



cutting through complexity

FINANCIAL SERVICES

# Evolving Investment Management Regulation

Light at the end  
of the tunnel?

June 2013

[kpmg.com](http://kpmg.com)



## Lead Editors



**Charles Muller**

Partner, Financial Services  
Regulatory Center of  
Excellence, EMA region  
KPMG in Luxembourg



**James Suglia**

Head of KPMG's  
Investment  
Management Sector,  
Advisory  
KPMG in the US



**Bonn Liu**

Head of Investment  
Management,  
KPMG's ASPAC region  
KPMG in China

## Financial Services Regulatory Centers of Excellence

### Giles Williams

Partner, Financial Services  
Regulatory Center of  
Excellence, EMA region  
KPMG in the UK  
T: +44 20 7311 5354  
E: giles.williams@kpmg.co.uk

### Jim Low

Partner, Financial Services  
Regulatory Center of  
Excellence, Americas region  
KPMG in the US  
T: +1 21 2872 3205  
E: jhlow@kpmg.com

### Simon Topping

Principal, Financial Services  
Regulatory Center of  
Excellence, ASPAC region  
KPMG in China  
T: +852 2826 7283  
E: simon.topping@kpmg.com

## About this report

This report was developed by KPMG's network of regulatory experts. The insights are based on discussion with our firms' clients, our professionals' assessment of key regulatory developments and through our links with policy bodies. We would like to thank all members of the editorial and project teams who have helped develop this report.

## Marketing and project teams

### Weronika Anasz

KPMG in China

### Charissa Dekoninck

KPMG in Canada

### Cara Scarpino

KPMG in the US

### Aggie Anthimidou

KPMG in the UK

### Nicole Elfassy

KPMG in Canada

### Mireille Voysest

KPMG in the UK

### Charlotte Beck

KPMG in the UK

### Rachael Kinsella

KPMG in the UK

# Contents

<b>Foreword</b>	2	<b>05</b>	<b>Governance and responsibility</b>	44
<b>Executive Summary</b>	4	<b>06</b>	<b>Remuneration</b>	48
<b>01</b>		<b>07</b>	<b>Capital markets and infrastructure</b>	52
<b>Global Perspectives</b>		<b>08</b>	<b>Tax</b>	56
<b>Perspectives: Europe, Middle East and Africa (EMA)</b>	8	<b>09</b>	<b>Pensions</b>	62
Views from Africa	11	<b>10</b>	<b>Sustainable investment</b>	71
Views from the Middle East	15	<b>11</b>	<b>Abbreviations</b>	75
<b>Perspectives: Americas</b>	19	<b>12</b>	<b>Acknowledgements</b>	76
Views from Canada and Latin America	20			
<b>Perspectives: Offshore</b>	23			
<b>Perspectives: Asia-Pacific (ASPAC)</b>	24			
<b>02</b>				
<b>Investor education and protection</b>	26			
<b>03</b>				
<b>Retail products and distribution</b>	30			
<b>04</b>				
<b>Institutional perspectives – Alternative products and distribution</b>	36			

# Foreword – Light at the end of the tunnel?

We believed 2013 would be ‘The Year of Implementation’ for the post-crisis regulatory reforms. While new policies continue to emerge, several key investment management regulations are already at the implementation stage. Each brings specific challenges but, as the intensity calms, there does appear to be light at the end of the tunnel.

*Evolving Investment Management Regulation* brings together the key regulatory issues affecting asset managers and investors in the Americas, Asia-Pacific, Europe and the Middle East, highlighting implications for now and the future. After five years of relentless and difficult regulatory change and intervention, the financial landscape is emerging fundamentally altered. Progress has been made in two key areas: creating a safer, more stable financial system, in line with the aims of the G20; and Investors everywhere should be treated ‘fairly’.

But what will the investment management industry look like once this seemingly endless wave of change has passed? What other factors could affect the landscape – and could give rise to future regulation? Perhaps most importantly, why is it vital for both regulators and the industry to get the regulatory regime right?

## **A global pattern emerges...**

In the 2012 edition of this publication, we concluded that the impact of regulatory change in the asset management world had not yet reached the crescendo it has across the wider financial sector. We believed that a number of regulatory initiatives from banking and insurance would be likely to spill over into the investment management industry – and this is now starting to play out. The conduct, investor protection and governance agendas are taking shape across financial services, and investment management is no exception. There are fundamental market infrastructure changes, with a suite of global and regional regulations affecting the trading

and reporting of derivatives. Pension funds around the globe are rapidly transforming, with developments in particular regions sure to have knock-on global effects. Significant tax compliance issues, such as FATCA, will dramatically alter the way investment firms do business.

More positively, a global pattern of opportunity seems to be emerging – one of changing distribution models, new ways of doing business and a more investor-focused structure. Government pushes towards savings create opportunities for investment and wealth managers. So, while all this change is difficult, it can also be rewarding, with careful planning, bold execution and



**Jeremy Anderson, CBE**  
Chairman, Global Financial Services



**Tom Brown**  
Global Head of Investment Management

sufficient client-centricity all being key priorities for success.

However, thinking the unthinkable, planning for change and actually managing changing client needs and expectations are imperatives – those who are not prepared will not survive in this new world.

## **The supervisory agenda – a changing regulatory framework**

Investment management firms have had to gauge the read-across from the banking regulatory agenda into their own sector. Some initiatives are clearly linked, such as investor protection and shadow banking. For others, the linkage is less direct, but exists nonetheless. With the



International Organization of Securities Commissions (IOSCO) flagging their new approach to policymaking, it is anticipated that they will take a supervisory approach closer to that of the Basel Committee on Banking Supervision (BCBS). Their joint 2012 Consultation with the BCBS on derivatives harmonization and recent substantive Consultation on Regulation of Retail Structured Products are indicative of their increased responsibility. We think that the scope for local interpretations of regulation will reduce as IOSCO defines its focus.

#### **The economic environment – balancing long-term savings with growth and risk appetite**

The industry and new regulations do not exist in a bubble. Investment management, banking and insurance are more intertwined now than ever, alongside the rest of the economy. How does the regulatory agenda link to the current macro-economic situation, and how do they complement or oppose each other? Various tensions seem to be emerging here, such as low interest rates – potentially for the medium-term – alongside inflationary pressure and the search for returns by investors. How do you balance investor security and risk appetite, while encouraging economic growth? The drive by many governments to encourage long-term saving jars with the public and supervisory fear of the mis-selling of particular products; and continued pressure on balance sheets means that there will be risk transfer to individuals in terms of pension provision. This should create an opportunity for investment managers, given the potential volume of new capital flowing into the industry.

#### **The internal environment – governance and risk management**

New systems and controls should be integrated into managers' operating models, so that firms can achieve the more cost-effective cost structures needed to control overheads and plan for long-term growth.

By increasing the reach and sophistication of their governance and internal controls, investment firms can distinguish themselves from competitors, survive thorough due diligence by increasingly demanding clients, and gain the benefits of new opportunities for investment.

To make the most of new opportunities in this changing environment, investment managers should seek to create new internal controls that address the evolving challenges in risk and compliance management. Internal controls are no longer merely a requirement to remain in operation.

Stronger controls and greater transparency have also become requirements for attracting and retaining clients. Highly desired clients must be able to see that investment managers grasp the importance of risk and regulatory management. Managers must demonstrate that they are taking all the necessary steps – both structurally and organizationally – to manage money with greater transparency in an environment increasingly defined by complexity and risk.

#### **Product and distribution – client-centric strategies**

Firms should now be putting clients at the heart of their business, adapting products and distribution channels accordingly. Considerable work from both the industry and regulators is going into new product development, better

aligning these with clients' needs, while at the same time being more transparent and easier to understand. Regulation has focused on these key areas, with a new, more sustainable product and distribution landscape evolving.

#### **The future landscape**

We are already seeing the global impacts of the regulatory change agenda on investment managers – and the challenges and opportunities emerging as it unfolds. In our conversations with clients, the main challenge raised, time and again, is the implementation of the volume of regulatory change. It remains to be seen whether the changes implemented will achieve what they were intended to do – to strengthen the financial system and overall market stability; and deliver a fair outcome to consumers.

**Will the current waves of regulation mean that the investment management industry will become better at delivering value to the real economy, and play its role of matching those with the capital to those who need capital? Time will tell, but one thing is certain – firms who stay on top will be those who capitalize on the opportunities emerging now – and not waiting until the dust has settled.**

# Executive Summary

*A perceived lack of global harmonization of the regulatory agenda adds to the complexity of compliance and strategic focus.*

In the context of a world where investors are always on the lookout for additional returns; inflationary expectations are unclear; security and counterparty risk is increasingly important; and fees are under pressure, investment managers today face the challenges of a raft of complex and often contradictory regulatory reforms. At the same time, balancing the implementation of existing regulatory requirements while being mindful of the additional initiatives on the horizon remains a key challenge for the industry. The compliance requirements alone can create significant strategic and operational challenges, but investment firms should do more than just comply to truly survive and thrive in this new regulatory landscape.

## **Are we any closer to regulatory harmonization?**

Investment managers should already be aware of, and acting upon, the regulatory change agenda, adapting business models, systems and controls accordingly. A perceived lack of global harmonization of the regulatory agenda adds to the complexity of compliance and strategic focus. Work is being undertaken by regulators across the world in an attempt to harmonize some aspects of the global regulatory agenda, such as the European Union (EU) and US rules in the areas of derivatives (regulations such as the US Dodd-Frank Act and the European Market Infrastructure Regulation, or EMIR). However, there is still significant work to be done in aligning local, international and global standards.

## **Business challenges – strategic and operational**

There are specific business challenges arising from regulatory change. One such challenge is the new, different retail distribution models that have followed proposed or already implemented regulation such as the revised Markets in Financial Instruments Directive (MiFID 2) in Europe; the Retail Distribution Review (RDR) in the UK; the Future of Financial Advice (FoFA) reforms in Australia; and the Financial Advisory Industry Review (FAIR) in Singapore, to name but a few. In the US, fiduciary standards for broker dealers continue to be an area of focus for regulators, and may also result in significant changes to distribution models.

There are some new, innovative ways of doing business, in particular, the rise of transacting business over the internet. The increased use of the internet for investment business also brings further regulatory compliance into the spotlight, such as data protection proposals at the

EU level, where a parliamentary vote is expected imminently; and the final Identity Theft Red Flag rules just passed in the US. New ways of doing business raise the questions, “who will pay for advice?” and, “how will distribution channels be organized and remunerated?”

## **Opportunities as well as challenges – light at the end of the tunnel?**

However, the seemingly endless waves of regulation bring with them opportunities as well as challenges. There is significant potential in emerging and new markets, and the global drive toward better long-term savings and financial stability will also create opportunities for funds managers, with an influx of funds flowing across the globe in consumers’ efforts to save for retirement and long-term security. Even regulatory initiatives that have onerous elements for the investment management community offer some opportunities, for example, certain shadow banking proposals, which may see investment managers leading the way, where banks can no longer follow. The Volcker rule in the US and the Likannen Report and bank restructuring proposals in Europe may also change the balance between banking and investment management products.

## **Regulatory priorities**

The main aims of all current and future regulatory initiatives in investment management are to protect investors and to promote a more stable and robust financial system.

## **1) Investor protection, conduct and transparency**

The drive for better investor protection, improved transparency and ‘best practice’ across the industry is now a key focus for policymakers and standard



## Challenges – and opportunities – for the investment management industry

The key challenges for the industry in 2013 and beyond, driven by the new regulatory agenda, include investor protection and education, alongside increased efforts to improve financial stability.

### Key strategic challenges

- A lack of global industry/regulatory harmonization, eg. the Alternative Investment Fund Managers Directive (AIFMD), Foreign Account Tax Compliance Act (FATCA), Financial Transactions tax (FTT), Undertaking for Collective Investment in Transferable Securities (UCITS), European Market Infrastructure Regulation (EMIR), and Markets in Financial Instruments Directive (MiFID).
- Cross-border business – levels of global, international and national implementation.
- Investor protection, education and trust – changing distribution models, eg. MiFID 2 and the UK Retail Distribution Review (RDR). There is a disconnect between government encouragement to save and fear of mis-selling.
- Global implications of regional regulation such as FATCA (US) or AIFMD (EU) with impacts on remuneration, delegation, reporting, third-country and marketing questions/challenges.
- Deposit taking – the shadow banking Money Market Funds Regulation is imminent.

### Key operational challenges

- Product regulation, investor education and advice, eg. MiFID, Packaged Retail Investment Products (PRIps) and the Key Information Document (KID).
- Remuneration, fees and transparency, eg. UCITS 5, AIFMD, MiFID 2. The extra-territorial implications of regulatory change – tax legislation on cross-border business, eg. FATCA, FTT, Dodd-Frank and AIFMD.
- Increased costs and spend – the expense of having the right infrastructure, IT, technology, and processes. The European Commission estimated the one-off cost of compliance with MiFID as €512 – €732 million, with the ongoing compliance cost anticipated as between €312 – €586 million.<sup>1</sup> The compliance cost of AIFMD for hedge funds is estimated at US\$6 billion – which, in turn, is expected to be passed on to investors.<sup>2</sup> The asset management industry's operating margins dipped during the crisis and are still struggling to reach the pre-crisis levels.<sup>3</sup>
- Increased reporting and accountability – significant cost and complexity of having and reporting the right data.
- Increased risk management and governance requirements – this is fundamentally changing the structure of the business.

### Opportunities

While facing the challenges of the changing regulatory landscape implementation and implementation of regulatory reforms, there are opportunities coming to light, including:

- The trust agenda – building business around better investor relationships.
- Opportunities in growing and emerging markets.
- Shadow banking – picking up on opportunities in lending and funding, where banking cannot follow.
- Long-term savings and asset protection.

1. Proposal for a regulation of the European Parliament and of the Council on Markets in Financial Instruments and amending Regulation [EMIR] on OTC derivatives, central counterparties and trade repositories, European Commission, Brussels, October 2011  
 2. Comments on the Consultation Paper on ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive (AIFMD), Alternative Investment Management Association (AIMA), September 2011  
 3. Source: BCG Global Asset Management Market-Sizing Database, 2012

setters, with a suite of new regulatory initiatives and reviews of existing regimes already underway. This has now become a much bigger issue in Asia-Pacific, with key developments such as FAIR in Singapore; FOFA in Australia; and additional disclosure requirements in Japan. Further investor protection initiatives are still rolling out in Hong Kong, Singapore, Australia, India and Taiwan.

In Europe, there is now clear regulatory headway in improving the safety, transparency of and information on retail products. Remuneration is under sharp scrutiny (for example through UCITS, AIFMD and MiFID 2 in Europe; and reforms in Hong Kong), with regulatory measures and even specific sanctions on the table. Work is being undertaken in an attempt to level the playing field and remove conflicts of interest, for example, PRIIPS or MiFID 2 in Europe and the RDR in the UK. Fund management fees are being assessed for performance, fairness and transparency.

Throughout the EMA region, updates to existing legislation continue, with a steady stream of new Directives and Regulations. South Africa is still grappling with Treating Customers Fairly (TCF), a customer-focused regulatory initiative already implemented in the UK.

## 2) Market infrastructure change

There is now a strong global emphasis across all jurisdictions on creating a safer and more stable market infrastructure and increasing the transparency of capital markets. In Europe, these issues have led to key regulations such as EMIR, certain aspects of the proposed MiFID 2 and the Market Abuse Directive and Regulation (MAD/MAR). The AIFMD will also affect capital markets, with implications across the global financial sector.

While European capital markets are changing rapidly, in the Americas, the pace of change is slower, with continued uncertainty around the Volcker Rule. But while the pace has slowed, considerable change has already taken place. The effects of the Volcker amendments are yet to be seen, which may have considerable implications for the investment management world, including a significant effect on liquidity. Investment firms will need to reassess their trading and positioning strategies if the expected Volcker amendment redefines the trading landscape. Central clearing has started in earnest – we believe this is likely to continue to expand to other products. The recent regulations on the exchange trading of derivatives will further add to market complexity, changing the way firms go about their trading decisions. With the extent of change in market infrastructure, many firms are carefully planning for the additional costs of reporting and compliance, while at the same time reviewing their portfolios to assess which areas of their business may or may not be profitable enough to continue.

There have been further developments in Asia-Pacific capital markets, where work is being undertaken to encourage the use of clearing houses in Japan, and the ban on naked short-selling continues, with the potential to become a permanent measure.

While certain regulatory changes might have been decided in principle on a global (G20) level, the ways in which these decisions have been implemented in different regions are diverging widely. These not only create significant challenges for large, global asset managers, but also for regional firms, as many of the regulations on the agenda have clear extra-territorial effects. For

example, a European asset manager will also have to look into Dodd-Frank, while their US equivalent will have to comply with AIFMD or EMIR. In the words of Richard Saunders, Former Chief Executive of the Investment Management Association, “We are seeing a rise in more aggressive extra-territorial regulation which is adding cost and complexity to the industry and breeding protectionism in different jurisdictions.”<sup>4</sup>

## 3) Governance and taxes

Regulation that was initially intended for the banking sector appears to be moving into investment management, and some key lessons can be learned. The alternative investment space is changing rapidly as a result of new regulation. Hedge funds, in particular, will be feeling the heat of increased accountability, reporting, remuneration restrictions and management measures, predominantly through the AIFMD. Offshore firms are caught up in a number of key regulations from global regulators. In particular, regulation from Europe (such as the AIFMD) and America (such as Dodd-Frank and FATCA), will have considerable implications for offshore centers.

Yet many regulators feel that the benefit of the financial system for the ‘real’ economy still needs to be demonstrated; and professionals in the financial sector lack social accountability and moral standards, while benefitting from excessive remuneration. Both the public and the regulatory community need to be convinced that firms have their customers’ best interests at heart.

Tax reforms create a huge operational challenge for the investment management industry. The US Foreign Account Tax Compliance Act (FATCA), in particular, poses increased operational risks for global investment managers, notably the extra-territorial effects and



*Regulation that was initially intended for the banking sector appears to be moving into investment management, and there are some key lessons to be learned.*

reporting burdens, and the threat of non-compliance. FATCA affects all financial firms across the globe – especially those across Europe and Asia-Pacific – and will have particular implications for asset managers and pension funds outside the US, owing to the Foreign Financial Institutions (FFI) rules. There is also continued uncertainty on additional tax obligations in the Americas region – already manifesting itself in tax enforcement measures at federal and state level. The length and complexity of the required international operational processes – for example, the lengthy timescales between signing inter-governmental agreements (IGAs) and receiving final rules – mean that we are still a long way from a global level playing field.

The recent proposal to create a European FATCA is likely to further increase the need for asset managers to, like banks, have elaborate governance and reporting mechanisms in place and be ready for stringent tax enforcement legislation. The proposed Financial Transaction Tax (FTT) is a much debated and controversial issue throughout Europe. It remains to be seen how this plays out across in the weeks and months to come, as the situation is constantly changing, following intense political debate.

A key element of the new investment landscape is the shift of responsibility – and the risk – from state and employer to the personal investor for retirement income/long-term financial security. This direction of travel is particularly clear in pensions markets. The new generation of workers and pensioners must take on their own investment risk. How are governments going to manage this new balance, and how will investors respond, given the current lack of trust?

Historically, corporations have taken on the pension risk and liability – now,

their priority is to divest themselves of their pension liabilities. In the UK alone, over £300 billion of mandates are now invested from a liability-driven investment basis.<sup>5</sup> In the US, new accounting rules are expected to result in additional liabilities for public pension plans, further adding to the global pensions challenge. The new, more stringent rules on the valuation of assets and liabilities would push the funding ratio of about 126 pension funds to approximately 57 percent (that is, their assets would cover 57 percent of their obligations), down from 76 percent in 2010.

There have been significant regulatory developments in the EU, such as the European Council initiative to encourage saving and work towards a single European market for pension products – alongside large-scale changes at national level, such as the UK pensions market. Yet there are conflicting pressures from all angles, further complicating this challenging environment:

- Government pressures – implementing austerity measures, encouraging long-term saving, yet squeezing income;
- Public perceptions – the lack of confidence in the system coupled with the need for consumers to recognize the importance of long-term saving;
- Economic pressures – interest rates are below inflation, meaning negative real returns;
- Demographic pressures – mortality rates are lower – people are living longer and therefore have to work longer and/or save more for their retirement.

#### 4) Financial Stability

The global focus on market transparency and stability continues across the financial services landscape. Globally, the Financial Stability Board (FSB) and IOSCO have done substantial work on

shadow banking – their findings will affect rules on securities lending, securitization or money market funds. Local implementation of global recommendations differs widely between regions – as the recent debate on a potential ban of constant Net Asset Value (cNAV) money market funds demonstrates. More common ground can be found on the need – expressed by global regulators – of having more reliable figures in order to better monitor the industry; and prevent the kind of financial instability and crisis of 2008-2009. The new reporting requirements, while a practical challenge for asset managers, should help regulators to take more informed decisions in the future.

Many regulators have taken note of the volume of global regulation affecting the financial services industry and the potential extra-territorial effects, working towards greater global harmonization. This is clear in a recent European Parliament Consultation, for example, which aims to assess the full global regulatory framework and investigate ways to reshape the spirit of regulation – less on a product-by-product basis, more in creating common rules for all financial instruments sold to investors in order to create a level playing field globally.

**While the industry might now expect an end to these waves of regulatory reforms – and a return to ‘business as usual’ – it is clear that the upsurge of change has not yet fully subsided. Yet there is light at the end of the tunnel...**

4. Richard Saunders, Former Chief Executive, Investment Management Association, September 2012  
5. Source: KPMG analysis, 2012

# 01

## Global Perspectives



## Perspectives: Europe, Middle East and Africa (EMA) The European regulatory avalanche

In May 2014, the current term of the European Commission and Parliament will come to an end. New MEPs will be voted in and a new European Commission will be formed. For Commissioner Barnier, in charge of Internal Market (including financial services and therefore asset management) an extraordinarily busy five years will come to an end: a period where almost everything changed, especially in relation to regulation.

Implementation of this avalanche of regulatory reforms nationally, internationally and globally is a significant challenge for the industry. The commitments to investor protection and financial stability originally made at the G20 level need to be implemented at country level and therefore in Europe.



**Charles Muller**  
Partner, Financial Services  
Regulatory Center of Excellence,  
EMA region

## Key Regulatory Developments

The regulatory ‘avalanche’ was drafted around four principles for the asset management industry:

- better informed and better protected investors;
- increased financial stability;
- reinforced ethics (and sanctions in case of misbehavior); and
- increased benefits of the financial system to the so-called ‘real’ economy.

### 1) Investor information and protection: retail products and distribution

#### Undertakings for Collective Investment in Transferable Securities (UCITS)

As part of a package of measures to rebuild consumer trust in financial markets and align rules across competing products, the EU Commission published in July 2012 legislative proposals, UCITS 5. These proposals, learning from the lessons of the financial crisis, focus on harmonizing the role and liability of UCITS depositaries, the remuneration of UCITS managers and introducing a sanctioning regime. The text is currently under discussion in the European Parliament and is not expected to be transposed and effective before 2016.

However, even without further enhancements, UCITS is today recognized as a success story for Europe and beyond. UCITS funds are today distributed throughout the world, from Asia to Latin America; from the Middle East to South Africa. These growing emerging markets continue to offer significant distribution opportunities.

#### Packaged Retail Investment Products (PRIIPs)

Also part of the package of measures to rebuild investor confidence, the EU Commission issued in July 2012 the PRIIPs proposal for a Key Information Document (KID). The regulation will

require the preparation of a harmonized KID for a certain number of products:

- structured products;
- derivative instruments; and
- insurance products exposed to the fluctuation of reference assets.

The scope of the regulation is being largely debated in European Parliament and the outcome is unclear. However, the larger the scope the more difficult it will be to find common grounds for a harmonized presentation of the document between the different products. The KID should not be applicable before 2015, but the evolution of this regulation should certainly be followed up closely by firms in order to anticipate a smooth implementation, as experience from the UCITS Key Investor Information Document (KIID) has shown that it can require significant efforts.

#### The revised Markets in Financial Instruments Directive (MiFID 2)

Finally, as part of the investor protection measures contained in the MiFID 2 proposals issued in 2011, the Commission envisages a ban on third party inducements for portfolio managers and for independent investment advisers. This requirement raises concerns on the future of the distribution chain of investment funds and the remuneration of the intermediaries in that chain, as it requires a significant change in distribution model. The objective of the Commission is to ensure that the price of advice is transparent for the investor.

