Delegation – the backbone of the European asset management industry

The ICMA's Asset Management and Investors Council (AMIC) was established in March 2008 to represent the buy-side members of the ICMA membership. ICMA is one of the few trade associations with a European focus having both buy-side and sell-side representation. Our investor members represented by the AMIC want to emphasise the importance of delegation to the asset management industry in Europe.

The delegation model

Delegation is one of the key pillars supporting the EU's cross-border investment model which has made UCITS, and increasingly AIFs, a global brand and a European success story.

The current fund distribution model in Europe, where assets are managed in local markets and funds are offered across borders, functions well. UCITS is a recognised global brand and a European success story. Together, UCITS and AIFs are recognised in over 75 jurisdictions worldwide including Asia and South America. These funds channel investment into Europe as well as across the rest of the world, funding corporate growth and job creation as well as enabling European savers to benefit from fund management expertise around the globe while enjoying the same level of investment protection as within the EU.

UCITS have democratised investment and helped European citizens to invest and save for their retirements by diversifying their portfolios to increase returns and manage risk. Delegation is the key to offering savers best-in-class global investment opportunities, wherever in the world they are located.

Delegation under threat

On 20 September 2017, the European Commission issued proposals to reform the European Supervisory Agencies (ESAs). AMIC members welcome many of the very positive aspects of the proposals. ICMA and AMIC are strong supporters of Capital Markets Union (CMU) and we welcome proposals which will help to deliver better functioning capital markets for investors. However, AMIC is very concerned about the proposal to give the European Securities and Markets Authority (ESMA) power to issue opinions on delegation arrangements which could lead to an unwinding of existing approved delegation arrangements.

The Commission's proposal would give the ESAs new powers to review both new and old delegation decisions firms to outsource, delegate or transfer a material part of risk outside the EU. Our concern relates to how this proposal would affect in practice the established and well-functioning model for fund delegation in Europe as governed by the AIFM and UCITS Directives.

We understand the legitimate objective of the Commission to maintain strict quality standard and avoid letter-box entities, but we fear that the proposals to give ESMA powers to issue opinions and recommendations on existing and future delegation arrangements could undermine the delegation of functions to third country entities and therefore, possibly, endanger the existing successful model applicable to investment funds.

The delegation frameworks of UCITS and AIFMD are especially effective as they enable investment funds to delegate functions such as custody and portfolio management whilst being subject to strict control, oversight and accountability by those funds' national regulator in compliance with EU rules.

Furthermore, the EU framework, specifically the AIFMD and ESMA sectoral opinions on delegation, requires firms to meet certain conditions before they can delegate activities to ensure that they are not just 'letter-box' entities. The AIFMD has detailed rules in place governing the conditions applying when portfolio or risk management functions are delegated and criteria to avoid letter-box entity status. These provisions of AIFMD were specifically introduced to avoid the risk of letter-box entities and such delegation does not prevent NCAs from undertaking effective supervision and the asset management company is required to act in the best interests of the investors and to monitor the activities of the delegate effectively.

In addition, regarding the detail of the proposal in Article 31a, the Commission's notion of "material" creates a lot of uncertainty in its meaning and consequences from a delegation perspective. The scope of the proposed ESAs' Review provision is not clearly defined and raises additional concerns among market participants.

Finally, giving ESMA the power to publish recommendations which would withdraw existing third country delegations already allowed by NCAs would lead to significant practical problems and would destabilise the sound portfolio management of the relevant funds, if it should lead to the repeal of delegations already allowed. Ultimately, investors in the funds would pay the price.

The future of delegation in Europe

There is concern within the asset management industry that recent initiatives such as the ESAs Review will call into question the current fundamentals of the UCITS and AIFMD framework, the robust principles of which are key to UCITS' success and to how cross border investment is organised today. It is important not to jeopardise well-functioning savings and investment markets through policy initiatives that may have good intentions but result in potentially serious damage to the industry.

CMU provides Europe with the opportunity to lead in advocating for sound and orderly markets globally which could be promoted actively through cross-border cooperation and supervisory MOUs and Cooperation agreements between jurisdictions. With the global savings gap increasing, the European fund industry can help provide solutions to bridge this gap in an international savings environment.

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