Management Company CEO Survey 2016

Flourishing in a prickly environment
Today, it is clearer than ever how interconnected we are in the global economy. While demographic megatrends point towards huge growth potential for the asset management industry, succeeding and even surviving in this industry has become much harder.

Future growth in assets under management (AUM) seems to be closely linked to digital strategy, as new generations of investors adopt new and different ways of investing. This calls for a rethink of which strategies can best capture the next generation of customers and compete against new digital players who are already adept at delivering a strong customer experience. Digital distribution is therefore expected to disrupt the traditional distribution landscape.

The asset management industry has been very profitable in the past. However, there are presently a number of factors putting pressure on margins, such as increasing fee competition and the increasing cost of regulatory compliance. This means that companies need to keep tight control over costs and to find innovative ways to operate with lower cost structures.

In such a fast-changing environment, it is valuable to know what the leaders of management companies are anticipating for the years ahead.

CEOs of management companies have told us that, despite the tough environment, they intend to grow their volumes and operations, tailor new business models for these new challenges, and actively seek talent with specific skill-sets in risk management, regulatory topics, and oversight. The rapid pace of regulatory and tax change is perceived to be a source of extra risk in operating in this industry.

We hope this survey provides you with a source of insight about what the industry is expecting, and about how to position your company in the next few years.
Roadmap for the future?

01. Grow AUM

02. Manage Costs

03. Navigate Regulatory Changes

04. Develop and Perfect Data and Digital Strategy

05. Adapt to Disruptive Innovation in the Business Environment

06. Enhance Customer Experience
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The next few years will be challenging for management company CEOs. While their confidence about their growth prospects remains high, they are operating in a tougher environment. In the context of the Luxembourg management company, the top challenges include:

II adapting governance models to deal with an increasing level of oversight and due diligence duties;

II finding the right balance between having sufficient substance on the ground and implementing a sourcing strategy that optimises the cost structure;

II keeping tight control over costs as oversight, documentation, and reporting requirements escalate;

II navigating regulatory changes which have a considerable impact on products, operating models, processes, skilled resources, and data infrastructure; and

II starting the digital transformation journey despite uncertainty as to how it will bring concrete short-term benefits.
Key findings

- The average management company’s governance body had five board directors and three conducting officers.
- Substance on the ground has increased over the last two years in areas such as risk management, investment compliance, internal audit, and fund accounting/NAV oversight. The increase has been more than what was predicted in our previous survey in 2013.
- Cost-income ratios have suffered over the last two years, more markedly amongst smaller management companies.
- The regulatory topics most occupying management company CEOs’ attention are those relating to the implementation of alternative investments (AIFMD), anti-money laundering (AML), and retail funds (UCITS V and MiFID II).
- A large proportion of our surveyed companies are still in the early days of their digital transformation journey. Whereas most respondents recognise that the quality of oversight can be improved by the use of data and analytics, very few are using it effectively yet.

Oversight of outsourced services:
Seventy-eight percent of CEOs thought that the controls and tools for monitoring outsourced activities could be improved.

Frequency of board meetings:
Eighty-two percent of management company board meetings were held at least quarterly.

Sourcing strategy:
Risk management was fully insourced in 63% of cases, up from 28% two years ago.

Data quality:
Seventy-seven percent of CEOs felt that data quality was a top challenge in achieving better customer profiling, improving the quality of management information, and driving efficiency.

Digital challenges:
With only 17% of CEOs worried about the threat of disruptive technologies and only 24% about new types of competitors, it appears that we are only at the start of the digital journey, and that digital disruptors may take many by surprise.
As the regulation has developed very fast in the past years and as it is still in evolution, training programmes play a crucial role in the qualification of local people.

CSSF: Innovation and data are key topics for the regulator.

As a regulator, what is challenging about adapting to an industry that’s shifting towards a more digital environment, i.e. one using more digital distribution channels and having a KYC mentality? What role does the CSSF want to play in the digital transformation of the fund industry?

When we see that innovation is taking place within the industry, then naturally we’ll have a look at it and our first focus is to analyse if the regulation is observed. We are not an authority who is ignoring innovation—on the contrary: a functional industry has to be dynamic and has to evolve. In fact, we have created a new department within the CSSF that is devoted to innovation (not exclusively for the fund industry) called Innovation, Payment, Market Infrastructures, and Governance. In this way we are demonstrating our interest in the evolution of the financial industry, and that we want it to be able to take advantage of new technologies that can increase efficiency.
Regarding more particularly the fund industry and KYC, we know that there are IT projects underway to facilitate and operate the KYC checks. One key area of KYC is the question of how you can validate transactions that occur via internet platforms, and what technology is needed to ensure that the persons behind the screen are really who they say they are. A new framework has to be put in place in order to handle the evolution in this field. Once clarified it will most probably affect the distribution channels.

Regulators are starting to collect a lot of data. Are there any plans to use this data in the context of data analytics?

The first thing to mention is that data collection is a major issue amongst European and international authorities. It has been widely seen that, in the wake of the 2008 financial crisis, there is a need for much more information with regard to the financial sector in order to enhance the stability of the sector. Currently, a huge focus is put on systemic and liquidity risk, not just for banks but also for asset managers.

What needs to spring up—at least in a more noticeable way—are training programmes geared towards needed positions in the fund industry and asset management, like directors, compliance officers, risk managers, etc. As the regulation has developed very fast in the past years and as it is still in evolution, training programmes play a crucial role in the qualification of local people. I am aware that a lot of effort is being made by the industry associations to keep pace with new regulation. However, I think that the training programmes should be revisited as they have to play even a bigger role than in the past. The Luxembourg fund industry is operating in a global and a more and more complex market and it goes without saying that the sustainability of the industry is based, amongst other things, on skilled people. It is therefore important that the workforce is trained in a way that anticipates changes in the market. For example, if a regulation is said to come into force in a certain timeframe, training programmes should anticipate the new regulation.

How do you see the current spread of products and services in Luxembourg changing in the coming year?

