

Massimo Paolo Gentili



**THE EUROPEAN
INVESTMENT FUND
MANAGEMENT
INDUSTRY**



EDIBANK

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ABOUT THE AUTHOR

I learned the value of hard work by working hard.
Margaret Mead

Massimo Paolo Gentili is the founding partner of Gentili & Partners (the Firm), a consulting boutique founded in 1994 that brings together Chartered Accountants and Lawyers, specialised in regulatory, organisational, and corporate advice to all kinds of financial institutions, investment funds, club deals, and family offices.

To provide its clients with a complete range of services and maintain its independence, the Firm boasts sound relations with several international and local firms.

Massimo Paolo participated as an equity partner in the 2004 MBO of TMF Group and then in its development until 2018, when it counted 125 offices in 83 jurisdictions and was acquired by CVC Capital Partners.

Relying on his previous managerial experiences, he often plays a significant role in complex projects involving national and international external professional skills and resources.

Chartered Accountant, Massimo Paolo holds a degree in Business Administration from Luigi Bocconi University in Milan. After serving at Coopers & Lybrand S.p.A., he took the office of CFO of Gemofin Sim S.p.A. and Gemofid Fiduciaria S.p.A., and then he founded his own Firm.

Massimo Paolo has been based in Luxembourg for over 12 years and regularly travels between London, Zurich, Geneva, Lugano, and Milan. He holds several appointments in financial intermediaries in different jurisdictions with in-depth knowledge of the workings of several markets.

He wrote a number of articles and published books about the valuation of financial intermediaries, SICAVs, and European asset managers.



FOREWORD

*Despite all the hype about exploding connectivity and the death of distance,
where we live, and work is more important than ever.
It is true that things can be done anywhere on the Internet,
but at the end of the day, it's still a people's business.*

Enrico Moretti

The emergence of the asset management industry is a direct consequence of some critical post-war historical events. The general improvement in the standard of living in developed countries allowed households to start saving and, over time, to think about diversifying their investments.

Asset management is a fundamental concept which directly or indirectly concerns any natural, legal or moral person, whether or not of high class. Individuals should have at least a basic knowledge of investment funds because, sometimes, even without knowing it, everyone is invested in one of these financial market products.

The role of asset management is crucial for the development of the economy. Private individuals' savings are injected into the economy, financing companies and projects. The proceeds from the funding are then turned back to private individuals in the form of capital appreciation or dividends, thereby creating wealth.

The asset management industry is relatively young, as we shall see in this volume, and is characterised by very different players operating in the wealth management value chain for the creation, management, and distribution of products. The latter can be relatively simple, such as those intended for retail clients, and sophisticated, such as those for institutional clients or those with a very high level and financial culture. To provide some preliminary data that will be analysed in more detail, the industry, despite the crisis period, is growing relatively steadily, as in 2017, there were 4,393 asset managers, while in 2021, already 4,803 (an increase of about 9%)¹. Underlying this industry are clear and well-defined objectives related to managing savings for re-use in the economic cycle by providing customers with a cost-efficient instrument, diversified in terms of investment types, with an appropriate risk control policy and in a regulated and controlled environment.

The regulation of this sector is one of the key elements we will deal with in this volume. Financial markets are among the most regulated sectors of the economy to pro-

¹ Reprocessing of data provided by EFAMA in their report *Asset Management in Europe - An Overview of the Asset Management Industry*.

tect participants from ensuring the system's stability and the financial markets' functioning.

The regulation's expansion partly coincides with current States' tendency to intervene as market "regulators". States intervene in economic life in a way that differs from the previous "liberal" States, which essentially dictated rules in criminal law and regulated relations between private individuals.

Although examples of asset management products, in one form or another, have been around for a long time, it is only in the last few decades that a proper financial market and new financial products, such as managed accounts and investment funds, have developed in Europe. These are the years in which, fortunately, some of the most important European regulations have been envisaged. These have allowed investors to obtain protection and safeguard their investments, creating products that have become worldwide brands, such as the Undertakings for Collective Investments in Transferable Securities (UCITS) and the Alternative Investment Funds (AIFs) that we will discuss at length in this volume. In terms of products, the market is also growing considerably. In fact, since 2008, UCITS and AIFs have experienced remarkable growth rates in assets under management, rising from EUR 4,477 bl and EUR 1,637 bl in 2008 to EUR 12,063 bl and EUR 7,360 bl, respectively, in 2022².

The transition from a loosely regulated market to a highly regulated one has certainly not been easy and not without criticism; many argue that the investment market is, as of nowadays, filled with ever-evolving rules and regulations, the costs of which often end up falling on the investors themselves. Nevertheless, it is undeniable that the work done by the regulators is definitely in the right direction. Perhaps we will see a simplification of some regulations once the market has adjusted to specific cultural and behavioural standards that must be fundamental to investor protection.

The regulation has enabled the asset management sector to become a credible industry, thanks to the willingness of national authorities and, in Europe, the European Community, to regulate this industry while closely monitoring its evolution.

The phenomenon that I find very interesting and, in some ways, surprising is that some products, born thanks to the vision of the European Community, such as UCITS, have managed to become recognised brands not only in Europe, but also in America and Asia. The same, albeit with different dynamics, is happening with AIFs, which are enjoying great success worldwide.

Over 12 years ago, I decided to move my main work base to Luxembourg to experience the development of the asset management industry first-hand. I had been frequenting the Grand Duchy assiduously since the late 1990s. I had become aware of the transformation that was taking place in the country, which had focused heavily on the investment fund industry. The country's system had all players' support while respecting their roles, which had a considerable multiplier effect.

