stated that they would be willing to pay between 5% and 9% more in management fees should this price increase be translated into quality improvements in their GPs' ESG data reporting practices. An additional 23% of LPs stated their willingness to absorb increases over 10%.

This is familiar to Van Tuyckom, who underscores the importance of ESG data reporting in investment management generally. He states, "Enhanced fees for ESG reporting should not be the key criterion for improving reporting, as it is not reflected in the fundraising market. Instead, the quality, reliability and transparency of ESG data reporting are crucial aspects of investment management, informing sound decisions where risks and opportunities can have a real impact."

Duffy, while emphasising the vital role of enhanced ESG reporting for investors, nonetheless expresses concern over differing ESG standards and calls for a consistent or standardised methodology

"THE QUALITY, RELIABILITY AND TRANSPARENCY OF ESG DATA REPORTING ARE CRUCIAL ASPECTS OF INVESTMENT MANAGEMENT, INFORMING SOUND DECISIONS WHERE RISKS AND OPPORTUNITIES CAN HAVE A REAL IMPACT."

Charles Van Tuyckom

for evaluating ESG performance across all firms globally. He advises firms to ensure honesty and transparency with all ESG data to align their ESG reporting with best practices and recognised frameworks. He cautions against any attempts to hide or embellish data, as scrutiny in ESG ratings and reporting is increasing, and any hint of "greenwashing" could have severe consequences for a firm's reputation.

This concern agrees with the eighth annual 'ESG Manual Survey' by Russell Investments, which indicated that data limitations and non-standardised reporting frameworks constitute the biggest challenges for investment managers. The survey found that less than 30% of firms out of 236 can report on their respective portfolios' carbon-related metrics. The survey findings disclosed that ESG reporting remains the most significant challenge despite increased expectations of adequate reporting, the firm said. Yoshie Phillips, head of fixed income ESG investing at Russell Investments, said ESG-related reporting continues to develop in an "unstructured fashion" due to the lack of unambiguous industry standards.

ESG challenges and reporting discrepancies

Due to perceived incompatibility, private equity (PE) has been slower in adopting ESG practices, according to the report, compared to other private market asset classes. The global PE industry lags in ESG uptake, with only 57.4% of PE LPs and 47.6% of GPs allocating over 30% of their assets to ESG products. ESG reporting holds lower strategic importance for PE LPs compared to other investors, with only 61.7% considering it crucial in GP selection.

However, 75.7% of surveyed PE GPs recognise quality ESG reporting as a competitive advantage. Discrepancies exist between LPs' reporting

"WHILE OPPORTUNITIES AND CHALLENGES VARY GREATLY FROM REGION TO REGION AND ASSET CLASS TO ASSET CLASS, THE KEY MESSAGE REMAINS THE SAME: RETHINK THE STATUS QUO AND VIEW YOUR OPERATIONS AND LICENCE TO EXIST THROUGH AN ESG LENS."

Olivier Carré

requirements and GPs' practices. LPs in Europe have higher expectations, but only 65.0% are satisfied with current reporting practices. Moreover, GPs in Europe face challenges meeting sophisticated ESG requirements and investor demands. Desired improvements include qualitative data on Taxonomy alignment (mentioned by 40% of EU LPs) and more frequent data on sustainable development goals (SDG) alignment and climate impact (mentioned by 35% of LPs).

The report notes that maintaining an open dialogue with investors is recommended to adapt reporting practices and exceed regulatory compliance. While overall satisfaction with GPs' ESG reporting is high, GPs in Europe should be mindful of potential reputational damage and loss of business if they fail to address shortcomings. Moreover, institutional investors can enhance their portfolios and contribute to a more sustainable and resilient private market ecosystem by capitalising on this growth potential.

Building trust through EU regulation

The sentiment towards EU regulation regarding ESG is overwhelmingly positive among institutional investors. The survey findings reveal that 60.5% of EU LPs describe themselves as very satisfied with developments in EU regulation, closely followed by GPs, with an average satisfaction rate of 57.1%.

This demonstrates the positive impact of ESG regulation in providing a clear framework and standardisation, which contributes to building trust and confidence among institutional investors.

However, diverging opinions exist between LPs and GPs regarding the effectiveness of regulations in addressing greenwashing concerns. While 63.8% of LPs are satisfied, only 49.2% of GPs share this view.

According to the report, GPs may consider the regulations as an additional compliance burden rather than guidance to prevent greenwashing, as they believe they already have strong internal policies.

