



Parting of the ways

Evolving Asset Management Regulation report

Executive Summary

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Executive summary

In last year's report¹ we conjectured that the new political context within Europe and in the US, and developments in Asia and elsewhere, were likely to have a significant influence on regulatory policy and rule-making, during 2017 and beyond. Our insight has been proven correct.

After the financial crisis, regulators around the globe agreed common aims to enhance the integrity of markets and to reduce risks for governments and consumers. There was consensus on the overall regulatory agenda and priorities, leading to a convergence of worldwide regulatory standards. **That consensus now appears to be breaking down:** there is a parting of the ways.

The US administration believes the raft of post-crisis regulation has encumbered its asset management industry. There is a desire to deregulate and take a path that forks from that of other countries, which are forging ahead with the implementation of new rules.

Within Europe, each piece of post-crisis regulation has a review clause, but each of these reviews has a different due-by date. There are some calls to review rules in the round and consider rationalization, as has happened in the US. It will be interesting to see whether and how the deregulatory agenda in the US impacts policy makers' views on the extent to which EU legislation should be rationalized. **Will competitiveness become a key theme in regulatory debates?**

As regards supervisory activities, though, there is a common global theme – increased scrutiny of the asset management sector. Regulators are evolving their supervisory approach, seeking increased resources and harnessing technology.

A parting of the ways is especially clear in the **ongoing debate about systemic risks** inherent in asset management activities and investment funds. Outside the US, the application of a banking policy mind-set to open-ended funds is creating tension within the global industry. The need for debate on leverage and on liquidity risk management is understood, but the narrow focus on widely-held open-ended funds is questioned. The growth in exchange-traded funds has brought them under the spotlight, but arguments, counter-arguments and mixed messages make it difficult to call the direction of the debate.

¹ <https://home.kpmg.com/uk/en/home/insights/2017/06/evolving-investment-management-regulation-fs.html>

Meanwhile, **regulators continue to focus on governance, culture and conduct.** Within Europe, MiFID II² has thrown up a number of implementation issues and questions about fragmentation of the single market. Elsewhere, a number of emerging themes chime with European developments, such as increasing focus on named individuals and clarity of roles, and on risk and compliance functions. Product governance and disclosures remain firmly in regulators' sights, as do fund distributors in general and financial advisers in particular.

The **protection of client data has emerged as a major priority**, with big questions for asset managers about what data they hold and whether they may need to restrict cross border flows.

Simple and meaningful cost disclosures for funds remain firmly on the regulatory agenda but are elusive. And an increasing number of regulators are also scrutinizing the level of costs and charges. **Are investors being put front and centre?**

A number of countries are establishing new domestic fund structures to compete with foreign options. The word **competitiveness is beginning to re-enter regulatory language.** Despite best intentions, though, cross-border distribution of investment funds is far from frictionless.

Use of the Asian fund passports remains low and bilateral passporting arrangements seem more promising in the short term. The European Commission has made it a priority for 2018 to remove barriers to creating a more competitive pan-EU investment landscape, including for personal pensions. However, there are questions about whether its proposals will result in more red tape, not less.

"Brexit" will impact cross border flows between the UK and the rest of the EU, in both directions. Also, the EU regulatory approach to the provision of portfolio management from one jurisdiction to another – or "delegation" – looks set to become more demanding.

It seems that asset managers will need to **navigate a complex distribution landscape** for some years to come.

Regulation is also entering new areas of the asset management business. It is evolving to facilitate the development of "fintech" and to be fit-for-purpose in the digital age, for example. Regulators recognize the benefits of new technologies and are seeking to accommodate them, but they are also concerned about existing risks that could be heightened by the new forms of services. Cyber security, robo-advice, crowdfunding and cryptocurrencies are all under consideration.

Sustainable investing was until recently considered a matter only for asset managers and investor preferences.

² Markets In Financial Instruments Directive, revised

This subject, too, has now entered the regulatory mainstream. Initiatives relating to environmental, social and governance (ESG) factors and socially-responsible investing (SRI) have received regulatory support in several countries.

As institutional investors increasingly ask more questions about ESG and SRI – in part prompted by their own beneficiaries' demands, in part by regulatory suasion – the long-standing debate about **whether consideration of ESG factors or SRI fits with fiduciary responsibility** is evolving. Also, some regulators are beginning to ask questions about diversity in the work force.

While navigating an increasingly complex regulatory landscape, asset managers will need to keep their eye on the reviews of post-crisis regulation and further regulatory proposals. It seems that the industry will need to operate within and manage uncertainty, for some time to come.

Key issues for CEOs

- **Factor into your business plans both the fragmenting and complex regulatory landscape and increasing supervisory scrutiny**
- **Watch carefully the evolving debate on systemic risks as more sectors of the industry are brought into focus**
- **Ensure your governance model, culture and conduct conform with new regulatory expressions of good practice, including product governance, disclosures and protection of client data**
- **Review your decision-making and monitoring process around fee structures and fee rates. Can you evidence that the investor is being put front and centre in those decisions?**
- **Consider how best to navigate an increasingly complex distribution landscape**
- **Embrace technological developments but ensure full consideration of the attendant risks**
- **Consider ESG factors and SRI, which are becoming a regulatory must for asset managers and institutional investors**

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Parting of the ways



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End of the post-financial crisis consensus?



Chapter 2

Systemic risk - the big divide



Chapter 3

Outside the US, drive to implement rules is relentless



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No let-up on costs and charges



Chapter 5

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Chapter 6

Creating innovative, competitive environments



Chapter 7

Sustainable finance moves into the regulatory mainstream