Derville Rowland: Global factors shaping asset management

Remarks by Ms Derville Rowland, Deputy Governor of the Central Bank of Ireland, at the Irish Funds Annual Global Funds Conference, Dublin, 23 May 2024.

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Good Morning,

Thank you to Irish Funds for the invitation to address your annual conference. It is always a pleasure to have the opportunity to attend your events and hear the perspective of the funds and asset management industry.

Yours is truly a global industry. So let me give you some perspectives of the global factors shaping asset management at the moment.

Economic activity was surprisingly resilient through 2022 to 2023 and recent global growth forecasts have been revised upwards.[1] Near term financial stability risks have also receded as disinflation is entering its so-called "last mile". We need to all remain watchful for strains in the CRE market, stalling disinflation and looking to the medium term - the build-up of debt in public and private sectors.[2] Recent IMF reports also suggest that medium-term global growth prospects remain weak. Turning closer to home, Euro area financial stability conditions have improved as recession risks decline.[3]

In a European policy context, change also continues - we have seen political agreement reached on the EU's Artificial Intelligence Act and on proposals around the EU's Anti-Money Laundering (AML) Package. The revised ELTIF Regulation has entered into application, with the first Irish ELTIFs subsequently being authorised. In the face of the many challenges the EU faces, there has been an emphasis on EU competiveness, a renewed focus on progressing Capital Markets Union. And climate issues remain a perennial, pertinent and persistent backdrop to both policy and risk discussions.

How people, politics and institutions respond to these changes will very much be shaped by major events like the forthcoming European Parliament elections and the formation of the new agenda for the next European Commission. That agenda will of course continue to be shaped by the prevailing themes of ever increasing interaction and strategic autonomy, which will raise important issues in the context of the funds sector, including evaluating EU-level supervision and reliance on third countries.

While there are many uncertainties about the future, there are many things which are known.

We know that **economic growth in the European Union** has remained low since the 2008 Global Financial Crisis. While the EU has responded well to crises such as the COVID-19 pandemic, the war in Ukraine and resulting energy crisis, the EU economy continues to be outperformed by the United States and China.

We know that due to structural issues, the European economy is dependent **on bank financing with smaller capital markets which are fragmented along national lines**. As a result, it is less resilient to shocks.[4]

We know that funding is needed to **support the green, digital and other transitions**. How we respond to supporting these will require innovative thinking both from industry and from policymakers. It will need enormous investment to achieve a more competitive, innovative, de-carbonised and digitally transformed European economy.

We also know that the pace of **innovation and emergence of new technologies** will accelerate.[5] The proliferation of powerful new technologies will impact on all aspects of daily life. They will undoubtedly bring benefits in delivering financial services which will involve greater accessibility and efficiencies and this will be good for consumers, businesses, the economy and society as a whole.

So how do we respond to these challenges and changes?

There is much to consider and debate within all of these. Indeed an understandable reaction to change can be to resist or seek to frustrate some elements of it. Instead, the quote attributed to Abraham Lincoln, neatly summaries the philosophy that is now needed – *"the best way to predict the future is to create it".*

In doing so, there is a role for all of us.

There is a role at both a **political and public policy level in Europe** to address the structural challenges Europe is facing. Strong collective action will be required if we are to have well-functioning capital markets which can compete in an increasingly fragmented world.

There is a role at a **political and public policy level in Ireland** and in other Member States to address certain issues, such as long term savings needs and pension system reform. This will be critical to enable private funding to drive the next cycle of investment to respond to these challenges.

The Irish funds sector has a pivotal role to play in addressing these challenges. Enabling investors to participate in capital markets, through better investment choices, is an economic necessity for the Europe. Investment funds allow investors to increase their investment opportunity set, to improve the risk/return profile of their portfolio and to entrust oversight of their investments to a professional fund manager.

The Letta report makes a strong and reasoned case for a new type of single market under the banner of a **Savings and Investment Union**. There is a need to create a bridge between EU savings and investing in the EU. We need to incentivise European savers to want to invest in Europe. Not because we are European, but because Europe should be an attractive market for all investors. I will come back to this a little later in terms of the steps needed to progress this.