The report highlights conflicts between EU and national regulations and the need for alignment in ESG taxonomies to ensure the distribution of funds. Compliance requirements are burdensome, especially for smaller investors, adding complexity and cost. Despite these challenges, the EU's sustainable finance framework is expected to harmonise, and stakeholders will drive ESG momentum.

A strategic imperative

The rise of ESG signifies a paradigm shift in the institutional investment space, where financial returns and societal impact go hand in hand.

The report substantiates the view that institutional investors can drive positive change and shape a more sustainable future by proactively embracing ESG

"QUANTIFYING AND REPORTING ESG ASPECTS TO INVESTORS TRANSPARENTLY AND EFFECTIVELY ARE THE FUNDAMENTAL CHANGE WE SEE DEVELOPING, DRIVEN BY INVESTOR INTERESTS AND RECOGNITION OF THE IMPORTANCE OF ESG RISKS AND OPPORTUNITIES."

Charles Van Tuyckom

principles, improving reporting standards and seizing growth opportunities in private markets.

Investors in Europe appear aligned – by prioritising ESG considerations, investments with values and expectations can be aligned while delivering sustainable returns. The increasing commitment to ESG reflects an understanding of its potential to unlock long-term value and contribute to a resilient investment ecosystem. However, challenges persist, such as the need for standardised methodologies and transparent reporting to combat greenwashing. Moreover, open dialogue, adaptation and continuous improvement in ESG practices are necessary.

As institutional investors reflect on the transformative power of ESG, they might be tempted to consider their role in shaping a responsible investment landscape. By embracing ESG principles, the forecast seems clear: investors can contribute to a more sustainable future while pursuing financial success. **f**e

The eternal search for efficiency

FUNDS EUROPE TALKS TO KATE WEBBER OF NORTHERN TRUST, WINNER OF THE 2022 TRANSFER AGENT OF THE YEAR AWARD, ABOUT THE FUTURE OF THE TRANSFER AGENCY FUNCTION.

