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Supervisory priorities for asset management in the next EU legislative cycle

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Chair

Introduction

Ladies and Gentlemen,

Good afternoon. I am delighted to be here today right at the start of the 30th edition of the EFAMA Investment Management Forum. It has now become a longstanding tradition for me to attend this event.

2024 has been quite a year. A new European Parliament, a new European Commission about to enter into office and a new President in the US. All this impacts ESMA as Europe's securities markets regulator and supervisor as much as it impacts you as market players.

Ensuring the resilience of the investment management sector remains a priority given the role the sector plays in the wider financial market and the economy as a whole, and the sector's relevance for investors.

Today I will focus my remarks on three main topics. Firstly, financial stability, which is very topical due to the Commission's ongoing consultation on the macro prudential framework for Non-Bank Financial Intermediation (NBFI). Secondly, I would then like to touch on the importance of the UCITS brand for the European capital markets and refer to our ongoing work on the Eligible Asset Directive. Finally, I will share a few thoughts on T+1, a topic on which we have worked very closely with all of you and where we delivered this week ESMA's assessment of the shortening the settlement cycle in the EU.

Before I dive into the details, I want to take the opportunity to remind everyone of one topic I will not have time to go into in my remarks today. Sustainable finance remains high on ESMA's agenda and we continue to support the Commission in their efforts to streamline the EU regulatory framework on sustainable finance. We are mindful of the importance of enhancing trust in the EU's capital markets when it comes to financing the transition and making sustainable investment safe and attractive for retail investors. It is an interesting coincidence in timing that the ESMA guidelines on ESG and sustainability-related terms in funds' names

start applying for new funds today. You can rest assured that we are monitoring the application of the guidelines carefully and remain vigilant about the need for any support and further guidance to facilitate their proper implementation.

Financial stability

Now, let me turn to the important topic of financial stability. As you know the European Commission launched in May a consultation on the review of the Macro Prudential Framework for non-bank financial intermediation (NBFI). Today at EFAMA, we will primarily talk about investment funds, but we need to bear in mind that the scope of NBFI is much broader, comprising the asset management sector at large, insurance companies, other financial intermediaries as well as a wide range of financial activities. The EU NBFI sector represents around 45 trillion euros of assets, with investment funds alone managing 19 trillion euros in the Euro area, nearly tripling in size since the Global Financial Crisis.

The consultation will close tomorrow, and I would like to take the opportunity of my speech today to share with you ESMA's position on some of the questions raised in this consultation.

First of all, let me start by saying that ESMA welcomes the initiative of the European Commission.

In the EU, the recent reviews of key asset management regulations are set to implement the latest global standards provided by the FSB and IOSCO. In particular, UCITS, AIFMD and the EU long-term investment fund framework will make a broad set of Liquidity Management Tools (LMTs) available to fund managers in normal and stressed market conditions.

We believe that the new provisions on LMTs, once fully implemented, will help address potential remaining liquidity mismatches in open-ended funds (OEFs). Greater and more consistent use of LMTs will we believe deliver macroprudential benefits. As you know, ESMA is now working on drafting Regulatory Technical Standards and guidelines on LMTs. Following the implementation of the new rules, careful monitoring of the LMT activation rates will be needed.

Despite these positive regulatory developments, we can't rest on our laurels and need to continue to be vigilant about possible remaining instances of unmitigated liquidity mismatches in OEFs. Let me explain to you why.

With respect to ELTIFs, the European Commission has not retained the ESMA proposal in the technical standards for notice periods when investors want to redeem. We understand that this was not retained because it was considered not compatible with the requirements of the ELTIF Regulation at Level 1. We believe that this might be a source of future systemic risk. Therefore, in our view any future review of the ELTIF Regulation should consider allowing for this proposal of notice periods explicitly.

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Beyond the specific case of ELTIFs, we consider that similar rules should also apply to funds that are not ELTIFs but invest in illiquid or long-term assets. Such funds should be structured as closed-ended funds, or – if they are open ended – they should have an appropriate allocation of liquid assets or implement a long notice period.

In that context, ESMA supports the FSB's recommendations relating to the classification of OEFs and we would advocate convergent and consistent application of these recommendations in the EU.

While it is important to have the appropriate set of rules in place to mitigate liquidity mismatches in OEFs, supervision also plays an instrumental role.

This is why I would like to reiterate the importance of NCAs using the full range of the supervisory and enforcement toolkit already available to them under the existing legal framework. In particular, in the course of their supervisory activity NCAs should use all the powers they have to request the submission of Liquidity Stress Tests ('LSTs') performed by fund managers (in line with the ESMA Guidelines on LSTs). This would help NCAs monitor the liquidity risks of investment funds, especially under stressed market conditions, and to identify potential unmitigated liquidity mismatches. At the micro level, it could also serve as a basis for NCAs to assess whether liquidity mismatches are adequately mitigated by specific tools, such as LMTs. At the macro level, it would give an indication of the collective reaction to a common shock, and whether the scenarios used by managers adequately consider the reaction chain of other market participants.