While MiFID 2 is under discussion within the European Parliament and Council – and the question of the inducements is not solved at that level – some countries, such as the UK and the Netherlands, have begun to implement – or are in the process of implementing –

*UCITS is today recognized as a success story for Europe and beyond. UCITS funds are today distributed throughout the world, from Asia to Latin America; from the Middle East to South Africa; and these growing emerging markets continue to offer significant distribution opportunities.*

local regulations in relation to retail distribution that include a ban on inducements.

## 2) Getting to grips with systemic risk

### Hedge funds regulation – AIFMD

Based on the G20 decision that hedge funds – believed to be a culprit of the crisis – should be adequately supervised, European regulators decided to regulate all alternative funds, forcing them to report extensively in an effort to get to grips with systemic risk. The AIFMD Directive, officially adopted in 2011, should be transposed into national law by all Member States by July 2013. However, due to political controversy, the Commission only released implementing measures in December 2012. At the end of May 2013, not a single one of the 27 countries had actually passed the necessary laws. Nevertheless, asset managers and depositaries are expected to comply with the new provisions as of 22 July 2013, not only in the EU, but also worldwide.

The AIFMD will undoubtedly have substantial effects on third country managers wishing to distribute their funds into Europe, or wishing to provide services to European alternative investment fund managers. As a result, a certain number of non-EU countries, such as the Channel Islands and Switzerland, are in the process of getting ready to be compliant with EU requirements, or already have their own regulation.

In the context of shadow banking rules discussed at the level of the Financial Stability Board (FSB), the EU Commission also worked on specific rules for Europe, especially regarding Money Market Funds (MMFs). These were addressed in the so-called UCITS 6 Consultation issued in July 2012 and additional orientation is expected in the near future.

### Market infrastructure changes

Market infrastructure is also undergoing a wave of legislative changes, in particular the European Market Infrastructure Regulation (EMIR) and MiFID 2, which will have implications for investment managers. It is important to start planning now for the required new operating models.

### Additional taxation burdens

At the end of 2012, the investment management industry was hit by the outlook of additional regulation and burden in the area of taxation, with growing discussions, followed by the expressed willingness of 11 countries to move forward under enhanced cooperation to establish a Financial Transaction Tax (FTT).

## 3) Ethics and sanctions

Probably the most public element of the current regulatory change agenda has to do with the belief that the financial industry lacks ethics; and continued to earn vast amounts of money during the crisis, while companies and countries were going bankrupt. As a result, European politicians have insisted on imposing strict limits on remuneration – especially bonuses. Some countries have also agreed to create a new Financial Transaction Tax that is officially justified with the need to reduce excessive trading, while it is in fact more likely to see the light in the context of budgetary difficulties in certain countries. Finally, the EU Commission has announced that each new European proposal would include a ‘sanctions’ section to give teeth to their rules. These include heavy fines and the threat to lose a license on a permanent basis.

## 4) Finance and the real economy

Where does investment management sit within the financial services sector?

Asset managers play a key role in the functioning of the economy. In order to improve the link between finance and the real economy, the EU adopted two new specific regulatory regimes: the EU Venture Capital; and the EU Social Entrepreneurship regulations. Both will apply as of 22 July 2013.

### Pensions reforms

Given the current issues that public pension schemes are facing for the financing of future liabilities, the EU Commission has also decided to encourage ‘third pillar’ pensions by the creation of a new investment vehicle. After the Consultation in the context of UCITS 6 in the Summer of 2012, a new regulatory initiative is anticipated, containing proposals for a new European product specifically designed for long-term investments (ie. with fewer liquidity requirements than UCITS). The EU Commission also issued a Consultation on long-term financing in March 2013.



# Views from Africa

The level of maturity of the fund management industry differs across African countries. While there are significant challenges in doing business within Africa, this continent also presents great opportunities.

There have been a number of important regulatory developments in the region over the past year. These include:



## **South Africa** **Fund classification**

The Association for Savings and Investments South Africa (ASISA) published the new collective investment scheme classification structure during September 2012. The new structure has done away with classifying funds according to investment styles such as growth and value. Funds will instead be classified according to the fund's geographic exposure and its underlying assets. The classifications will adopt a three tiered approach, as follows:

- Funds will firstly be classified as either South African (previously Domestic), Worldwide, Global (previously Foreign) or Regional (new category).
- Each of these categories will be sub-categorized into Equity, Multi Asset (previously Asset Allocation), Interest Bearing (previously Fixed Interest), and Real Estate portfolios.

- The third tier of classification will categorize funds according to their main investment focus, for example Equity – Large Cap, Multi Asset – High Equity, Interest Bearing – Money Market, or Real Estate – General.

Each of these categories (and sub categories) is subject to various limitations with regards to the minimum and maximum percentages to be invested in specific asset classes.

The new classification standard took effect on 1 January 2013, and is expected to simplify the process of selecting amongst the approximately 967 local and 319 foreign collective investment schemes currently registered in South Africa. The new standards should also enhance the process of comparing the performance of various funds.

*New standards should also enhance the process of comparing the performance of funds.*

### Retirement reform

The National Treasury released an updated paper on South Africa's proposed retirement system. The final Consultations with stakeholders are due to take place before the end of May 2013. The reform proposals aim to achieve the following:

- Harmonization of the tax breaks granted for saving. This includes a proposed cap of the lower of 27.5 percent of taxable income or R350 000.
- Improve the likelihood that retirees will have adequate capital at retirement.
- Improve governance of retirement funds.

The proposal also calls for the implementation of tax-preferred savings and investment accounts to be introduced by April 2015. All returns accrued within these accounts and any withdrawals would be exempt from tax. The account would have an initial annual contribution limit of R30 000 and a lifetime limit of R500 000.

### Treating Customers Fairly (TCF) – delays to the legislative framework

As discussed in the 2012 publication, the South African Financial Services Board (FSB) is implementing a program for regulating the market conduct of financial services firms, entitled Treating Customers Fairly (TCF). The TCF approach seeks to ensure that fair treatment of customers is embedded within the culture of financial firms. TCF will use a combination of market conduct principles and explicit rules to drive the delivery of clear and measurable fairness outcomes, and will enforce the delivery of these outcomes through imposing a range of visible and credible deterrents to unfair treatment.

The ASISA is represented on the TCF regulatory steering committee and is integrally involved in a number of the work streams across the different sectors. The end goal is to “establish across the various sectors, which current regulatory provisions support TCF, which provisions are inconsistent with TCF principles, where there are overlaps and where there are regulatory gaps.”

The initial intention was for the FSB to publish proposals for a legislative framework for TCF by the end of 2012, but there has been a delay. The target implementation date for the regulatory framework legislative changes is January 2014.

### Twin Peaks

A summary of the proposals for implementing the Twin Peaks model of financial regulation was published in February 2013. As detailed in a statement issued by the National Treasury:

“The ‘Twin Peaks’ approach entails creating a prudential regulator housed in the South African Reserve Bank (SARB), and transforming the Financial Services Board into a dedicated market conduct regulator. The objective of the prudential regulator will be to maintain and enhance the safety and soundness of regulated financial institutions. Prudential safety and soundness imply the continued financial health of regulated institutions. The market conduct regulator’s objective will be to protect consumers of financial services and promote confidence in the South African financial system.”

Underpinning the Twin Peaks regulatory system will be the strengthening of the prudential supervision system, by enhancing the Reserve Bank’s powers to promote financial system stability and empowering it to become the systemic

regulator. The Reserve Bank will also be allocated new powers with respect to financial markets infrastructure such as exchanges, clearing houses and the central securities depository.

### Hedge Fund Regulation

The FSB is currently looking at the proposed regulation of the hedge fund industry. It builds on previous efforts by the Regulator, and industry, prior to the financial crisis.

The Minister of Finance released a paper *The Regulation of Hedge Funds in South Africa: A Proposed Framework*<sup>6</sup> issued by the National Treasury and Financial Services Board in September 2012. On behalf of the industry, the ASISA Hedge Fund Standing Committee drafted comments and is currently awaiting feedback from National Treasury and the FSB on the way forward.

6. The Regulation of Hedge Funds in South Africa: A Proposed Framework, National Treasury and Financial Services Board, September 2013

*Never has there been a more apt time for asset managers to position themselves to take advantage of the long-term growth prospects in Africa.*

## Opportunities for Investment Managers across Africa



Africa represents a key growth opportunity and can be categorized into two areas:

### **Investing in companies established or in the process of establishing a significant presence in Africa.**

Many listed South African companies have established a strong presence in Africa, driving growth in their businesses and ultimately generating excellent returns for their shareholders. Several local and international companies have come out in support of the opportunity within Africa and launched ambitious growth initiatives within the continent.

### **Asset managers establishing localized operations in the key Sub-Saharan Africa countries, developing products and solutions for the local populations.**

A number of local asset managers have operations in the Southern African region and are well established within South Africa. However, the key growth market is in sub-Saharan Africa. According to the World Bank global economic prospects June 2012 report, "GDP in Sub-Saharan Africa grew at a still robust 4.7 percent in 2011 (down from 5 percent in 2010). Excluding South Africa, growth in the rest of

Sub-Saharan Africa was stronger at 5.5 percent. This was a higher rate than the developing country average (excluding China) of 4.9 percent, making Sub-Saharan Africa one of the fastest growing developing regions in 2011". The report continues that the region is expected to record 5 percent growth in 2012, and 5.3 percent in 2013. With these levels of growth, the regions' upper and middle class will continue to grow. According to a report by the African Development Bank entitled *The Middle of the Pyramid: Dynamics of the Middle Class in Africa*, "the middle class had risen to 34 percent of Africa's population – or nearly 350 million people – up from about 126 million or 27 percent in 1980."

While the estimated growth in Africa will fuel demand for consumer goods, there will also be increased demand for investment products, creating a significant opportunity for asset managers.

### **Understanding the market to embrace opportunity**

Entrance into these markets is challenging due to cultural and language differences, in addition to the political risk – however, these are not insurmountable. It is critical to obtain a deep understanding of the

market you plan on entering, as failure to do so could result in significant losses. While this may not be as important for asset managers which form part of a bigger group already established in these markets, smaller and less globalized asset managers could look to form strategic partnerships with locally-based asset managers. They have the benefit of understanding the political and regulatory environment, connections within the institutional market and a greater appreciation for the culture.

Never has there been a more apt time for asset managers to position themselves to take advantage of the long-term growth prospects in Africa. While there is undoubtedly significant risk, those who do so successfully will be extremely profitable through organic business growth and through generating excellent returns for their clients.



### **Mauritius** **Limited Partnership Act (LPA)**

The LPA came into effect on 15 December 2011. It aims to enhance the use of the Mauritian investment platform, primarily by US and European private equity funds seeking investment opportunities in African and Asian markets. Compared to a company, this new investment vehicle provides more flexibility to investors. The limited partnership will not be subject to the provisions of the Mauritian company law.

The principal attraction of the limited partnership for the partners is its tax transparency. Profits and losses are attributed to the partners themselves, who will be taxed according to their proportionate share of such profits and losses. The limited partnership holding a Category 1 Global Business Licence may elect to be taxed as a company, in which case it will be liable to tax at the maximum effective rate of 3 percent (after taking into account deemed foreign tax credit) on its foreign-sourced income.

### **Foundations Act**

The Foundations Act came into effect on 1 July 2012. It aims to allow for the setting-up of foundations in Mauritius. A Foundation is a wealth management vehicle which appeals more to clients who are based in civil law countries who are less familiar with the trust concept. Foundations have some hybrid features of a trust and a company. Every Foundation is liable to income tax on its chargeable income at the rate of 15 percent. A Foundation holding a Category 1 Global Business Licence (GBL) is subject to income tax at a maximum effective tax rate of 3 percent.

However, a Foundation of which the founder is a non-resident, or holds a GBL 1 under the FSA – and all the beneficiaries appointed under the terms of a charter or a will are, throughout an income year, non-resident or hold a GBL 1 – are exempt from income tax in respect of that year. The exemption is obtained by depositing a declaration of non-residence for any income year with the Director-General of the Mauritius Revenue Authority within three months from the expiry of the income year. Any distribution to a beneficiary of a Foundation is considered to be a dividend to the beneficiary.



### **Nigeria** **IFRS adoption**

On 28 July 2010, the federal executive council unveiled the road map for Nigeria's adoption of International Financial reporting Standards (IFRS), effective 1 January 2012. Under the Road map for adoption of IFRS in Nigeria, reporting entities are to migrate from Nigerian generally accepted accounting practices over a period of three years.

Listed investment schemes are required to comply with the 2012 adoption date while unlisted schemes are required to comply by 2013. Collective investment schemes are registered with the Securities and Exchange Commission (SEC) in accordance with the provisions of the Investment and Securities Act (2007) and adhere to financial reporting requirements issued by same body.

*The new Mauritian Limited Partnership Act provides more flexibility to investors.*





# Views from the Middle East

The growing and emerging markets across the Middle East region provide considerable opportunities for investment managers, as well as posing some unique regulatory challenges.



## **Bahrain**

### **The changing regulatory landscape**

The investment management industry regulatory landscape has changed significantly over the past year, with the introduction of the new collective investment scheme rules in May 2012 (the third change since 1992, having been previously revamped in 2007) in response to evolving trends both regionally and internationally. The Central Bank of Bahrain (CBB) which is the regulator of the investment management industry in Bahrain, introduced Volume Seven – Collective Investment Undertakings (CIUs) module forming part of the CBB Rule Book after extensive Consultation from the investment industry participants.

The mutual funds industry in Bahrain had matured to a certain extent, which made it necessary for the CBB to undergo the exercise of revamping the regulatory framework for mutual funds, to keep pace with the current international and regional developments and best practice. This update was also

investor driven, who, as markets began to slowly recover after the financial crises, investors identified opportunities in the region and there was demand for new innovative investment products to cater for specific kinds of investor needs.

### **A new regulatory framework**

The new regulatory framework has taken account of the importance of expanding key areas such as the corporate governance framework, and the role and responsibilities of each relevant party to a fund. This in effect has increased the regulatory oversight over each of the relevant persons with respect to their roles which are now clearly prescribed in the new regulations.

The regulatory framework prior to May 2012 was effectively geared towards the retail investor. The new regulations updated the previous regulations and also provided for a greater range of CIUs to be offered, through its provisions regarding expert CIUs and exempt CIUs. Two new main categories of funds were introduced, the Bahrain Real Estate Investment Trusts (B-REITs) to serve the needs of the local and regional markets; and the Private Investment Undertakings (PIUs), which are in effect a new breed of mutual funds

*The new regulatory framework has taken account of the importance of expanding key areas such as the corporate governance framework, and the role and responsibilities of each relevant party to a fund.*

with a high degree of flexibility in structuring aimed to facilitate private investments and as such can only be offered to high net-worth individuals and institutional investors. This has expanded the variety of funds that can be established in Bahrain.

#### A new breed of investor

The new rules have effectively addressed investor needs through profiling mutual funds by category – Retail, Expert, Exempt and Private – each with a separate set of rules, observing the type of targeted investors and their level of sophistication, and applying the appropriate level of supervision on such basis. It is expected that this new regulatory framework will further enhance the healthy growth and progression of the industry.

Regulation in Bahrain does not require the operator wishing to establish a Bahrain domiciled CIU to be domiciled in Bahrain, only that they be domiciled in a reputable jurisdiction that is acceptable to the CBB.

#### Opportunities for local investors

The regulatory framework in Bahrain also allows for overseas domiciled funds established in and regulated by jurisdictions recognized by the CBB to be offered to investors in Bahrain. This is subject to being registered/ authorized by the CBB prior to being offered to investors and can only be offered to expert and accredited investors. This provides opportunities to local investors to obtain exposure to investment opportunities all over the world based on the overseas fund they invest in.



#### Qatar

##### A growing market

After facing the 2008 financial crisis shake-up, the Gulf Cooperation Council's (GCC) Asset Management Industry is slowly picking up, and Qatar is showing positive signs. The asset management industry in Qatar is set to grow strongly over the coming years, driven by a likely infrastructure boom ahead of the World Cup and an opportunity to generate emerging market returns in a comparatively low risk environment.

Qatar is home to a nascent but fast growing fund management industry of US\$156.6 million, spread across six managers and 11 fund vehicles. The majority of these assets are placed in equity vehicles, which account for approximately 99 percent of the Assets under Management (AuM). The funds are managed by Qatar's five largest asset management firms.

GCC Sovereign Wealth Funds (SWFs) have also grown their asset bases significantly over the last few years, accounting for half of all foreign assets held by the GCC. Qatar's SWF, the Qatar Investment Authority, had assets totaling circa US\$115 billion at the end of 2012<sup>7</sup>.

##### A new regulatory framework

There are three regulatory bodies in Qatar: Qatar Central Bank (QCB), Qatar Financial Centre Regulatory Authority (QFCRA) and Qatar Financial Market Authority (QFMA), which regulate the financial and capital markets. In December 2012, a new financial regulation framework was enacted by the unification of regulatory regime; the three regulatory bodies will function

under one umbrella. The new law lays the foundation for increased cooperation between the regulatory bodies in Qatar, as they develop and apply regulatory policy and implement international standards and best practices to deliver the objectives of the Qatar National Vision 2030 and Qatar National Development Strategy 2011–2016. QCB acquires responsibility for the licensing and supervision of insurance companies, reinsurance companies and insurance intermediaries that were previously licensed by the Ministry of Business and Trade.

The Asset Management regime of the QFC has benefited from a number of regulatory initiatives that have paved the way for a strong, dynamic and progressive asset management sector.

The QFC Regulatory Authority Collective Investment Schemes Rules 2010 (COLL) and the Private Placement Schemes Rules 2010 (PRIV) are the primary rulebooks pertaining to the asset management sector. The new schemes regime complies with international standards while providing for a diverse range of schemes that meets the needs of all categories of customers. Additionally, the QFC Regulatory Authority's Conduct of Business Rulebook (COND) sets forth requirements and standards in respect of financial promotions conducted in or from the QFC, including the marketing and sale of collective investment schemes. Minimum capital requirements by the Qatar Financial Centre Regulation Authority for fund managers range from \$250,000 (for operating a collective investment fund if restricted to providing fund administration) to \$2 million for dealing in investments as principal.

<sup>7</sup> TheCityUK Sovereign Wealth Funds Report, March 2013

*One of the biggest challenges that will be faced by asset managers is the introduction of the Foreign Account Tax Compliance Act (FATCA), which requires asset managers to identify US persons who have invested in either non-US financial accounts or non-US entities.*

### **Regulatory changes from the QFCRA**

In 2013, QFCRA introduced the following new changes to further strengthen the regulations for financial institutions:

#### **Corporate governance**

The new rules issued on Governance and Controlled Functions will come into force on 1 July 2013. The QFCRA has stated that these new rules will seek to reinforce regulation covering governance and risk management by requiring the governing body of a Qatar Financial Centre (QFC) authorized firm to approve and establish:

- A formal governance framework
- Risk management and internal controls framework
- Remuneration policy.

#### **Anti-Money Laundering**

In 2010, as part of its commitment to work with the Financial Action Task Force (FATF) to implement anti-money laundering and counter-terrorist financing measures, Qatar updated its anti-money laundering and counter-terrorism financing legislation by issuing Law No (4) of 2010, Combating Money Laundering and the Financing of Terrorism Law, which became effective on 18 March 2010.

The QFCRA's new rule changes concerning Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) came into force on 1 February 2013 and reflect Qatar's wider FATF commitment.

#### **Islamic windows**

A new regulation prohibiting the operation of Islamic windows (departments of conventional banks offering Islamic finance in Qatar) came into force on 1 February 2013. These new rules in essence stop the operation

of all Islamic windows by QFC Firms, with the exception of any takaful insurance business conducted under the QFC Insurance Business Rules 2006.

#### **FATCA**

One of the biggest challenges that will be faced by asset managers is the introduction of the Foreign Account Tax Compliance Act (FATCA), which requires asset managers to identify US persons who have invested in either non-US financial accounts or non-US entities. Significant process and technology changes are needed in order to comply. (See our Chapter 8 – Tax for further information on FATCA and its implications for the industry).

#### **The growth of Shari'ah funds**

Despite these challenges, one of the most exciting growth opportunities for the fund management industry in the GCC region, including Qatar, is in the growth of Shari'ah-compliant funds, which are becoming increasingly popular. Interest in Shari'ah funds has been driven by the overall strong performance; their conservative investment approach; and a historical shortage of mainstream investment products in the region. With around 26 percent of the world's population estimated to be Muslim, less than 1 percent of the world's financial assets are Shari'ah-compliant. This apparent disconnect provides ample opportunity for asset managers to tap into a thriving sector.

The combination of Qatar's fast growing economy and onshore operating environment, as well as a robust regulatory and legal regime, will certainly boost the asset management industry in the years to come.



### **The Kingdom of Saudi Arabia** **An expanding market...**

The investment management industry in Saudi Arabia is expanding due to an increase in the number of high net worth individuals and overall strong economic growth. Activities in Saudi Arabia are regulated by the Capital Market Authority (CMA), which grants licenses to 'authorized persons' to undertake dealing, managing, arranging, advisory and custody business. The CMA's functions are to regulate and develop the Saudi Arabian capital market, by issuing required rules and regulations for implementing the provisions of capital market law.

### **Enhanced supervision**

To enhance supervisory oversight and management of the authorized persons and for effective monitoring the local stock market, CMA has recently taken action to better regulate and monitor the market. Some of the key initiatives implemented by CMA are as follows:

- A new set of prudential rules for authorized persons, implementing minimum capital requirements based on the risk weighted asset calculations in accordance with Basel guidelines. These are based on the three pillars of minimum capital requirements, Internal Capital Adequacy and Assessment Process (ICAAP); and Disclosures.

- To develop the capital market and improve the methods of system and entities trading in securities, CMA has issued a draft Investment Funds Regulation to regulate the establishment, offering and management of investment funds and associated activities in the Kingdom.
- CMA has published a draft credit rating agencies regulation, regulating the conduct of rating activities in the Kingdom, and the monitoring thereof, specifying the procedures and conditions for obtaining an authorization.

### **Opening up markets – increased transparency?**

Based on recent media reports, there is a possibility that Saudi Arabia will open up its market to foreign investors on a gradual basis. Currently, foreign investors based outside the GCC are only allowed to invest in the local market through equity swaps and exchange-traded funds. If such an opening up of the market materializes, it is expected that it will have the potential to bring in a significant amount of foreign investment and greater market transparency.

*The investment management industry in Saudi Arabia is expanding due to an increase in the number of high net worth individuals and overall strong economic growth.*



## Perspectives: Americas

### The need for greater business efficiency



**John Schneider**  
US Head of Investment Management  
Regulatory Practice, KPMG in the US

The tidal wave of new regulatory requirements and increased examination and enforcement scrutiny has prompted many investment managers to scramble and fulfill these new requirements as best they could. Most managers and fund administrators have by now survived the first onslaught. Some of the primary changes that managers have complied with include disclosure requirements (Form ADV), increased custody requirements (custody rule), systemic risk reporting (Form PF and Form CPO-PQR) and increased monitoring and oversight. Many managers who have successfully implemented solutions to address the regulatory requirements and/or have been subject to the latest round of SEC examinations are now asking themselves, "Going forward, how can we address our regulatory requirements, which initially have been so onerous, more efficiently and cost-effectively?" This question has more broadly been the focus of managers during the recession due to limited growth and margin pressures.

It is not the only question that managers should be asking. They should also ask, "How can the business model and risk mitigation systems be deployed to create strategic advantage in the market place?"

Many of the strategic initiatives will focus on the client experience, on-

boarding, data completeness and integrity, which are some of the core business activities that will be required to be enhanced to increase efficiency, reduce risk and improve business performance. Approaching the regulatory processes in this manner will ensure full integration into the business model and assist in the rapid deployment of complying with additional changes that are almost inevitable. More importantly, the enhancements will allow managers to plan for the long-term growth of their business.

Undoubtedly, new regulatory requirements will continue to emerge from investment-related events taking place in the US and around the world. Newly-registered advisors have at times encountered questions and requests for information from SEC examiners that range beyond initial, high-level topics. Regulators are holding Boards of directors more accountable for overall governance and specifically for issues such as valuation methodologies. Particularly among alternative investments, expense allocation policies are receiving greater scrutiny. As a final example, leaders of regulatory agencies around the globe are watching each other's activities with greater interest; therefore, there is no telling how regulatory changes in one country may someday affect requirements in the US.