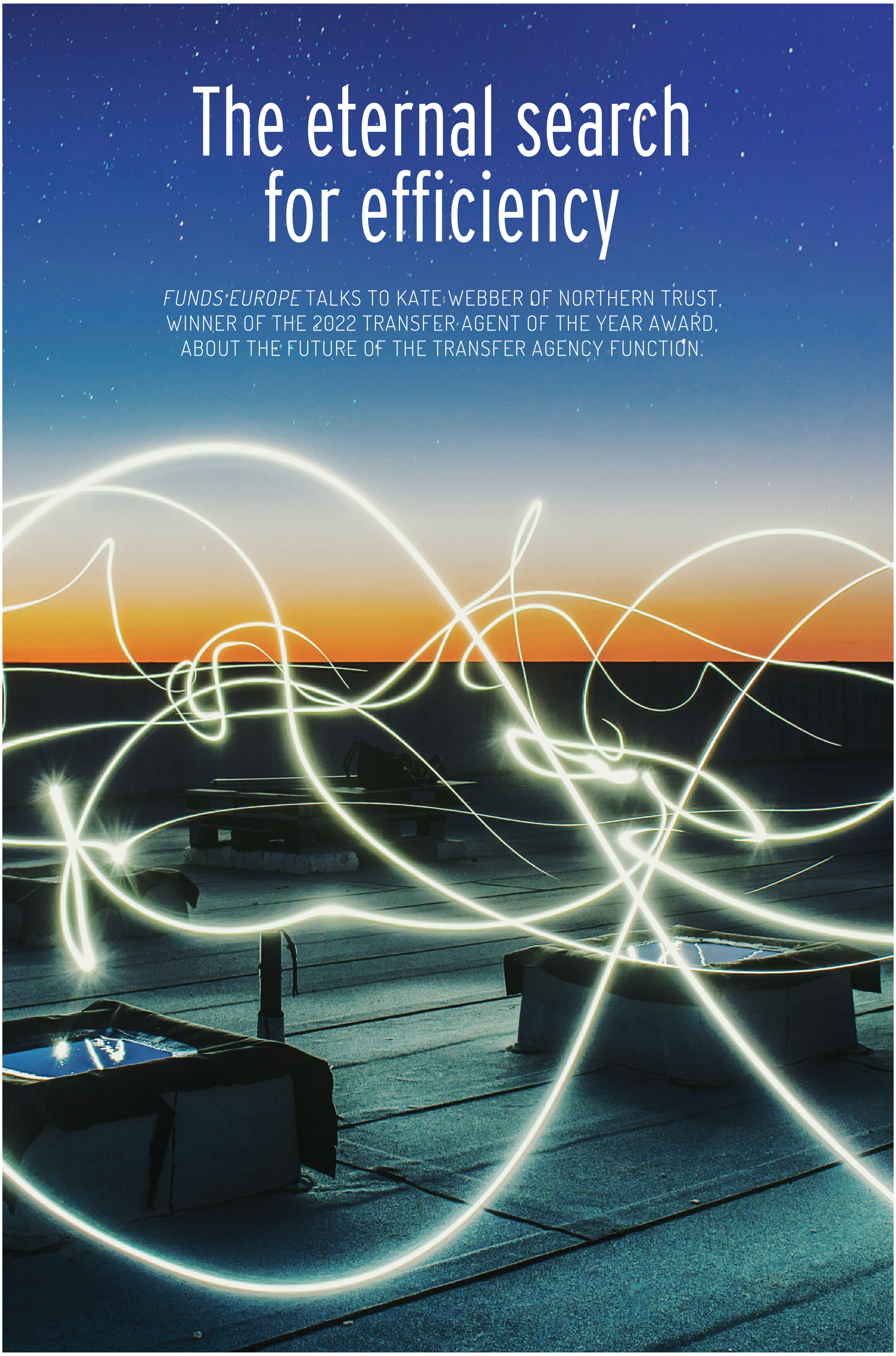


IMAGE ON UNSPLASH - Federico Beccari

"THE MATRIX PLATFORM COMBINES TECHNOLOGY AND OPERATING MODEL INNOVATIONS TO SUPPORT NEW WAYS OF MANAGING AND DELIVERING DATA."

Kate Webber

THE TRANSFER AGENCY FUNCTION has been much debated in recent years. As the first point of contact for many investors, its role has sometimes been underappreciated. It has not helped that almost all asset managers have outsourced a function that used to be treasured as a vital part of the user experience.

But have the third-party asset servicers that have taken on the role been able to invest the necessary capital to keep their services fit for purpose? Have they been able to use new technology to improve their service?

New technology has become central to the TA function, namely blockchain and distributed ledger technology (DLT). Northern Trust won the *Funds Europe* Transfer Agent of the Year 2022 award, so we talked to Kate Webber, head of product strategy at the firm, about the company's offering, the potential for using new technology and the overall role of the TA.

When the *Funds Europe* judging panel selected NT as transfer agent of the year, it remarked on the firm's investment in technology and commitment to innovation, as demonstrated by the rollout of its Fund Utility service to UK clients, a digital initiative designed to improve straight-through processing and information delivery.

According to Webber, Northern Trust applies "a focused business model at the centre of which are our clients and our core principles of service, integrity and expertise". This enables the firm to provide "exceptional service for our transfer agency clients, deploying both our knowledge and technology capabilities for their advantage".

The transfer agency offering is also one of the first Northern Trust products to use the firm's Northern Matrix data platform, built to help digitise the asset servicing business, says Webber. "The Matrix platform combines technology and operating model innovations to support new ways of managing and delivering data. A dedicated investor shared-service group powered by Matrix creates a differentiated investor experience, which will be further enhanced by digital portals that we are deploying," says Webber.

TA services are being developed for the digital-only investor who wants to do everything online, she adds. "We are moving to an age where investors will need key information to be available instantly. Our strategy is very much focused on being fully digital across transfer agency, and we believe this adoption is already underway and moving at speed."

This strategy means a greater focus on data visualisation in near-real time and enabling the TA platform to run fully digitally, from fund launch to investor account opening, to the final settlement of a trade.

Data has also become critical to asset managers' ESG and sustainability requirements. The introduction of various disclosure regimes and reporting requirements has elevated the TA role, says Webber. "From a funds perspective, it all comes down to the data and an ability to track the ESG ratings. We see the transfer agency's role as a key in terms of providing data capture and information delivery. As keepers of the investor's data, there is potentially an ability for us to combine investor data and fund-level ESG data to create a personalised ESG rating based on an individual retail or institutional portfolio."

As stated, the TA is typically the first contact for the investor rather than the asset manager. So, should more be done to make the process more efficient and enable a better user experience?

"First impressions are certainly critical in this business," says Webber. "The experience for an investor when onboarding into a fund needs to be frictionless and timely."

For example, says Webber, enabling the investor onboarding journey through portals ensures a smoother account opening process but also provides better transparency on their investments. "It is paramount that the onboarding process is streamlined and that the opportunity for investors to self-serve is at their fingertips. This can only be done by digitising the investor record-keeping and onboarding journey."