The industry has gone through big regulatory changes since the aftermath of the crisis in 2008. These changes have not yet been entirely processed by the management companies. I think that, from today’s perspective, and without any further market turbulence, the product lines of the management companies will not encounter any major changes. Regulation costs will affect management companies, leading them to carefully analyse the products they will take on board. In my opinion, there will be no major changes in the year to come with regard to the diversification of regulated products (UCITS still being the core product).

I would like to mention at this point that there may be changes coming forth in the area of alternative investment funds (AIFs). AIFs may be regulated or non-regulated products. The CSSF has come across, in the recent past, a few “innovative” regulated products, packaged in specialised investment funds that are investing in non-common asset classes. The CSSF in cooperation with the industry has finalised a draft bill and a CSSF regulation to limit the scope of eligible asset classes for specialised investment funds. On the other side, a draft bill for non-regulated reserved alternative investment funds (RAIFs) has been finalised recently by the industry. At this stage, it is too early to make any comment on the impact of these new regulations.

One key area of KYC is the question of how you can validate transactions that occur via internet platforms.

But on the topic of data collection, it should be mentioned that data from AIFMs has started being collected only quite recently. We are now in the process, mainly, of collecting it and verifying that the AIFMs have put in place the necessary infrastructure to fulfil the requirements of the reporting. Once the collection process is appropriately implemented and improved, we will be able to use the data more effectively. A main focus of the analysis will be—as already mentioned previously—on liquidity risk and on spill-over effects to other sectors of the financial industry. We aim to do more in-depth analysis of the AIFM reporting during 2016.

How have the skill-sets of people employed in the fund industry changed/evolved in recent years?

As management companies have had to adapt to new regulation, in particular circular 12/546 with regard to the organisation of the management company, the industry has had to recruit people with specialised skills in the fields of management, outsourcing, controlling, compliance, and risk. Management companies are working hard to find people with the right profile.
UBS: FinTech will play an ever-growing role in our industry.

What, in your opinion, is the role of FinTech in the future of the fund industry?

FinTech should be looked at as the provision of new capabilities, or in other words, services that bring added-value to the fund industry in Luxembourg. For FinTech to become an asset for Luxembourg, the industry has to first define the services that don’t yet exist but that would be welcomed by market participants.

For a management company, one of the main tech-related challenges is access to and the availability of structured data. Consider the sheer volume of data that needs to be collected across the entire organisation and from third parties (such as third-party custodians and administrators), plus the varying formats that this data will come in, plus the different ways it needs to be combined and analysed by different people on different platforms—it’s a huge task. You have to coordinate its collection, validation, storage, and compatibility. So the challenge is to go from a system of data silos to a system combined on one platform, but it’s not simple.

Besides data, there are efficiency factors that could involve FinTech. Some of the tasks a management company does are recurrent for each Luxembourg management company, so the centralisation of these tasks by a single service provider could greatly aid the industry. An example of something centralisable would be the research and documentation of AML/KYC due diligence processes. Overall, I’m sure that FinTech will have an ever-growing role to play in our industry.

What does UBS see as the key advantages of Luxembourg?

There are two points that come to mind. First are the traditional advantages of Luxembourg: it’s reliable—you can plan for the future from political, tax, and regulatory points of view—it has a AAA rating and is perceived as a well-regulated and well-supervised domicile of investment funds and related infrastructure. Second is Luxembourg’s available infrastructure, be it human skills or service providers. In the past Luxembourg has been able to attract both and has put in place measures to continue to do so. Promoters as well as investors benefit from this efficient and client-oriented atmosphere.

How do you predict Luxembourg’s fund industry will evolve in the future, and how does that match UBS’s strategy?

Well, positively we hope! But it’s a sensitive topic. Luxembourg has to be careful about the decisions it takes, especially decisions having an effect on the predictability of business plans or on the products managed out of Luxembourg. There is no doubt that the regulatory, political, and social environments will evolve, but as long as no major barriers arise which would force promoters to rethink their location strategy, I see excellent potential for the Luxembourg fund industry to continue its success story.

Passporting has to become more transparent, standardised, and simplified throughout the European countries, if market participants are to use this facility extensively.
You mentioned passporting capabilities as a way to increase efficiency. Would you say that the current framework for passporting is sufficient? What changes in the regulatory framework would you like to see?

With passporting you can enhance your efficiency because it allows you to use infrastructures that are already in place in other countries to serve new purposes. This means you don’t have to duplicate your structure. However, it still needs time to become a commonly used technique. Even if you’re able to passport to other countries, we’ve seen that there are still per-country, individual adaptations that must be made. It has to become more transparent, standardised, and simplified throughout the European countries, if market participants are to use this facility extensively. It was UCITS III that introduced passporting capabilities, but they were rarely used because of the persisting uncertainty on tax treatment and on other aspects. The environment is now changing, and passporting is becoming an opportunity. My hope is that, as management companies and also regulators gain more experience, the process can become simpler and simpler.

You asked how Luxembourg could support the perception of the management company as more than just a commodity. Luxembourg has to continue and even increase its efforts to attract specialists when it comes to risk managers and decision-makers recognised for their competence and dynamism. It also has to kindle the development of the FinTech industry, giving start-ups and other FinTech players competitive advantages over other countries and further embedding management companies in the product-to-client journey.

Our results indicate that UCITS and traditional asset classes within AIFs still dominate. If Luxembourg wants to remain a centre of excellence in the fund industry, what products do you think will become more important in the future and could work as unique selling points?

I think UCITS will stay our brand. Then it’s a question of how the world will evolve. Real estate, for example, is a growing market where Luxembourg is not represented strongly. The same is true for infrastructure and private equity, so I see some potential in these types of assets. For hedge funds, however, I’m not so sure. Luxembourg isn’t known for this asset group so the future will have to tell us on that one. Then there are microfinance funds and sustainability projects or funds which, in the context of a circular economy, could have potential in Luxembourg.

As long as no major barriers arise which would force promoters to rethink their location strategy, I see excellent potential for the Luxembourg fund industry to continue its success story.

How can a management company succeed in shifting the way the group perceives it from being a commodity to being a value-adding element of the group? Which services could bring added-value? How can Luxembourg as a hub work as a facilitator to support such a shift?