The fact remains that, however the landscape changes, the benefits will only grow stronger for managers who are willing to think strategically about new challenges, rather than merely satisfying the requirements of the moment. As a result, managers must expect their consultants to bring a full range of capabilities to bear on an issue, because long-term solutions will require vision more than simple expertise. With visionary thinking, the new data – along with the new technology and personal skills – created to satisfy an imminent regulatory requirement can be repurposed to meet a wide variety of commercial and long-term, strategic needs.

The events of the past year have clearly demonstrated that those firms who address regulatory issues with vision and commitment can create leaner organizations with lower operating costs, better risk management capabilities, and stronger business models. Finally, those firms that address immediate challenges with long-term vision will be well positioned to improve services and distinguish themselves from competitors in ways that will enable them to attract the most desired customers.

Strategic thinking has always been essential to long-term growth, but never more so than now.



# Views from Canada and Latin America

Countries in the Americas are feeling the effects of global regulation



## Canada

### The local landscape – steady and manageable?

Change in the local regulatory landscape for investment management in Canada has generally been steady and manageable, but has been accentuated by periods of more rapid change in certain areas.

For several years, the Ontario Securities Commission has been rewriting rules for investing in most types of prospectus-based investment products, but has also been busy rule-making for other market segments, such as hedge funds, closed-end funds and derivatives. More recently, new proposals may ultimately restrict investment choices for closed-end funds, which would push many investments into the private space.

### Alternative investments

Managers who handle alternative investments have always been subject to a very high level of regulation in Canada, including working capital, insurance and investment proficiency requirements.

These have generally created higher barriers to entry compared to many other jurisdictions.

### Rapid global change

In contrast to the slow but steady local changes, the sweeping transformations taking place in the US and EU are forcing Canadian managers and their advisors to deal effectively with extremely rapid change. A Canadian manager of private funds who has US investors in those funds will most likely have to register with the SEC as an investment adviser.

### Increased compliance and reporting requirements

FATCA is also affecting Canadian managers who hold US investments and advise US advisors. Even those managers who have no US investments or investors are finding that their counterparties will not deal with them unless they comply with FATCA. The Canadian government is close to completing an inter-governmental agreement with the Internal Revenue Service (IRS) to simplify reporting for Canadian-domiciled funds and managers, but the details of this agreement will not be known until later this year.

In addition, many Canadian managers that were previously exempt from the Commodity Futures Trading Commission

(CFTC) requirements found themselves recently having to register as Chartered Tax Advisers (CTAs) and commence reporting to the National Futures Association (NFA) and the Commodity Futures Trading Commission (CFTC). Outside North America, Canadian managers also now have to navigate the labyrinth that is the regulation of investment products in the EU. Most notably, AIFMD is now coming online, which at its least impactful to third country managers (such as Canadian manager) introduces significant transparency reporting requirements to the EU regulators.

### Managing the global fallout...

Beyond these specific regulatory challenges, the global fallout from the US and the EU will continue to affect the landscape in Canada. Issues addressed by regulatory agencies around the world will also be addressed in Canada, meaning that the slow but steady pace of change that has generally characterized the Canadian landscape will often be interrupted by more sweeping – and even dramatic – developments around the globe.



## Chile

Two related issues dominate the landscape for investment management in Chile.

### 1. Consumer and investor protection

The government and the investment industry continue to push for greater protection for consumers. For this reason, much discussion has taken place around issues such as conflicts of interest, fees and commissions, and corporate governance.

### 2. Attracting global investment

Greater protection for consumers will help the government in Chile to advance its other major goal: to attract investors from around the world and make Chile a major financial center for Latin America. Chile has many attractive advantages for investors, including a mature pension fund system.

### Making the most of advantages and opportunities

Chile has first world indicators in terms of macro-economic stability, rule of law and regulations. This is shown by the recent improvement in Chile's risk rating, placed among the top 20 countries worldwide. Chile also has sophisticated AuM and a well-developed financial infrastructure. These benefits combine to create unmatched regional advantages to transform Chile into an international platform and financial center for the region.

However, those capacities are not sufficiently exploited if the market does not attract foreign investors. The AuM industry size is US\$ 50,000 million (approximately 18 percent of GDP), but there is almost no involvement by foreign investors. Pension funds managed total US\$150,000 million.

### Simplifying the legislative landscape

The Chilean Government has therefore just approved an 'AuM unique Law', which summarizes in one single legal text all the standards currently in existence in Chile (the Mutual Funds Act, Investment Funds Act, and Foreign Capital Funds Act). In addition, the new law introduces enhancements, tailored to the current financial industry requirements. The new law will simplify the AuM industry, including foreign capital investment funds, which will allow the same entity to manage different types of funds. Likewise, it clearly provides the standards applicable to deal with conflicts of interest that may arise and affect contributing parties, as well as managers' accountabilities to provide increased protection to investors in line with their risk profiles, enhanced assurance for small investors and increased deregulation for major investors, referred to as 'qualified investors.'

One of the most interesting innovations in this law includes the standard that allows funds to avoid foreign investors paying taxes for capital earnings, generated in funds where they invest at least 80 percent of their assets abroad. Another innovation comes in the section that exempts payment of value-added tax for fees received by AuM. In this sense, the new law pursues promoting the competitiveness and

internationalization of the Chilean investment management industry, as well as following the recommendations made by the Organisation for Economic Co-operation and Development (OECD).

The Chilean government is now working to reduce barriers to foreign investment and promote the AuM industry to become a financial center alongside London, Hong Kong and Singapore. The government expects that the new regulatory framework will attract investors through the quality of services, which are completely different from the so-called 'tax havens'.

*Even those managers who have no US investments or investors are finding that their counterparties will not deal with them unless they comply with FATCA.*



**Brazil**  
**A stable and well regulated environment?**

The long-stable and well regulated environment for investment in Brazil, based on high returns for fixed-income investments, has been rapidly changing. As interest rates come down, fund administrators and managers are being asked to revise existing portfolios in order to help clients obtain higher interest rates. The focus for investment has been shifting to new, more sophisticated products in private credit, private equity, hedge funds and real estate funds. This shift will continue, especially as regulation has changed, thereby allowing clients to invest in funds outside Brazil.

**Opportunities and risks**

With all these new opportunities for investing in long-term and illiquid products also come new requirements and, inevitably, new risks. The preparation of financial statements is therefore becoming more complicated, as the audit and risk-management processes increases in depth and complexity. Accounting and reporting standards for credit funds and real estate funds have changed towards IFRS from years ended August 2012 and December 2012 respectively. The shift to international standards for accounting continues – perhaps be extended to product classes that not covered currently, such as the private equity funds.

*With all these new opportunities for investing in long-term and illiquid products also come new requirements and, inevitably, new risks.*







# Perspectives: Offshore

## Onshore is the new offshore

Boundaries are being redrawn and new markets established.

### Tax issues

As 2013 progresses, a rapid evolution of both the regulatory and tax debates continues. The frequently derogatory tax commentary aimed at the island based financial centers is also now being directed at major onshore economies, such as Austria, Switzerland and Luxembourg. The tax morality and automatic exchange of information advances are creating waves but ultimately should deliver a much needed and more transparent level playing field for all. As growth stimulus in the EU becomes a priority, with evidence of lowering corporate tax rates, the age old tax arbitrage debate becomes nearly obsolete. Regulation is now starting to drive conversations about product structuring in the investment management world – and this debate isn't about onshore versus offshore, it's about EU versus non-EU.

While the mainstream media rail against multinational companies playing tax arbitrage in Ireland or Switzerland and against perceived tax haven abuses, the real business of tax-neutral investment management continues unabated. In the funds world, tax neutrality is key and

simply means the investor and manager pay tax based on their residency/domicile – but not where the fund is established.

### AIFMD – offshore implications

The impact of AIFMD is more clearly known now than a year ago, despite the plethora of uncertain interpretations and different rates of legislative progress across Member States. Investment managers are looking at their product range and reconfirming the best route to market for each investor base. Whilst there is a perceived access advantage with the EU passport, it comes at a not insignificant cost to manager and fund, in terms of the additional direct (depository) and indirect (business structure, process and reporting) cost.

The additional cost of the passport only makes commercial sense if a wide and predominantly EU investor base is desired or non-EU investors want to access the highest regulatory standard. As soon as the non-EU investor base grows to a material percentage, then the cost debate is relevant for institutional investors. Many managers are content to continue with private placement albeit fully aware of its future restrictions. Others are reorganising so they are out of scope or even moving product out of the EU.

Going forward, there are at least two jurisdictions that have announced dual investment fund regimes. These regimes will allow a manager to choose whether he subjects all or some of its investors to the cost of alternative investment fund manager (AIFM) compliance or falls outside scope. EU fund domiciles must apply these rules and costs, whilst non-EU jurisdictions can do so more flexibly or not at all. The dual regimes will allow the marketing of funds to both EU and non-EU markets, which EU regulated managers will not be able to do in a cost effective manner.

From conversations being had across the industry, it is clear that there will be strategic product moves both into and out of the EU in the coming years, but the final trend is yet to be determined.

*From conversations being had across the industry, it is clear that there will be strategic product moves both into and out of the EU in the coming years, but the final trend is yet to be determined.*



# Perspectives: Asia-Pacific (ASPAC) Significant regulatory change



**Bonn Liu**  
Head of Investment Management,  
KPMG's ASPAC region



## China

China and Hong Kong have started discussions regarding mutual recognition for the cross-border sale of collective investment funds. If agreed, such a regime would have significant potential benefits for both: Hong Kong, if offered exclusive access to Chinese investors, would become a major funds center and the main destination for mainland Chinese investment. For China, such a scheme will provide Chinese investors with unprecedented access to international investment products allowing them to diversify their investment portfolio. This will be a significant step in Hong Kong's aspirations to be a major international funds center and reinforces its position as an offshore Renminbi center.



## Singapore

Singapore's asset management sector's progression towards becoming one of

Asia's leading asset management hubs has been developing over the years. In the 10 years to 2011, its assets under management (AuM) witnessed tremendous growth from S\$307 billion to S\$1.34 trillion. Singapore is steadily moving to act as the gateway to the world for Asian investors and for the world to tap Asian investments. Like other foreign fund management jurisdictions, Singapore has been undergoing significant recent regulatory changes. The local regulator, the Monetary Authority of Singapore (MAS) issued two Consultation Papers on the review of the fund management regulatory framework in Singapore in April 2010 and September 2011; the new regulations proposed in these Consultation Papers were implemented on 7 August 2012. Under the Securities and Futures (Licensing and Conduct of Business) (Amendment No 2) Regulations 2012, fund managers will fall into three classes as follows:

- Fund management companies (FMCs) providing fund management services to not more than 30 qualified investors of which no more than 15 can be funds or limited partnership fund structures and their total AuM cannot exceed S\$250 million (US\$201.5 million). Such fund management companies

*We expect the compliance cost and burden [of newly enacted regulations] to be significant especially for the small and medium-sized investment companies which make up a significant proportion of Japan's investment managers due to their small scale.*

are classified as Registered Fund Management Companies (Registered FMCs).

- Licensed Accredited/Institutional FMCs (A/I FMCs). Licensed/accredited institutional fund management companies hold a capital markets services (CMS) licence for fund management and can do business with qualified investors only, without restrictions as to the number of investors or AuM.
- Licensed FMCs, Licensed FMCs hold a CMS licence for fund management and can do business with any investors (including retail), without restrictions as to the number of investors or AuM.

The new regulatory requirements have had the biggest impact on the Registered FMCs, requiring the FMCs to maintain minimum base capital requirements, annual independent audits (previously many were exempt from statutory audits), having a risk management framework in place, having an independent custodian, ensuring AuM are independently valued and minimum competency requirements for directors and fund professionals. Registered FMCs typically comprise hedge fund managers and smaller boutique fund managers.

Another recent regulatory development in relation to the Risk Based Capital (RBC) framework for licensed fund management companies came into effect on 3 April 2013. In April 2012, the MAS issued a Consultation paper on "Proposed Revisions to the Regulatory Capital Framework for Holders of CMS licences", inviting comments on the proposed changes to the existing regulatory capital framework so as to align it across licence holders in Divisions 1, 2, and 3 under the Securities and Futures (Financial and Margin

Requirements for Holders of Capital Markets Services Licences) Regulations (SFR (FMR)) arising from MAS' ongoing review. Licence holders solely involved in the regulated activity of fund management belonged to Division 3 and were subject to a simplified RBC framework. The Notice establishes the methodology which a holder of a CMS licence shall use to calculate its financial resources and total risk requirement. Some CMS licence holders may find the detailed monitoring requirements challenging to implement and the MAS has therefore given a transitional period of two years before its requirements are fully effective.



### Japan

Japanese authorities will adopt NISA (the Japanese version of Individual Savings Account scheme, originally promoted in US) from January 2015 in order to encourage more individuals to become active in the securities market. NISA accounts at Japanese banks and securities companies will be exempt from tax charges on capital and income gains for five years, as long as they do not exceed 1 million JPY. Financial institutions are committed to launch campaigns and develop products to attract retail investors with the expectation that retail investment sector will grow.

On the other hand, the AIJ Scandal of 2012 involving the 'disappearance' of pension assets focused a spotlight onto the Japanese investment management sector and forced Japanese authorities to introduce new and tangible regulations. As AIJ's deception relied on auditors

who were in effect its own affiliates, allowing the company to misrepresent information in performance reports to its clients, the Japan's Financial Services Agency (JFSA) has required that investment management companies inform their clients whether they were subject to audit by independent external auditors prior to contracting. This requirement becomes effective on 1 July 2013. The JFSA has specified reportable external audits to include fund audits, ISAE3402, SSAE16, and GPS verifications. According to JFSA's research, over 60 percent of investment managers in Japan, comprising mainly small and medium-sized companies, have not been audited by external auditors. We expect this will result in more such companies being externally audited than previously.

In addition, the JFSA has newly enacted regulations to:

- require domestic trust banks performing custodian functions to directly obtain the fund standard price and fund audit reports;
- require an enhancement in the contents of investment performance reports produced by investment companies; and
- introduce harsher sanctions for misconduct by investment management firms.

While these regulations aim to increase transparency and information available to investors, we expect the compliance cost and burden to be significant – especially for the small and medium-sized investment companies, which make up a significant proportion of Japan's investment managers due to their small scale.

# 02

## Investor protection and education



## EMA Restoring investor confidence

Figures from the International Investment Funds Association (IIFA) again revealed an all-time peak of assets under management in mutual funds – adding up to US\$26.84 trillion at 2012 year-end. However, retail investor trust in financial products is still damaged – and the financial crisis and its consequences continue to nourish the desire to enhance the rules of the game on financial markets, both locally and cross-border. Reinstating investor confidence and trust is therefore still paramount on the agenda of regulators.

### Investor information

The European Union has built on common G20 decisions to implement an ambitious program relating to the monitoring of systemic risk and the OECD consumer protection principles, aimed at the improvement of investor information and protection. Pre-crisis, UCITS 4 had already introduced the Key Investor Information Document (KIID) as a new information tool; implemented rules around cross-border activities, like mergers and master-feeder-structures; introduced the management company passport; and adjusted the notification procedure to enable better cross-border marketing. UCITS funds – being open to both retail and professional investors – are now generally set up in order to create a distribution opportunity across Europe.

In order to create a level playing field with UCITS for product disclosure rules, the Packaged Retail Investment Products (PRIIPs) Regulation aims to extend the KIID to all financial products offered to retail investors for which the amount repayable is exposed to fluctuations in reference value, or the performance of

the underlying assets. A KIID is a two-page document that is supposed to provide the client with the basic information of a product in an easy to understand format. PRIPs is still under debate, with the scope of application being one of the major discussion points. While some believe that insurance products should be excluded, others maintain that unpackaged products, such as bonds or shares, should also be included. The PRIPs-KID would be different from the UCITS-KIID as far as the language is concerned: there should be simple questions such as “what is it for?” or “could I lose money?” It would be up to the product manufacturer to produce the KID; and up to the distributor to make sure that it reaches the investor. PRIPs is still being discussed at the European Parliament level – final adoption is unlikely before the end of 2013, so it will not become applicable before the end of 2015 according to the expected transposition period.

### **What product – and for which customer?**

The question of whether the present UCITS framework can still be reasonably considered as delivering adequate products for retail investors is subject to intensive debate. Notably, products pursuing highly sophisticated investment strategies exploiting the extension of eligible assets under UCITS 3 are perceived as being either too risky and/or too difficult to understand for the average investor. Together with several other topics – for example, the need for extraordinary liquidity management tools, efficient portfolio management techniques or the design of money market funds – the issue of eligible assets was compiled into a Consultation Paper by the European Commission in

July 2012. This Consultation is also referred to as UCITS 6 and closed in October 2012 – at the time of writing, awaiting further steps. Since there is now an alternative framework with a passport for non-retail funds (AIFMD), some advocate that certain UCITS products should be moved to this framework and no longer be available to retail investors – at least on a cross-border basis.

There could also be a new definition for those funds that would remain in the UCITS framework; since the draft revised Markets in Financial Instruments Directive (MiFID 2) introduces a distinction between ‘complex’ and ‘non-complex’ UCITS. This would mean that certain UCITS would not be available for sale by execution only, that is, without advice. MiFID 2 also intensifies the requirements for providing investment advice; and strengthens the rules for order execution.

IOSCO only recently issued a Consultation on the Regulation of Retail Structured Products on 18 April 2013, proposing a Toolkit that sets out regulatory options in the area of investor protection to support its members in their regulation of retail structured products.

The financial crisis has also, once again, brought forward the theme of investor education; a topic that is more difficult to tackle on a European level, since education still remains the national responsibility of individual Member States.

*The European Union has built on common G20 decisions to implement an ambitious program relating to the monitoring of systemic risk, as well as the improvement of investor information and protection.*



## ASPAC

### A drive for transparency and governance



#### China

In March 2013, the Chinese regulator, the China Securities Regulatory Commission (CSRC), announced plans to improve retail investor protection by either expanding the scope of services of the current Investor Protection Bureau or creating a whole new institution.

While the CSRC has been implementing various retail investor protection measures over the past year, the most recent effort will aim to create an institution to represent retail shareholders' interests at shareholder meetings of large listed companies. The initiative will provide added guidance for retail investors who, despite accounting for a large share of all transactions in China's equity markets, remain relatively inexperienced in assessing and mitigating investment risks. This is the latest in many initiatives taken by the CSRC since early 2012.

Approximately 70 new policies and guidance papers have been issued, many with the express aim to protect retail investors.

The CSRC and its banking industry counterpart, the China Banking Regulatory Commission (CBRC), have jointly issued a new set of Administrative Measures for Securities Investment Fund Custody Business, to facilitate the opening up of the fund custody business, boost market competition, and clearly define the responsibilities of public fund custodians.

With more transparency in regards to regulatory expectations, the CSRC hopes that more eligible banks will apply for custodianship qualification. Both Chinese and foreign banks are eligible to apply. For commercial banks already in the custodian business, this will likely create added pressure to ensure efficient operations, plan ahead and expand their custody business to cover a broader range of investment products. As part of its transparency drive, the CSRC will boost its on-site inspections of fund

custodian banks, implement an accountability mechanism including sanctions against custodian institutions and their management for violations, and promote the professional and business development of fund companies.

*Approximately 70 new policies and guidance papers have been issued, many with the express aim to protect retail investors.*



### Hong Kong

In Hong Kong, the Securities and Futures Commission has moved to enhanced disclosure requirements for Investment-Linked Assurance (ILAS) Schemes to promote investor protection in these increasingly complex products. The Enhanced Disclosure Requirements require that the following new disclosures be made in an upfront manner:

- statement of purpose of investing in the ILAS Scheme;
- total fees and charges disclosure (TFCD) setting out, amongst others, the total fees and charges in investing in the ILAS Scheme as a percentage of the total premium(s) to be paid by a policyholder under the ILAS Scheme;
- more prominent disclosures on certain long-term features, including upfront charges, early surrender or withdrawal charges, and loyalty bonuses; and
- disclosure about insurance intermediaries' remuneration.



### Singapore

In Singapore, the MAS has focused on developing investor knowledge and skills in relation to their investments in the financial markets. Part of the MAS's drive to raise consumer understanding of basic money management, financial planning, and investment products, the MAS has put in place a MoneySENSE national financial program. Investor education is key in the MAS's thrust in developing the capital markets and protecting retail investors.



### Australia

The Future of Financial Advice (FoFA) reforms in Australia focus on improving the quality of financial advice, particularly product recommendations, and expanding the availability of more affordable forms of advice. The reforms are intended to improve investor protection and instill confidence in the financial advice industry in Australia. In an attempt to further improve accessibility to financial advice, under the Stronger Super reforms, a superannuation fund trustee can offer intra-fund advice to members of any MySuper product or Choice product of the fund after 1 July 2013.



### Japan

JFSA's Investment Trust and Investment Corporation Legal Framework Review Working Group posted their final report on Japan's investment management sector in December 2012. In the report, the group emphasizes the need for an improved financial consulting function and stewardship by investment managers, firmly based on the client's life plan and corresponding investment planning. The working group believes this would facilitate an increase in the numbers of individual retail investors, while reducing the sector's current reliance on the population of retail investors around retirement age (60 years old under Japanese law), which is on the decrease.

Although we have heard similar sentiments promoting the importance of investor education voiced in the past, there has been no follow-through with policy measures to date. We will monitor whether this recent report will lead to concrete policies or regulatory changes.



# 03

## Retail products and distribution

### EMA

## Changing processes and distribution models

Throughout the EMA region – Europe in particular – significant regulatory change is underway in the development and distribution of products. The new focus on remuneration, fair customer treatment and investor protection is driving strategic change, creating different distribution models for the industry.



### Changes to the UCITS framework

The proposed changes to the UCITS framework (UCITS 5), borne out of the crisis (especially the Lehman Brothers bankruptcy and Madoff fraud), aim to harmonize depositary duties and liabilities across the EU – as well as the regulated entities eligible to act as depositary – in order to establish an even level of protection for investors in different jurisdictions. According to the proposed text, each UCITS fund will be required to have a single depositary, evidenced by a written contract. The depositary will have in-depth duties regarding safekeeping of assets, cash monitoring and oversight. Strengthened rules for the delegation of the depositary's tasks (eg. due diligence requirements), as well as clarifications on the depositary's liability, are further defined.

The depositary will be liable for a loss by the depositary or a third party to whom custody has been delegated, unless it can prove that the loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all efforts to the contrary.

### Remuneration

To avoid short-term decision making and adverse incentive structures for risk taking, UCITS 5 also deals with the topic of remuneration. To ensure sound risk management and control of risk-taking behavior, the management company should implement remuneration policies for those categories of staff whose professional activities have a material impact on the risk profile of the UCITS that they manage. It should further comply with a list of principles to have remuneration policies in place that are appropriate to its size, internal organization, nature, scale and the

complexity of its activities. The remuneration policies should be designed to:

- discourage any risk-taking inconsistent with the UCITS risk profile;
- prevent conflicts of interest; and
- protect investor interests.

In this respect, the recent vote of the European Economic and Monetary Affairs Committee (ECON) in March 2013 has led to serious concerns within the industry, as it additionally introduced a limitation of any variable component of total remuneration to the one-time fixed component for all employees in scope, going even beyond the rules adopted for banks under the Capital Requirements Directive (CRD 4). To better align the interests of investors and the management company, ECON also touched on the design of performance fees, requiring, inter alia, a symmetric pay-off structure, which would impose penalties on fund managers who fail to beat their benchmarks.

The UCITS 5 Directive also introduces a sanctions regime across the EU, providing for a catalog of sanctions, and measures the national competent authorities may apply.

As with PRIPs, UCITS 5 is not definite and amendments are still possible in all key areas. In particular, the provisions for remuneration and performance fees introduced by ECON and the EU Parliament may well amend the version in its proposed form. The final version is expected at its earliest in Q3 2013, followed by a two-year implementation period.

