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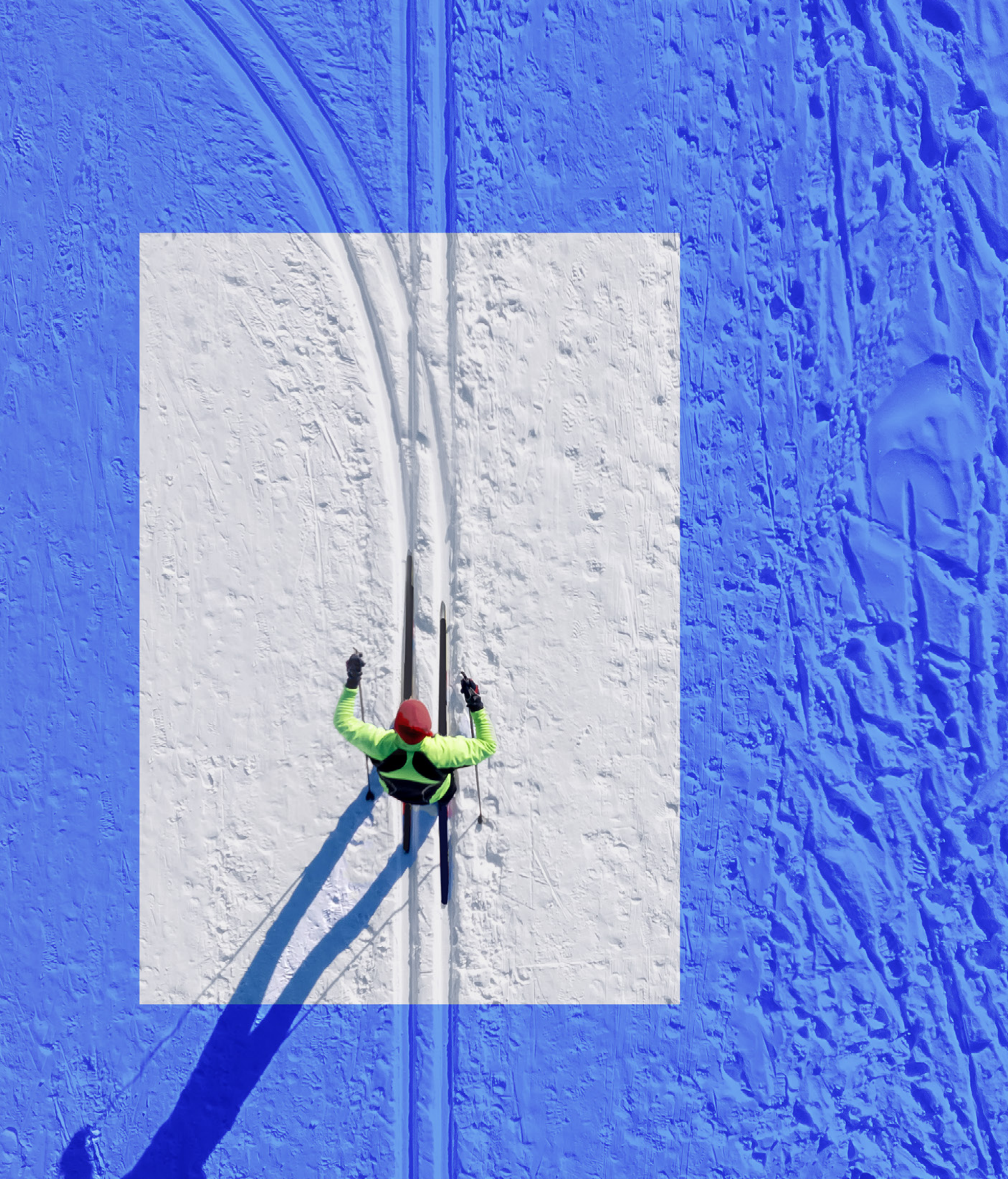
Managing divergence

Evolving Asset Management Regulation Report 2023

There are many external challenges facing the asset management industry, including demands for sustainable finance, volatility in capital markets, technological innovation, and cyber threats. Firms must also navigate further rafts of new rules, increasing regulatory divergence and greater supervisory scrutiny. Firms need to adopt resilient and dynamic business models if they are to be successful.