A commodity is something that you use to enable you to do business—not more, not less. But a management company is not a commodity, because it creates added-value: it is a solution provider, it is the governance of the product. It brings oversight and structure to a multitude of services that would otherwise be provided in an uncoordinated way. An example could be in product development: imagine a team that might be the incubator of an initial idea, but lacks the know-how and the market intelligence that would allow the idea to take off. It is the management company that will be able to fill this knowledge and know-how gap. In fact, we have seen this recently in an AIF fund: the solution to a structuring question about maximising efficiency while remaining compliant came out of the management company.
Aberdeen Asset Management: We see our partnership with Google as a win-win situation.

What is your view of the survey results? Are they in line with your expectations?

On the whole, the results are as we expected; however, the main surprise was the number of management companies appointing independent directors. This might indicate one of two things: either it’s a real trend, or management companies may have differing interpretations of what constitutes an “independent director.”

At Aberdeen, we have already discussed the possibility of taking on an independent director. Although we certainly understand the advantages that this can bring and are generally in favour of the extra governance discipline that independent directors can bring to shareholder funds, there are different challenges for wholly owned subsidiaries. We need to consider whether it would work well in practice, given that directors need to fully understand how the firm operates and that requires insight across our business as a whole, not just the operating subsidiary involved. This is certainly a topic meriting further consideration and understanding of industry developments.

How would you describe the business model of Aberdeen Asset Management (AAM) in Luxembourg and its role at the group level?

In Luxembourg, we have two companies: Aberdeen Global Services (AGS) for UCITS structures; and Aberdeen Management Services (AMS) for real estate investments.

Our cultural heritage and legacy is from the UK. However, at a group level we recognise that Luxembourg is a strategic European hub for funds. We strive to leverage on this, especially in terms of global distribution. Where possible, we choose Luxembourg as our primary platform when we launch a fund.

Will your model change in light of the AIFMD and the opportunity to consolidate different entities in Luxembourg?

We see the “SuperManCo” structure as an opportunity to gain efficiency. We currently have a number of different entities, a system which is often inefficient. This is especially the case when it comes to implementing change: you need to take into account the specific laws and market conditions that apply in each jurisdiction and this can be resource-intensive.

A “SuperManCo” will allow us to consolidate the many fund management entities we have scattered across Europe in one central location. Luxembourg was a natural choice for consolidation, given our existing activities here and its role as our primary distribution platform, as I previously mentioned.

Overall, this is part of a more general move here at Aberdeen towards a centralised model, allowing for economies of scale. In this context, we are currently looking to merge our two Luxembourg management companies—AGS and AMS—to further simplify our approach and fully centralise our business.
What advantages do you see in your organisation’s approach to regulatory change, wherein global work committees identify and implement the actions needed to comply?

Our group committees allow us to have a centrally coordinated approach to regulatory change, while keeping a global perspective on each project. The AGS and AMS merger to create a “SuperManCo” is a perfect example of this approach in action. Luxembourg will drive the change, but the impact the merger will have in other countries is also important to consider: this means leveraging local expertise—which is greatest in Luxembourg—while never falling into the trap of thinking that models can automatically be replicated elsewhere without any knock-on effects.

To what extent do you believe that data management and big data will have an impact on AAM’s business model?

The ability to process and exploit data is very important. While it will not necessarily revolutionise our business, it will certainly confer competitive first-mover advantages.

We were looking for a strategic partner to help us process data with minimum data cleansing and we found Google. Recently we have been working with them to examine our processes and leverage off their know-how. Specifically, they have helped us...

...use their data management capabilities.

As Google already has the knowledge and data management techniques we are looking for—in terms of cleaning, homogenising, and structuring data—we can reduce use of our internal resources, and at the same time build on their expertise.

...work around existing limitations.

Data quality is always a concern, but with Google we can leverage off a wider suite of tools to ensure the production of clean data.

...spot trends.

Google tells us what users are searching for, their areas of interest, and reoccurring themes. Access to intelligent data can help us both in terms of development of our products and in terms of being better able to target our clients.

...build an intelligent reporting tool.

This will mean that we can respond to data in marketing terms in a more efficient manner and build reliable sources of information without spending in a vacuum, where returns are more uncertain.

“Working in conjunction with companies like Google and seeing their thought-processes is extremely stimulating.”

Some may see your partnership with Google as “partnering with the enemy.” Do you have any concerns about working with a potential competitor?

Working in conjunction with companies like Google and seeing their thought-processes is extremely stimulating. Although a common fear in the market is that someone else will move faster, we see our partnership with Google as a win-win situation. We can better leverage our information and Google can develop a new revenue stream. Data management is an area that we believe will evolve rapidly so we need to make sure we get ahead of it.

Our key remaining challenge is to make sure we take advantage of our new data management tools. Working with Google also helps us on our approach, by guiding us towards the right questions to ask and tailoring our solutions accordingly.

This is a project mainly driven by the UK, but we plan to roll it out globally. The evolutionary nature of the project pushes us to build consistently better data management practices, such as further improving our digital platform to better interact with end-users.

What is your view about the future of asset management in Europe? How do you see it having an impact on AAM’s product offering?

The future will largely be shaped by changes in the nature of distribution, with increasingly empowered end-users. Take for example robo-advisers in the USA: with minimal human interaction, they analyse your individual profile and indicate where you should invest. European regulation—and notably MiFID and MiFID II—draw a clear line between guidance and advice, with strict rules in place regarding the latter. This, therefore, makes it more challenging to do something similar in the EU. Growing consumer empowerment is directly linked to regulation, and further decisions about what is—and what is not—acceptable will have to be made before we see robo-advisers and other developments becoming more widespread in Europe. For the time being, it is clear that if you are committed to a domestic market, you have to play by the local rules.
Union Investment Germany: Luxembourg has the know-how we need.

How would you describe Union Investment’s business model in Luxembourg? And Union Investment Luxembourg’s role at the group level? What challenges are you experiencing?

Our Luxembourg entity is part of the wider Union Investment Group, one of the largest German asset managers for private and institutional investors.