The final Guidelines on Exchange Traded Funds (ETFs) and other UCITS issues, published by the European Securities and Markets Authority (ESMA) on 18 December 2012, constitute a further piece of legislation. The

*To avoid short-term decision making and adverse incentive structures for risk taking, UCITS 5 also deals with the topic of remuneration.*

Guidelines are aimed at increasing investor protection, providing guidance on:

- the information that should be communicated for index-tracking UCITS and UCITS ETFs;
- specific rules to be applied by UCITS engaging in Over the Counter (OTC) transactions and efficient portfolio management techniques; and
- criteria to be respected by financial indices in which UCITS invest.

#### **Money Market Funds – under continuous scrutiny**

In the context of the wider debate on ‘shadow banking’, the discussion on the features of certain fund products continued during the year, both globally and at European level. Money Market Funds (MMFs), in particular those

providing a constant Net Asset Value (cNAV), have been further scrutinized, the latter being accused of giving a false ‘impression of safety’ to investors. After IOSCO and the Financial Stability Board made earlier recommendations on a global level, the European Systemic Risk Board (ESRB) on 20 December 2012 issued a recommendation on MMFs covering NAV, liquidity, disclosure and reporting requirements. The European Commission is also expected to publish a draft Regulation soon, which we expect to require cNAV MMFs to implement a 3 percent cash buffer and to require MMFs in general to adhere to strict portfolio construction rules and to adopt sound internal procedures and stress testing processes, in addition to transparency measures.

*In the context of the wider debate on ‘shadow banking’, the discussion on the features of certain fund products continued during the year, both globally and at European level.*



## MiFID 2 – implications for the investment management industry



In the context of the revision of financial markets and conduct rules at EU level, MiFID 2 and MiFIR, inter alia, address certain investor protection themes. The proposed new rules will affect both product manufacturers (such as investment managers and fund arrangers) and distributors (intermediaries/ financial advisers). These developments will have implications for investment management – in particular, in designing products for the retail or professional investor market.

### Inducements

Relevant rules are still evolving, but it appears that, at the very least, a ban on receiving and/or retaining up-front commissions or trailer fees for ‘independent’ advisers and portfolio managers will be introduced. Product and sales structures will therefore need to be re-designed and aligned in accordance with these rules.

### Transparency

Existing rules on product transparency are to be further enhanced, including disclosure of commissions/fees and sales/services concepts.

### Product manufacturing

Product manufacturers will need to have in place a certain product design and approval process, which should:

- be properly documented;
- be reviewed at least annually; and
- provide proof to the regulator upon request.

When manufacturing products, the target market should be identified, all relevant risks need to be assessed, and the interests of the prospective investors should be taken into account. Similar rules will apply to intermediaries when selecting products for distribution, so that products designed without appropriately taking these requirements into account may no longer be merchantable.

### Intervention rights

The European Securities and Markets Authority (ESMA) and local regulators are to be empowered to ‘proactively investigate new investment products’ before they are marketed, and to ‘prohibit or restrict’ the ongoing ‘marketing, distribution or sale’ of investment products.

Such new rules – particularly the combination of tightened product manufacturing and inducements requirements, alongside additional supervisory intervention powers – require investment managers to assess the sustainability of their current strategies, processes and products, in a timely and thorough way. The new regulatory concept of ‘pre-emption’ rather than, as before, response and remediation, matches the most recent approaches by local regulators such as the new Financial Conduct Authority (FCA) in the UK.

# ASPAC

## New rules and reviews



### China

Eligibility requirements for asset management companies to manage mutual funds are set to change in China.

The Interim Provisions on the Conduct by Asset Management Institutions of Mutual Fund Management Businesses (the 'Rules') released by the CSRC in February 2013 have relaxed some eligibility requirements for asset management companies to manage mutual funds, and allow private equity managers and venture capital investment managers to also apply for the qualification to manage mutual funds.

The new Rules have removed the three-year profit record requirement and replaced it with the requirement for proof of good performance by the applicant in its securities-related assets management products in the last three years. The Rules have also relaxed certain minimum AuM requirements (and capital requirements in the case of private equity (PE) fund managers, or net assets in case of Insurance asset managers) which were set out in the Consultation draft.



### Singapore

In order to safeguard the interests of retail investors, the Singaporean regulator, the MAS, has implemented certain new requirements in connection with the marketing of investment products. These include the following:

- Financial advisers are obliged to carry out a due diligence exercise before selling or marketing any new product in Singapore, to ascertain whether the new product is suitable for the targeted clients; and
- The holder of a CMS licence will be required to assess whether a customer has the relevant knowledge or experience to understand the risks and features of Specified Investment Products (as defined) before transacting in the product for the customer. Notwithstanding a positive assessment, the CMS Licence holder shall offer to provide advice concerning the investment product to the customer.

The above came into effect in 2011 and 2012. The requirements highlight the MAS's ongoing need for financial institutions to undertake due diligence in terms of 'screening' potential customers, and ensuring that certain products are only sold to investors who understand the inherent risks of such asset classes.

In continuing to regulate the distribution of products to investors, in March 2012 the MAS announced the launch of the Financial Advisory Industry Review (FAIR), aimed at raising the standards of practice in the financial advisory (FA) industry and improving the efficiency in the distribution of life insurance and investment products in Singapore. A panel (the FAIR Panel), chaired by the MAS and comprising representatives from industry associations, consumer and investor bodies, academia, media, and other stakeholders, was formed in April 2012 to conduct the review.

The FAIR Panel submitted its recommendations to the MAS in January 2013 in its Panel Report, under the following five key drivers:

- (a) Raising the competence of FA representatives.
- (b) Raising the quality of FA firms.
- (c) Making financial advising a dedicated service.
- (d) Lowering distribution costs.
- (e) Promoting a culture of fair dealing.

The MAS has reviewed the Panel Report and agrees in principle with the recommendations made by the FAIR Panel. In addition, the MAS has made further recommendations relating to the five key thrusts. A Consultation paper was issued to interested persons to provide their views and comments on the recommendations made by the FAIR Panel and MAS. The Consultation closed on 4 June 2013, after which necessary regulatory Directives are expected to be issued by the MAS.



### Australia

Once implemented in full, the Future of Financial Advice (FoFA) reforms will have a significant impact on the structure and distribution of retail products in Australia. The introduction of a 'best interests' duty means advisers will be required to act in the best interests of their retail clients and place their clients' interests ahead of their own when developing and providing personal advice. This will require advisers to apply a much more rigorous and transparent process for product selection. Advisers will also be required to request their retail clients opt-in, or renew, their advice agreements every two years if clients are paying ongoing fees. In addition, an annual statement outlining the fees charged and services provided in the previous 12 months must be provided to clients paying ongoing fees. This means advisers will be in regular contact with their clients and will need to demonstrate the value of the services they are providing their clients.



### Japan

JFSA's Working Group has published a statement that the increased financial product complexity both in the wholesale market and retail market makes it necessary for investors to receive improved performance reports clearly showing the performance results including total return, as well as product risks. They recommend that, for example, risks should be written in a quantitative way.

This discussion is along the same lines as the global push for improvements, such as European Key Investor Information Document (KIID) and the US Dodd-Frank Act. We expect that self-regulation of the sector will play a central role in the progress of these discussions. As for retail sales, both the OTC channel and online channel are expected to be regulated, with onus on financial institutions (brokerages and banks being the largest outlets) expected to take action towards adopting suitable approaches.

*Once implemented in full, the Future of Financial Advice (FoFA) reforms will have a significant impact on the structure and distribution of retail products in Australia.*

A photograph of a man in a checkered shirt looking out a window, with a blurred background of a modern office or building. The image is partially cut off on the right side.

# 04

## Institutional perspectives – Alternative products and distribution

### EMA

## AIFMD: The realities of implementation start to show as the regulatory framework becomes clearer

The global financial crisis convinced regulators that not only mutual funds need regulation, and in 2009 the G20 took the decision that alternative fund managers – especially hedge fund managers – should also be subject to some form of registration and reporting. The EU has gone even further by creating a new regulatory regime the Alternative Investment Fund Managers Directive (AIFMD) that captures any fund that is marketed to European investors, irrespective of the fund domicile.

The new regime not only deals with financial stability issues but also includes investor protection measures and transparency requirements that go far beyond what had previously been agreed on a global level. The AIFMD will have an impact on asset managers worldwide – even more than its US equivalent in the Dodd-Frank act.

*The AIFMD will have an impact on asset managers worldwide – even more than its US equivalent in the Dodd-Frank act.*

### Level 2 measures

With the July 2013 implementation deadline looming, there have been a number of developments – at both European and national level – that have helped to clear some of the fog which has surrounded the hotly-contested AIFMD since its publication in June 2011. Following many months of controversial discussions and heavy lobbying from all parties, the European legislator published the implementing measures for the AIFMD at the end of 2012.

These so called ‘Level 2’ measures clarify a number of important elements of the Directive, such as scope, operating conditions, delegation, depositaries, leverage and transparency. The most contentious aspect – and one of the main reasons for the delay in the agreement of the regulation – has been the question of the maximum extent of delegation permissible for a manager of an alternative fund, better known as the famous ‘letter-box entity’ provision.

Some of the other pressing aspects of the AIFMD have been tackled by the European Securities and Markets Authority (ESMA) in the past months. Remuneration rules were further specified in February 2013 when ESMA published its final Guidelines on sound remuneration policies under the AIFMD. ESMA is also in the process of clarifying scope and exemptions of the Directive through draft regulatory technical standards on types of AIFM, defining what constitutes an open-ended and closed-ended alternative investment fund (AIF) – issued in April, to be endorsed by the European Commission – and Guidelines on key concepts of the AIFMD, further specifying the broad AIF definition set out in the Directive.

### National regulations gather pace...

Meanwhile, national regulators throughout the EU are to implement the Directive into their local legislation. Out of the 27 EU Member States, 16 have already issued drafts or Consultation Papers on the future legal framework governing their local alternative investment sector. Attention has to be given to the national process, as the EU Member States are positioning themselves in quite different ways, both in regards to regulatory aspects and taxation. In addition, Member States might make changes to their local marketing rules. This is particularly important for non-EU fund managers marketing into the EU through private placements. EU fund managers with retail investors also need to pay attention to these changes, as the AIFMD marketing passport does not cover marketing to non-professional investors.

Alternative fund managers and promoters both in and outside the EU would be well advised to closely monitor and process the impact of AIFMD on their structures and businesses – and to take appropriate action in advance.

## AIFMD – Primary issues

Some of the main issues of the AIFMD that alternative fund managers and promoters should be considering are:

### Delegation

The implementing measures include a definition of what constitutes a letter-box entity that is based on a number of quantitative and qualitative criteria to be assessed by the competent authorities on a case-by-case basis. While earlier drafts of the Level 2 rules indicated a quantitative approach for the assessment, the final wording strongly

emphasizes the qualitative aspects of the delegation structure. Competent authorities will therefore not only have to look at the number or percentage of assets managed under delegation but also look closely into qualitative aspects of the delegation structure such as the types of assets invested in, the importance of the assets managed under delegation for the risk and return profile of the AIF, the types of tasks delegated in relation to those retained and whether the AIFM and delegate are in the same corporate group.

Although the different national competent authorities have not yet declared how they are going to read this provision, we expect that complete delegation of both risk management and portfolio management at the same time will not work in the alternative funds sector.

### Remuneration

The remuneration rules apply to a broad group of staff members which the ESMA Guidelines refer to as ‘identified staff’. Certain categories of staff should generally be considered as identified staff unless the AIFM can demonstrate that they do not have a material impact on the risk profile. These include members of the governing body of the AIFM (both executive and non-executive), senior management, risk takers, control functions, staff responsible for heading the portfolio management, administration, marketing or HR and any employee receiving total remuneration that takes them into the same remuneration bracket as the aforementioned categories of staff. Unfortunately, the ESMA Guidelines do not specify what constitutes ‘material impact’. Instead, ESMA leaves this question to the AIFM as they will have to define what constitutes materiality within the context of their AIFM and the AIFs they manage.

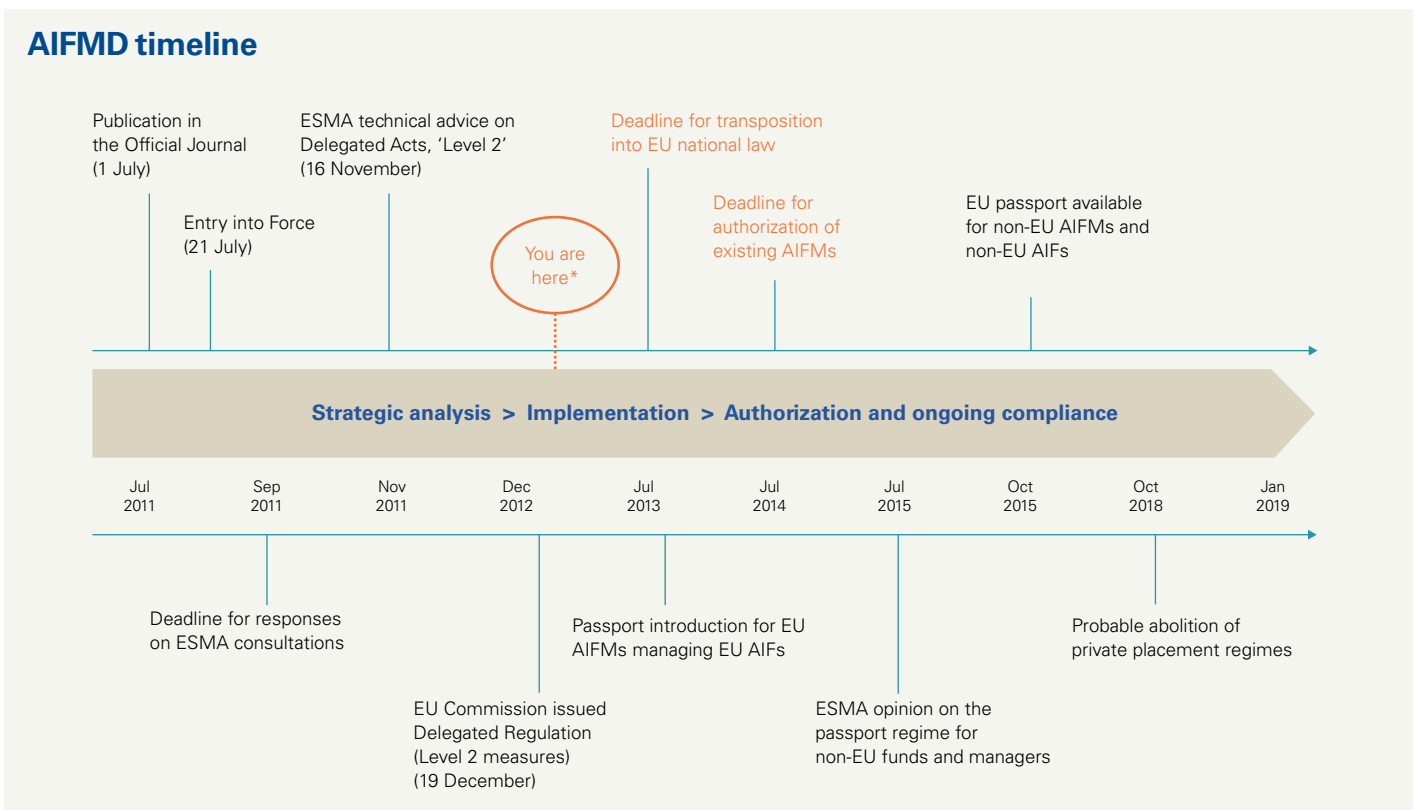
*Alternative fund managers and promoters both in and outside the EU would be well advised to closely monitor and process the impact of AIFMD on their structures and businesses – and to take appropriate action in advance.*

The assessment of performance for the identified staff should be set in a multi-year framework appropriate to the life-cycle of the AIF managed and the payment of any performance-based component should be spread over a period taking into account the redemption policy of the AIF managed and the investment risks. The fixed and variable components of remuneration should be appropriately balanced and at least 50 percent of any variable remuneration should consist of shares/units in the AIF concerned. At least 40 percent of variable remuneration has to be deferred for a minimum of three to five years. In addition, AIFMs that are significant in terms of size or assets should have a remuneration committee.

However, certain requirements of the Guidelines can be dis-applied ('neutralized') in their entirety if this is reconcilable with the risk profile and the strategy of the AIFM/AIF, eg. payment of variable remuneration in instruments of the fund and rules on deferral/retention period/clawbacks of bonuses. The ESMA Guidelines also set out that an AIFM may not be required to establish a remuneration committee where its AuM does not exceed €1.25 billion and the AIFM does not have more than 50 employees. The AIFM may also not need a remuneration committee where it is part of a broader group, with a remuneration committee that performs tasks and duties for the whole group and is subject to certain rules equivalent to

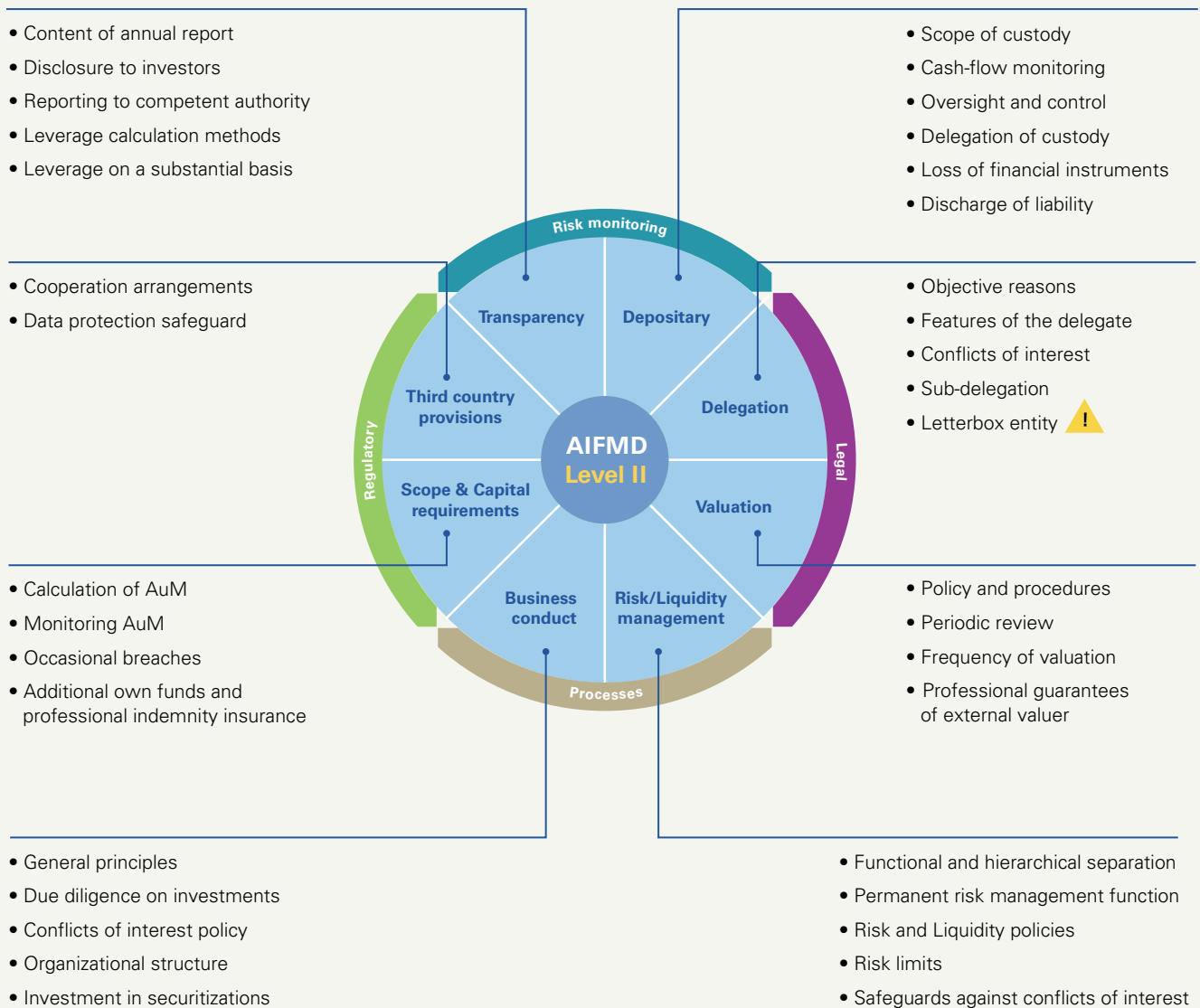
the ones set out in these Guidelines. As the Guidelines do not clearly define the situations in which 'proportionality' applies (or even leads to dis-application of certain requirements), the practical application of certain remuneration provisions will ultimately be determined by the national regulators.

ESMA Guidelines require that entities to which an AIFM has delegated portfolio management or risk management activities shall be subject to regulatory requirements on remuneration that are equally effective. Where this is not the case, the AIFM needs to ensure that appropriate contractual arrangements are put in place with such entities to make sure there is no circumvention of the remuneration requirements of the ESMA





## Impact of AIFMD detailed rules



Guidelines. Such contractual arrangements should cover any payments made to the identified staff of the delegate as compensation for the performance of portfolio or risk management activities on behalf of the AIFM. This requirement will be a particular challenge for many fund structures using a portfolio manager or having their risk management located outside of the EU.

#### **Risk management**

The AIFM will need to ensure that risk management is functionally and hierarchically separate from operations, including portfolio management. Persons in risk management should not be supervised by the head of operating units, including portfolio management, and they should not perform activities within the operating units. The basis for calculating their remuneration should be independent of the performance of the operating units.

The AIFM will be required to implement adequate risk management systems to identify, measure, manage and monitor all risks that each AIF is exposed to. The AIFM will need to have an adequately documented risk management policy covering all risks faced by the AIFs and will need to set quantitative or qualitative risk limits for each AIF covering market, credit, liquidity, counterparty and operational risks. Risk measurement includes requirements for back-testing, stress testing and scenario analyses and the rules also require remedial actions for breaches of limits. The risk management systems should be subject to an annual review by the senior management.

The AIFM does not place limits on the investments or the strategies that an AIF may employ. However, it requires the AIFM to set a maximum leverage limit for each AIF managed that should be disclosed in the AIF offering documents. This maximum level should be set by taking into account the investment

strategy, the sources of leverage, the need to limit the exposure to a single counterparty and the extent of collateral. The total amount of leverage employed by the AIF will need to be disclosed to investors on a regular basis. The competent authorities may impose limits on the level of leverage that an AIFM is entitled to employ based on concerns regarding systemic risk and disorderly markets.

#### **Depositary functions**

The depositary's core functions of safekeeping and oversight are complemented by the requirement to properly monitor AIFs' cash flows and to ensure that payments from investors and all AIF cash are booked in cash accounts opened in the name of the AIF, or the AIFM or the depositary on behalf of the AIF. If the cash account is opened in the name of the depositary, none of the depositary's own cash may be booked in the account. The depositary



*AIFMD affects all fund managers worldwide who market non-UCITS funds (eg. hedge, private equity, venture capital, real estate and other alternative investment funds) into the EU, or who are managing an EU-domiciled fund.*

will become a central hub for cash-flows as the implementing measures require the depositary to perform daily reconciliations of all AIF cash flows on an ex-post basis. The depositary will also be required to identify significant cash-flows that are inconsistent with the AIF normal activity. In terms of safe-keeping duties and ownership verification the implementing measures require the depositary to apply a 'look-through basis' to assets held by financial or legal structures controlled directly or indirectly by the AIF/AIFM, but exempt Fund of Funds and Master-Feeder structures provided that they have a depositary.

A very critical point is the liability of depositaries in the case of loss of financial instruments. Not only is there a reverse burden of proof, but losses resulting from fraudulent behavior or operational failures (including sub-depositaries) are also within scope.

The depositary will be exempted from liability if it can prove that the loss of a financial instrument has arisen as a result of an external event, which fell beyond reasonable control, and was unavoidable despite all reasonable efforts to the contrary. An external event beyond reasonable control that would delineate liability is limited to natural events, acts of government, war, riots or major upheavals. The depositary may be able to contract out of this liability if it has complied with all obligations set out in the Directive and there is an 'objective reason' to expressly contract such a discharge. For this purpose, the depositary needs to demonstrate that it had no other option but to delegate its custody duties to a third party. This shall be the case if the law of the third country requires that certain financial instruments are held in custody by a local entity – and local entities exist that satisfy the detailed delegation criteria of the AIFMD

– or the AIFM insists on maintaining an investment in a particular jurisdiction despite warnings by the depositary as to the increased risk this presents.