To further improve the liquidity risk assessment framework for OEFs in the EU, ESMA stands ready to develop, together with NCAs, a harmonised analytical framework for regular liquidity risk assessment for OEFs. Such a framework would not only be a step forward in terms of data-driven supervision. It would also allow for more harmonised supervisory actions, on the basis of existing or new supervisory tools, where necessary.

Access to comprehensive, timely, and good quality data is essential to high-quality micro-supervision and macroprudential policy. In the context of the AIFMD and UCITS review, ESMA, in close collaboration with the ECB and the other ESAs, is studying how to establish an integrated reporting system. By avoiding overlapping and inconsistent requirements, such an integrated system would also minimise the compliance burden for the reporting entities. Enhanced data sharing, including by and among supervisors and central banks at national and EU level, could help ensure that authorities have access- to the required information necessary to fulfil their tasks, without imposing new obligations on reporting entities.

Last but not least, strong coordination is essential in macroprudential policy. This also applies to the asset management sector, in particular for coordination on leverage limits under Article 25 of AIFMD.

Indeed, a lack of coordination could undermine the efficiency of measures taken in one jurisdiction to curtail a systemic risk, and could create a risk of regulatory arbitrage.

For these reasons, ESMA is of the view that there is scope to go further on reciprocity. For example, NCAs could be required to assess whether a national measure notified by one NCA should also apply to similar funds in their jurisdiction. Similarly, ESMA could be required to assess whether a national measure notified by one NCA should also be applied across the EU. Such a mechanism could make national measures ultimately more effective in a European capital market. We at ESMA would stand ready to look further into how such a framework could work most effectively.

What is clear in my view is that to enhance the effectiveness of monitoring and supervising non-bank systemic risks, there is a need to ensure enhanced cooperation across borders and across sectors - as financial stability risk does not stop at national boundaries or sectorial frontiers.

The future of UCITS

Now let me move to a topic close to ESMA's heart: the success story of UCITS. The UCITS investment fund framework has created an essential financial product for the European capital market. The label has demonstrated its capacity to adapt to market challenges and has grown from strength to strength, with its distinguishing feature being a high level of retail investor protection. It is important to remember that UCITS have been primarily designed for retail investors.

The strength of the UCITS brand lies in its comprehensive rules, which have made it a trusted financial vehicle and permitted it to successfully navigate recent market dislocations caused by COVID and geopolitical developments. Nevertheless, the European Commission asked ESMA for advice on how to review and update the rules on eligibility of assets into which UCITS may invest, to keep up with market developments.

An important part of the framework is the Eligible Assets Directive (EAD), which dates back to 2007. Since then, many things have changed: in addition to external crises requiring adjustments, financial markets have evolved significantly since the Directive's inception. New asset classes and financial instruments have been introduced into the markets over the last 17 years. This evolution has led to ambiguities and divergent interpretations regarding the eligibility of certain assets.

It is against this background that ESMA received a mandate from the European Commission to assess the state of implementation of the EAD. We were asked to propose clarifications on key definitions and criteria for asset eligibility. The mandate also includes a request to evaluate the risks and benefits for the UCITS framework of allowing indirect exposures to ineligible assets. The mandate finally invited ESMA to gather data from NCAs and market participants to get insights into the manner and the extent to which UCITS have gained direct and indirect

exposures to certain asset categories – and whether that may give rise to divergent interpretations and/or specific risk for retail investors.

ESMA launched a Call for Evidence last May which concluded at the end of August. The Call for Evidence attracted significant attention, primarily in relation to specific asset classes such as crypto assets. We received a considerable number of responses from market participants and other stakeholders. We are very grateful for the responses, which were wide ranging in terms of backgrounds of the respondents, focus of their answers and the areas of expertise. We received views from investment fund representatives, investors and depositaries, as well as significant fund management groups, law firms and associations.

We were not surprised to read that the responses agreed with the key message which I have emphasised earlier: UCITS remains a key pillar of the EU capital market and a trusted brand within and outside the EU. However, we see diverging views when it comes to specific assets and whether they should be eligible or not. Many certainly believe that the UCITS brand would benefit from a greater level of EU harmonisation.

Several stakeholders saw the UCITS EAD review as an opportunity to broaden the UCITS investment universe, by including certain new assets in the list of the eligible assets. Unfortunately, our consultation did not provide us with a lot of factual and quantitative evidence – therefore we face a lack of reliable data to determine to what extent UCITS funds have already gained direct and indirect exposures to certain assets. This is something we would be keen to get further input on.

In considering what next steps to take, we must think about the most relevant question for the future of the UCITS framework: what kind of UCITS do we want. This requires reflecting, among others, on two different but related key aspects: firstly, the level of harmonisation amid Member States, and secondly, the criteria for exposures, direct or indirect, that UCITS gain to certain asset classes.