There is a discussion in the industry about having a shared AML digital capability, which could significantly streamline the AML/KYC process, exponentially reducing investor onboarding times, says Webber. "Having such a capability would require a community model whereby all participants in the community agree with the interpretation of those measures provided by the capability. Each participant would have their internal risk tolerances, which would still be in place, but the outreach for this data would be fully streamlined."

Important interface

A criticism of the decision to outsource the TA process is that the asset manager is losing an important interface with their client. But Webber believes that this digital model enables the asset manager to maintain a strong relationship with both the investor and the TA. "Ultimately, clients are looking for a high level of service that enables the investor to enter a fund and have transparent meaningful investment data," she says.

"It's worth noting the level of data the administrators are holding when consolidated across functions such as transfer agency, fund accounting and custody – using a transfer agency in this way can create better data insights for both the investor and the asset manager, which in turn can help drive better investment decisions."

Then again, is the importance of the user experience overstated? Is the TA an essential touchstone with the end client, or do investors want the administration of their investments to be as efficient and painless as possible, regardless of who is providing the service?

"Investors today want to have the same customer experience in asset servicing as they have with their own personal banking practices," says Webber. "To enable this, creating persona-based user experiences are foundational to meeting investor expectations. We need to understand what is – and isn't – important to investors regarding their touchpoints with their asset manager. Cost efficiency can only be realised by moving all key business events through the lifecycle of a trade into an automated process and spending time only on tasks that are business exceptions."

Clearly, technology is central to the future development of the TA and distributed ledger technology (DLT) especially, but the relationship between TA and DLT has been somewhat complicated. In the early days of the technology, when the blockchain was suggested to replace all the traditional and costly components in the funds processing lifecycle, the TA was top of the kill list.

But, as the technology has matured, is it still an existential threat or are TAs finding ways to use the technology to enhance their own offerings? "Through Northern Trust's digital transformation programme, we are creating an open architecture, event-driven data platform into which we can integrate our underlying engine and applications as well as client applications," says Webber.

"This also gives us the ability to integrate with one or, more likely, multiple DLTs, including our own asset-agnostic tokenisation platform. Whilst a DLT for transfer agency seems like a potential solution for the agent, we believe that the requirement to have all stakeholders accessing the same distributed ledger makes it unlikely in the short term."

Connecting to multiple DLTs and enhancements in data transfer through APIs may be more impactful in the short to medium term, suggests Webber. "Our digital transformation

"CREATING PERSONA-BASED USER EXPERIENCES ARE FOUNDATIONAL TO MEETING INVESTOR EXPECTATIONS."

programme shares many of the attributes of a distributed ledger with the concept of 'golden source of truth'. This means that the data construct in the event-driven architecture is such that it enables 100% trust in the data elements that are critical to a successful and efficient platform."

But perhaps the greatest challenge for the TA is the fact that it is relying on other developments, such as the abolition of counterparties' legacy systems or the use of faxes, or the introduction of single digital identity initiatives, to achieve greater efficiency.

"The industry as a whole is focusing on providing a fully digital KYC lifecycle," says Webber. "We know the technology is available to have a single digital identity which can be used across funds and businesses. We have created a global investor concept within our transfer agency architecture which will significantly speed up the KYC process, reducing the need for multiple identities interacting across various fund ranges.

"Even where fax instructions are submitted, many semantic AI solutions can read and digitise the instruction into readable data, enabling automation and providing efficiency across the entire process. The reality is that whether via AI or robotic process automation, there are plenty of no-code, low-code and some-code solutions that are enabling efficiency across transfer agency." **f**e

Mental fitness for fund managers

MARKET VOLATILITY HAS LIKELY IMPACTED MENTAL HEALTH – AND THE PAST YEAR HAS SEEN A RISE IN COACHING FOR ADAPTIVE THINKING, **PIYASI MITRA** HEARS.

VOLATILITY WILL TAKE ITS TOLL on portfolios – but could equally have a toll on the minds of those managing the portfolios. Mental Health First Aid England reveals that 83% of employees from the financial services sector have considered changing jobs due to the impact of work on their mental health.

"The demand for adaptive thinking, resilience and stress response management among fund managers has shot up post-Covid and the market shock of 2022," says Ron William, cross-asset tactical strategist and performance coach at RW Advisory.