As a cooperative organisation, we are strongly influenced by the cooperative financial network’s philosophy of sustainability. Our aim is to offer investors and partners sustainable and innovative solutions with lasting value. To do this, an in-depth understanding of investors’ interests is key.

Here in Luxembourg, we offer a wide range of tailored investment solutions including equity, bond, and money market funds, as well as capital-protected product solutions. Our main market for the sale and distribution of our funds is the cooperative financial network in Germany, but we also cover much of Western Europe, from Spain and Italy right up to Sweden and Finland.

Luxembourg offers significant flexibility regarding its product range. On which products does Union Investment focus?

Union Investment Luxembourg (UIL) offers a wide range of products launched out of the Grand Duchy. While we mainly focus on UCITS for both retail and institutional clients, the UIL management company is also registered as an AIFM, administering 18 alternative investment funds directly from Luxembourg. UIL is able to offer a wide range of investment opportunities through these AIFs, including infrastructure, private equity, and real estate structures.

How do you benefit from being in Luxembourg?

Above and beyond the product range, Luxembourg is also responsible for the management and monitoring of cross-border distribution for the 500 funds and shares that our group sells across Europe. This is where Luxembourg’s competitive edge comes into play: only Luxembourg has the know-how we need for the successful cross-border distribution of our funds. The large selection of investment vehicles on offer in Luxembourg is easily able to accommodate any investment strategy. Relations between the government, legislator, and the private sector are also very close, meaning that the legal and regulatory framework is regularly updated. In this way, Luxembourg is able to react extremely quickly to market developments and modify policies relating to investment funds as and when required. All this combined enables us to adapt quickly to our clients’ needs.

Hans Joachim Reinke
CEO Union Investment Germany

Interview date: 16 June, 2015
Where many management companies see a major challenge in the increase in regulatory requirements, Union Investment sees potential opportunities. Could you please expand on this?

As a result of the financial crisis, we in the asset management industry—and our clients—face a double threat from new regulatory requirements and a low interest rate environment. However, at UIL, we also see an opportunity in these threats. In a nutshell: new regulations that have an impact on our clients—and particularly on institutional investors—constitute opportunities for asset managers. We can provide new solutions and service offerings that help our clients address liquidity capital ratios (LCRs) and Solvency II capital requirements. And due to the low-yield environment, now more than ever before, retail clients need investment funds that allow them to benefit from capital market opportunities.

The EU Commission’s Capital Market Union project has the potential to play a key role in making this happen. Should it come to fruition, it will help break down current obstacles to the movement of capital between investors on the one hand, and those in need of funding on the other. If it meets its aim of improving prospectus requirements—in addition to creating a framework for simple, transparent, and standardised securitisation—it would help asset managers grow their investment opportunities.

What role does data management / big data play in your company?

Big data plays an increasingly important role for us. Since information is one of the core assets of portfolio managers, it’s absolutely vital to us to take advantage of the new possibilities associated with it. With regard to our relationship with customers, we are of course very careful since the trust of our clients is the most important asset we have.

Digitalisation is changing the industry. What impacts does it have on your business and how will these transform your organisation and processes?

Digitalisation is the name of the game these days. Sometimes it is only associated with technical advancements, but digital progress only meets with success when the technology matches up with people’s needs. That is why we think digitalisation has to be viewed from a holistic perspective. It influences everything: our processes, our products, our business model, and most importantly our client relationships. We are in the process of adapting to this trend, but we’re keeping a sense of proportion at the same time.

Where do you see your company two years from now, and what is your strategy for getting there?

We are confident that the Union Investment Group will continue on its growth path, as investment funds are becoming more attractive to investors looking for returns and a well-balanced spread of investments. This is reflected in our strong new business. In the first half of 2015, Union Investment has achieved its best-ever level of net new business in the first half of any year. In our institutional business, we are experiencing huge demand which we put down to our risk-management skills. In addition, we are pushing international growth, focusing on institutional clients across Europe. The success of our retail business is based on our strategy of offering a small number of solutions focusing on customers’ key reasons for investing, as well as our close links with our partners in the cooperative financial network.

Only Luxembourg has the know-how we need for the successful cross-border distribution of our funds.
There are three main types of business models observed in Luxembourg management companies, as shown in the diagram below. The prevalent model in Luxembourg is still the in-house model, but we expect the third-party model to gain more traction with the increase in the number of relatively small alternative investment funds, and new products such as the Reserved Alternative Investment Fund (RAIF).

We also expect that increasing costs linked with having an in-house business model will put pressure on those management companies with fewer AUM to either try to consider using a third-party model, or to consolidate.
In terms of links between asset types and business models, we observe that:

II small in-house management companies are managing a number of real-estate structures;

II large in-house management companies are managing an increasing number of alternative assets (28%), mainly in the form of private equity or real estate; and

II third-party management companies are managing a number of private equity structures.

Master-feeder structures were used by 43% of the management companies surveyed. Among those 43%, over half (57%) had their master structure located in Luxembourg.

In terms of links between asset types and business models, we observe that:

<table>
<thead>
<tr>
<th>Type of ManCo</th>
<th>UCITS</th>
<th>AIF</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large in-house</td>
<td>91</td>
<td>7</td>
<td>2</td>
</tr>
<tr>
<td>Medium in-house</td>
<td>82</td>
<td>10</td>
<td>8</td>
</tr>
<tr>
<td>Small in-house</td>
<td>56</td>
<td>43</td>
<td>1</td>
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<tr>
<td>Third-party</td>
<td>58</td>
<td>23</td>
<td>19</td>
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<tr>
<td>Mixed-business-model</td>
<td>81</td>
<td>19</td>
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UCITS represent 86% of the AUM managed by the management companies we surveyed. Nineteen percent of the companies also manage non-Luxembourg domiciled funds, representing mostly AIFs.