Regulators around the world are focusing on common themes in a fast-changing world. However, a lack of global standards and national nuances mean that they are implementing detailed rules and guidance in different ways. Increasing regulatory divergence is causing complexity and challenges for cross-border asset managers in terms of how they manage and market their products.



Regulators are responding to both global and regional priorities. Some are introducing fundamentally **new regulatory frameworks** for the industry or are undertaking major reviews of existing ones.

There are new rules and substantial amendments to existing requirements relating to **sustainable finance**. Preventing "greenwashing" is a common priority among policymakers, but they are seeking to address this concern in diverse ways. More broadly, there are efforts to make firms take account of sustainability risks throughout their business, including investment processes and remuneration policies. Initiatives relating to enhanced reporting aim to capture more firms and products in the capital market ecosystem, and to increase the flow of information from companies to stakeholders, including asset managers.

The increasingly vital role asset managers play in the financial system and funding the real economy means that **systemic risk** continues to be an important regulatory priority. Most regulatory initiatives relate to tightening up liquidity management in open-ended investment funds and the use of leverage more generally, but regulators are exploring potential risks and vulnerabilities in other areas, such as private markets and crypto-assets.

> **Global issues in financial services are best addressed at global level.**
>
> **Jean-Paul Servais,** IOSCO Board Chair and Financial Services and Markets Authority (FSMA) Chairman, June 2023

Managing wider risks to enhance the resilience of business models remains important, and there are new requirements relating to protecting against cyber threats, enhancing operational resilience, and overseeing outsourced activities. The adequacy of asset managers' financial resources is also under review in some jurisdictions.

Technological innovation continues at pace and regulators are balancing facilitation of developments with the need for proper risk mitigation. Artificial intelligence and the use of distributed ledger technology are key areas of regulatory attention. Firms need to consider both the potential benefits and the risks of new technologies.

The bar has been raised when it comes to protecting and educating investors. New conduct frameworks have been introduced, costs and charges are under significant scrutiny, and efforts are being made to bring disclosure and distribution arrangements into line with technological developments.

Firms' governance arrangements remain a regulatory priority. This year, the focus is on culture, the fitness and probity of individuals, and there being sufficient "substance" in regulated firms. Preventing financial crime, promoting clean markets, and devoting sufficient rigor to the stewardship of investments continue to be seen by regulators as facets of good governance.

Finally, in response to the ongoing need to rebuild economies and increase market share, jurisdictions continue to compete and offer more choice to firms and investors. Some jurisdictions are opening their capital markets further to foreign investors, re-assessing their fund frameworks, and launching new (or revising existing) fund vehicles to bolster investment.

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Key actions for CEOs:

- **Deliver sustainable finance:** Review the firm's overall strategy, embed sustainability factors into the investment process, ensure names and disclosures correctly reflect product offerings, and prepare to meet expanding disclosure requirements.
- **Mitigate systemic risk:** Review investment risk management arrangements, particularly relating to the liquidity management of open-ended funds, and stress testing. Control the use of leverage and adopt asset valuation best practices, especially for private, real and crypto-assets.
- **Double-down on resilience:** Review the risk management framework and controls in the light of challenges and opportunities. Identify and manage operational and information security-related risks, including third-party oversight arrangements. Maintain adequate financial resources.
- **Embrace innovation:** Explore potential uses of tokenization and artificial intelligence to drive efficiencies and new business, within the guardrails of the evolving regulatory framework.
- **Protect investors:** Align the firm's strategy, culture, and purpose with clients' best interests.
- **Project good governance:** Evaluate the success of the firm's culture, leadership, and governance model, and make changes where needed. Encourage a "speak-up" culture, ensure the composition of boards provides sufficient knowledge, expertise, experience and challenge, adopt a flexible business model, and deter financial crime.
- **Seize opportunities:** Factor opening markets and new and evolving fund vehicles into the business and product strategy.

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