² Reprocessing of data provided by EFAMA in their *Quarterly Statistical Reports* from 2008 to 2022 for both UCITS Funds and Alternative Investment Funds.

I believe that giving a relatively concise overview of complex sectors and operations in an international context is a very challenging task. My goal with this publication is to show a rapidly expanding industry to individuals who are unfamiliar with it or have a hazy understanding of it. Many professionals work in it, but not everyone has an overview of the regulations, the main existing structures, the dynamics, and the industry's size.

After more than thirty years in this industry, perhaps I myself felt the need to put things in order and better understand the direction in which the industry is heading. We are all swept up in the whirlwind of the day-to-day and need to give ourselves a wide important goal (WIG), a stimulus to get out of the routine and look at the picture as a whole. Several successful professionals, be they asset managers, lawyers, CEOs, family offices, private bankers, and service providers, sometimes have excellent vertical skills but often lack an overall vision. This book has been my WIG for a long time. I hope that this work is only the beginning of a long journey, the birth of a small tool, which at its first appearance will not be without flaws but can then be perfected, expanded and improved.



INTRODUCTION

*A bad book is as much of a labor to write as a good one,
it comes as sincerely from the author's soul.*

Aldous Huxley

Delineating a precise and clear picture of the asset management industry is not easy, as many of the operational boundaries regarding individual business areas and industry players overlap due to the ongoing process of evolution and growth of the field. This book is organised into six main chapters and divided into three macro areas for intellectual and academic rigour. The main characteristics of management companies, actively managed investment funds, and passively managed products will be analysed to provide a comprehensive overview of the asset management industry. Various statistics will also be provided to support the discussion to give more colour to specific aspects and offer a better idea of the size and characteristics of the market.

The first chapter serves as a general introduction and will provide a broad overview of the asset management sector, highlighting several critical issues of particular interest. After briefly reviewing the history and emphasising the leading authorities at the European level, a preliminary examination of the macro composition of the asset management sector will be conducted, dividing by compartments for the primary investment products, investors, and managers. Secondly, asset management's vital role in the economy will be analysed together with the relatively recent impact of ESG regulations on the manner in which business is carried out. Thirdly, the future traits of the industry will be emphasised, particularly looking at the impact that technology is having and will bring about a fundamental and radical change in the industry.

In the second chapter, we delve into the analysis of the first major topic of the book: management companies. The main characteristics of management companies, dedicated to traditional UCITS and alternative funds, will be analysed, focusing on regulatory aspects such as authorisation, operational requirements, delegation, and remuneration systems. In addition, more business-related topics will be touched upon, such as the primary business models and structures' organisational features, highlighting the vital role played by third-party management companies, especially in the current context, and the activism within the asset management industry.

The third, fourth, and fifth chapters deal with the second macro topic: actively managed investment funds. Specifically, traditional UCITS funds are covered in the

third chapter, alternative funds in the fourth, and the fifth chapter will attempt to combine the common elements. Chapters three and four have been constructed to be essentially the same in their structure and thus offer a relatively simple and immediate yardstick for comparing the two products. In this regard, the general distinguishing features will be analysed, including, among others, the different types of funds (for alternative investments), eligible investments and related limits and restrictions (for UCITS funds), as well as primary compensation structures and the main structures used in Luxembourg and Ireland from a legal, regulatory and company law perspective. Finally, chapter five underlines, albeit with due distinctions and caution, several aspects that are common or at least similar to make parallelisms between UCITS and alternative funds, including the form, organisational structures, service providers, and the functioning of corporate governance, as well as regulatory aspects such as the documentation and reporting requirements, master-feeder structures, and cross-border distribution, and extraordinary transactions.

Chapter six is dedicated to the last topic of the book: passively managed investment products. Given their relevance in today's asset management industry, it will provide a high-level overview of exchange-traded products, particularly exchange-traded funds, analysing the main basic features, including replication strategies and dealing arrangements, and highlighting their costs and relative performance.

Over the past few years, we have increasingly heard about asset management and its vital role in the economy. Asset management is the practice of increasing clients' wealth through the acquisition, maintenance, and disposal of investments. Asset management performs a crucial function in the lives of citizens and businesses, channelling savings towards investments. An asset manager's core mission is to invest clients' capital into productive economic activity, allowing companies to develop by providing access to new funding sources. This, in turn, enables them to create employment and better serve their customers and employees. The proceeds from financing these companies are then returned to investors, allowing them to meet their financial goals.

Asset management is an essential economic value-creating mechanism when employed on a large scale. The dimensional aspect from the latest industry data confirms this, showing how this sector, despite the infra-annual volatility and periods of financial strain, is in constant expansion and an industry that investors trust.

The asset management industry took on a different connotation in Europe, though with significant repercussions worldwide, when the European Union decided to regulate the sector by creating a harmonised regulatory framework for investment fund management. The landscape in which asset management operates has changed radically under the impetus of the continuous evolution of Community legislation, hinged on two pillars. First, in 1985, with the introduction of the Directive on Undertakings for Collective Investment in Transferable Securities (UCITS) and, later in 2011, with the Alternative Investment Fund Managers Directive (AIFMD).

The book is characterised by the richness of its content and breadth of analysis and considerations, making an important contribution to the development of asset management in Europe by providing a comprehensive overview.

Massimo Paolo Gentili, founder of the consulting boutique Gentili & Partners, is a professional based in Luxembourg with comprehensive experience in regulatory, organisational, and corporate advice to all kinds of financial institutions, investment funds, club deals, and family offices. He holds several appointments in many investment funds and management companies and has published a number of articles and books concerning the asset management sector.



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