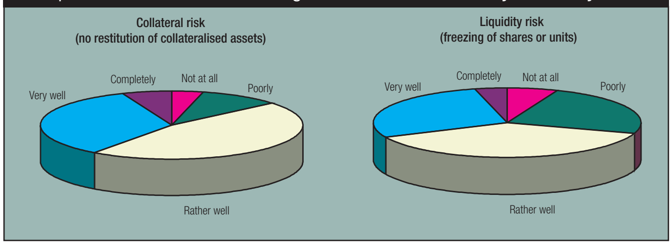
Fears grow over operational complexity

TRANSPARENCY TOPS FUND MANAGERS' CONCERNS, AS **GRAHAM BUCK** DISCOVERED.

Europe's fund management industry professionals cite "transparency, information and governance" as their major concerns in the area of non-financial risk management, according to a new survey.

More the 160 industry members were canvassed by research facility EDHEC-Risk Institute as part of its research project into risk and regulation in the European fund management industry.

How protected from the following non-financial risks do you think you are?



The survey, entitled Shedding Light on Non-Financial Risks, asked participants what they regarded as the main causes of the rise in non-financial risks experienced by the industry.

The growing sophistication of operations was seen as the main reason, with 77% regarding it as important. This was followed by the reduced capacity of some intermediaries to guarantee deposits, mentioned by 59% of respondents. Unclear or inappropriate regulation scored 57% and a lack of responsibility by management companies in providing restitution 53%.

EDHEC-Risk Institute says the survey findings emphasise that fund management professionals are worried by areas of regulation that the regulator has often neglected in recent years, most notably the Alternative Investment Fund Managers Directive (AIFMD).

"For the respondents, 'transparency, information and governance' are the priority for the regulation of non-financial risks, followed by the financial responsibility of the industry," it notes. "On the latter point, it is important to stress the recognition that non-financial risks are largely the consequence of the fund manager's decisions."

On the main concern of transparency, 91% of respondents thought that the regulator should ensure that information is genuinely clear and fair and does not mislead.

On the industry's financial responsibility for non-financial risks, which was the second biggest concern of respondents to the survey, 79% agreed that "fiduciary duties of asset managers should be reinforced, by stating that they must invest for the sole benefit of their clients", while 67% agreed that asset managers should have greater responsibility for non-financial risks.

These opinions tally with an earlier EDHEC-Risk Institute survey, which concluded that responsibility for decisions and compliance with regulatory obligations does not rest solely with the depositary.

Other survey responses include support for contractually defining responsibilities between depositaries and asset managers for restitution of assets – 68% thought this should be done at the creation of the fund. The suggestion that depositaries should be unconditionally responsible only for assets they actually control was supported by 69%, meaning that responsibilities should be defined by asset class.

Asked about distribution, 81% of respondents favoured clarifying responsibilities according to who controls the information and 69% agreed that distributors had a role to play as the first line of defence for investors.

There was general agreement that the costs of stronger protection should largely be shouldered by the industry rather than being passed on to investors. Stronger regulation would result in a net cost to custodians, according to 73% of respondents, asset managers (70%) and depositaries (69%).

EDHEC-Risk Institute also suggested to respondents that in response to the growing complexity of UCITS (Undertakings for Collective Investment in Transferable Securities) and resulting counterparty risks, the concept of secure UCITS funds should be considered, where the depositary would be unconditionally responsible for the restitution of assets. The idea was supported by 67% of respondents.

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The complete survey can be accessed free of charge at http://bit.ly/JVZw7Y