### **Third country implications and recent developments**

AIFMD affects all fund managers worldwide who market non-UCITS funds (eg. hedge, private equity, venture capital, real estate and other alternative investment funds) in the EU, or who are managing an EU-domiciled fund.

For an initial period following the transposition of AIFMD, the marketing of non-EU AIFs managed by EU AIFM, and EU and non-EU AIFs managed by non-EU AIFM to investors in the EU, will continue to be permitted under national marketing rules or private placement regimes. EU AIFMs managing non-EU AIFs marketed to professional investors in the EU will then have to comply with the AIFMD, except for the full depositary provisions. However, they will need to ensure that one or more entities are appointed to perform the cash monitoring, safe-keeping and oversight duties, which cannot be performed by the AIFM.

Non-EU AIFM managing EU AIFs or non-EU AIFs that are marketed in the EU will need to comply with the transparency requirements (annual report, investor disclosures, regulatory reporting) and the major holdings and control requirements of the AIFMD from July 2013. However, there have been recent discussions on whether or not non-EU AIFMs could also benefit from the grandfathering rules set out in the AIFMD. It remains to be seen how national regulators (and ESMA) are going to position themselves on this.

The AIFMD also requires appropriate co-operation arrangements for systemic risk monitoring purposes to be in place between the competent authorities of

the Member States where the AIFs are marketed, and those of the non-EU AIFM and non-EU AIF. Co-operation arrangements are also needed in case of delegation of portfolio or risk management tasks to an enterprise in a third country.

ESMA is currently negotiating on behalf of all EU Member States with regulators in relevant third country jurisdictions to reach agreement, in the form a memorandum of understanding (MoU) based on the templates produced by IOSCO. ESMA originally intended to agree MoU with regulators in the key non-EU jurisdictions in advance of the July deadline. Writing only weeks away from this date, it currently seems as if ESMA might not be able to reach agreements with all relevant regulators in time. A political solution to this legal problem could be found in the formal extension (or wider interpretation) of the grandfathering provision. It remains to be seen how ESMA is going to deal with this issue.

The Marketing Passport is expected to be available to EU AIFMs marketing non-EU AIFs, and to non-EU AIFMs marketing EU or non-EU AIF in the EU from (at the earliest) late 2015. However, this is subject to positive advice and opinion from ESMA and a legislative act to be adopted by the European Commission. Non-EU AIFM that manage EU AIF should be aware that, assuming the passport regime is activated in late 2015, they will at that time need to apply for full authorization. The non-EU AIFM will have to submit an application file to the competent authority in its EU Member State of Reference (MSR) to become authorized and the application file will also need to include an explanation as to how the fund manager determined its MSR. Key determinants are where

the AIFM intends to develop its effective marketing, where most of the EU AIFs are established and where the greater amount of assets are managed. The fund manager is also required to appoint a legal representative established in the MSR. The legal representative will act as the point of contact for the non-EU fund manager in the EU for official correspondence between the competent authorities, the investors and the non-EU fund manager.

#### Reporting and transparency

The reporting and transparency requirements of the AIFMD are vast and also apply to non-EU managers that are marketing AIF in the EU under the national marketing rules or private placements regimes. Annual reports for each AIF managed need to be made available to competent authorities within six months of the financial year end of the AIF and to investors on request. The annual report must include audited financial statements, a report on the AIF's activities over the financial year and must be prepared in accordance with the accounting standards of the jurisdiction where the AIF is established and must be audited in accordance with international standards. Probably the most sensitive area of the annual report will be the information relating to staff remuneration. These disclosures must include the total amount of remuneration (split into fixed and variable) to be paid to the AIFM's staff, the number of beneficiaries, carried interest paid by the AIF and the aggregate amount of remuneration broken down by senior management and members of staff of the AIFM whose actions have a material impact on the risk profile of the AIF. The AIFMD also sets out a list of

information that must be disclosed to investors prior to investment including the AIF's investment strategy, restrictions and risks, the circumstances in which the AIF may employ leverage and detail on the types and sources of leverage used, the valuation procedure and pricing methodology, and the approach to liquidity risk management. In addition to the prior investment disclosures AIFM will also have to periodically disclose to investors information on risk and liquidity management. The implementing measures have further specified the information to be disclosed and the list includes disclosures on the percentage of assets which are subject to special arrangements due to their illiquid nature, liquidity information regarding the AIF, the risk profile of the AIF and the risk management systems employed by the AIFM.

One of the most onerous requirements of the AIFMD will be the regular reporting to competent authorities. AIFMs will have to provide detailed information to the competent authorities of their home Member State in order to enhance the ability of regulators to identify, assess, monitor and manage systemic risk effectively. Fund managers marketing under the national marketing rules or private placement regimes will even need to report to each EU Member State where the AIF is marketed. Reporting will be semi-annual or quarterly for managers, depending on size. In respect of unleveraged PE/VC AIF there will be only annual reporting. The reporting templates are contained in Annex IV of the Level 2 Regulation. The information required is similar in some ways to Form PF, which US managers will be familiar with. However, AIFMD reporting differs from Form PF, not only in terms of format, but also regarding certain technical aspects

involved, such as the calculation of the assets under management (AuM) and leverage. In practical terms, aggregating all the necessary information to report to the competent authorities will be a real challenge for all fund managers.

*One of the most onerous requirements of the AIFMD will be the regular reporting to competent authorities. AIFMs will have to provide detailed information to the competent authorities of its home Member State in order to enhance the ability of regulators to identify, assess, monitor and manage systemic risk effectively.*

# ASPAC

## The search for stability...



### China

When the Qualified Domestic Limited Partner (QDLP) quota plans were announced in December 2012, the plans caused a surge of excitement among foreign hedge funds in China. The system would complement the qualified foreign limited partner system trialed in Shanghai since 2011. The system allows foreign hedge funds to raise yuan capital (subject to a quota) on the mainland to make investments in overseas securities.

Once QDLP is implemented, total initial investment between USD3 billion and USD5 billion will be permitted, with the proposed individual-investor minimum threshold set at approximately RMB20m.

Under the scheme, qualifying foreign hedge funds must be registered with local authorities before they can convert yuan funds that they will be allowed to raise from mainland high-net-worth individuals into foreign currencies for securities investments in foreign markets.



### Japan

In Japan, as a result of the AIJ scandal involving the 'disappearance' of pension assets, the JFSA tightened several regulations including:

- the obligation for investment management companies to inform their clients whether they were audited by external auditors, prior to contracting with the client;
- improvement of disclosure; and
- enhancement of supervision, inspection and sanctions (for misconduct, misstatement, misreporting and miscalculation).

Meanwhile, there is a strong perception that investment skills of institutional investors such as pension funds are not at a sufficient level. To counter these problems, there are expectations of significant reforms in the Japanese pension system, including major restructuring of employee pension schemes.

The JFSA's working group report also emphasized the importance of diversifying financing methods, improving stability of financial system, and enhanced stewardship of funds. To achieve these goals, the working group has suggested tools such as rights offering and reduction of capital without compensation to stabilize the financial system. They also suggested the inclusion of trades of investment unit of funds into insider trading regulations.

Additionally, they are considering making the limited-time ban in naked short selling a permanent measure. These measures and policies may expand the financing methods of alternative funds, but simultaneously place more regulatory burden upon them. A permanent ban on naked short selling would narrow the investment strategy of such funds, and the expansion of insider regulation of investment unit trading may affect the real estate sector because real estate companies which sponsor real estate funds would be covered by this regulatory scheme.

The Japanese REIT market is expected to receive a boost however with an easing of the restriction on holding the voting rights of overseas-domiciled special purpose companies (SPC) by non-Japanese entities. This will allow investment corporations to acquire more overseas real estate assets.

# 05

## Governance and responsibility



## Evolving corporate governance in financial services – lessons for the investment management industry

### What makes good corporate governance?

The Organisation for Economic Co-operation and Development's (OECD) 2004 Principles of Corporate Governance<sup>8</sup>, created as "a guide for exchanges, investors, corporations and others that have a role in the process of developing good corporate governance", define corporate governance as "Procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization – such as the Board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making."

### Governance – underlying principles

Good risk management policies and effective governance are inextricably linked, as the OECD pointed out in 2009, "Deficiencies in risk management and distorted incentive systems point to deficient Board oversight." The pressure is on for senior individuals to be implicitly responsible for their actions, with clear accountability for risk-taking. They also emphasized the clear accountability of the Board, "Risk policy is a clear duty of the Board in any organization."

Across financial services, senior management have to ensure they give appropriate attention to the full breadth of risks arising from their activities. But the key issue here is accountability. The

8. OECD Principles of Corporate Governance, OECD, 1999 – revised 2004.

*Poor standards of corporate governance were one of the causes of the financial crisis, so, understandably, policymakers and regulators have been actively building a framework of a more robust and challenging set of standards.*

### Regulatory Developments in Corporate Governance

<b>Global</b>	<ul style="list-style-type: none"> <li>• G20</li> <li>• Financial Stability Board (FSB)</li> <li>• International Monetary Fund (IMF)</li> <li>• Financial Action Task Force (FATF)</li> <li>• Basel Committee on Banking Supervision (BCBS)</li> </ul>
<b>United Kingdom</b>	<ul style="list-style-type: none"> <li>• Walker Review of Corporate Governance of UK Banking Industry</li> <li>• UK Corporate Governance Code (2009)</li> <li>• Guidance on Audit Committees (2010)</li> <li>• Going Concern and Liquidity Risk: Guidance for Directors of UK Companies</li> <li>• UK Stewardship Code</li> <li>• HM Treasury, Sanctions for the Directors of failed banks, Consultation Paper (July 2012)</li> </ul>
<b>USA</b>	<ul style="list-style-type: none"> <li>• Dodd-Frank Wall Street Reform and Consumer Protection Act (July 2010)</li> <li>• Study and Recommendations on Prohibitions of Property Trading and certain relationships with Hedge Funds and Private Equity</li> </ul>
<b>EU</b>	<ul style="list-style-type: none"> <li>• European Commission – Green Paper on Corporate Governance in Financial Institutions and remuneration policies (June 2011)</li> </ul>
<b>Australia</b>	<ul style="list-style-type: none"> <li>• Amendments to the Corporate Governance Principles and Recommendations (2010)</li> <li>• Listing Rule amendments about Trading policies and Remuneration Committees (2010)</li> </ul>
<b>South Africa</b>	<ul style="list-style-type: none"> <li>• King Report on Corporate Governance III (September 2009)</li> <li>• Amendments to the Fit and Proper requirements (2010)</li> </ul>
<b>Cayman</b>	<ul style="list-style-type: none"> <li>• Cayman Islands Monetary Authority (CIMA) request for comments on corporate governance standards</li> </ul>

pressure is on for senior individuals to be implicitly responsible for their actions, with clear accountability for risk-taking.

They also have to assess whether their existing governance framework is effective in defining clear accountabilities for identification, measurement and management of risks and controls in their business.

#### Another regulatory avalanche...

Poor standards of corporate governance were one of the causes of the financial crisis, so, understandably, policymakers and regulators have been actively building a framework of a more robust and challenging set of standards. There is still strong public feeling on financial risk – borne out of public anger at the banking bailouts and the perceived causes of the

financial crisis. The sentiment that firms ‘need to be safer’ pervades the financial sector, and asset management is no exception. In response to the crisis, there has been an avalanche of new corporate governance regulatory proposals across the financial services industry, some examples of which are illustrated in the table above. There are a number of different regulatory initiatives taking place across the globe, raising concerns about the lack of harmonization across these regulations.

#### Changing cultures and behaviors

Regulation is attempting to address cultural issues and the need to curb excessive risk-taking in financial services. Governance measures are intended to heighten the focus of Boards and

senior management on risk; remuneration measures are designed to reduce the incentives for inappropriate and excessive risk-taking; and conduct measures increasingly focus on both the design and distribution of financial products and on the incentives of customer-facing sales and advice staff. Increased measures around investor protection go some way to address adapting behaviors to a greater focus on the investor, helping shift both investment and banking models towards a better investor focus and alignment. But culture and behavior – and indeed, public perception – will not be changed purely through regulation – a lesson that the banking industry, for example, has learned the hard way...

*Compliance still creates opportunities... It is no secret that those organizations that ensure a high level of risk control, management and governance will be the first-movers, best place to tackle this new world order.*

There are clear global trends developing around governance, including:

### 1. Composition

- **Independents** – The percentage of Independent Directors (IDs) has increased.
- **Time commitment** – A cap on multiple directorships. For example, in 2011, some Cayman hedge fund Board directors were found to sit on hundreds of different Boards, which is clearly not sustainable and not conducive to individual accountability and appropriate risk assessment. This brings back to light past scandals such as the mutual funds scandal in the US in 2003, where charges were brought against directors; and in the UK in the 90s, where senior individuals were criticized and brought to court for taking too many Board-level appointments.<sup>9</sup>
- **Diversity** – Pressure to increase Board diversity, eg. gender, race, disability.
- **Re-election** – Annual election of directors to focus on performance.
- **Financial industry experience** – More IDs with financial services experience. “Among the lessons learnt since 2007 is that bank Boards need to have some non-executive directors who understand risk in financial institutions and can grasp the complexities of financial products and financial plumbing.”<sup>10</sup>

### 2. Culture and behaviors

- **Board leadership structure** – A ‘comply or explain’ approach for combined CEO/Chairman roles.
- **Focus on culture** – Expectations from stakeholders for the Board to set the right culture.

### 3. Risk management

- **Risk Committee** – A requirement to have a separate Board risk committee.
- **Setting the tone at the top** – Define organizational risk appetite appropriately and manage risks effectively.

### 4. Remuneration/compensation

- **Pay for performance and pay for prudence?** – A trend towards pay being aligned to prudent risk taking.
- **Long-term incentives** – Directors’ wealth tied into company via share ownership (as opposed to cash bonuses) – aimed at preventing short-term risk-taking.
- **Clawback for poor performance** – A trend toward clawing back bonuses from Directors for poor outcomes.

### Compliance still creates opportunities...

It is no secret that those organizations who ensure a high level of risk control, management and governance will be the first-movers, best placed to tackle this new world order. Compliance should not just be considered for compliance’s sake, or just for specific rules. Instead, it should be viewed and considered as a whole, across regulations and legislation, and fully embedded in the organization’s culture and behavior.

Investment firms should move away from short-term thinking and develop long-term investment strategies that use realistic assessment of both the risks and opportunities that lie ahead. While doing this, senior management need to be clear about their responsibilities for risk and accountability in providing advice to investors.

## Governance in Investment Management

The most notable recent development in governance in the asset management industry comes through the AIFMD Remuneration rules, which:

- discourage ‘inconsistent’ risk-taking;
- set performance in a multi-year framework;
- have balanced fixed and variable components of remuneration: at least 50 percent in shares/units in the AIF concerned;
- a proportion deferred for a minimum of three to five years; and
- AIFMs that are significant in terms of size or assets should have a remuneration committee.

See **Chapter 4 – Institutional Perspectives** on pages 36–42; and **Chapter 6 – Remuneration** on pages 48–50 of this publication for more detail on the AIFMD.

9. Cayman directors sit on hundreds of Boards, Sam Jones, FT, November 2011

10. The divine right of the imperial CEO, Jon Plender, FT, 26 May 2013



# ASPAC

## Enhanced accountability and supervision



### China

The news of the CSRC entering into a Memorandum of Understanding (MoU) with the US Ministry of Finance (MOF) and the Public Company Accounting Oversight Board (PCAOB) has opened a new avenue for enforcement cooperation which was a long time in the works.

The May 2013 MoU established a cooperative framework for the exchange of audit documents relevant to investigation in both countries' respective jurisdictions. The MoU is a significant step in China-US audit oversight cross-border enforcement cooperation, and paves the way for cross-border enforcement assistance.

The CSRC and MOF will continue to seek a mutually recognized way of regulating Chinese accounting firms that provide auditing service to companies trading on US exchanges.



### Australia

In March 2013, the Australian Securities and Investments Commission (ASIC) released a Consultation paper and proposed regulatory guidance on risk management practices for responsible entities in the managed funds sector. ASIC's proposals, which reflect international standards and developments in risk management, came about after a review by ASIC which found that most responsible entities indicated that their risk management

system did not change as a result of the global financial crisis. The proposals aim to help responsible entities to better manage the risks they face as responsible entities, especially in relation to operating scheme(s).



### Japan

After the AIJ Scandal, JFSA tightened the regulations, supervision and inspections relating to investment management companies by:

- enhancement of JFSA filings of investment management companies (documentation of fund schemes, external audits, and key performance indicators for past three years);
- mandatory preapproval by the Board of the Investment Management Company for trades with a party such as the parent company, a subsidiary, affiliates or certain shareholders where there may be a conflict of interest;
- enhanced scope of supervision and inspection; and
- small and medium-sized investment companies, and REITs which do not have sufficient internal controls, may be heavily affected by these regulations due to cost of compliance.

*The Memorandum of Understanding is a significant step in China-US audit oversight cross-border enforcement cooperation, and paves the way for cross-border enforcement assistance.*

# 06

## Remuneration



### EMA

## Strategic and practical considerations

Flexible resourcing and remuneration models are in increasing demand in the investment management industry, to better align costs to revenues and provide the capability to quickly scale up and down with demand. This is against the backdrop of:

- Remuneration policies of financial institutions remaining high in the political agenda – and remaining so for the near future.
- Additional impetus from the wave of global regulatory reform designed to address issues from systemic risks to investor protection and to improve transparency, corporate governance and tax compliance.
- The need to attract, retain and develop high quality, commercially minded employees who are alert to opportunities and threats and support the execution of the broader strategy.
- Banks aggressively searching for the same capabilities as investment management organizations with the ability to offer higher base salaries.
- Challenges of balancing the competing demands of global, regional and national regulators and the increased costs of compliance.

*The regulations will require investment management firms to make changes to the structure and governance of remuneration, and will become subject to a new disclosure regime.*

The re-regulation of financial services in the wake of the financial crisis will clearly have a significant effect on the investment management industry. As regulators focus on prudential management, conduct of business and financial stability, they are also – for the first time – directly addressing the issue of remuneration.

For investment managers in Europe, this focus on remuneration will mainly be felt through the new AIFMD.

### Aims

The expressed aim of AIFMD's remuneration related Guidelines is to promote effective risk management. However, this aim should also be set in the context of the wider debate about the role of alternative fund managers in the financial markets, the purpose they serve and the benefits they bring, and the wider questions regarding the levels of pay in the financial services sector. While the fund management industry has not received the level of public opprobrium that the banking industry has received, they have not been immune from criticism; and within the European Union, their role and behavior – including the role of incentives and levels of remuneration – are likely to come under continued heavy scrutiny.

### Key Requirements

The regulations will require investment management firms to make changes to the structure and governance of remuneration, and will become subject to a new disclosure regime. In-scope firms will be required to have remuneration policies that 'promote effective risk management', while at the same time being able to take risks in line with their investment objectives. The remuneration requirements will primarily apply to employees whose role has a material impact on the risk profiles of the

firm or the funds under management ('identified staff'). The requirements cover the following areas:

- Remuneration policy – should be consistent with and promote sound and effective risk management.
- Remuneration structures – specific requirements in relation to the funding and delivery of variable remuneration (a portion of the variable remuneration for identified staff must be deferred for between 3–5 years, unless the lifecycle of the fund is shorter. Of the total variable remuneration at least 50 percent must be in the form of equity instruments linked to the performance of the funds managed. The variable remuneration should be determined by performance of the funds, the business unit and the individual combined), ratio between fixed: variable remuneration, guarantees, severance pay and personal hedging strategies.
- Remuneration governance – requirement to set up a Remuneration Committee dependent on size.
- Control function remuneration – remuneration should not create conflicts of interest and variable remuneration should be based on function-specific performance.
- Reporting and disclosure – aggregate remuneration disclosure in the annual report for investors and external disclosure of overall policy and decision-making process.

ESMA has introduced various anti-avoidance measures to ensure that the regulations capture the intended firms, individuals and forms of remuneration. The provisions also introduce the concept of applying 'malus' or 'clawback' provisions for remuneration. These concepts will be familiar to many in, for example, the banking sector, where they have become a feature of packages post-

crisis. However, it remains unclear how they will work in practice in other industries and for a wide population of staff.

### Implementation

Given the short deadline, many firms are already preparing for the introduction of the regulation, including identifying the entities and the staff that will be caught and formulating a joined up approach between the business, compliance and human resources. During the transition period, firms are expected to make 'best efforts' to comply with the remuneration provisions – all firms must be fully authorized by July 2014.

As with many EU regulations, AIFMD contains scope for proportionality, based on three areas:

1. The size of the AIFM and funds under management.
2. The legal structure, the complexity of the internal governance structure and the nature of ownership (eg. listed on a regulated market).
3. The type of activities it undertakes, its investment strategies and whether it operates cross-border.

*Perhaps one of the most significant challenges of AIFMD will be managing compliance in an environment of overlapping regulation.*

### The complexities of overlapping regulations

Perhaps one of the most significant challenges of AIFMD will be managing compliance in an environment of overlapping regulation. Firms caught by AIFMD may also be subject to UCITS 5, MiFID 2 and CRD 4. CRD 4 already contains firm proposals on remuneration, including a cap on the ratio between fixed and variable remuneration. UCITS 5 and MiFID 2 are currently at the proposal stage, but the drafts contain a variety of remuneration-focused proposals.

Following a Consultation Paper issued in September 2012, ESMA has just published in June 2013 its final Guidelines on Remuneration Policies and Practices under MiFID.<sup>11</sup> These Guidelines will not only apply to MiFID investment firms, but also to credit institutions providing investment services listed in MiFID – as well as UCITS management companies and external AIFMs providing the investment services of individual portfolio management or non-core services.

The multitude of regulatory requirements is likely to make for a complex environment in which firms' Operations, Legal, Compliance and Human Resources functions need to work together, to ensure that the rules are abided by in a way that still allows for the efficient operation of business.

### Implications for Investment Managers

The strategic and practical priorities for asset management organizations can be summarized as follows:

- A culture that starts with leadership behaviors, values and clarity and continuity of organizational priorities – embedded using structure, process and training and passed on over time through stories of successes, failures, doing the right thing and doing things right- reinforced through incentives.
- Connecting performance and reward with the strategy, priorities and value drivers of the organization through bespoke incentive arrangements – linking funding and payouts to fund, desk, subsidiary performance rather than the organizations'.
- Focusing on the non-financial dimension when competing for high caliber talent such as providing an entrepreneurial culture in a relatively stable environment.
- Embedding effective risk management into remuneration structures.
- Commercially-driven arrangements that minimize the effective tax rate for both employees and the organization.
- Embracing regulatory initiatives early on – seek the opportunities rather than focusing on the challenges – respond and act quickly ahead of the competition.
- Avoiding fragmentation as a result of varying regulations in different countries.
- Ensuring robust governance arrangements are in place including the role of control functions.

11. ESMA/2013/606, 11 June 2013]

# ASPAC

## All under control?



### Australia

The Australian Future of Financial Advice (FoFA) reforms will see the introduction of a ban on conflicted remuneration, including commissions. This means that licensees and authorized representatives will not be allowed to give or receive payments or non-monetary benefits if the payment or benefit could reasonably be expected to influence financial product recommendations or financial product advice provided to retail clients. Exceptions to the ban on conflicted remuneration are provided in certain circumstances. Volume payments (payments dependent on the total number or value of financial products of a particular class or classes) will be presumed to be conflicted but it will be open to advisers to prove that they are not. This reform will encourage financial advisers to become more client-focused, as more of their fees will be paid directly by the client rather than indirectly through product commissions.



### Japan

While there is currently no specific regulation governing the amount or payment of executive remuneration in Japan, JFSA holds supervisory powers over the remuneration system of financial institutions. If the reward system is deemed to potentially enlarge an institution's risk appetite beyond what is considered reasonable, the JFSA can request the institution to reform its system. There is also a disclosure obligation of high salaries, requiring financial institutions to disclose both the number of highly remunerated individuals and the amounts. In general, the remuneration system in Japanese financial institutions tends to be based on regular wages and is not considered to directly lead the financial institutions to take higher risks. Therefore, the JFSA's power over remuneration has had an impact only on a small number of institutions and attracted relatively little interest from the industry.

