Making regulation work for real estate

Catherine Martougin accentuates the positive

IQ caught up with Catherine Martougin, Partner at Baker & McKenzie in Luxembourg, to discuss regulation and how initiatives like the introduction of RAIFs, the reserved alternative investment funds, may help cope with time constraints created by regulations.

As a lawyer specialising in Luxembourg non-listed funds, regulation is always near the top of Catherine Martougin's agenda, both in her day job and as chair of INREV's Public Affairs Committee. She is in no doubt that much still needs to be done before regulation can work as well as it could for real estate investment.

'Since the Global Financial Crisis regulation relating to real estate has become much more demanding,' she says. 'The impact of AIFMD on the asset management industry has been most significant, given the requirements for transparency and reporting that it places on managers. This wouldn't necessarily be a bad thing, particularly from an investor's perspective – the challenge is that AIFMD wasn't framed with real estate funds in mind. Even after a lot of feedback and proposals for improvement by INREV and others, many of its provisions remain more suited to other asset types – like hedge funds or private equity – than real estate.'

'These regulations also have unintended consequences. Although they aim to protect investors, the need for greater transparency can mean higher IT and administration costs, which can put smaller asset managers under severe financial pressure – perhaps even putting some out of business. This can result in less competition and a smaller choice of providers and products for investors.'

INREV'S ROLE

Catherine believes that organisations like INREV have an important role to play here. Having been a member of INREV's Public Affairs Committee for two years, and its chair since April 2016, she is aware of the diversity of interests within real estate investment – all of which need to have their say on how regulation develops.

'The most important first step is to make sure that policy makers, particularly those in Brussels for the European Union, but also globally, appreciate the importance of real estate in the economy and understand that investment decisions about real estate don't just affect managers. The INREV team that Jeff Rupp leads in Brussels is helping to get this message across by informing and educating those who formulate regulations.'

Catherine believes it is also important to keep the industry up to date on recent regulatory developments and interpretations. INREV's activities including its frequent publications, studies and participation at industry events are crucial; one example is the ALFI Conference in Luxembourg, where Jeff Rupp will again be speaking on November 22 and 23. INREV also provides important professional standards products such as the INREV Guidelines, the standard data delivery sheet and the due diligence questionnaire. They help the industry harmonise operationally, an area that is under more and more scrutiny from regulators as they develop stricter regulations. The Public Affairs Committee has also begun working on the upcoming market consultation with EU institutions on AIFMD 2.

CATHERINE MARTOUGIN

LOOKING FOR HARMONY

'As a general principle, INREV is supporting the harmonisation of real estate regulation across national markets in Europe. But that doesn't mean practices have to be strictly standardised when it comes to the range of the products on offer. On the contrary, investors benefit from having a variety of products to choose from to meet their goals and give them the desired balance between long term security, predictable income and potential capital gains.'

'The most important first step is to make sure that policy makers, particularly those in Brussels, appreciate the importance of real estate in the economy'

Nevertheless, Catherine agrees that many of the practical difficulties regulation poses for both asset managers and investors do stem from inconsistencies in European and national regulations. For example, AIFMD has not provided a clear definition of what marketing means and the period in which the activation of the passport under AIFMD is required. Generally, managers are not supposed to market their funds until they have notified their home regulator regarding a new product to be set up. This process can take different lengths of time depending on the jurisdiction, and the AIFMD passport allowing the fund to operate across jurisdictions cannot become active until this has happened. This goes against the market practice of involving potential investors at an early stage to determine a fund's features. The result can be long hold ups in the process of setting up the fund.

RAIFS – A STEP IN THE RIGHT DIRECTION

Still, legal changes at a national level can help overcome some of these issues. 'As a specialist in Luxembourg funds, I am particularly enthusiastic about the Luxembourg law of July 2016 that allows for a new form of fund – the RAIF (Reserved Alternative Investment Fund),' explains Catherine. 'This new product, which has been proposed by the funds industry, does not require an authorisation at the product level, based on the precondition that such unregulated funds will be managed by managers holding an AIFM license. Investors in these funds will still be protected indirectly by regulators' supervision and in particular the detailed reporting that it entails. The main benefit of this structure is likely to be a big reduction in the time needed to set up a fund, which should fall from months to a matter of days.'

Catherine sees the biggest cloud on the horizon for the European investment industry as the UK's decision to leave the European Union. 'It's difficult to know exactly how Brexit will affect UK fund managers, and as a consequence, the European fund industry,' she says. 'A lot will depend on how the political situation develops and whether UK-based managers will be able to retain the passport for operating in European jurisdictions as a third country. There are key elections coming up shortly and the results could make a big difference to the EU's approach to negotiating the new relationship with the UK. This uncertainty could mean that some managers may be tempted to move from London to more favourable jurisdictions, like Luxembourg or Ireland.'

But over the long term, she is still hopeful that the non-listed business will continue to globalise and deepen its product offer, even if political fragmentation could create some additional hurdles to overcome.