In addition, more must be done on **improving EU competitiveness** and to more fully integrate the Single Market. Competitiveness will be a defining feature of the next European Commission's agenda. The much anticipated Draghi Report will be an important contribution to this debate, but as the author has indicated already, 'radical change' is needed for the EU to remain competitive.[6] This will be critical if Europe is to respond to effectively to the challenges and opportunities presented by the green and digital transitions.

As I have mentioned, innovative technology and digitalisation will also bring challenges. Existing firms will face increased competition from challenger firms, you will need to innovate quickly and also invest heavily in order to meet increased expectations from your consumers. Equally, regulators will need to be attuned so they can respond quickly to anticipate as well as to support innovation so that the benefits can be harnessed in a proportionate and risk-cognisant manner.

With this in mind, it is evident the objectives of the funds sector, of public policy makers, and of Europe, are intrinsically aligned when it comes to meeting the aims of Capital Markets Union (CMU).

The latest contribution to the debate on Capital Markets Union was published yesterday by the European Securities and Markets Authority (ESMA).[7] ESMA's statement outlines 20 recommendations aimed at a range of actors – EU institutions, Member States and market practitioners alike.

For **EU citizens**, the recommendations are designed to support the availability of simple, cost-efficient, investment options which are crucial for empowering citizens to invest their savings in capital markets that serve their long-term needs. Key recommendations in this area include the development of basic long-term investment products and pension systems that are suitably incentivised and contribute to the development of capital markets.

For **EU companies**, ESMA believes diverse and sustainable financing options are critical for fuelling growth and innovation in the EU, especially for SMEs. Key recommendations in this area include developing a conducive ecosystem for public companies, and fostering pan-European markets while addressing barriers to integration, particularly for market infrastructures.

For **EU regulation and supervision**, the ESMA recommendations focus on ensuring EU capital markets are agile to respond to evolving needs. ESMA focuses on modernisation the EU's regulatory framework and drive supervisory consistency amongst EU supervisors, while suggesting that centralisation of supervision at EU level should be further evaluated.

In particular, I would call out the recommendations ESMA has put forward around encouraging greater retail participation in capital markets. ESMA has identified that *"Member States should consider how domestic tax policy can better incentivise retail investors to participate in and benefit from capital markets."* In this context, in Ireland, it will be important that we consider potential barriers to investor participation and measures to support their access to a wider range of well-regulated and cost-effective investment products. The Department of Finance's ongoing Funds Review provides an important opportunity to address the disincentives which exist for Irish consumers accessing the wide array of investment products that are provided in the funds sector.

ESMA also identifies the need to support digital solutions for retail investors. In a world where consumers have so many new ways of interfacing with financial services and advice, this will involve equipping consumers not just to understand the basics of financial services but also supporting them to understand the risks to which they are exposed in digital environments. In this regard, the steps being taken by the Irish Government on its financial literacy strategy and at international level by the OECD and the International Network on Financial Education (INFE) are welcome.[8]

Commissioner Mairead McGuinness, speaking last month[9] about the Commission's Retail Investment Strategy outlined that successful capital markets rely on trust. I agree wholeheartedly with her. The benchmark for retail investor trust needs to be set incredibly high. A well-functioning financial system depends upon trust and confidence between customers and their product providers. You will know all too well that the trust of investors is hard earned, and easily lost. As we seek to encourage greater retail participation in capital markets it will be important that all of us play our role in supporting that trust.

For regulators our interventions are intended to:

1. Protect investors (which includes promoting and safeguarding the integrity of funds and maintaining confidence in the funds industry among potential investors and the public generally); and
2. Identify and mitigate systemic risks which may arise.

High quality regulation plays a vital role in supporting well-functioning capital markets. It ensures that investors are protected and that risks to financial stability are identified and mitigated. At the same time, regulatory intervention should:

1. support innovation and product development to meet the changing needs of investors and the broader evolution of the global financial sector; and
2. be appropriately calibrated in order to achieve the right outcomes without being unduly onerous on market participants as ultimately inefficiencies will be borne either by the end investors or users of the financial service.

In Europe, ensuring consistent regulatory outcomes across the Union is key in a multi-polar capital market. This is particularly important where the cross-border nature of financial services, and funds in particular, can bring an added complexity.

