

**REPLIES OF THE EUROPEAN COMMISSION  
TO THE EUROPEAN COURT OF AUDITORS SPECIAL REPORT:**

**“INVESTMENT FUNDS: EU ACTIONS HAVE NOT YET CREATED A TRUE SINGLE  
MARKET BENEFITTING INVESTORS”**

EXECUTIVE SUMMARY

**Replies from the Commission on the Executive summary (paragraph I-X):**

The Commission considers that the EU has a robust regulatory and supervisory framework governing collective investment funds, including in the area of investor protection.

Regarding investment funds offered to retail investors the UCITS Directive is globally considered as the gold standard. Investor protection rules laid down in the AIFMD are regarded as one of the most stringent and some even consider that there is too much protection for professional investors.

The EU has developed a protective framework in relation to inducements to prevent conflicts of interests. The Commission is also preparing a retail investment strategy for the end of 2022 in the context of which a public consultation has been already launched and covered inducements and quality of advice.

The Commission’s Better Regulation Agenda ensures evidence-based and transparent EU law-making and lays down principles that have been followed in the development and review of the legislative acts governing investment funds.

After the ECA audit, certain measures have been either adopted by the Commission or were implemented in the Union, but have not yet produced their effects. Therefore, these changes could not be taken into account by this audit.

The recent legislative proposals adopted by the Commission on 25 November 2021 amending the AIFMD, UCITSD and ELTIFR, address many issues highlighted in this audit report and more. It will be possible to evaluate the benefits of these initiatives only in 6-7 years. The precise timing depends on the length of the discussions in the Council and the European Parliament prior to the adoption of the recently proposed amendments. Once adopted, the new rules have to be transposed by Member States, which will happen two years after the adoption. Subsequently experience with the application of the new rules needs to be gained and sufficient and relevant data collected, which should take at least three years, leading to a total of 6-7 years from now.

With regard to cross-border activities, the Commission considers that the management company passport is widely used. In a number of Member States over 40% of investments funds are cross-border funds promoted by foreign providers (figure 6 in the ECA report). The Commission agrees that still investors may not be able to fully enjoy the benefits of cross-border activities due to certain remaining obstacles. Whilst many of these obstacles were tackled by the cross-border distribution of funds package, its potential positive effects cannot be evaluated yet since the package entered into application only in August 2021. The Commission will conduct a review of this package in 2024 as decided by the co-legislators. In addition, certain market realities and policy choices cannot be addressed by EU law, such as taxation, local demand and instances where asset managers choose to distribute their investment funds.

As far as supervisory data are concerned, the Commission is working on improved supervisory reporting in all financial sectors, including data-sharing between authorities, and adopted a supervisory data strategy on 15 December 2021. Improved reporting in the investment funds sector is part of that strategy and of the proposal to amend the AIFMD and UCITSD adopted by the Commission on 25 November 2021.

Concerning ESMA's governance and convergence work, significant improvements were achieved with the last ESA's review even if the initial proposals of the Commission were not all retained by co-legislators. These changes started to apply in 2020 and time is needed to assess their effectiveness and make the case for reopening negotiations on ESMA's governance structure.

VIII. The Commission does not accept recommendation 1.a), partially accepts recommendations 1.b) and 3.a), accepts recommendations 2.a) and 5 and refers to the detailed replies under each recommendation.

## OBSERVATIONS

### **Common Commission's reply to paragraphs 24 and 25:**

Regarding the assessment of the degree of the harmonisation of national laws applicable to collective investment funds and their managers, the Commission would like to stress that the choice of the legislative instruments depends on the Treaty. Where possible, the Commission uses Regulations (for example for EuVECA, EuSEF, ELTIF, MMF). By contrast, access to market and establishment rights cannot be regulated by Regulations also in light of article 53 of the TFUE and reasons of proportionality of EU intervention. Therefore, the conditions for the access to the internal market of UCITS and AIFMs are laid down in Directives. While Member States enjoy a large discretion as to the transposition of the Union Directives, stricter national rules might still be in line with the objectives and concrete parameters of the Union law.

27. The main responsibility to ensure a correct application of the rules in concrete cases lies with the national supervisory authorities. The Commission focuses its enforcement activities on the implementation of the Union law and alleged breaches thereof by the Member States. To improve cross-border distribution of investment funds the Commission concluded that divergences existing in the national legal systems could be addressed by further harmonisation at EU level.

28. The delay in reviewing the UCITS Directive is due to the fact that the review of the provisions on sanctions had to be postponed because limited information was available in 2017 on the use of sanctions by the National Competent Authorities. The Commission will publish shortly a report on this subject since in the meantime more information became available. As mentioned previously a comprehensive review of the AIFMD and, to the relevant extent, the UCITS Directive was carried out resulting in a legislative proposal adopted in November 2021.

29. The Commission considers that the overall EU legal framework for asset management proved to be suitable and effective in achieving the pursued objectives for an effective internal market. It is regularly revised in order to identify and address shortcomings.

For details see reply to Recommendation 1 (a).