**AUM distribution across asset type**

<table>
<thead>
<tr>
<th>Type of ManCo</th>
<th>Real estate</th>
<th>Private equity</th>
<th>Hedge funds</th>
<th>Traditional assets</th>
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<tbody>
<tr>
<td>Large in-house</td>
<td>10</td>
<td>18</td>
<td>1</td>
<td>71</td>
</tr>
<tr>
<td>Medium in-house</td>
<td>11</td>
<td>7</td>
<td>1</td>
<td>81</td>
</tr>
<tr>
<td>Small in-house</td>
<td>43</td>
<td>1</td>
<td>1</td>
<td>55</td>
</tr>
<tr>
<td>Third-party</td>
<td>6</td>
<td>18</td>
<td>3</td>
<td>73</td>
</tr>
<tr>
<td>Mixed-business-model</td>
<td>0</td>
<td>15</td>
<td>0</td>
<td>85</td>
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</tbody>
</table>
“The future belongs to people who see possibilities before they become obvious.”

Ted Levitt
American economist and professor
Harvard Business School
1. Governance model

Size and composition
Our surveyed management companies had an average of three conducting officers, and their boards of directors had an average of five members. The larger boards, going up to nine members, were found in the larger management companies.

Independent directors
Only 38% of the respondents had independent directors on their boards. We expect this ratio to increase, in the context of UCITS V’s Level 2 text regarding the need for independent directors.

For those using independent directors, the main benefit they perceive is the broader industry experience that independent directors bring to board discussions.

Corporate governance composition

<table>
<thead>
<tr>
<th>Gender Diversity</th>
<th>Board of Directors</th>
<th>Conducting Officers</th>
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</thead>
<tbody>
<tr>
<td>Average Persons</td>
<td>4.7</td>
<td>3.0</td>
</tr>
<tr>
<td>Gender Diversity</td>
<td>86% 14%</td>
<td>84% 16%</td>
</tr>
</tbody>
</table>

ManCos with at least one independent director

<table>
<thead>
<tr>
<th>Type of ManCo</th>
<th>At least one independent director</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large in-house</td>
<td>20%</td>
</tr>
<tr>
<td>Small in-house</td>
<td>30%</td>
</tr>
<tr>
<td>Medium in-house</td>
<td>31%</td>
</tr>
<tr>
<td>Third-party</td>
<td>50%</td>
</tr>
<tr>
<td>Mixed-business-model</td>
<td>73%</td>
</tr>
</tbody>
</table>
ManCos and funds with the same directors

- >50% of the directors of the ManCos = directors of the funds
- directors of the ManCos = directors of the funds

17% 20%

Overlap of responsibilities
Seventeen percent of the management companies said that over half of their board members were also on the board of the funds they manage. However, this figure is expected to decrease as many companies already have plans to reduce the proportion of board members who are on both boards (the management company’s and the fund’s) to around 30%.

Meeting frequency
Market practice in terms of board meeting frequency is at least quarterly, for both management company boards and fund boards.

<table>
<thead>
<tr>
<th>FREQUENCY</th>
<th>WEEKLY</th>
<th>BI-WEEKLY</th>
<th>MONTHLY</th>
<th>QUARTERLY</th>
<th>SEMI-ANNUALLY</th>
<th>ANNUALLY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board of directors</td>
<td>13%</td>
<td>69%</td>
<td>16%</td>
<td>4%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conducting officers</td>
<td>29%</td>
<td>19%</td>
<td>49%</td>
<td>3%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board of directors</td>
<td>5%</td>
<td>65%</td>
<td>25%</td>
<td>5%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
We have observed that management companies have continued to build substance over the last few years, in areas such as risk management, compliance, internal audit, and fund accounting / NAV oversight. The increase has been more than what was predicted in our previous survey in 2013.

**Status 2012/2013**

<table>
<thead>
<tr>
<th>Activity</th>
<th>Insourced</th>
<th>Outsourced</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk management</td>
<td>28%</td>
<td>72%</td>
</tr>
<tr>
<td>Investment compliance</td>
<td>26%</td>
<td>74%</td>
</tr>
<tr>
<td>Internal audit</td>
<td>15%</td>
<td>85%</td>
</tr>
<tr>
<td>Fund accounting / NAV oversight</td>
<td>19%</td>
<td>81%</td>
</tr>
</tbody>
</table>

**Activities:**

- Insourced
- Outsourced

**Two-year forecast in 2012/2013**

<table>
<thead>
<tr>
<th>Activity</th>
<th>Insourced</th>
<th>Outsourced</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk management</td>
<td>53%</td>
<td>47%</td>
</tr>
<tr>
<td>Investment compliance</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>Internal audit</td>
<td>45%</td>
<td>55%</td>
</tr>
<tr>
<td>Fund accounting / NAV oversight</td>
<td>50%</td>
<td>50%</td>
</tr>
</tbody>
</table>

**Activities:**

- Insourced
- Outsourced
Insourcing vs. outsourcing strategy

Result 2016/17

<table>
<thead>
<tr>
<th>Activity</th>
<th>Insourced</th>
<th>ManCo and outsourced</th>
<th>Outsourced</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk management</td>
<td>63%</td>
<td>31%</td>
<td>6%</td>
</tr>
<tr>
<td>Investment compliance</td>
<td>44%</td>
<td>37%</td>
<td>19%</td>
</tr>
<tr>
<td>Internal audit</td>
<td>42%</td>
<td>34%</td>
<td>24%</td>
</tr>
<tr>
<td>Fund accounting / NAV oversight</td>
<td>32%</td>
<td>26%</td>
<td>42%</td>
</tr>
</tbody>
</table>

Activities:

- Risk management
- Investment compliance
- Internal audit
- Fund accounting / NAV oversight

Amongst companies with in-house activities, we note that more portfolio management is performed in Luxembourg, whereas in the past this function was primarily done abroad.

Proportion of FTEs dedicated to activity (if performed in-house)

<table>
<thead>
<tr>
<th>Activity</th>
<th>FTEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portfolio management</td>
<td>14%</td>
</tr>
<tr>
<td>Risk management</td>
<td>13%</td>
</tr>
<tr>
<td>Transfer agency</td>
<td>13%</td>
</tr>
<tr>
<td>Investment management compliance</td>
<td>11%</td>
</tr>
<tr>
<td>Regulatory reporting</td>
<td>10%</td>
</tr>
<tr>
<td>Tax reporting</td>
<td>6%</td>
</tr>
</tbody>
</table>

Substance and sourcing strategy

21
We observed that the two main factors that helped management companies reduce their cost-income ratios were increased AUM and increased use of automated operational flows and processes. Smaller management companies seem to be the most affected by an increase in their cost-income ratios over the past two years. This was to be expected, since the volume of assets managed largely determines the size of revenue and margins of management companies.