*The Australian Future of Financial Advice will encourage financial advisers to become more client-focused, as more of their fees will be paid directly by the client rather than indirectly through product commissions.*



# 07

## Capital markets and infrastructure



## EMA Coping with uncertainty at the 11th hour

The Alternative Investment Fund Manager's Directive (AIFMD) and European Market Infrastructure Regulation (EMIR) are the two latest regulatory changes to have imminent impacts on the investment management industry. However, in both cases, although the regulation is in force, there is still uncertainty as to how capital market participants will comply in practice. This is due in part to the varied timetables for transposing AIFMD from various Member States and the phased implementation of the requirements within the regulatory technical standards (RTS) for EMIR.

### Keeping client assets safe

One of the most important aspects of both Directives is the safe-keeping of investor's assets, to ensure a Madoff-like incident does not occur again. However, asset ownership and protection rules are not harmonized across the EU and add another level of complexity for investment managers in complying with both Directives. In relation to AIFMD, prime brokers and depositaries are still trying to put in place day-to-day working practices that can adhere to the depositaries' onerous liability for safe-keeping of these assets and having oversight of risk. Until now, prime brokers could exercise rights of use over client assets in accordance with contractual arrangements, without having a depositaries' oversight. The depositaries' ability to discharge unlimited liability (while remaining responsible for the oversight of activities undertaken) with objective reasons; and having the prime as sub-custodian may be options, but Member States have already indicated the bar for permitting this be set high.

### Opening up the lines of communication

With regard to EMIR, many investment managers will need to have indirect clearing arrangements in place to clear OTC derivatives. Many have not appreciated the significant addenda and repapering of agreements that will be required to ensure that such agreements are put into place and that client assets are held in segregated or omnibus accounts at Clearing Members according to their client's best interests and wishes.

While investment managers' service providers are busy trying to understand how they will work together in the new regulatory landscape and how much they will charge, investment managers are patiently waiting for official communication. There has been some consolidation and alliances formed between services providers in the industry, but there is a question of whether this could potentially increase counterparty and concentration risk? For example, if a depository only wants to work with a limited number of prime brokers, could this create another too big to fail situation?

Some member state regulators, such as the UK Financial Conduct Authority (FCA), have realized that this may be a problem and to an extent have tried to consider this through their 'Dear CEO' letters to investment managers on the topic of outsourcing. Overall, it is recognized that there is no simple solution.

Regulatory Technical Standards (RTS) for EMIR came into force on 15 March 2013, but requirements will be phased in, starting with risk mitigation for non-cleared OTC derivatives.

### Trading and product strategy

Another significant impact of emerging regulation from a capital markets perspective is on investment managers' trading and product strategy. The increased scrutiny on the 'shadow-banking' sector will no doubt re-shape how market participants interact with each other. The current draft of the Money-market regulation requires managers of cNAV funds to hold a three percent buffer against the NAV of the fund, which could have a negative impact on this type of product and its availability in the market. There may also be unintended consequences, as banks are some of the biggest users of money market funds to assist with liquidity and short-term financing needs. The February draft of the Financial Transaction Tax (FTT) would also have impacts on the trading of instruments of any institution within the 11 Member States currently signed-up; reducing liquidity and subsequently increasing the cost of capital.

EMIR will also affect the trading of OTC derivatives, particularly the collateral requirements and being able to post appropriate collateral. Investment managers face a tough choice of either holding more cash or appropriate instruments that can be used as collateral in the fund which may drag on performance, or paying fees for collateral transformation services from banks. There has been extensive media coverage of a potential collateral crunch which may also be a consideration in the minds of investment managers.

EMIR will have a number of other impacts on investment managers. In particular, market participants will be required to report transactions in exchange-traded and OTC derivatives to Trade Repositories (TRs); the obligation for which will be phased in

during 2013–2014. Firms will need to consider their contractual relationships with TRs, and also whether their existing data repository and infrastructure is capable of meeting the requirements.

Non-cleared OTC derivatives will be subject to additional risk mitigation techniques. In particular, most transactions will need to be collateralized, confirmations will need to be sent in a timely manner and contracts will need to be marked-to-market/model on a daily basis. The collateralization of transactions will carry a number of opportunity costs and the impact to profitability on existing products and services will need to be modelled.

### MiFID 2 – uncertain outcomes?

Following 18 months of lengthy discussions in the European Council, progress was made and an initial 'General Agreement' reached on 14 June 2013, enabling the next stage, Trilogue negotiations, to begin.

Changes to reporting requirements – particularly pre- and post-trade transparency – the requirements to trade OTC derivatives on regulated trading venues; position limits; data consolidation; and access requirements of CCPs will have significant impacts on markets. The definition and regulation of algorithm trades – as well as the requirement to provide liquidity in these markets – will be of significant importance to a number of hedge-funds and investment managers.

Investment firms should now start to consider how their service provider arrangements and business models may need to change in response. Final rules and compliance deadlines are still anticipated for 2015, depending on the outcomes of the Trilogue negotiations.

# Americas

## Evolving slowly...

The landscape for Capital Markets regulatory initiatives is evolving slowly. OTC derivatives continue to be defined by incremental changes in regulations. In addition, there is continued uncertainty around major regulations such as the Volcker rule. Last year, KPMG in the US stated that the Volcker rule would ultimately be enacted in some form, which we still believe will happen. However, the end result of all the commentary surrounding the Volcker rule remains unclear. We hope that, in its final form, Volcker does not have a significant impact on liquidity in the marketplace, or the unintended consequence of having unregulated entities be the provider of liquidity and possibly add more systemic risk to the system.

### Significant movement in derivatives markets

KPMG member firms have seen some significant movement in the OTC derivatives space during the past year. The first – and perhaps most significant – event for the industry was the Securities Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) working together to finalize rules on defining a Swap Dealer and a Securities-Based Swap Dealer (SBSD); as well as definitions for Major Swap Participants (MSPs) and Major Securities Based Swap Participants (MSBSPs). That was followed by the final product definitions of a Swap and a Securities Based Swap. These new rules provided a basis for entities to determine whether they meet the requirements to register. Based on the finalization of these rules, firms that met the registration requirements of a Swap Dealer began to register with the CFTC on 31 December 2012.

### New reporting and clearing requirements

Real-time trade reporting and historical trade reporting for Swap Dealers began with the first stage of registration and, for the most part, all transactions are currently reportable by Swap Dealers. Reporting for transactions where both parties are not swap dealers will phase in during the remainder of the year.

The requirement for centralized clearing of Swap transactions for certain defined products started in March 2013 for transaction between Swap Dealers. By September 2013, all transactions in these defined products will be required to be centrally cleared, except where one party can avail themselves of the commercial end user status. We anticipate that additional products will be approved for clearing as the process matures, which will lead to greater transparency in the marketplace. Regulations for Swap Execution Facilities are being finalized; and we anticipate exchange-like trading to commence by early 2014.

Registered swap dealers currently have no financial reporting responsibilities. Although the CFTC proposed capital and margin rules in 2011, the final rules have not been approved. The SEC proposed their margin and capital rules in November 2012; and there appear to be significant differences between the two regimes. The industry has provided comments, with a strong emphasis on harmonization.

The SEC has not yet finalized their rules – so Security Based Swap Dealers have not registered, and trade reporting and mandatory clearance have not started for Security Based Swaps.

### Extra-territorial concerns

In addition to the above issues, rules defining extra-territorial reach are still being developed by both the CFTC and the SEC – and the impact on non-US entities is still to be determined.

### Adapting systems, infrastructure and business models

In the meantime, as the dealer community absorbs the costs of expanding their databases and making other expensive changes in infrastructure to comply with the new regulations, these firms are also examining their portfolios to determine what products or lines of business may not remain profitable enough to continue selling. For example, in the past, a swap dealer could ask for collateral from a client; and perhaps use that collateral to hedge the dealer's transactions. Eventually, dealers will not be able to use collateral from customers. In fact, dealers will have to post their own collateral. As a result, margins for these dealers will be lower.

### Increasing costs – inevitable?

None of these developments come as a surprise to investment managers who transact in OTC derivatives, because they understand that greater transparency and new rules for clearing trades were inevitable, in order to reduce risk and restore confidence among investors. However, these managers should keep in mind that changes in transparency and clearing have only just begun. As more products are subject to clearing; and as exchange-type executions evolve – as well as further refinement of the regulations – further infrastructure cost will be warranted, along with the additional cost of compliance.



# ASPAC

## Developments in the exchange landscape



### China

Considering the high interest from foreign investors to invest in China's capital markets, the CSRC issued details of a revised Pilot Scheme framework to allow inbound securities investments by Renminbi (RMB) Qualified Foreign Institutional Investors in March 2013.

In the revision, the CSRC has recognized the importance of Hong Kong's role as an international financial hub and the need to facilitate the development of Hong Kong's offshore RMB market to further open China's domestic capital markets.

While a similar scheme (Renminbi Qualified Foreign Institutional Investor or RQFII) had been in existence previously, the new framework allows a more diverse range of institutions to participate, opening the doors to Hong Kong subsidiaries of Chinese commercial banks and insurance companies – and financial institutions registered or having their principal place of business in Hong Kong. Another upgrade is a relaxation of restrictions on investment scope, allowing more discretion to the scheme participants on products to be included.

The revisions also specify relevant requirements on the investment scope and shareholding ratio; and streamline application procedures.



### Japan

In January 2013, Tokyo Stock Exchange and Osaka Stock Exchange merged to form the Japan Exchange Group, the largest exchange in Japan. This exchange aims to become a significant market for both securities and derivatives, looking to compete globally by implementing sophisticated infrastructure to handle high frequency trading and OTC clearing.

The industry's Self Regulation Committee represented by the Japan Securities Dealers Association shortened the span of trade and settlement of Japanese Government Bonds (JGB) from three days to two days in April 2012. They further plan to shorten it to one day. They also aim to encourage market participants to use a JGB clearing house such as Japan Government Bond Clearing Corporation (JGBCC) to improve and expand their liquidity financing capabilities. In addition, the Committee is promoting the digitalization of stock lending infrastructure.

As mentioned in **Chapter 4**, the ban on naked short selling is in place until October 2013. The JFSA is considering making this ban a permanent measure.

*None of these developments come as a surprise to investment managers who transact in OTC derivatives, because they understand that greater transparency and new rules for clearing trades were inevitable, in order to reduce risk and restore confidence among investors.*



# 08 Tax

## EMA Significant European and global tax challenges

### Foreign Account Tax Compliance Act (FATCA)

The US FATCA regime has created a new reporting framework, which is designed to compel non-US financial institutions to identify and report to the Internal Revenue Service (IRS) those relationships they have with US clients, investors and counter-parties.

FATCA presents a range of challenges due to the outsourced model in the investment fund industry. In order to comply with FATCA, co-operation and reliance on various parties in the value chain such as managers, distributors, fund administrators and transfer agents will be required. Furthermore, uncertainty remains around some aspects of the regime.

Recent FATCA publications show that US authorities are willing to make FATCA implementation workable for asset manager. Nevertheless, most global distribution models still not elect for an exempt statute, a so-called 'deemed-compliant statute', drafted to relieve institutions representing low risk of tax evasion from important compliance obligations. Time is running out, as asset managers have to define the FATCA statute for themselves and their investments funds under management, have to register and have to comply with the FATCA regime as of 1 January 2014.

### Global implications of FATCA

The changes contained in the final regulations, which will have implications

across global investment management, mean that more entities in the fund management business model are considered Foreign Financial Institutions (FFIs). The regulations previously explained that an FFI was a business that:

- as a substantial portion of its business, holds financial assets for the account of others; or
- is engaged primarily in the business of investing, reinvesting, or trading in securities, commodities, and other contracts including any interest in such contracts (including a futures or forward contract or option).

Now the definition has changed to include an 'Investment Entity', which

*Time is running out, as asset managers have to define the FATCA statute for themselves and their investments funds under management, have to register and have to comply with the FATCA regime as of 1 January 2014.*

means 'any entity that conducts as a business (or is managed by an entity that conducts as a business) trading, portfolio management, or investing, administering, or managing funds for or on behalf of a customer' – this now means that investment managers and administrators are considered to be an FFI, in addition to the funds and custodians under the draft definitions.

#### **Intergovernmental approach**

In an effort to simplify FATCA implementation, US have started negotiating bilateral agreements, so-called 'intergovernmental agreements', aiming to get the cooperation of local authorities to fulfill the objectives of FATCA. In return to transposing FATCA into national law, local authorities should be more flexible in interpretation for specific country requirements. Two different models of bilateral agreements have recently been developed. The first involves an information exchange process on an intergovernmental level, whereas the second, in contrast, foresees that each foreign financial institution reports directly to the US authorities. To date, the US is negotiating with over 75 different countries. Most European countries have preferred to enter into an intergovernmental agreement, to reduce the FATCA administrative burden for their local financial institutions. Asset managers in multinational groups will face the risk that they have to monitor, analyze and apply different set of rules, depending on where the related entities are incorporated.

#### **European FATCA**

On a European level, five countries – Germany, Italy, Spain, France and the UK – engaged to develop a pilot multilateral exchange facility to enhance

automatic information exchange. To date, 16 countries already agreed to participate in this pilot program, which is based on the FATCA intergovernmental agreement that is currently negotiated by multiple countries with the US. The objective should be to promote a global system of automatic information exchange, removing the possibility to hide money from tax authorities.

#### **Financial Transaction Tax (FTT)**

During the EU ECOFIN debate held on 22 June 2012, it became clear that the European Commission's proposal for an EU wide Financial Transaction Tax (FTT) was not unanimously supported by Member States. Since then, the focus has shifted to possible adoption by a smaller group of Member States under the 'enhanced cooperation' procedure. On 14 February 2013, the European Commission issued a draft Directive for an FTT. To date, 11 Member States are looking to implement FTT under enhanced cooperation.

The FTT, which is supposed to enter into force from 1 January 2014, is a tax on financial transactions between financial institutions, including investment vehicles (ie. UCITS and AIF) charging 0.01 percent across derivative contracts and 0.1 percent against all other financial transactions, including, inter alia, the purchase, sale, redemption, exchange and repurchase agreement on financial instruments. However, primary market transactions, ie. subscriptions, would be exempted.

Under the proposals, a charge to FTT could be triggered under either the 'issuance' or the 'establishment' principle. Under the issuance principle, a financial institution – wherever they are based – will be charged FTT if they are party to a transaction involving financial instruments that have been issued by an

entity based in one of the 11 Member States that will make up the 'FTT zone'. The 'establishment' principle imposes FTT on financial institutions that are established in the FTT zone. Under the proposals, a financial institution will be deemed established in the FTT zone whenever it deals with a counterparty that is resident in one of the participating Member States. The operation of the 'issuance' and the 'establishment' principle means that FTT will impact financial institutions based outside of the FTT zone. The extra-territorial scope of FTT has also led the UK Government to launch a legal challenge against certain aspects of the proposed FTT rules.

The FTT is designed to cover a wide range of financial transactions, such as the purchase, sale and transfer of financial instruments, or the conclusion of derivatives agreements. There is no market maker or intermediary exemption under the proposed rules which means that there could be multiple charges to FTT arising when a transaction involves a chain of financial intermediaries that are operating in the capacity of principal rather than agent.

According to the European Fund and Asset Management Association (EFAMA), the impact of the FTT would have reached €13 billion, if applied at the start of 2011. Investors would have paid €4 billion on the redemptions of UCITS shares/units, whereas €9 billion would have been levied on the sales and purchases of securities by UCITS fund managers.

Based on the EFAMA study, the risk of double taxation for investment funds should not be underestimated. Asset managers should therefore begin to undertake impact assessments and monitor alternative strategies in order to minimize their potential FTT liability. The European Commission envisages

that FTT shall still become effective from 1 January 2014. For a variety of reasons, it is expected that this timeframe will have to be pushed back, although there have been no public announcements to this effect. It is also anticipated that the proposal will significantly change prior to implementation.

FTT could have a profoundly negative effect on many funds and it is to be hoped that the proposals are watered down prior to adoption.

#### **EU withholding tax reclaims**

Following the Fokus Bank case (Case E-1/04), investment funds which have suffered withholding tax on dividend income from EU and EEA countries can make a claim to the appropriate overseas tax authorities for that tax to be repaid to the fund, on the basis that the withholding tax was in breach of EU and EEA law allowing the free movement of capital. Furthermore, the 2009 Court of Justice of the European Union (CJEU) decision in the Aberdeen case (C-303/07) provides a solid basis for all investment funds, UCITS or non-UCITS to reclaim withholding taxes unduly suffered in the Member States where they have made investments.

Certain non-complying EU Member States have already been granting refunds for some time, such as Finland, Poland and Norway. In 2013, some major countries – such as France and Spain – have begun to grant reimbursements on this basis, such as France, and Spain while other are under increasing pressure to do so, especially Belgium, Germany and Sweden.

In the Santander case (C-338/11), which was decided in May 2012, the CJEU confirmed that the French withholding tax on dividends paid to foreign investment funds is contrary to EU law. However, the reason the case

is so significant is because two of the claimants were US funds and this is the first time the CJEU has been asked to accept such a claim by a non-EU fund. The wider implications of this decision on third country claims are potentially very far reaching.

In addition to the opportunity to obtain refunds and increase the investment return for all unit holders, given the dynamics of the topic, executives should carefully evaluate their options. In fact, protective claims have to be filed in order to safeguard the right of the fund to ask for a refund. Boards should document the decisions taken in this respect and closely monitor developments in the relevant jurisdictions.

#### **VAT consequences of AIFMD implementation**

According to article 135 (1) (g) of Council Directive 2006/112/EC the management of Special Investment Funds as defined by the Member States shall be VAT exempt. Thus, in many cases, funds subject to the supervision of a regulatory body, such as UCITS, benefit from a VAT exemption for management services. However, for Alternative Investment Funds (AIF), the legal basis is less specific. As the implementations of the above mentioned article 135 (1) (g) of Council Directive 2006/112/EC into national VAT Laws of the Member States do not include AIF, these funds should not benefit from the VAT exemption.

In light of the implementation of the AIFMD in the different Member States, it should be verified whether changes in local VAT Laws will affect the VAT rules applicable to AIF or not. An extension of the VAT exemption to AIF should impact the VAT recovery right.

As funds qualify as taxable persons, they are liable for VAT on services received from suppliers established

outside the country where the fund is established. Depending on where the fund is located, the standard VAT rates due on the above mentioned services will differ from 15 percent (Luxembourg) to 27 percent (Hungary). This demonstrates that it is quite important to consider VAT aspects as well, when choosing the perfect location of the set-up of new funds.

#### **Tax reporting**

Due to more stringent tax regulations, many European countries are currently experiencing a general reorganization of their respective tax regimes. The implementation of the AIFMD Guidelines into national law have significantly altered the landscape of the investment fund industry by now including alternative investment vehicles into regular taxation schemes. This poses both opportunities and challenges at the same time. National legislators may have differing positions on how alternative investment products are defined in accordance with their respective tax legislation.

As the tax scope of investment vehicles has broadened, the regulations governing these have become more intricate. Non-compliance can result in unfavorable lump sum taxation, producing unnecessary additional costs for investment managers by making their product less attractive to investors. Management should no longer consider tax as a purely operational issue, but should instead respond to the challenges with a global tax compliance strategy, taking into account the global regulatory developments and viewing the operational and strategic options across the business.

*The European Commission envisages that FTT shall become effective from 1 January 2014. For a variety of reasons, it is expected that this timeframe will have to be pushed back although there have been no public announcements to this effect. It is also anticipated that the proposal will significantly change prior to implementation.*

**Exchange of information/EU Savings Directive**

The European Directive (2011/16/EU) on administrative cooperation in the field of taxation should have been transposed into national laws as of 1 January 2013 – except for mandatory automatic exchange of information that should be implemented into national laws with effect from 1 January 2015.

In relation to exchange of information, the Luxembourg and Austrian governments have called for the EU

to delay any further discussions on a potential extension of the scope of the EU Savings Directive – as foreseen by the draft proposal presented by the EU Commission on 31 October 2008 – until a commitment on the automatic exchange of information has been obtained from Switzerland, Liechtenstein, Monaco, Andorra and San Marino, to be negotiated in the EU's agreements.



# Americas

## Increasing tax enforcement

The difficulties with key legislative initiatives illustrate the situation in many areas of tax law today: legislation is proposed that may trigger sweeping changes in rules for investors. Following this, either the laborious process associated with enacting legislation – or the increasing reliance of rule-making bodies to provide guidance to implement legislation – creates time-consuming delays or, in some cases, its early repeal. Is it any wonder that investors don't know where they stand?

Despite this lingering uncertainty, investment managers need to be ready to address the increasing number of tax enforcement initiatives that have been implemented; alongside those initiatives that are expected to continue to be enacted by the federal, state, and local legislatures – respectively subject to enforcement by the IRS as well as state and local tax authorities. FATCA provides one example of the need for investment firms to prepare for an uncertain future. The latest version of the most recent general guidance implemented under FATCA is almost 600 pages long. How these rules will affect clients will take time to determine. For example, given

FATCA's trans-national impact, no one can say how long it will take to work out the intergovernmental agreements associated with its intended global enforcement.

Because of its many complexities; and as implementation matters continue to remain unresolved in this latest FATCA guidance, the IRS may wish to consider to apply a phased-in enforcement period over the next few years. Despite all the uncertainty, KPMG member firms are advising clients to proceed as if the phase-in dates for the principal parts of FATCA will continue to remain on schedule, as they are currently scheduled. Only by doing so will clients be fully prepared to deal with FATCA, whatever happens.

When uncertainty pervades the landscape, investors – and their tax advisors – must take a broad and long-term view of any issue before deciding how to proceed. More than ever, investment firms must be open to engaging in a thorough analysis of multiple alternatives.

At the same time, firms must expect their tax professionals to be just as open-minded, and closely in touch with other

professionals whose advice may close certain doors and open others. This level of awareness has become increasingly important when evaluating many US federal tax rules governing the financial markets where certain definitions in such tax rules are driven by definitions in securities laws and corporate laws.

In a landscape characterized by continued delays and lingering uncertainty, everyone must look beyond the short-term costs and focus on how to achieve long-term benefits.

*When uncertainty pervades the landscape, investors – and their tax advisors – must take a broad and long-term view of any issue before deciding how to proceed. More than ever, clients must be open to engaging in a thorough analysis of multiple alternatives.*



# ASPAC

## Feeling the heat of regional and global developments



### Hong Kong

The Hong Kong Inland Revenue Department (HK IRD) has made allowances for acceptance of industry practices in the past, however in some instances this has resulted in inconsistent application of operating protocols by some funds. In 2012, the IRD targeted the funds sector and is currently auditing the operations of many offshore funds for compliance with its regulations. The review is said to include around 35 PE and hedge funds, and have a particular focus on those with key personnel in Hong Kong. The review focuses primarily on:

- transfer pricing and whether the typical cost-plus arrangements can be supported;
- taxation of offshore managers;
- fund subject to direct taxation in Hong Kong; and
- tax treatment of carry arrangements.

The HK IRD appears to be taking a very proactive stance, questioning all aspects of a fund structure in detail including reviewing compensation arrangements and cross checking with employee remuneration reported in employer returns. The audits have led to some adjustments of the tax positions for the last six years, and some resulted in penalties with settlements resulting in very different fee arrangements to the industry standard.

Additionally, the methodology of allocating management fees has been scrutinized. For example, a simple cost plus (5-10 percent) basis for remunerating a Hong Kong-based Investment Advisor is no longer acceptable. Instead, the fees must

reflect the functions performed in Hong Kong vis-a-vis other locations.

If protocols are already in place, the HK IRD may accept that the Investment Manager is not taxable directly, instead allocating more management fees to Hong Kong. While the HK IRD accepts the value of an offshore manager, it requires proof of commercial substance. It should be noted that the HK IRD is not pursuing funds but is seeking to tax income from investments, and questions in relation to carry arrangements are part of the audit.



### Singapore

To promote the development of the fund management industry in Singapore, the Singapore Government has over the years introduced and implemented various tax incentives and measures to attract fund management companies and funds to establish their base in Singapore. This, together with Singapore having one of the best infrastructure amongst top cities globally, its political stability and wide treaty network, have allowed Singapore to progress significantly towards becoming one of Asia's leading fund management hubs.

Over the last two years, various enhancement and liberalization of the tax rules were introduced which include the rationalization of the designated investment list and revision to the specified income list into an exclusion list. These changes have not only maintained the relevance and attractiveness of the tax incentive schemes available to the funds, but also further stimulated the Singapore fund management industry. We have noted

an increasing interest from fund management companies planning to set up offices in Singapore and establishing fund vehicles using Singapore as a hub for outbound investments into the region.