33. Due to the late notification of transposition measures by the Member States, the last infringement case for non-communication of AIFMD transposing measures was closed in 2018 (more than 4 years after the transposition deadline of AIFMD in July 2013). The conformity checks of AIFMD have been finished in October 2021. Similarly, the amendments to UCITS Directive from 2014 were not enacted on time by 16 Member States. The last infringement case was closed in 2019, which was 3 years after the deadline for transposition in March 2016.

47. In its recent proposal of 25 November 2021 amending AIFMD and UCITSD, the Commission proposes that ESMA regularly conducts a peer review of supervisory practices regarding the application of rules on delegation with a particular focus on preventing the creation of letter-box entities.

54. On the subject of delegation (possibility of management companies to delegate functions to third parties), the Commission proposal on the review of the AIFMD adopted on 25 November 2021, includes several proposals which seek to clarify existing rules in the AIFMD and UCITSD and to enhance supervisory cooperation.

The proposal provides for improved clarity of the rules on delegation and ensures that fund managers adhere to high standards applicable across the Union, when they make use of delegation. Additional clarifications aim at ensuring that asset managers deploy the necessary resources to perform retained tasks and to supervise the delegated tasks.

72. Retail investors resident in the Union have access to investment funds domiciled outside the Union, provided such funds meet certain conditions.

The rules in question aim to strengthen consumer protection and confidence of retail investors in the financial market, while creating a level playing field between different products and distribution channels.

78. New disclosure rules for all investment products which are offered to retail investors improved the transparency over last years. The Commission continues its effort to further increase comparability of retail investments and incentivise competition, which in turn should be expected to have effects on price, return and risks of such investments.

From 1 January 2023, retail investment funds will draw up a Key Information Document in accordance with the PRIIPs Regulation 1286/2014, and the PRIIPs Commission Delegated Regulation 2017/653. The PRIIPs high standard for disclosure underpinned by the calculation methodologies will allow retail investors/advisers/comparison sites to compare UCITS, retail AIFs and other PRIIPs products such as insurance based investment products, certain types of corporate bonds, derivatives etc.

80. Second indent - The Commission proposal amending AIFMD and UCITSD adopted on 25 November 2021 also requires more granular and periodical reporting on fees.

#### **Common Commission's reply to paragraphs 82 and 83:**

The Commission has been very active in the field of sustainable finance. Since the action plan on sustainable finance adopted by the Commission in 2018 a multitude of actions have already materialized or are underway, that, among other objectives, address greenwashing. The Commission introduced disclosure requirements for sustainable investments and on the sustainability impact of investments and made a proposal to strengthen sustainability reporting rules, the Taxonomy Regulation will ensure that companies disclose on the alignment of their activities with the taxonomy. The Commission will also assess the reliability, comparability and transparency of ESG ratings. As part of the Strategy for Financing the Transition, the Commission, with the support of the ESAs, will monitor greenwashing risks and take further action if needed, i.e. assess the current supervisory and enforcement toolkit available to competent authorities and consider the need for a stronger coordination and convergence role by the ESAs or other amendments to EU legislation.

#### **Common Commission's reply to paragraphs 89 to 93:**

The EU has developed a protective framework in relation to inducements to prevent conflicts of interests (see more detail under Commission's reply to Recommendation 3.a).

The Commission is also preparing a retail investment strategy for the end of 2022.

In May 2021, the Commission launched a public consultation on an EU strategy for retail investors, which covers inducements and quality of advice.

97. The Commission recently proposed to harmonize the set of liquidity management tools to better facilitate liquidity risk management by managers of open-ended investment funds (AIFs and UCITS) with a view to addressing the recommendations by the European Systemic Risk Board (ESRB) and the European Securities and Markets Authority (ESMA).

#### **Common Commission's reply to paragraphs 113 to 126:**

Data standardisation and comparability of data collected under different reporting frameworks is one of the four key building blocks of the modernisation of supervisory reporting under the Commission's strategy on supervisory data in EU financial services, adopted on 15 December 2021.

As part of the strategy, for the investment funds sector, in the proposal for the AIFMD review and the accompanying proposals regarding UCITSD adopted in November 2021, the Commission proposes to empower the European Securities and Markets Authority (ESMA) to improve data collection from alternative investment fund managers and to harmonise data reporting requirements for undertakings for collective investments in transferable securities (UCITS) and allow ESMA to get more granular data.

Before amending or developing new reporting templates, ESMA is required to carry out a technical assessment, working with the ECB and EIOPA. The purpose of the assessment is to ensure consistency with other reporting requirements for investment funds, including in particular the data already collected for statistical purposes by the European System of Central Banks (ESCB).

As part of the above supervisory data strategy, the proposal of November 2021 amending UCITSD foresees that information gathering and sharing through supervisory reporting should be improved by subjecting UCITS to supervisory reporting obligations.

122. Advancing the use of internationally accepted common identifiers (including the LEI), which is key to ensuring data consistency, is also part of this supervisory data strategy. The Commission will propose amendments in relevant reporting frameworks to systematically require reporting of the LEI by entities that have it and, by 2023, report on whether or not to make the LEI mandatory for a wider range of legal entities, in line with the ESRB recommendation.