William points to a study that found a successful archetype for asset managers is the 'NTJ' type - or 'intuitive, thinking, judging' in the Myers and Briggs 16 personality types test. These are strategic thinkers and objectively identify key patterns and cause-effect relationships. Not everyone will be this type, but "market and mind" strategies can help optimise behaviours, says William, and the instability of performance returns is prompting fund managers to seek mental alpha differentiators.

While DNA programming is fixed, influencing survival instincts and ultimately risk or loss aversion, these 'laws of nature' can still be optimised using a mix of self-assessment training, applied best practices and performance coaching. Results normally show after a minimum of six to 12 months, says William, who is currently working with firms and supported by regulatory guidance.

Loss aversion might cause managers to underallocate to stocks, or take profits too soon. There is also 'thesis drift' – the temptation to change an investment thesis to fit emotions, says William.

He and his team have developed the 'A* Strategy', which he says can help fund managers better navigate volatile market conditions and behavioural bias.

William's approach is to assess the fund manager's mindset or personality temperament alongside whether their strategy is active or passive. These factors are placed in the context of the market regime with reference to key drivers, such as macro, trend or volatility.

Ultimately, the blend of self-awareness, behavioural optimisation and peak performance should help to enhance the 'behavioural alpha' in a fund manager's portfolio. Behavioural biases can be overcome through mitigation strategies, which could include scenario planning for situations such as macroeconomic shocks, geopolitical tensions or a banking crisis. A concept with roots in the military, scenario planning is more about preparation than predicting the outcome.

"WHEN WE ARE TALKING ABOUT EXPERIENCE OF FEAR BEING WIRED IN, WE ARE TALKING ABOUT SYNAPTIC STRENGTH. NEURONS THAT DIDN'T PREVIOUSLY COMMUNICATE WELL NOW DO SO AT LIGHTNING SPEED."

Sarah Steventon

Hijacking the cortex

Brain training, based on the principle of neuroplasticity, aims to incorporate changes at a cerebral level to achieve desired changes in response patterns.

It is difficult to stop subconscious feelings driving behaviour. Sarah Steventon, psychotherapist and founder of Psychological Capital Group, says the threat response will kick in when there is a perceived threat from adverse market conditions, at which point reasoning and planning in the brain's prefrontal cortex gets hijacked. Decisions are then made based on emotions, and moves made during these times might not be the smartest, adds Steventon.

"Fear of missing out, walking away too soon, looking stupid, letting people down – the theme is clear."

Much of the fear system is a memory or learning system. Learning occurs due to neuroplasticity, which involves the strengthening of particular connections between neurons so that those neurons can now talk to other neurons more robustly. "When we are talking about experience of fear being wired in, we are talking about synaptic strength. Neurons that didn't previously communicate well now do so at lightning speed, analogous to going from a dial-up connection to a 5G connection – so, much faster and clearer. If a fund manager has a bad run, they can easily start to operate from a state of fear. They stop trusting themselves, making fear-based decisions, being too cautious – all of which can impact the alpha dramatically."

However, Steventon says fear can be dampened through cutting-edge therapy techniques. "By leveraging the brain's natural ability to adapt and change, we can regulate emotion to optimise brain function."

Not all psychology or self-analysis is created equal, says Denise Shull, a performance coach and CEO of The ReThink Group. "Purely cognitive approaches are unlikely to be as impactful, both as reported by clients and as understood by neuroscience. How one feels is the most important data point to work upon."

Shull says there is a misunderstanding between cognition and conviction. Confirmation bias, for example, is where people favour information to support their beliefs, but she believes it mostly stems from the anticipation of displeasure at being proved wrong.

There is a magic in knowing what one is feeling – even when it is "bad", says Shull. "One portfolio manager realised that a key part of what they needed, given their complex life, was an assistant. If we hadn't dug into the depth of the frustration, that idea would have taken much longer to come to consciousness."

There is no one-size-fits-all approach for managing feelings, personality and traits. Differences are real, says Sarah-Jane Last, CEO of The Work Psychologists. She cites a study by Barclays (Berthet V, 2022) that revealed fixed income fund managers tended to be more risk-averse and less prone to cognitive biases than their equity counterparts. "Psychological assessment can help fund managers identify their strengths, weaknesses and cognitive biases they may be prone to," says Last. She emphasises the role of mindfulness training in helping fund managers develop skills to stay focused in the moment, reducing stress and making clear-headed decisions.

Self-analysis by monitoring investment decisions and tracking thoughts and emotions helps fund managers make insightful decisions, says Steve Ward of Performance Edge Consulting.