### Australia

In relation to the Investment Manager Regime (IMR), the Australian Government released an Exposure Draft (ED) legislation in April 2013. Generally, the ED takes into account many of the changes suggested by various lobby groups which will have a positive effect on investment by foreign funds. While foreign funds still need to be widely held, it is now possible to trace and prove this test.

Further, the IMR also now provides some protection to foreign funds that are resident of countries with which Australia has an Exchange of Information Agreement. Unfortunately, however, non Exchange of Information countries will not receive the benefits of this new legislation. In addition, a number of technical issues arising from IMR 2 have been rectified and the exemption has been significantly extended to ensure (with the exception of real property interests) there will be generally an exemption from Australia tax. Disappointingly, the ED has some substantial annual reporting requirements for a foreign fund. Details of the information to be provided to the Australian Taxation Office (ATO) have not yet been set out but we have significant concerns the information required will be extremely onerous in practice, resulting in the foreign fund not being entitled to the exemption.

# 09

## Pensions



### EMA

## A wave of change

There is significant regulatory change in the global pensions industry. Specific developments in particular regions, such as the UK, the Netherlands, South Africa and Australia, are likely to have marked effects on the global marketplace.

The combination of pan-European reforms and regulatory change at both regional and local level is changing the shape of the global pensions landscape – effects are being felt across the world, and there will be continued impacts on the global pensions markets. There are clear challenges for investment managers and fund administrators as a result, but also opportunities. It will certainly be interesting to see how the different global developments play out, both in the short- and long-term.

The pensions industry across Europe is also grappling with reforms stemming from the insurance landscape, such as the proposed pan-European Solvency II regime for pensions. This key development in the pipeline across the EMA region consists of a plan for a pan-European Solvency II regime for pensions. Although the outcomes are still uncertain, it could have considerable implications for pension funds throughout Europe and beyond.



*The results of the QIS were not surprising, with five of the seven participating countries showing significant overall deficits – both in terms of liabilities against financial assets, and in terms of the holistic balance sheet.*

## Pan-European developments



### Solvency II for Pensions – more work to be done...

In 2012, we reported on the plans by the European Commission and the European Insurance and Occupational Pensions Authority (EIOPA) to develop a pan-European Solvency II regime for occupational pension schemes. Since then EIOPA, in conjunction with national pensions regulators, has run a Quantitative Impact Study (QIS) on their initial proposals. This included their first attempt at valuing employer covenant for inclusion in a 'holistic balance sheet', to include the value of a sponsoring employer's support for a scheme alongside the value of its financial assets.

EIOPA has published the preliminary results of this QIS – with several warnings about their interpretation. Firstly, EIOPA accepts that more work is needed to define sensibly the values of employer covenants, and so further Consultation is expected on this subject. Secondly, EIOPA accepts that some aspects of the technical specifications may not have been sufficiently clear, leading to different interpretations by different schemes participating in the QIS.

Having said that, the results of the QIS were not surprising, with five of the seven participating countries showing significant overall deficits – both in terms of liabilities (measured on a risk-free

basis, plus a risk margin) against financial assets, and in terms of the holistic balance sheet (full Solvency II liabilities including solvency capital requirements, and assets including the values of employer covenant). The country showing the largest deficits was Ireland (by a considerable margin), with the UK showing the next largest. One of the reasons for this is the greater weighting of risk assets in these countries' schemes, leading to higher solvency capital requirements.

### Where next?

EIOPA has said that further work is needed, on employer support and other aspects. The European Commission has now acknowledged this. In a statement on 23 May 2013, the Commission said that it will proceed this year with proposals for improved governance, transparency, and reporting of European pension funds, but will re-examine solvency proposals when they have more data.

### A single EU Market for personal pension products?

Alongside the Solvency II developments, in July 2012, that the European Commission requested that EIOPA provide technical advice on the prudential regulations and consumer protection measures needed to create a single market for personal pensions.

In order to deliver this technical advice, EIOPA, as a first step, published on 14 May 2013 its Discussion Paper on a possible EU-single market for personal pension products. The goal of the

Discussion Paper is to engage stakeholders at an early stage in the project by gathering their views on a wide range of issues relating to personal pensions. It focuses on three key aspects of personal pensions:

1. A possible definition of a personal pension;
2. Potential cross-border frameworks (passporting and the so-called second (or 28th) regime, which would create a uniform European system as an alternative to the different national regimes); and
3. Consumer protection, including information disclosure and selling practices.

### Next steps

The period for providing comments ends on 16 August 2013. Once stakeholders' comments have been analysed, EIOPA will prepare a report including issues and options, which will be made available to the European Commission in early 2014. The Commission is then expected to issue a detailed Call for Advice to EIOPA, with a response deadline set for 2015.

# Pensions in the UK

## A challenging set of circumstances

There are a number of significant developments in the UK pensions industry, which will have considerable knock-on effects on global investment management as a whole. These key regulatory drivers will re-shape the UK and European marketplace to a high volume, low value approach, with clear implications for investment managers overseas in terms of flows of money into funds, systems, controls and assessing risk.

### 1. Defined Benefit (DB) Schemes – Funding

The Pensions Regulator in the UK issued their second annual funding statement in May 2013, giving guidance to trustees and employers involved in scheme funding discussions. This recognizes that market conditions for schemes undertaking their triennial valuations this year are more challenging than when they had their last valuations three years ago.

Although it is not yet in place, the Regulator already has an eye to a new statutory objective that will be given to them, following Consultation by the Department for Work and Pensions. This new objective is in the recently published draft Pensions Bill, and as currently drafted is for the Regulator to “minimize any adverse impact on the sustainable growth of an employer” in relation to funding valuations. It is intended to provide something of a balance against the Regulator’s existing objectives to protect pension scheme members and the Pension Protection Fund, and so to mitigate the ongoing pressure for employers to put ever more cash into their schemes in the short-term.

Accordingly, the Regulator’s latest statement emphasizes the flexibility in the UK regime – in particular, for recovery plans to be extended if necessary. The Regulator has also reinforced earlier messages about the importance of trustees assessing their employers’ covenants, and their investment strategies, at the same time as their funding plans.

An increasingly popular response to the funding challenges facing employers is to utilize contingent assets for their schemes, often through asset-backed funding vehicles. These can give greater security for trustees whilst reducing the immediate cash demands on employers and with care can be implemented in a tax-efficient way. KPMG in the UK has found this to be an innovative and successful approach for clients.

### 2. State Pension Changes

The UK Government is proceeding this year with legislation to make major reforms to the state pension system – with significant knock-on effects to many DB schemes. In summary, the basic state pension will be increased by some 33 percent, and the state second pension will cease, in April 2016. State pension age will continue to increase – to 66 by 2020, and to 67 by 2028.

*The focus on providing pensions for the mass market will lead to significant numbers of new pension scheme members and large volumes of money flowing into these funds, providing considerable work for providers and investment managers to cope with this volume.*



Of the (reducing) number of DB schemes in the private sector which are still open to new members, or at least still provide accruing benefits to existing members, most are integrated with the state second pension. So its abolition means that employers must re-assess the design of these schemes, if they are not to incur extra costs. The likely outcome is that most such schemes may well close their doors, with a final rush to defined contribution schemes by these employers.

#### **Auto-enrolment and Defined Contribution (DC) schemes**

2013 has seen the commencement of auto-enrolment – the compulsory entry of all of a company’s employees into a qualifying pension scheme. So far, this is happening for the largest employers only, with progressively smaller employers being ‘staged-in’ over the next few years.

Most employers are using DC arrangements for such new pension scheme members. In particular, the government-sponsored National Employment Savings Trust (NEST) scheme has an obligation to pick up any auto-enrolees that are sent to it, no matter how small their contributions. Other new master-trust schemes have been established to cater for this new mass-market.

The default investment strategies from these providers vary. NEST has opted for target-date funds. Others are following a lifestyling approach for their default strategies.

Alongside this, the Pensions Regulator has also been busy, issuing a detailed new set of principles and proposing a new code for trustees of defined contribution schemes. The Regulator has commented several times that

they do not see a long-term place for smaller schemes, believing that they cannot be efficient in terms of governance and charges compared to large schemes. This may well see the continued rise of the master trust and other large providers.

It is too early to tell what the level of new pensions inflows will be from auto-enrolment. However, early signs are encouraging, with some large employers reporting relatively high take-up rates of 75 percent or more of eligible employees. But it has to be remembered that the level of contributions in most cases is modest, at the statutory minimum level which will only gradually increase to a total of 8 percent of earnings. This will lead to more emphasis on individuals being responsible for assessing their own levels of retirement savings.

The focus on providing pensions for the mass market will lead to significant numbers of new pension scheme members and large volumes of money flowing into these funds, providing considerable work for providers and investment managers to cope with this volume. Both pensions administrators and investment managers will need the right platforms, IT infrastructure, and back and front-end systems in place to deal with these. It is opening up the market to a much wider range of investors – but what is their risk appetite, and how modest will their individual savings be?

For both investment managers and pension administrators, it will be critical that their systems provide scalability and flexibility to cater for the greater demands from new DC pension scheme members. There will be the need for systems to offer access to a wider range of investment solutions, as well

as operationally being able to administer a high volume of investment strategy changes requested by members, accurately and on a timely basis. If members are able to manage their schemes online it will be paramount that this service is well protected from cyber threats and confidentiality breaches through a combination of effective technical preventative measures and security monitoring tools.

There is also a greater expectation from regulators that pension schemes can demonstrate effective governance and oversight over any outsourced arrangements with third-party pension fund managers and administrators. A recent area of regulatory focus includes confirming the IT resilience of third parties to ensure members are not disadvantaged, if, for example, automated trading systems at an investment manager suffers a significant outage.

Another key area of focus continues to be the robustness of the data and confidentiality processes over the member data held, which are processed by third parties. Based on recent regulator interest, it seems that they are expecting greater levels of interaction and engagement with third parties, over and above reliance on the typical ISAE 3402 controls assurance report provided by administrators on an annual basis.

A similar system is also being recommended in Ireland. In April 2013, the OECD review of the Irish pension system commissioned by the government recommended introducing a system of auto-enrolment or mandatory pensions in order to improve coverage. These options are currently under consideration – if implemented, this would create further similarities between UK and Irish pensions markets.



### 3. De-risking and future investment strategies

De-risking is high on the agendas of many schemes – driven by the regulator’s continued pressure on trustees to follow prudent strategies, and the desire of some employers to remove risk and ultimately to exit their DB liabilities.

Over recent years, the amount of risk transferred to the insurance sector from pension schemes has been fairly modest – some £4 billion per annum out of total pension scheme assets of some £1.1 trillion. Although there is capacity for this to increase, it still represents only a very small percentage of the pensions market. The emphasis on risk reduction is therefore in schemes’ investment strategies.

The latest asset allocation figures for UK DB schemes show a continued trend away from equity investment. According to the Towers Watson Global Asset Survey<sup>12</sup>, equity allocations were 45 percent at the end of 2012, a reduction of more than 10 percent over the past five years.

KPMG’s latest Liability Driven Investment (LDI) survey<sup>13</sup> shows a continuing growth in managing assets from a liability-driven investment basis. Over £300 billion of mandates are now invested in this way, although this does cover a wide variety of approaches, depending on the degree of matching to liabilities undertaken.

From a governance perspective, pensions trustees are also becoming far more interested in where the risks lie in back office functions – there will be increasing pressure to accurately demonstrate this.

#### Multiple regulators

Pensions in the UK are also subject to supervisory changes. The supervisory split between the Prudential Regulation Authority (PRA), Financial Conduct Authority (FCA) and the Pensions Regulator – and potential here for confusion – is leading to calls for a single supervisor for the industry.

12. Global Pensions Asset Study, Towers Watson, January 2013  
13. 2012 KPMG LDI Survey – Exploring the Evolution of the LDI Market, KPMG in the UK, April 2012

## Key pensions developments in Ireland and the Netherlands – will the rest of Europe follow?

### Ireland faces similar issues to the UK

Similar to the UK, Irish occupational pension schemes are set up as exempt unit trust structures and are either Defined Benefit (DB) or Defined Contribution (DC) in nature. Virtually all new schemes being set up are DC, whilst the majority of DB schemes are being contracted either by way of closure, reduced accrual, liability management, wind up.

Deficit reduction actions which once had been deemed drastic or radical are now becoming increasingly common, even among some of the largest pension funds and employers.

DB schemes are pre-funded, although the majority (circa 80 percent<sup>14</sup>) are underfunded relative to the country's 'minimum funding standard'.

A 30 June 2013 deadline is looming for all underfunded schemes to submit funding proposals (deficit repair plans) to the Board – proposals which, in most cases, involve a negotiated solution with trustees and other stakeholders. Funding proposals typically require a combination of one or more of increased contributions, reduced/restructured benefits, and an altered investment strategy. The upcoming 30 June funding proposal deadline follows a hiatus on this requirement for a number of years, introduced to allow pension schemes – the majority of which suffered from ballooning deficits during the economic recession – some breathing space.

In terms of investment strategy, trustees and employers submitting funding proposals are required to match liability obligations for retired members (which represent an increasing proportion of the overall liabilities for most schemes) with bonds. The funding standard also allows credit for the inclusion of certain bonds into investment strategies, by way of a reduced 'risk reserve' requirement. Funds are now able to use certain corporate bonds and fixed income underwritten by European sovereigns – such as issuances from the International Monetary Fund (IMF), central banks and the European Investment Bank –

to reduce the burden of the risk reserve.

To date, only sovereign debt from EU Member States and cash could be used for such purposes.

Irish investment strategies are therefore of necessity increasingly liability-focused and dynamic, prompting many of the largest Irish pension funds to implement fiduciary management solutions in order to delegate day to day decision making.

Unlike the UK, to date, no 'debt on the employer' legislation exists in Ireland, meaning that an employer can in theory wind up an underfunded DB scheme and 'walk away' from its obligations. In practice, when a scheme is wound up, a negotiated outcome is usually agreed upon with trustees and other stakeholders.

The recent European Court of Justice (ECJ) Waterford Crystal judgement, which found that the state failed to adequately protect pension members in the event of the 'double insolvency' of Waterford Crystal (insolvency of company and insolvency of scheme) has prompted many in the industry to speculate on the potential wider ramifications, including government pressure to allow a pension guarantee arrangement – or at least consider such a step – if Ireland's highest court rules in favor of Waterford workers.

The introduction of a government guarantee fund or protection mechanism for insolvent employers would likely lead to wider legislative change including amendments to Section 50 of the Pensions Act, (which allows for the reduction of benefits for underfunded schemes), in order to provide a level of consistency between the protections to be afforded to members of schemes with insolvent and solvent employers.

More dramatically, the introduction of any government protection mechanism would likely herald the onset of some form of debt upon the employer legislation, in order to eliminate loopholes and moral hazard risk, putting Irish schemes on a similar legislative footing to their UK

counterparts and rendering the negotiated 'walk away'/settlement option to a thing of the past.

### Cutting the pensions rights...

A subject of great discussion and debate in the Netherlands is the phenomenon of funds cutting the pensions rights if they do not comply with the regions' strict solvency requirements. This is as a direct result of the robust regulatory and solvency framework and low interest rates in the Netherlands, rather than being caused by poor fund performance.

The methodology of measuring solvency requirements in the Netherlands, as described in the Financial Assessment Framework for Dutch pension funds, are broadly comparable with Solvency II, with specific liability and interest rate calculations. The rules specify that funds must have 105 percent in assets – if the assets fall below this, they must prove how they can repair this solvency situation, by:

- increasing premiums; and
- not compensating for inflation

If neither of these measures work, the fund must cut down on liabilities – the only way to do this being cutting the pensions rights.

It is estimated that around one third of the pensions funds in the Netherlands were affected by these measures, equating to approximately 100 funds. However, since the regulator changed the way in which the interest rate is calculated, an estimated 20–30 pension funds – many of them large and prominent in the industry – now fall into scope.<sup>15</sup>

Regarding EU Solvency II measures, the Netherlands currently have the Institutions for Institutions for Occupational Retirement Provision Directive (IORP) for DC pensions plans only – DB plans are still under discussion at the local government level.

14. KPMG analysis, 2012  
15. KPMG analysis, 2012

## Fiduciary Management (FM)

Fiduciary Management (FM) involves the delegation of investment decision-making responsibilities from the Trustees to a fiduciary manager (the provider). The rationale behind FM is to allow trustees to better utilize their time, whilst helping investment decisions to be taken and implemented more quickly and with clear accountability. The concept was first accepted in the Netherlands and in the US, and has more recently spread to the UK in a slightly different structure.

In the UK, an FM provider can assume responsibility for a range of tasks, including both investment consulting and asset management services. This can encompass: journey plan design; strategic and tactical asset allocation; growth and matching portfolio structuring; investment manager selection; and administration.

Unfortunately, there is ongoing confusion within the industry around 'which' services constitute fiduciary management. KPMG in the UK defines 'Full Delegation fiduciary management' as a service where the Trustees set the strategic asset allocation, risk and return targets based on advice from the provider but delegate asset allocation decisions as well as manager selections across the full scheme assets to a fiduciary manager. This means full delegation fiduciary management is a cross over service requiring investment consulting and asset management skills. The UK firm then defines 'Partial FM' as any FM mandate where the FM provider does not hold complete responsibility and/or manage the full scheme assets.



### Size and Structure of the FM Market in the UK

Over the past five years, the UK FM market has grown steadily from a small base, both in terms of number of mandates and assets under management (AuM) and also across both 'full' and 'partial' delegation appointments. At June 2012, the size of market was in excess of £50 billion, with around 300 UK pension scheme mandates. The full delegation portion comprised c. £23 billion of total asset under management. This figure is the sum of 174 full delegation markets and equates to c. 2.5 percent of the total UK DB pension scheme industry (by AuM).<sup>16</sup>

Looking forward, the UK firm expects the UK FM market to continue to grow. FM is not the silver bullet to solve all a pension fund's problems. However, in the UK it is a solution that can be very useful for some pension schemes and groups of trustees.

KPMG in the UK believes that the market has come to realize the heterogeneity and lack of standardization in the FM market and the need of independent advice when assessing suitability of FM for their scheme, selecting a fiduciary manager and also structuring appointment terms to ensure appropriate terms and protections built into the agreement. In that respect, we expect a more open competition for mandates going forward and also a range of the early FM

mandates, which haven't been put out for competitive tender, to come out for re-tender after they now have been in place for three to five years.



### FM in the Netherlands – a different story

In contrast, in the Netherlands, the term 'fiduciary management' has become contaminated. The reasons for this are the hard lessons learned during the recent financial crises and the stricter attitude of the Dutch supervisory body toward pension funds. Where historically the term 'fiduciary management' was used, it is often now replaced by 'integral management'. The Dutch central bank (DNB) is very clear on this issue: a healthy outsourcing relationship is based on an unambiguous and clearly defined mandate and an adequate control framework. It is therefore crucial that the fund offers adequate countervailing power towards its integral manager. Trust alone is not a healthy basis for the relationship: an assertive 'show me and prove it to me' is required. The more neutral term, 'integral management', is therefore a more appropriate term to describe the relationship.<sup>17</sup>

16. KPMG's UK Fiduciary Management Market Survey, KPMG in the UK, 2012

17. Integral asset management: More than a make-over of fiduciary management, KPMG in the Netherlands, 2012

# Americas

## A pensions landscape still to be determined...

The landscape for pension planning in the Americas remains difficult to predict. Many issues that loomed large only a year ago have either stalled, or presented fewer difficulties than anticipated. Other issues have assumed greater prominence in the past year and should continue to dominate the pensions landscape for the immediate future.

### Calculating liability

Recently revised government accounting standards may be a challenge for public pension plans to institute, particularly in the calculation of a pension plan's actuarial liability. Governments will have less flexibility in determining the actuarial liability. Many of these plans are now gathering additional information for complying with the new standards. Disclosure of the pension liability will be more transparent. As a result, plan sponsors may need to deal more aggressively with the disclosure of funding shortfalls. Actions may include increasing employee contributions or driving portfolio changes with the goal of enhancing the return on their investment portfolios, or re-structuring benefits.

### Re-examining expense ratios

Final Employee Retirement Income Security Act (ERISA) 408 (b) (2) regulations published in 2012 gave plan sponsors an incentive to re-examine their investment expense ratios. Plan sponsors are continuing to ask if the fees they are paying are too high, considering the risk in and performance of their asset classes.

### Key discussions – uncertain outcomes

Looking at pensions from a broad perspective, we see two discussions that continue to dominate the landscape, either:

- an acceleration of de-risking among large corporate pension plans; or
- efforts to increase risk as a result of the continued low interest rate environment.

Several large pension plans have sold large pieces of their benefit obligations to insurance companies. It is difficult to predict the reaction of regulators or affected employees if this trend continues or accelerates.

*Recently revised government accounting standards may be a challenge for public pension plans to institute, particularly in the calculation of a pension plan's actuarial liability.*

### Pensions in the US – some concerning statistics

- New Governmental Accounting Standards Board (GASB) rules taking effect in 2014/15 are likely to reduce funding ratios for state pensions and necessitate higher employee contributions resulting in a drag on current economic spending and a tough political hurdle for many states.<sup>18</sup>
- Figures from Pew Research show that 34 percent of the states are below the 80 percent funded level deemed healthy.<sup>19</sup> Cuts to benefits, increases in contributions and adjustments to allocation in search of higher returning assets are all necessary reforms. Rhode Island, for example, is a reform model that shows a dramatic turnaround.
- Rising rates are a double-edged sword – higher discount rates improve plan metrics, but large bond allocations are likely to suffer from negative convexity and low or negative total returns. Bonds may not be the low volatility asset they have been over the past decade.
- The multi-employer pension scheme covering 6.7 percent of the labor force (155 million people) is the weakest link in employer pensions liabilities are shared and incentives of individual companies are at odds with the group; the Pension Benefit Guarantee System can only support the system if the 40 percent of companies out of compliance bring funding above 80 percent, as required by law.<sup>20</sup>

18. How Would GASB Proposals Affect State And Local Pension Reporting? Center for Retirement Research at Boston College, June 2012; and Local Government Pensions Analysis, Fitch Ratings, April 2013

19. The Widening Gap Update, PEW Center for States, June 2012

20. US pension insurer warns of rising deficit, Financial Times, January 2013

# ASPAC

## Significant pools of retirement assets in Australia



### Hong Kong

While Hong Kong has a Mandatory Provident Fund (MPF) in place, 2013 year-end statistics show that 12 percent of the employed population are not required to join any local retirement scheme according to law, with a further four percent avoiding payments for the scheme.

In March 2013, Hong Kong announced that it will conduct a new study on the structure of retirement protection in Hong Kong going forward. The study is expected to be made public in 2014 and is expected to discuss a universal pension system among its conclusions.



### Australia

Australia has overtaken the Netherlands and Canada to have the fourth largest pool of retirement fund assets in the world, just behind Japan and the UK. Following the Australian Federal Government's comprehensive review of the superannuation system, legislation and regulations to implement the Stronger Super reforms has been progressively introduced since 2011. The remaining measures are expected to be introduced in several tranches over the remainder of 2013.

Specifically, the Government's stated objectives of the Stronger Super reforms are to:

- Create a new simple, low cost default superannuation product called 'MySuper', with the related objective of protecting disengaged members and achieving greater transparency;
- Make the processing of everyday transactions easier, cheaper and faster, through the 'SuperStream' package of measures; and
- Strengthen the governance, integrity and regulatory settings of the superannuation system by mandating greater transparency and addressing issues such as conflicts of interest.

In contemplation of the Stronger Super reforms, the Australian Prudential Regulation Authority (APRA) released a comprehensive set of prudential standards for superannuation in November 2012, followed by the release of prudential practice guides in April 2013.

The prudential standards and prudential practice guides implement APRA's prudential framework for superannuation, covering both topics common to other APRA-regulated industries in Australia and superannuation-specific topics. The prudential standards incorporate those elements of the Government's superannuation reforms that come within APRA's mandate.

Going forward, Australian funds will face a much more comprehensive regulatory environment as a result of the Stronger Super reforms and APRA's prudential framework for superannuation.



### Japan

The corporate pension system in Japan is slowly undergoing reform. The Japanese Diet (Kokkai) is currently deliberating on a bill to abolish the Employee's Pension Fund System, which was the main victim of the AIJ scandal.