In the funds sector, and as per the AIFMD review proposal and the accompanying proposals regarding UCITSD, the requirement to use or report on the LEI (or other identifiers) is envisaged at Level 2, with the Level 1 text giving the empowerments to define the relevant technical standards, including on identifiers such as the LEI.

## CONCLUSIONS AND RECOMMENDATIONS

127. The Commission considers that the framework is overall adequate and it's being continuously improved (see below). However, also due to external factors that cannot be addressed by EU law, the single market for investment funds remains incomplete.

128. The Commission considers that the principal remaining legal barriers to cross-border distribution of investment funds have been addressed through the Cross-border distribution of funds package, which entered into application in August 2021. In addition, the Commission has recently proposed the reviews of AIFMD, UCITSD and ELTIFR. The results of all these initiatives cannot be evaluated yet.

### **Recommendation 1 – Assess the suitability of the existing framework to achieve the desired objectives**

#### **The Commission does not accept recommendation 1a.**

The Commission considers that the overall EU legal framework for asset management proved to be suitable and effective in achieving the pursued objectives for an effective internal market. It is regularly revised in order to identify and address shortcomings.

The Cross-border distribution of investment funds package entered into application in August 2021. The Commission will conduct a review of this package in 2024 as decided by the co-legislators. This is the earliest moment to judge the benefits brought about by the package, building on the relevant data and experience in application of these rules, which can only be appraised after a certain period of time, following the entry into force of those new rules.

A comprehensive review of AIFMD and ELTIFR has just taken place and targeted amendments to AIFMD and accompanying amendments to UCITSD, as well as to ELTIFR were tabled by the Commission in November 2021.

Effects of the proposed legislative changes need to be observed and evaluated according to the Better Regulation principles.

The Commission believes that the next evaluation of the EU asset management framework will be possible only in 6-7 years depending on the time needed for the Council and the European Parliament to adopt the recently proposed amendments. The precise timing depends on the length of the discussions in the Council and the European Parliament prior to the adoption of the recently proposed amendments. Once adopted, the new rules have to be transposed by Member States, which will happen 2 years after the adoption. Subsequently experience with the application of the new rules needs to be gained and sufficient and relevant data collected, which should take at least 3 years, leading to a total of 6-7 years from now. In the meantime, the Commission does not exclude the possibility to propose amendments to certain investment product rules such as rules on disclosure and on retail investor protection, which are currently under consideration.

### **The Commission partially accepts recommendation 1b.**

Performance measurement and monitoring activities go beyond the necessarily limited set of indicators used in the Strategic Plan. The Commission will review the indicators in its Strategic Plans in the context of the next strategic planning cycle covering period 2025- 2029.

132. Regarding the observation on the supervisory convergence addressed to ESMA, the Commission considers that there are also other sources of evidence related to the usefulness of the preparatory tools used by ESMA. For example, in the recent consultation on supervisory convergence and the single rulebook ([https://ec.europa.eu/info/consultations/finance-2021-esas-review\\_en](https://ec.europa.eu/info/consultations/finance-2021-esas-review_en)) respondents assessed rather positively the contribution of ESMA's guidelines and Q&As to building a common supervisory culture.

### **Recommendation 2 – Enhance the effectiveness of ESMA's convergence work**

#### **The Commission accepts recommendation 2.**

In 2017 the Commission proposed changes to the ESMA's governance such as creating an Executive Board who would have taken ESMA's decisions of a supervisory nature (breach of Union law, dispute settlements, peer reviews). These proposals were not retained by the co-legislators.

### **Recommendation 3 – Protect investors better against undue costs and misleading information**

#### **The Commission partially accepts recommendation 3a.**

The Commission considers that investment funds are highly regulated and transparent. However, the Commission will assess the role of inducements as part of its planned retail investment strategy. The strategy will cover a range of initiatives designed to provide the necessary level of confidence and assurance for retail investors. The strategy is planned to be complemented by legislative proposals. In May 2021, the Commission launched a public consultation on an EU strategy for retail investors, which covers inducements and quality of advice.

138. As described in the Commission's replies on paragraphs from 114 to 127, data standardisation and a comparability of data collected under different reporting frameworks is one of the four key building blocks of the modernisation of the supervisory reporting under the Commission's strategy on supervisory data in EU financial services, adopted on 15 December 2021.

As part of the strategy, for the investment funds sector, in the proposal for the AIFMD review and the accompanying proposals regarding UCITSD adopted in November 2021, the Commission proposes to empower ESMA to collect more granular and consistent data from alternative investment fund managers and to harmonise data reporting requirements for UCITS.

## **Recommendation 5 – Streamline data collection and update reporting regimes**

### **The Commission accepts recommendation 5**

The Commission's proposal amending the AIFMD and UCITS Directives adopted on 25 November 2021 addresses these recommendations and foresees measures to improve and streamline data collection going forward. This is part of the wider supervisory data strategy that was adopted on 15 December 2021.