

ALFI London Conference 2023

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Fund industry links with London remain strong as new regulatory era beckons

The investment fund sectors in London and Luxembourg continue to co-operate symbiotically, but a new era will open next April when the United Kingdom introduces a new regime for the distribution of overseas funds, replacing the single market arrangements that prevailed when Britain was a member of the European Union, according to [Mhairi Jackson, manager of funds and asset management policy at the UK's Financial Conduct Authority](#).

Ms Jackson's discussion with [Marco Zwick, director of fund supervision at Luxembourg regulator CSSF](#), was one of the highlights of the 2023 ALFI London Conference, held in the heart of the City of London on October 19. The event is now the largest organised by Luxembourg's fund industry organisation and this year attracted 1,100 delegates who signed up to attend in person, plus a further 500 who followed proceedings remotely, up from a total of 1,300 in 2022, according to [ALFI chairman Jean-Marc Goy](#).

The close ties between fund professionals in the two financial hubs have grown steadily since the inception of the European cross-border asset management sector in the late 1980s. Today €700 billion in assets held by Luxembourg funds are overseen by London-based managers, according to [Jonathan Lipkin, director of policy, strategy and innovation at the UK's Investment Association](#).

But the industry faces an environment posing challenges unprecedented in recent memory, Mr Lipkin noted, with indicators flashing red across areas including politics, the economy and societal change. In recent years fund professionals have been confronted by the cumulative impact of a series of shocks starting with Brexit and including the Covid-19 pandemic and war between Russia and Ukraine.

Dealing with AI and blockchain

Today the industry is dealing with the fall-out from the ending of quantitative easing and unprecedented new factors such as the widespread adoption of artificial intelligence and blockchain technology. In the UK they are also dealing with regulatory developments such as the introduction of consumer duty requirements across the financial sector.

The industry is also confronted by need for resilience to cope with market shocks such as last year's sovereign bond market turbulence that upset liability-driven investment (LDI) strategies, typically implemented by structures in Luxembourg and Ireland for UK pension funds, while cyber-security has moved close to the top of groups' agendas.

Mr Goy acknowledged the challenges: "We've seen better days, but it could also be worse. Luxembourg's fund assets have declined from a peak of €5.9 trillion to around €5.2 trillion, and we face renewed testing times with high inflation and interest rates." But he also sees

positive developments, and also opportunities, quoting with relish the late, great Formula 1 racing driver Ayrton Senna: “You cannot overtake 15 cars in sunny weather – but you can when it's raining.”

While the grand duchy’s fund assets may have fallen since the end of 2021 as a result of falling equity and bond market prices, they remain more than four times the level when Mr Goy began his career a couple of decades earlier, he noted. And Luxembourg is forging dominance in new types of strategy and products, accounting for 34% of article 8 and 51% of article 9 funds under the EU’s Sustainable Finance Disclosure Regulation, 61% of the European Long-Term Investment Funds launched to date, and 61% of assets of non-UCITS alternative funds in the EU, up from 16% in 2022.

China and the (temporary) death of inflation

Asset managers and fund service providers are operating amid powerful cross-currents shaking the global economic environment, noted [David Rees, senior emerging market economist at Schroder Investment Management](#), stemming from deglobalisation, demographics and decarbonisation. Since the late 1990s globalisation – and especially the entry of China and its extremely cheap labour force into the World Trade Organization – has been critical in keeping the price of goods down, offsetting services inflation and enabling central banks to keep interest rates at unprecedented low levels.

But apart from cheap consumer goods, Mr Rees said, this also had negative consequences: deindustrialization of developed market economies, protectionism in the US, and the populist resurgence that led to Brexit and the presidency of Donald Trump. Even as relations with Beijing deteriorate and industrial groups rethink their supply chains, with Apple turning to production in India and Vietnam and other US companies opting for ‘nearshoring’ in Mexico, businesses remain reluctant to lose access to China’s huge market.

There’s also a fourth critical ‘D’, he cautioned – debt. Rising sovereign debt in the developed world carried no urgency in the two decades from 2000 to 2020, when interest costs were falling almost to zero. However, the financial response to the pandemic’s disruption and then soaring fuel prices in 2022 is now running into higher interest rates and the end of loose monetary policy. Central banks are no longer absorbing enormous amounts of debt, and as private investors shift from riskier assets to fixed income, the threat of more LDI-style shocks is growing, Mr Rees concluded.

Against this backdrop, regulators are paying heightened attention to liquidity risk management in the fund sector, Mr Zwick and Ms Jackson agreed. They are also looking much more closely at the potential risks arising from non-bank financial intermediaries, such as the private debt funds that are taking an increasing share of the corporate lending market as well as becoming an important growth driver for Luxembourg’s alternative investment business, and also the possibility of turbulence among money market funds.