On the other hand, despite some minor changes to the Defined Contribution Pension System (such as implementation of matched contribution in 2012), its adoption has been slow. DB Corporate Pensions remain main stream. However, new accounting standards requiring corporations to reflect a shortfall of reserves against their DB Pension Fund accounts on their financial statements will come into effect from the end of March 2014. In response to this, some companies have started to adopt a Defined Contribution Pension System.

In terms of the public pension system, it has been already decided that the mutual pension funds of public officers will be merged with the corporate pension system by October 2019. Although no further information is available at this point, this area remains of high interest to the public and industry.



# 10

## Sustainable investment



## Assessing environmental, social and governance risks

**“We will incorporate ESG issues into investment analysis and decision-making processes.”<sup>21</sup>**

Following the implementation of the United Nations supported Principles for Responsible Investment (UN PRI) in 2006, the assessment of Environmental, Social and Governance (ESG) risks alongside financial risks of an investment is becoming more systematically used by mainstream portfolio managers. This investment strategy of explicit inclusion of ESG risks and opportunities into traditional financial analysis and investment decisions is referred to as ‘ESG integration’.

### **A change of approach...**

Over the last couple of years, there has been a significant shift in approach, from asset managers offering a limited number of specialized responsible investing (RI) products, to asset managers declaring that all their investment products – whether specialized RI or more mainstream – are invested incorporating RI principles into the investment decision process. RI strategies include ESG integration as well as exclusion strategies, norms-based screening, best-in-class selection, or sustainability themed such as environment or social-focused investments, as well as other strategies as outlined in the table on page 73.

21. Principle 1 of the United Nations-backed Principles for Responsible Investment (UNPRI)

*There is enormous disparity in the depth of analysis and methods used by asset managers to integrate environmental, social and governance analysis into investment decisions.*

And this shift has of course led to increased numbers of funds and AuM in the field of responsible investing.

The incorporation of ESG criteria into investment decision making processes is becoming a 'must-have' for many institutional investors when selecting asset managers and there are a number of industry initiatives and trends reflecting the influence of institutional investors and support of transparency in the RI market:

- All signatories to the UN PRI, representing close to US\$35 trillion of AuM (at end April 2013), will, from 2014, have to comply with mandatory public reporting highlighting concrete implementation of the six principles of the PRI;
- The European Commission recently released a legislative proposal on non-financial reporting for companies and this should help portfolio managers in understanding the financial as well as ESG risks of targeted investments, with increased transparency of information;
- A number of transparency initiatives, such as labels and logos for responsible investing funds, have emerged in EU countries highlighting best practices in the industry;
- Certain asset managers are already producing responsible investing annual reports to explain how they integrate ESG issues into investment products and processes.

While the RI market is largely driven by institutional investors, the retail market represents a largely untapped market. The latest Eurosif study<sup>22</sup> shows that the RI retail market represents only 6 percent of RI AuM; as compared to a 31 percent retail share of all European fund assets<sup>23</sup>. This gap represents a major opportunity for asset managers ready to develop their retail product offering.

#### Key questions

The basic principles of responsible investing strategies are reasonably straightforward; however there is enormous disparity in the depth of analysis and methods used by asset managers to integrate ESG analysis into investment decisions. And this raises certain questions, particularly for those asset managers focused on the retail market, which requires a simpler and clearer message (which is not solely a challenge when talking about RI but also other areas, currently being tackled by regulation):

- How certain can asset management companies really be, when they say their portfolio managers are incorporating ESG analysis alongside financial analysis when making decisions?
- Do portfolio managers really understand ESG research and use it in a systematic and appropriate way? After all, incorporating analysis other than financial analysis is relatively new.
- Can investors believe that asset managers really do integrate ESG across all their investment products?

These industry initiatives certainly respond to some of the questions; however, asset managers must continue to build on transparency initiatives.

#### Evolving strategies

Responsible investing strategies continue to evolve, presenting an attractive response to the financial crisis, and concretely helping to:

- Restore credibility and reputation of the financial sector that was significantly eroded throughout the crisis;
- Identify the environmental, social and governance risks of potential investments and better integrate them into the investment decision process;
- Face increased competition and identify new investment target opportunities;
- Adapt to changing investor demand.

22. European SRI study 2012, Eurosif

23. Asset Management in Europe, Facts and Figures, 5th annual review, EFAMA

## Responsible investing strategies

Strategy	Description
<b>Sustainability themed investment</b>	Investment in themes or assets linked to the development of sustainability. Thematic funds focus on specific or multiple issues related to ESG.
<b>Best-in-Class investment selection</b>	Approach where leading or best-performing investments within a universe, category, or class are selected or weighted based on ESG criteria.
<b>Norms-based screening</b>	Screening of investments according to their compliance with international standards and norms.
<b>Exclusion of holdings from investment universe</b>	An approach that excludes specific investments or classes of investment from the investable universe such as companies, sectors or countries.
<b>Integration of ESG factors in financial analysis</b>	The explicit inclusion by asset managers of ESG risks and opportunities into traditional financial analysis and investment decisions based on a systematic process and appropriate research sources.
<b>Engagement and voting on sustainability matters</b>	Engagement activities and active ownership through voting of shares and engagement with companies on ESG matters. This is a long-term process, seeking to influence behavior or increase disclosure.
<b>Impact investment</b>	Impact investments are investments made into companies, organizations and funds with the intention to generate social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market-to-market rate, depending upon the circumstances.

Source: European SRI study 2012, Eurosif

### Exploit the RI opportunities...

Those asset managers that are able to prove they have robust processes in place that to integrate ESG considerations in their investment decisions will certainly succeed. Models and methods to assess this in an independent, external manner are already being developed to assist asset managers in this process. There is clear pressure on the asset management industry as a whole to adopt RI principles in a more systematic manner, and there are clear opportunities to innovate and develop new products addressing the untapped retail market. Transparency and robust processes are critical to best exploit these opportunities.

# ASPAC

## Sustainable Investment



### China

A reduced Corporate Income Tax rate of 15 percent is given for qualified advanced and new technology enterprises in China, including solar energy, wind energy, biomaterial energy, and geothermal energy. A 2012 Association for Sustainable and Responsible Investment in Asia (ASrIA) survey indicated that 52 private equity managers based in Greater China plan to invest in environmental technology, committing allocations of over US\$19 billion.<sup>24</sup>



### Japan

Although the market value of Japanese Socially Responsible Investments (SRI) grew by 9 percent from the end of March 2012 to the end of March 2013, their total value is less than 0.1 percent of world market value (Europe: 65 percent, US: 28 percent<sup>25</sup>). This is due to multiple factors such as a lack of clear commitment from the Japanese government, of the reluctance of retail investors towards SRI as means of achieving value; limited information on SRI leading many investors to not consider SRI as an investment vehicle; and lack of uptake from pension funds. These factors cause a drag on the Japanese SRI market expansion, making it substantially slower than in Europe or the US.

While in these Western markets over 90 percent of SRI investors are institutional (pension funds and corporations), in Japan the majority are retail investors. Additionally, while public pension funds play an important role as SRI investors in Western markets, this role is taken by private pension funds in Japan. This may imply that Japanese public pension funds are sceptical about the profitability of ESG factors in the fund's performance.

Similar to their European and US counterparts, the major public pension funds dictate market trends in Japan and hold substantial influence over the institutional investment market. If Japanese public pension funds choose SRI as a vehicle of choice for their assets, then other public pension funds and private pension funds may rush in to follow the trend. Currently however, indication of such movements in the market remain limited to date.

*Similar to their European and US counterparts, the major public pension funds dictate market trends in Japan and hold substantial influence over the institutional investment market.*

24. Asia Sustainable Investment Review, Association for Sustainable and Responsible Investment in Asia, 2012

25. Asia Sustainable Investment Review, Association for Sustainable and Responsible Investment in Asia, 2012

# Abbreviations

<b>AIF</b>	Alternative Investment Fund	<b>GASB</b>	Governmental Accounting Standards Board
<b>AIFM</b>	Alternative Investment Fund Manager	<b>GBL</b>	Global Business Licence
<b>AIFMD</b>	Alternative Investment Fund Managers Directive	<b>GCC</b>	Gulf Cooperation Council's
<b>AIMA</b>	Alternative Investment Management Association	<b>HK</b>	IRD Hong Kong Inland Revenue Department
<b>AML</b>	Anti-Money Laundering	<b>ICAAP</b>	Internal Capital Adequacy and Assessment Process
<b>APRA</b>	Australian Prudential Regulation Authority	<b>IFRS</b>	International Financial Reporting Standards
<b>ASIC</b>	Australian Securities and Investments Commission	<b>IIFA</b>	International Investment Funds Association
<b>ASISA</b>	Association for Savings and Investment South Africa	<b>ILAS</b>	Investment-Linked Assurance
<b>ASPAC</b>	Asia-Pacific	<b>IMF</b>	International Monetary Fund
<b>ASrIA</b>	Association for Sustainable and Responsible Investment in Asia	<b>IMR</b>	Investment Manager Regime
<b>ATO</b>	Australian Taxation Office	<b>IORP</b>	Institutions for Occupational Retirement Provision Directive
<b>AuM</b>	Assets under Management	<b>IOSCO</b>	International Organization of Securities Commissions
<b>BCBS</b>	Basel Committee on Banking Supervision	<b>IRS</b>	Internal Revenue Service
<b>B-REITs</b>	Bahrain Real Estate Investment Trusts	<b>ISA</b>	Individual Savings Account
<b>CBB</b>	Central Bank of Bahrain	<b>JFSA</b>	Japan's Financial Services Agency
<b>CBRC</b>	China Banking Regulatory Commission	<b>KID</b>	Key Information Document
<b>CFT</b>	Combating the Financing of Terrorism	<b>KIID</b>	Key Investor Information Document
<b>CFTC</b>	Commodity Futures Trading Commission	<b>LDI</b>	Liability Driven Investment
<b>CIUs</b>	Collective Investment Undertakings	<b>LPA</b>	Limited Partnership Act
<b>CJEU</b>	Court of Justice of the European Union	<b>MAD</b>	Market Abuse Directive
<b>CMA</b>	Capital Market Authority	<b>MAR</b>	Market Abuse Regulation
<b>CMS</b>	Capital Markets Services	<b>MAS</b>	Monetary Authority of Singapore
<b>COLL</b>	Collective Investment Schemes Rules 2010	<b>MiFID</b>	Markets in Financial Instruments Directive
<b>COND</b>	Conduct of Business Rulebook	<b>MOF</b>	US Ministry of Finance
<b>CPOs</b>	Commodity Pool Operators	<b>MoU</b>	Memorandum of Understanding
<b>CRD 4</b>	Capital Requirements Directive 4	<b>MPF</b>	Mandatory Provident Fund
<b>CSRC</b>	China Securities Regulatory Commission	<b>NAV</b>	Net Asset Value
<b>CTAs</b>	Chartered Tax Advisers	<b>NFA</b>	National Futures Association
<b>DB</b>	Defined Benefit	<b>NISA</b>	Japanese ISA
<b>DC</b>	Defined Contribution	<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>ECJ</b>	European Court of Justice	<b>OTC</b>	Over the Counter
<b>ECON</b>	European Economic and Monetary Affairs Committee	<b>PE</b>	Private equity
<b>ED</b>	Exposure Draft	<b>PRA</b>	Prudential Regulation Authority
<b>EFAMA</b>	European Fund and Asset Management Association	<b>PRI</b>	Principles for Responsible Investment
<b>EIOPA</b>	European Insurance and Occupational Pensions Authority	<b>PRIPs</b>	Packaged Retail Investment Products
<b>EMA</b>	Europe, Middle-East and Africa	<b>PRIV</b>	Private Placement Schemes Rules 2010
<b>EMIR</b>	European Market Infrastructure Regulation	<b>QCB</b>	Qatar Central Bank
<b>ERISA</b>	Employee Retirement Income Security Act	<b>QFCRA</b>	Qatar Financial Centre Regulatory Authority
<b>ERSB</b>	European Systemic Risk Board	<b>QFMA</b>	Qatar Financial Market Authority
<b>ESG</b>	Environmental, Social and Governance	<b>RBC</b>	Risk Based Capital
<b>ESMA</b>	European Securities and Markets Authority	<b>RDR</b>	Retail Distribution Review
<b>ETFs</b>	Exchange Traded Funds	<b>RMB</b>	Renminbi
<b>EU</b>	European Union	<b>RQFII</b>	Renminbi Qualified Foreign Institutional Investor
<b>FA</b>	Financial Advisory	<b>SARB</b>	South African Reserve Bank
<b>FAIR</b>	Financial Advisory Industry Review (Singapore)	<b>SEC</b>	Securities and Exchange Commission
<b>FATCA</b>	Foreign Account Tax Compliance Act	<b>SPC</b>	Special Purpose Company
<b>FATF</b>	Financial Action Task Force	<b>SWF</b>	Sovereign Wealth Funds
<b>FCA</b>	Financial Conduct Authority	<b>TCF</b>	Treating Customers Fairly
<b>FFI</b>	Foreign Financial Institution	<b>TFCD</b>	Total fees and charges disclosure
<b>FMCs</b>	Fund Management Companies	<b>UCITS</b>	Undertaking for Collective Investments in Transferable Securities
<b>FOFA</b>	Future of Financial Advice	<b>UN PRI</b>	United Nations supported Principles for Responsible Investment
<b>FSB</b>	Financial Stability Board		
<b>FSB</b>	Financial Services Board (South Africa)		
<b>FTT</b>	Financial Transaction Tax		

# Acknowledgements

We would like to acknowledge the contribution of our colleagues from across KPMG's global network of member firms who helped develop this report:

## ASPAC region

### John Bataxis

KPMG in Australia  
T: +61 3 9838 4567  
E: jbatzaxis@kpmg.com.au

### Gary Daniel Chia

KPMG in Singapore  
T: +65 6411 8288  
E: garydanielchia@kpmg.com.sg

### Sean Hill

KPMG in Australia  
T: +61 3 9288 6948  
E: seanhill@kpmg.com.au

### Howard Liu

KPMG in China  
T: +852 2685 7624  
E: howard.liu@kpmg.com

### Jacinta Munro

KPMG in Australia  
T: +61 3 9288 5877  
E: jacintamunro@kpmg.com.au

### James O'Leary

KPMG in Australia  
T: +61 2 9335 7824  
E: jamesoleary@kpmg.com.au

### Divay Pranav

KPMG in India  
T: +91 12 4612 9213  
E: divaypranav@kpmg.com

### Tanya Tandon

KPMG in India  
T: +91 12 4612 9324  
E: tanyat@kpmg.com

### David Waller

KPMG in Singapore  
T: +65 6213 3007  
E: davidwaller@kpmg.com.sg

## EMA region

### Syed Anas Ali

KPMG in Qatar  
T: +974 4457 6583  
E: saali@kpmg.com

### Tim Barlage

KPMG in the Netherlands  
T: +31 2 0656 8152  
E: barlage.tim@kpmg.nl

### Georges Bock

KPMG in Luxembourg  
T: +35 222 5151 5522  
E: georges.bock@kpmg.lu

### Paul Bradbury

KPMG in the UK  
T: +44 20 76942946  
E: paul.bradbury@kpmg.co.uk

### Justin Chait

KPMG in South Africa  
T: +27 8 2719 1711  
E: justin.chait@kpmg.co.za

### Newton De Neise

KPMG in Qatar  
T: +974 4457 6512  
E: ndeniese@kpmg.com

### Laetitia Hamon

KPMG in Luxembourg  
T: +35 2 22 5151 6560  
E: laetitia.hamon@kpmg.lu

### Seamus Hand

KPMG in Ireland  
T: +35 3 1410 1437  
E: seamus.hand@kpmg.ie

### Rachel Hanger

KPMG in the UK  
T: +44 20 7311 5328  
E: rachel.hanger@kpmg.co.uk

### Monika Hildebrandt

KPMG in Luxembourg  
T: +35 2 22 5151 5467  
E: monika.hildebrandt@kpmg.lu

### Sven Höglund

KPMG in Sweden  
T: +46 8723 9777  
E: sven.hoglund@kpmg.se

### Tim Howarth

KPMG in the UK  
T: +44 20 7311 6640  
E: tim.howarth@kpmg.co.uk

### Gabrielle Jaminon

KPMG in Luxembourg  
T: +35 222 5151 7635  
E: gabrielle.jaminon@kpmg.lu

### Neale Jehan

KPMG in the Channel Islands  
T: +44 14 8174 1808  
E: njehan@kpmg.guernsey.gg

### Furqan Ullah Khan

KPMG in Saudi Arabia  
T: +966 1 1874 8500  
E: furqanullahkhan@kpmg.com

### Armughan Ahmed Kausar

KPMG in Saudi Arabia  
T: +966 1 874 8671  
E: akausar@kpmg.com

### Alexander Koriath

KPMG in the UK  
T: +44 20 7694 1902  
E: alexander.koriath@kpmg.co.uk

### Gustaaf Kruger

KPMG in South Africa  
T: +27 2 1408 7044  
E: gustaaf.kruger@kpmg.co.za

### Dr. Markus Lange

KPMG in Germany  
T: +49 69 9587 2530  
E: markuslange@kpmg.com

### Chris Leonard-Appleton

KPMG in the UK  
T: +44 20 7694 5800  
E: chris.leonard-appleton@kpmg.co.uk

### John Machin

KPMG in the UK  
T: +44 20 7311 5454  
E: john.machin@kpmg.co.uk

### Nisha Madhvani

KPMG in the UK  
T: +44 20 73114068  
E: nisha.madhvani@kpmg.co.uk

### Omar Mahmood

KPMG in Qatar  
T: +974 4457 6444  
E: omarmahmood@kpmg.com

### Dorothea Mevissen

KPMG in Luxembourg  
T: +35 222 5151 6392  
E: dorothea.mevissen@kpmg.lu

### Brian Morrissey

KPMG in Ireland  
T: +35 3 1410 1220  
E: brian.morrissey@kpmg.ie

### Kian Navid

KPMG in Luxembourg  
T: +35 222 5151 7294  
E: kian.navid@kpmg.lu

### Vincent Neate

KPMG in the UK  
T: +44 20 7694 3256  
E: vincent.neate@kpmg.co.uk

## Americas region

**Rupal Patel**

KPMG in the UK  
**T:** +44 20 7694 4708  
**E:** rupal.patel@kpmg.co.uk

**Gary Pickering**

KPMG in South Africa  
**T:** +27 2 1408 7310  
**E:** gary.pickering@kpmg.co.za

**Claude Poncelet**

KPMG in Luxembourg  
**T:** +35 2 2251 51 5567  
**E:** claude.poncelet@kpmg.lu

**Dee Ruddy**

KPMG in Luxembourg  
**T:** +35 222 5151 7369  
**E:** dee.ruddy@kpmg.lu

**Jeroen Ruepert**

KPMG in the Netherlands  
**T:** +31 2 0656 8346  
**E:** jeroen.ruepert@kpmg.co.uk

**Don Scott**

KPMG in the UK  
**T:** +44 20 7311 5867  
**E:** don.scott@kpmg.co.uk

**Alison Sewell**

KPMG in the UK  
**T:** +44 20 73111801  
**E:** alison.sewell@kpmg.co.uk

**Ameet Sharma**

KPMG in the UK  
**T:** +44 20 7694 4073  
**E:** ameen.sharma@kpmg.co.uk

**Gordon Sharp**

KPMG in the UK  
**T:** +44 20 7311 3194  
**E:** gordon.sharp@kpmg.co.uk

**Teresa Sienkiewicz OBE**

KPMG in the UK  
**T:** +44 20 7311 5738  
**E:** teresa.sienkiewicz@kpmg.co.uk

**Edward Snieder**

KPMG in the Netherlands  
**T:** +31 2 0656 7941  
**E:** snieder.edward@kpmg.nl

**Furqan Ullah Khan**

KPMG in Saudi Arabia  
**T:** +966 1874 8500  
**E:** furqanullahkhan@kpmg.com

**Jeroen Van Nek**

KPMG in the Netherlands  
**T:** +31 2 0656 7360  
**E:** vannek.jeroen@kpmg.nl

**Jane Wilkinson**

KPMG in Luxembourg  
**T:** +35 2 2251 51 6325  
**E:** jane.wilkinson@kpmg.lu

**Daniel Bender**

KPMG in the US  
**T:** +1 617 988 1013  
**E:** dsbender@kpmg.com

**Juan Pablo Carreño**

KPMG in Chile  
**T:** +56 2 2798 1260  
**E:** juancarreno@kpmg.com

**Peter Hayes**

KPMG in Canada  
**T:** +1 416 777 3939  
**E:** phayes@kpmg.ca

**John Hubbe**

KPMG in the US  
**T:** +1 21 2872 5515  
**E:** jhubbe@kpmg.com

**Constance L Hunter**

KPMG in the US  
**T:** +1 212 954 3396  
**E:** constancehunter@kpmg.com

**Lino Junior**

KPMG in Brazil  
**T:** +55 213 515 9441  
**E:** imjunior@kpmg.com.br

**Joaquin Lira**

KPMG in Chile  
**T:** +56 2 2798 1203  
**E:** jlira@kpmg.com

**James Loewen**

KPMG in Canada  
**T:** +1 41 6777 8427  
**E:** jloewen@kpmg.ca

**Daniel McIsaac**

KPMG in the US  
**T:** +1 212 954 5973  
**E:** dmcisaac@kpmg.com

**Daniel Reid**

KPMG in the US  
**T:** +1 212 954 8729  
**E:** dreid@kpmg.com

**Laurence J Shulman**

KPMG in the US  
**T:** +1 973 912 6261  
**E:** ishulman@kpmg.com

**Jeffrey Sion**

KPMG in the US  
**T:** +1 212 872 6758  
**E:** jsion@kpmg.com

**Contact us**

**Jeremy Anderson CBE**  
**Global Chairman, KPMG's  
Financial Services Practice**  
T: +44 20 7311 5800  
E: jeremy.anderson@kpmg.co.uk

**Tom Brown**  
**Global Head of Investment  
Management**  
KPMG in the UK  
T: +44 20 7694 2011  
E: tom.brown@kpmg.co.uk

**Bill Michael**  
**EMA Head of Financial Services**  
KPMG in the UK  
T: +44 20 7311 5292  
E: bill.michael@kpmg.co.uk

**James Suglia**  
**Head of KPMG's Investment  
Management Sector,  
Advisory**  
T: +1 61 7988 5607  
E: jsuglia@kpmg.com

**Bonn Liu**  
**Head of Investment  
Management**  
KPMG's ASPAC region  
T: +85 2 2826 7241  
E: bonn.liu@kpmg.com

**Giles Williams**  
**Partner**  
Financial Services  
Regulatory Center of  
Excellence, EMA region  
KPMG in the UK  
T: +44 20 7311 5354  
E: giles.williams@kpmg.co.uk

**John Schneider**  
**US Head of Investment  
Management Regulatory**  
KPMG in the US  
T: +1 61 7988 1085  
E: jjschneider@kpmg.com

**Simon Topping**  
**Principal**  
Financial Services  
Regulatory Center of  
Excellence, ASPAC region  
KPMG in China  
T: +85 2 2826 7283  
E: simon.topping@kpmg.com

**Charles Muller**  
**Partner**  
Financial Services  
Regulatory Center of  
Excellence, EMA region  
KPMG in Luxembourg  
T: +35 222 5151 7950  
E: charles.muller@kpmg.lu

**Jim Low**  
**Partner**  
Financial Services  
Regulatory Center of  
Excellence, Americas region  
KPMG in the US  
T: +1 21 2872 3205  
E: jhlow@kpmg.com

**Seiji Kamiya**  
**Partner**  
Financial Services  
Regulatory Center of  
Excellence, ASPAC region  
KPMG in Japan  
T: +81 3 3548 5100  
E: seiji.kamiya@jp.kpmg.com

[fsregulation@kpmg.co.uk](mailto:fsregulation@kpmg.co.uk)  
[www.kpmg.com/regulatorychallenges](http://www.kpmg.com/regulatorychallenges)

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2013 KPMG International Cooperative ("KPMG International"), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved. Printed in the UK.

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.

Produced by KPMG's Global Financial Services Practice in the UK.

Designed by Mytton Williams

Publication name: Evolving Investment Management Regulation

Publication number: 130356

Publication date: June 2013