He says some fund managers will see volatility as a threat, while others will see it as an opportunity. This is a function of personality and experience, and also of social context – in other words, the team or corporate culture around risk, performance and results. Asset managers should learn to identify specific emotions underneath the pervasive label of stress – frustration, fear or anger. Ward says: "Labelling emotions helps to get some distance from them, lessen reactivity and reduce the chance of acting them out. Understand that emotions are data – what might these feelings be telling you? Is there any action to take?"

> "ONE PORTFOLIO MANAGER REALISED THAT A KEY PART OF WHAT THEY NEEDED, GIVEN THEIR COMPLEX LIFE, WAS AN ASSISTANT. IF WE HADN'T DUG INTO THE DEPTH OF THE FRUSTRATION, THAT IDEA WOULD HAVE TAKEN MUCH LONGER TO COME TO CONSCIOUSNESS."
>
> *Denise Shull*

Awareness of risk personality can help determine how fund managers perceive, react to and manage uncertainty before making decisions, explains Ward. He focuses on helping fund managers develop "psychological flexibility and poise" – the ability to act effectively when faced with uncomfortable thoughts.

Reverend prebendary Dr Fiona Stewart-Darling, lead chaplain at the Canary Wharf Multifaith Chaplaincy, works with people in financial services, including on mental health, and urges them to remember timeworn tricks. "Exercise regularly, get enough sleep, eat well and practice mindfulness. Engage in recreational activities and stay socially connected. Social support increases resilience to stress, so connecting with others can help to avoid feeling consumed by anxious thoughts," she says. **f**e

MINDFULNESS - There is no one-size-fits-all approach for managing feelings, personality and traits.

Italian asset management reports positive growth in Q1 2023 net collections

ITALIAN ASSET MANAGEMENT EXPERIENCES POSITIVE GROWTH IN NET COLLECTIONS FOR Q1 2023, SIGNALLING A PROMISING START TO THE YEAR.

PHOTO BY Jack Ward on Unsplash

ITALIAN ASSET MANAGEMENT saw a slowdown in outflows during the first quarter of 2023, according to the recently released Quarterly Report by Assogestioni, the Italian association of fund and asset managers.

The report revealed a slight improvement compared to previous months, with estimated net flows at the end of March standing at -€7 billion, lower than the preliminary figure of -€8.9 billion..

Managed assets rose by nearly €50 billion, reaching €2.257 trillion by March-end, primarily due to a favourable market impact. Alessandro Rota, director of Assogestioni's research office, highlighted the significance: "The market effect was positive at +2.7%, driven by the strong performance of the equity sector, resulting in an asset growth of around €30 billion."

Open-end funds accounted for nearly 49% of total assets at €1.1 trillion, providing insights into the retail market with around 12 million Italian investors. Rota noted, "Considering only open-end funds, net collection was modestly negative at -€3.7 billion. However, the market effect was positive, reflecting the equity sector's good performance."

Equity funds exhibited a positive trend, attracting subscriptions totalling +€2.84 billion in 2022. Bond products rebounded with a collection of €2.96 billion in Q1, following a Q4 2022 decline of -€1.65 billion. However, balanced funds (-€3 billion) and flexible funds (-€5.18 billion) remained in negative territory. Rota commented on renewed interest in bond funds, stating, "Italian investors find value in these products again, as they now offer attractive yields after significant rate increases in 2022."

Positive flows in Italian funds

Italian funds outperformed foreign funds, collecting +€735 million compared to -€4.4 billion. The report provided an overview of Individual Retirement Plans (PIRs), with outflows of €720 million in Q1. Regular PIRs accounted for €779 million of the outflows, while alternative PIRs saw a positive collection of €58 million.

Rota highlighted the performance of specific fund types, stating, "Article 8 SFDR funds collected €1.26 billion, while Article 9 SFDR funds collected €360 million."

Portfolio management, comprising over 47% of total assets, experienced a decrease of -€4.29 billion in Q1. This decline was primarily due to €5.77 billion outflows from insurance product management. Institutional outflows of €2 billion, unrelated to pension or insurance mandates, resulted from internal movements within surveyed group companies.

Rota discussed the overall performance of institutional mandates, noting, "The institutional mandate segment showed a negative picture. However, the historically stable pension mandate segment and focused on long-term goals saw a positive growth of €2.4 billion."

Assogestioni's Quarterly Report provides insights into the positive growth of net collections in Italian asset management during Q1 2023. The increase in managed assets, driven by a favourable market impact, and the performance of specific fund types reflect the evolving investment landscape in Italy. fe