New focus on fund liquidity

Ms Jackson says the FCA has been focusing in recent years on how to embed best practice among asset managers and shift away from a past culture of box-ticking compliance habits. Both regulators emphasised the importance of avoiding liquidity mismatches as non-professional investors, who are used to regular redemption windows, start to invest in less liquid asset classes that previously have been the preserve of institutional investors.

This is something that will have to be managed as the EU awaits the entry into effect next January of the new ELTIF Regulation, which is seen as a means to channel retail capital into sustainable investments and other types of infrastructure. The UK has already launched a similar type of product, the Long-Term Asset Fund, which imposes a 90-day notice period for redemptions – a condition that is likely to be studied closely in drawing up detailed ELTIF rules.

The most important theme for asset managers is that the global environment has changed, and the world of free money has ended, according to [Rob Spanjaard, the Luxembourg-based group CEO and chief investment officer of AI-driven Johannesburg-headquartered firm Rezco Asset Management](#). And, said [Ed Dymott, his counterpart at the UK's Benchmark Capital](#), funds firms now find themselves in competition with annual interest on cash deposits of up to 6%.

Private assets are going mainstream, Mr Dymott argued, in a paradigm shift as the number of listed companies drops, in the UK as in the US, and managers converge in targeting the same kind of investor. The inevitable result, according to [Nicolas Buck, CEO of Luxembourg fund data solutions firm Avanterra](#), is a more intrusive regulatory environment covering areas such as client disclosure, processes and also green credentials, which will have inevitable cost implications.

Embracing the green

A different perspective on sustainable investment was offered by [Ben Goldsmith, CEO of energy and resources investor Menhaden Resource Efficiency](#), who bought a farm in Somerset while in his 20s. Now he champions the cause of investing in nature not for reasons of philanthropy, but because of tangible financial and human benefits derived from the natural environment, arguing that mental and physical problems often stem from lack of contact with nature.

Up to now the financial price put on natural resources that cannot be harvested or extracted has essentially been zero, but Mr Goldsmith says this is misguided. The nurturing of mangrove forests and the rewilding of wetland ecosystems, he says, are a rational answer to the growing problem of flooding, which now causes financial losses averaging £12bn a year in the UK. He envisages a system of tradable tokens derived from ecosystem protection that can be financed by sales to businesses such as housebuilders - a market that could be worth \$100bn by 2028, according to former Bank of England governor Mark Carney.

Private debt has grown at an average rate of 17% annually over the past five years, according to [Justina Deveikyte, director of European institutional asset management research at Cerulli](#)

[Associates](#), noting that around 30% of high net worth individuals and family offices in major European markets are looking to invest in debt over the next 24 months. They are also increasing exposure to private equity, she says, at the expense of real estate, traditionally a major focus for wealthy investors but one for which their appetite is generally shrinking.

Conference panellists say the sustainable investment sector now appears to be hostage of the European Commission's ongoing consultation on possibly far-reaching reform of the SFDR, including an option to embrace the product categorisation model adopted by the post-Brexit UK. This could help to address growing unease about the risk of greenwashing, which is becoming a bigger priority for regulators, according to [Arthur Carabia, director of ESG policy research at Morningstar Analytics](#).

[Stephanie Lhomme, head of forensic investigations for Europe at Arendt Regulatory & Consulting](#), says industry members as well as investors feel vulnerable about the regulatory uncertainty surrounding ESG as well as the shortage of data to underpin sustainability assessments. Investors are having to undertake more sophisticated due diligence, including on the methodology of data providers – but the next step will need to be testing of the quality of the data itself.

Toward the digital money revolution

The impact and opportunities stemming from asset digitalisation for both managers and service providers are starting to emerge from the shadow of the crypto-currency boom and bust, according to [HSBC global head of digital assets strategy John O'Neill](#). He said legislation and regulation was as important for the bank's Orion digital asset platform as technology, citing the country's dedicated blockchain law as a key factor in the choice of Luxembourg as domicile for the system.

The next challenge is the prospects of central bank digital bank's digital currencies being introduced in as many as 90 jurisdictions including the eurozone, the US, UK and China, noted [Matin Hargreaves, chief product officer of digital ledger solution provider Quant](#). He argues that as new, more complicated types and characteristics of money emerge, major changes lie ahead for the way markets such as foreign exchanges operate.

The conference concluded with a discussion about the democratisation of private assets, a trend embodied by the launch of Britain's LTAF and revision of the EU's ELTIF. Last year was a turning point, according to [Partners Group senior structuring professional Alena Shchelokova](#), with a surge in fundraising among non-professional investors, boosted by easier liquidity conditions – Partners Group launched its first evergreen rather than closed-ended fund in 2003, and since 2016 has launched six ELTIFs in Luxembourg.

[Jocelyn Pidoux, managing director for product development and structuring at alternative investment marketplace iCapital](#), says the industry has had to rethink features such as 100-page subscription documents and capital call structures in order to accommodate non-institutional investors. She says the aim is to make trading in private funds as easy in some

ways as dealing in shares or bonds – but there will always be features such as gates and lock-ups that are not seen in the UCITS universe.