### Evolution of cost-income ratio (CIR) by business model

<table>
<thead>
<tr>
<th>Business Model</th>
<th>Decreased</th>
<th>Remained stable</th>
<th>Increased</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large in-house ManCo</td>
<td>38%</td>
<td>50%</td>
<td>12%</td>
</tr>
<tr>
<td>Medium in-house ManCo</td>
<td>16%</td>
<td>44%</td>
<td>40%</td>
</tr>
<tr>
<td>Small in-house ManCo</td>
<td>26%</td>
<td></td>
<td>74%</td>
</tr>
<tr>
<td>Mixed-business-model ManCo</td>
<td>11%</td>
<td>35%</td>
<td>54%</td>
</tr>
<tr>
<td>Third-party ManCo</td>
<td>42%</td>
<td>16%</td>
<td>42%</td>
</tr>
</tbody>
</table>

- **Decreased**
- **Remained stable**
- **Increased**
The distribution of the cost-income ratio by business model is shown in the diagram below.

**Cost drivers of cost-income ratio (CIR)**

- Regulatory implementation: 58%
- Recruitment: 40%
- Business needs: 35%
- External resources: 33%

**CIR by business model**

We note that larger management companies enjoy the lowest cost-income ratios in the industry, whereas third-party management companies, due to a lower volume of AUM in comparison, have to work harder to keep tight control over cost-income ratios.
4. Operational excellence

Current primary challenges of ManCos

- Controls and tools for outsourced services: 78%
- Level of substance: 68%
- Effective due diligence: 56%

These challenges can be addressed, for example, by:

II increasing the use of data platforms, data and analytics, and automated KPIs to focus on exceptions;

II increasing the number of skilled resources and asset types as products evolve, e.g. risk managers, compliance officers, and portfolio managers, while at the same time outsourcing non-core and automatable tasks to lower cost platforms; and

II using a risk-based approach and data and analytics to determine due diligence frequency, while ensuring due diligence reviews are well-documented.

Predicted change in Luxembourg operations

Luxembourg operations
Over the next two years, almost half of the management companies surveyed intend to grow their operations in Luxembourg.
What kind of resources do you need?

Operations agenda items
The following topics form part of the operations agenda and will likely determine where time and investments are dedicated:

Upcoming topics in the next two years

<table>
<thead>
<tr>
<th>Topic</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investing in internal resources and skills</td>
<td>92%</td>
</tr>
<tr>
<td>Reviewing pricing and margin structures</td>
<td>89%</td>
</tr>
<tr>
<td>Optimising tools, e.g. RM, regulatory and risk reporting</td>
<td>84%</td>
</tr>
<tr>
<td>Improving operational efficiency and outsourcing oversight</td>
<td>75%</td>
</tr>
</tbody>
</table>

Risk management remains a key concern, and management company CEOs feel that they need the following resources the most:
Fee models
Forty-eight percent of the management companies surveyed apply some sort of flat-fee model when invoicing funds under management, and a further 8% of respondents plan to do so in the future.

The flat-fee model observed can be broken down into two further components as shown in the diagram below.

Flat-fee model components

Fees can be paid directly by the fund to service providers, or flow through the management company. We observed that, for 68% of the management companies, the fees flow through the management company.

Entity responsible for fund fee payment

How often do you adapt your flat fee at fund level?

Only 24% of the management companies surveyed adapt their flat-fee systematically on an annual basis.
5. Navigating the regulatory landscape

The regulatory topics most occupying management company CEOs’ attention are those relating to the implementation of regulations on alternative funds (AIFMD), anti-money laundering (AML), and retail funds (UCITS V and MiFID II).

**Top-ranked regulations and their impacts**

- **AIFMD** 68%
- **AML** 46%
- **UCITS V** 45%
- **PATCA/EXCH OF INFO** 45%
- **MIFID** 40%
- **EMIR** 32%
- **BEPS** 17%

We found that Luxembourg management companies are, to a large extent, involved in the process of identifying new regulatory requirements and their impact on the wider group outside Luxembourg. New rules with significant impact across the whole group are usually managed by competence centres/project committees at the group level.

**Identification of requirements**

- **EU regulations**
  - 87%
  - 49%
  - 35%
  - 45%
  - 3%
  - 14%
  - 22%
  - 15%

- **Local level**
- **Headquarter level**
- **Centralised at group level**

PRIIPs, Solvency II, and CRS were not viewed as hot topics at the time of the survey, but they have been added to most CEOs’ agendas since.
6. Data and analytics

Who is responsible for data management?

We expect data and analytics to play a key role in the future in achieving better customer profiling, improving the quality of management information, driving efficiency, and satisfying a number of reporting requirements. However, we note that there are a number of challenges to be addressed before this role can be fully realised.

For management companies, data management is currently done principally by their service providers (56%). This usually means having to coordinate varying systems, varying data sets, and varying types of reports.

Current top data challenges

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Data quality</td>
<td>77%</td>
</tr>
<tr>
<td>Regulatory reporting</td>
<td>59%</td>
</tr>
<tr>
<td>Optimisation of data management and governance</td>
<td>56%</td>
</tr>
<tr>
<td>Data consistency</td>
<td>46%</td>
</tr>
<tr>
<td>Investor reporting</td>
<td>27%</td>
</tr>
<tr>
<td>Unsatisfactory IT systems</td>
<td>23%</td>
</tr>
<tr>
<td>Complex data validation processes</td>
<td>12%</td>
</tr>
</tbody>
</table>
Data quality is essential for sound decision-making based on data and analytics, and for complete and accurate regulatory and investor reports. In terms of best practices on data management and quality, Basel Committee document BCBS 239—principles for effective risk data aggregation and risk reporting—is rapidly becoming a standard for the financial services industry. Management companies will likely have to adopt a number of these principles as part of their internal control environment to achieve the right level of data quality.