We are reflecting carefully on the extensive feedback we have received and are preparing our Technical Advice to the European Commission. While our Technical Advice will focus on the objectives of enhancing convergence and promoting financial stability, core to our consideration will be that any future framework enables retail investors to safely benefit from participating in sound capital markets.

In this way, our reflections should align with our vision set out in the ESMA Position Paper on building more effective and attractive markets in the EU, and in particular the goal to empower more EU citizens to invest in suitable, straightforward investment products that will serve their long-term financial goals. If we want to strengthen the EU capital markets and create a genuine ‘Savings and Investments Union’, any future UCITS framework needs to ensure we have a common view on asset eligibility that is well grounded and consistently applied.

Shorter settlement cycle (T+1)

Coming to the final element of my speech, as you are all aware, over the past year, we at ESMA have been working diligently to assess the settlement cycle in the EU. We have looked

into whether shortening it could enhance market efficiency, competitiveness, and alignment with international developments. Today, I am pleased to share some key outcomes of this work with you – based on the report we sent on Monday to the European Parliament and the Council.

But first, let me extend my gratitude to all of you. Your valuable contributions through your feedback to our call for evidence, through various published papers, and your participation at our public hearing have been instrumental in shaping our assessment.

We have now published our assessment of the shortening the settlement cycle in the EU, where we propose to the co-legislators that the EU should transition to a T+1 settlement cycle in the last quarter of 2027, with 11 October 2027 appearing as the optimal date. This recommendation, in my view, reflects a balanced approach: addressing the need for more efficient and competitive markets while giving market participants sufficient time to adapt.

The transition to T+1 will bring significant benefits for EU capital markets. It should:

- Lower margin requirements, and
- Minimise costs arising from misalignment with major global jurisdictions.

However, the shift to T+1 is not without challenges. It will profoundly transform market operations, impacting all entities across the transaction and settlement chains, with varying effects depending on stakeholder type, transaction category, and financial instrument.

Achieving this shorter settlement cycle will demand:

- Legal adjustments to ensure clarity and foster the necessary operational changes;
- Harmonisation, standardisation, and modernisation across the financial ecosystem; and,
- Investment in technology and processes.

Looking at the legal changes, we have recommended in our assessment that T+1 is enshrined in Level 1, to provide certainty for all stakeholders. We at ESMA will also work on reviewing the settlement discipline delegated regulation, which will help in driving the industry towards greater efficiency. These changes should support the transition to T+1 and enhance post-trade efficiency and resilience.

As I said, the journey to T+1 will not be without challenges. In addition to regulatory changes, it will require a deep revision of current market practices, cooperation across the financial ecosystem, and significant investment in infrastructure. But a more efficient, competitive, and resilient EU capital market should be well worth the effort.

Moreover, in my view this move aligns with broader objectives to strengthen EU market integration, efficiency, and resilience. The harmonisation and standardisation required for T+1 will not only facilitate the transition but also promote the Single Market's long-term objectives.

Given the complexity of this undertaking in the EU's intricate trading and post-trading environment, robust governance will be essential. ESMA has carefully considered the

feedback received, including suggestions to leverage existing industry bodies such as the T+1 Industry Task Force and the ECB's Advisory Group on Market Infrastructures for Securities and Collateral (the AMI SeCo).

While their work is highly valuable, the scale of this transition calls for a broader and more inclusive governance structure. ESMA, together with the European Commission and the ECB, are currently collaborating closely with the industry to ensure balanced sectoral and geographical representation in a governance structure that is as inclusive as possible but at the same time allows us to achieve the transition in a timely manner.

Our immediate next priority is to establish this governance framework and to provide clear visibility on how the transition will be managed, ensuring it is coordinated across the EU.

I can also reassure you that we have heard a very clear message from the market that this transition should be aligned with other jurisdictions in Europe.

As we move forward, time is of the essence. Accelerating the transition to T+1 is crucial to maintaining the EU's competitiveness, especially as other major jurisdictions have implemented or are in the process of implementing their own T+1 settlement cycles.

We at ESMA remain fully committed to working with all stakeholders to ensure a successful transition. Together, we can achieve this important milestone for the EU's financial markets.

Conclusion

On that optimistic note, I am coming towards the end of my intervention. I believe we are all looking forward to the new Commission to settle in and to start working on its priorities. The next few years surely will not be dull and as ESMA we will play our part in the key developments for financial markets.

Today I have touched on a number of important topics that are high up on the priorities list for ESMA at this juncture (macro-prudential considerations to safeguard financial stability, the advice we will give to the Commission on eligible assets for UCITS and the important debate on shorter settlement cycles). I know there are many other topics that are also of great interest to you, so I am available to take a few questions now.

Before I do so, I would like to reiterate our openness to engage with you on what is going to shape the future of the investment management sector. We are in the same boat: we want resilient, effective and attractive financial markets in the EU and we want to make sure that investors benefit from access to these markets.

Let me thank you all for your attention.