The Irish funds sector has built an international reputation for excellence and expertise. Our place as an international financial centre brings with it certain responsibilities. It requires a continued commitment to high quality and effective supervision while striving to play a leading role in international policy development in both European and international fora. These considerations have shaped our priorities and the Central Bank's strategy that recognises the complex and rapidly changing environment in which firms operate. While the continued growth of the sector in terms of both its size and range of activities can benefit the domestic economy, it also requires careful monitoring and ongoing management to mitigate against any potential risks to either investors or broader financial stability. In this context, it is important to consider both the functioning of the overall ecosystem as well as its constituent parts.

Macroprudential Regulation

This is why the Central Bank has sought to positon Ireland at the forefront of the development of a macro-prudential framework for non-banks, in particular investment funds. The aim of our contribution is to advance the debate the development and operationalisation of such a framework.

A feedback statement following our Discussion Paper on the topic will be issued over the coming months. This Feedback Statement will include elements of the discussion from the Central Bank's conference on macro-prudential policy for funds which we hosted earlier this week. This was an opportunity to bring together senior leaders – across the public and private sector in Ireland, Europe and internationally – for an exchange of views.

The topic is high on the European Commission's agenda – yesterday (22 May) their technical workshop on non-bank financial intermediation launched a targeted consultation on macro-prudential policies for the sector. That workshop focused on ensuring effective monitoring and risk management for funds from a financial stability perspective and how to enhance the role of macro-prudential authorities in monitoring interconnectedness, deploying tools and ensuring cross-border coordination. There were no doubt many interesting contributions throughout the course of the day – but two comments stood out. Firstly, elements of the macro-prudential debate and Capital Markets Union are closely related given the importance of cross-border coordination and reciprocity.

Secondly, while policy makers have learnt important lessons from recent experiences, such as the Archegos situation and LDI experience, nevertheless these events are very different in nature and the only common lesson that can be taken is that leverage can be dangerous when it is excessive.

Several episodes of stress in recent years have demonstrated how vulnerabilities in particular fund cohorts can act to amplify market-wide stresses. Ensuring that the funds sector overall and key cohorts within it remain resilient in the face of adverse shocks and does not contribute to excessive risk-taking during market upswings is key for both monetary and financial stability.

As you will be aware, the Central Bank has introduced macro-prudential measures in the funds sector on two occasions recently.[10] There will be time to more fully reflect on the lessons learnt from these experiences. However, already we know that some elements are critical for an effective macro-prudential toolkit. Most prominent amongst these is the need for a mechanism to ensure close coordination and cooperation – on a cross border basis – to ensure these interventions are successful.

Conclusion

The coming months and years ahead will see the pace of change continue to accelerate. This will impact on the European economy and society as a whole. But the impact on the asset management sector in particular will be profound. It will be incumbent on all of us – policy makers and market practitioners alike - to influence this change and the role the Irish financial sector plays in it.

If managed properly, better-developed capital markets in Europe can boost the financing available for innovative and growing companies and provide the finance to support the green and digital transitions. Greater cooperation across Europe will enhance overall systemic resilience and cross-border risk sharing while reducing the cost of financing and increasing returns for the end investors. It will form an essential part in developing Europe's overall strategic autonomy. This can all be delivered through well-regulated, high-quality products including funds that deliver value, choice and positive outcomes for investors.

Thank you.

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[1] World Economic Outlook, April 2024, IMF

[2] Global Financial Stability Report, April 2024, IMF

[3] Financial Stability Review, May 2024, ECB

[4] IMF Background Note on CMU for Eurogroup,15 June 2023

[5] For example, see Mustafa Suleyman (2023), *The Coming Wave,* Crown

[6] See remarks by Maro Draghi at the High-level Conference on the European Pillar of Social Rights, Brussels, 16 April 2024.

[7] See ESMA Position Paper – Building more effective and attractive capital markets in the EU.

[8] See Department of Finance Consultation on National Financial Literacy Strategy. See OECD and the International Network on Financial Education Guidance on Digital Delivery of Financial Education.

[9] See: Speech by Commissioner McGuinness at the Second Roundtable on the Distribution of Retail Investment Products, 11 April 2024.

[10] Note: In November 2022, the Central Bank announced new macro-prudential measures for Irish property funds. These were the first policy measures to be introduced under the third pillar of the Central Bank's macro-prudential framework, which covers non-banks. Last month we announced macro-prudential measures for Liability Driven Investment (LDI) funds. These measures were introduced in alignment with our regulatory counterparts in Luxembourg, after interaction with the ESMA.