Management company CEOs believe that they stand to benefit a lot from using data and analytics, but it will require an extensive data cleansing and aggregation exercise, also involving a redefinition of the data/IT architecture. Overall, actions taken in this direction have been limited so far.

**Status and relevance of data analytics over the next two years**

<table>
<thead>
<tr>
<th>Area</th>
<th>HIGH - MODERATE RELEVANCE</th>
<th>IMPLEMENTATION STATUS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Optimisation of data management and governance</td>
<td>82%</td>
<td>10%</td>
</tr>
<tr>
<td>(Re)definition of data architecture</td>
<td>67%</td>
<td>8%</td>
</tr>
<tr>
<td>Use of data analytics (e.g. for investor and product segmentation)</td>
<td>62%</td>
<td>6%</td>
</tr>
<tr>
<td>Optimisation of reporting using data analytics</td>
<td>56%</td>
<td>8%</td>
</tr>
<tr>
<td>Outsourcing of data management</td>
<td>30%</td>
<td>11%</td>
</tr>
</tbody>
</table>
“The first step in exceeding your customers’ expectations is to know those expectations.”

Roy H Williams
Author and Marketing Consultant
Although “digital” is a certainly a current buzzword, we observed that its exact meaning remains unclear or inconsistent in many minds.

Digital universe

Our view of the digital universe is summarised in the diagram below:

- How do I modify processes to make them simpler, cheaper, and quicker?
- How can technology make my organisation the employer of choice?
- How can I deliver exceptional services?
- What currently exists in the digital landscape?
- How can technology be used to engage customers?
- What are customers’ needs?
- How is digital technology being leveraged? Via advice? Directly? With genuine omni-channels?
- How can digital technology help make services simpler?

Source: KPMG International
### Current top digital-related challenges

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Evolving client needs</td>
<td>59%</td>
</tr>
<tr>
<td>Changing client interactions</td>
<td>54%</td>
</tr>
<tr>
<td>Digitalisation of internal processes</td>
<td>38%</td>
</tr>
<tr>
<td>Cyber risk</td>
<td>38%</td>
</tr>
<tr>
<td>Customer experience</td>
<td>37%</td>
</tr>
<tr>
<td>New types of competitors</td>
<td>24%</td>
</tr>
<tr>
<td>Disruptive technologies</td>
<td>17%</td>
</tr>
</tbody>
</table>

Based on the above diagram, digital cuts across the whole value chain, from selling products to maintaining them and performing oversight. Since investors’ buying behaviour, the need for tighter cost control, and better oversight are all evolving rapidly, a company’s digital strategy is key to ensuring survival and growth in this sector.

We noted that digital strategies still appeared to be in their infancy, compared to what we consider they will be in the future.

### Barriers to digital strategy formulation

<table>
<thead>
<tr>
<th>Barrier</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organisational culture and structure</td>
<td>52%</td>
</tr>
<tr>
<td>Budget restrictions</td>
<td>48%</td>
</tr>
<tr>
<td>Awareness of client needs</td>
<td>37%</td>
</tr>
<tr>
<td>Time constraints</td>
<td>33%</td>
</tr>
<tr>
<td>Unclear return on investments</td>
<td>27%</td>
</tr>
<tr>
<td>Technical restrictions and constraints</td>
<td>21%</td>
</tr>
<tr>
<td>Overwhelming amount of data</td>
<td>17%</td>
</tr>
<tr>
<td>Lack of digital resources and competence</td>
<td>10%</td>
</tr>
</tbody>
</table>

Of the factors slowing down efforts to develop and perfect digital strategies, the following barriers were felt to be the main ones to tackle:

The next step, therefore, seems to be to generate more awareness within the organisation as to the potential impacts, opportunities, and threats facing it, should it choose a wait-and-see approach to this important topic.
New types of competitors and disruptive technologies being at the bottom of the list demonstrates that the digital journey has only begun. A number of thought-leaders currently forecast that disruptive technologies and competitors will have a significant impact on all types of businesses, and will eventually reach retail consumer markets.

In the asset management arena, we have seen that robo-advising, KYC utility concepts, and the possible use of blockchain to achieve major operational efficiencies are only some of the ways in which the industry and its customers can benefit.

The next major step is defining a digital strategy. Management company CEOs felt that the next priorities in their digital agenda were as follows:

### Implementation status and relevance of data and analytics projects

<table>
<thead>
<tr>
<th>Offering a mobile platform</th>
<th>68%</th>
<th>6%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Definition of digital strategy</td>
<td>67%</td>
<td>7%</td>
</tr>
<tr>
<td>Implementation of web content management</td>
<td>63%</td>
<td>3%</td>
</tr>
<tr>
<td>Digitalisation of internal processes</td>
<td>62%</td>
<td>0%</td>
</tr>
<tr>
<td>Integration of CRM with other tools</td>
<td>61%</td>
<td>2%</td>
</tr>
<tr>
<td>Social marketing engagement</td>
<td>55%</td>
<td>2%</td>
</tr>
<tr>
<td>Use of big data</td>
<td>43%</td>
<td>2%</td>
</tr>
<tr>
<td>Crowdsourcing for products, services and market developments</td>
<td>27%</td>
<td>2%</td>
</tr>
</tbody>
</table>

*Implementation status completed*
The survey participants represent management companies of varying business models (in-house vs. third party), varying operational strategies (insourced vs. outsourced), varying sizes, and varying origins.

**Parent company location**

- **Luxembourg**: 22%
- **Switzerland**: 16%
- **Germany**: 14%
- **USA**: 13%
- **Italy**: 9%
- **France**: 9%
- **United Kingdom**: 8%
- **Other EU**: 8%
- **Other Non-EU**: 8%

**Type of parent company**

- **Asset managers**: 36%
- **Banks**: 32%
- **Others***: 32%

*holdings, independent ManCos, insurance companies, PSFs, investment managers

**Type of respondent**

- **CEO**: 80%
- **Director or equivalent**: 14%
- **Board member**: 6%
UCITS ManCo & AIFM: 76%
UCITS ManCo: 24%

90% of the top 20 ManCos by AUM

Category of management company

63% of the total AUM in Luxembourg

Market coverage

*These results represent a snapshot taken at the end of June 2015. In the meantime some of the UCITS ManCos have been in the process of obtaining the AIFM license.

Participants by ManCo AUM

- Small ManCos (<€5bn AUM): 32%
- Medium ManCos (€5 to €40bn AUM): 41%
- Large ManCos (>€40bn AUM): 27%

*Total AUM of participants / Total AUM of all ManCos in Luxembourg
Cost analysis on the pricing applied by administrators and custodian banks

In 2015 KPMG Luxembourg conducted a cost analysis to gain a high-level understanding of the pricing applied by fund administrators and custody agents in the context of a fund liquidation. To this end we reviewed 24 contracts from various administrative and custody agents in Luxembourg and established a detailed fee ranking.

Our key findings of the cost analysis are summarised below:

## Fee structure for each function during liquidation period

<table>
<thead>
<tr>
<th>Function</th>
<th>Fee Structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administration</td>
<td>Flat fee: 78%, Mixed: 11%, Variable: 11%</td>
</tr>
<tr>
<td>Custody</td>
<td>Flat fee: 22%, Mixed: 78%</td>
</tr>
<tr>
<td>Accounting</td>
<td>Flat fee: 100%</td>
</tr>
<tr>
<td>Transfer agent</td>
<td>Flat fee: 100%</td>
</tr>
<tr>
<td>Registrar agent</td>
<td>Flat fee: 100%</td>
</tr>
<tr>
<td>Domiciliation</td>
<td>Flat fee: 100%</td>
</tr>
</tbody>
</table>
Twenty-one percent of contracts were renegotiated following the fund’s liquidation start.

Almost half of contracts include a floor.

Our analysis indicates that there are significant disparities among costs applied by administrators and custodian banks during a fund’s liquidation. Moreover, while some actors renegotiate contracts leading to higher fees, certain commercial gestures may sometimes result in no costs being applied at all.

We trust that our cost analysis can be valuable to rapidly benchmark actors within the sector. Please contact Zia Hossen, Partner and Head of our Transactions and Restructuring Services for further information.

About other KPMG surveys 37
Top 10 domiciles of worldwide investment fund assets

48.4% Luxembourg
9.7% USA
5.1% LUXEMBOURG
4.8% IRELAND
4.8% FRANCE
4% GERMANY
3.7% UK
3.2% AUSTRALIA
3% JAPAN
2.9% CANADA
2.6% BRAZIL

€3.6 trillion net assets under management in Luxembourg funds


Evolution of Luxembourg's UCI net assets and UCITS management companies

Source: CSSF annual reports 2004-2014; CSSF newsletter 12/15
Almost half of our survey respondents indicated an intention to further increase their operations in Luxembourg, and a wish to expand their business in the near future.

10 reasons why management companies come to Luxembourg

1. Largest fund centre in Europe and largest international hub for fund distribution.
2. Worldwide recognition of UCITS brand "Made in Luxembourg".
3. Very low country risk.
4. Ideal strategic position at the heart of Europe and high standard of living.
5. Long-standing experience in multi-location fund administration.
7. Sophisticated but pragmatic legal and regulatory framework.
8. Large offer of fund structures beyond UCITS.
10. Efficient and reliable fund infrastructure.

Source: ALFI
KPMG would like to warmly thank all the participants who took part in this survey for their valuable help and time. In addition, we would like to express our sincere gratitude to all the interviewees who agreed to share their feedback and their vision of the challenges in the asset management industry, in particular:

II Simone Delcourt – Director, Commission de Surveillance du Secteur Financier
II Gary Marshall – Group Head of Product, Aberdeen Asset Management
II Hans Joachim Reinke – CEO, Union Investment Germany
II Gilbert Schintgen – CEO, UBS Fund Management (Luxembourg) S.A.
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGS</td>
<td>Aberdeen Global Services</td>
</tr>
<tr>
<td>AIFM / AIFMD</td>
<td>Alternative Investment Fund Managers Directive</td>
</tr>
<tr>
<td>AML</td>
<td>Anti-Money Laundering</td>
</tr>
<tr>
<td>AMS</td>
<td>Aberdeen Management Services</td>
</tr>
<tr>
<td>AUM</td>
<td>Assets under Management</td>
</tr>
<tr>
<td>BEPS</td>
<td>Base Erosion and Profit Shifting</td>
</tr>
<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>CIR</td>
<td>Cost-Income Ratio</td>
</tr>
<tr>
<td>CRS</td>
<td>Common Reporting Standards</td>
</tr>
<tr>
<td>CSSF</td>
<td>Commission de Surveillance du Secteur Financier</td>
</tr>
<tr>
<td>D&amp;A</td>
<td>Data &amp; Analytics</td>
</tr>
<tr>
<td>EMIR</td>
<td>European Market Infrastructure Regulation</td>
</tr>
<tr>
<td>FATCA</td>
<td>Foreign Account Tax Compliance Act</td>
</tr>
<tr>
<td>FTE</td>
<td>Full Time Equivalent</td>
</tr>
<tr>
<td>KYC</td>
<td>Know Your Customer</td>
</tr>
<tr>
<td>LCRs</td>
<td>Liquidity Capital Ratios</td>
</tr>
<tr>
<td>ManCo</td>
<td>Management Company</td>
</tr>
<tr>
<td>MIFID</td>
<td>Markets in Financial Instruments Directive</td>
</tr>
<tr>
<td>NAV</td>
<td>Net Asset Value</td>
</tr>
<tr>
<td>RAIF</td>
<td>Reserved Alternative Investment Fund</td>
</tr>
<tr>
<td>SICAR</td>
<td>Société d’Investissement en Capital à Risque</td>
</tr>
<tr>
<td>SICAV</td>
<td>Société d’Investissement à Capital Variable</td>
</tr>
<tr>
<td>SIF</td>
<td>Specialised Investment Fund</td>
</tr>
<tr>
<td>UCITS</td>
<td>Undertakings for Collective Investment in Transferable Securities</td>
</tr>
<tr>
<td>UIL</td>
<td>Union Investment Luxembourg</td>
</tr>
</tbody>
</table>
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