KPMG

Supporting growth and ensuring care

Evolving asset management regulation report

July 2020

Executive summary

This is the tenth edition of EAMR[1] and the beginning of a new decade. In January 2020, we predicted that it would be a busy year on the regulatory front and would herald a challenging decade, with new legislation to implement or under development, and heightened supervisory expectations and scrutiny. That prediction is now set against the most challenging economic and operational backdrop in living memory.

The asset management industry is being called upon to support the recovery. **Regulators are seeking to encourage growth and are demanding that firms take greater care of their customers**. Broadly, regulatory agendas have not changed, only relative priorities and perspectives. All parties need to embrace the evolving new reality, including an increasingly digital society, changes to working practices, demands for sustainable finance and greater awareness of global interconnectedness.

The **regulatory response** to the COVID-19 pandemic initially focused on banks and capital markets, but asset managers were granted certain concessions, including the use of capital buffers, easing of reporting and disclosure requirements, changes to market position limits, and delays to implementation or consultation deadlines. New requirements included short selling bans in a handful of European countries, restraint in dividend distribution and remuneration, and increased reporting on the liquidity positions of open-ended funds.

To a large degree, asset managers and investment funds have proved **operationally resilient**, but regulators will consider what lessons should be learnt and will require firms to demonstrate they have learnt those lessons. Given that revenue is predominantly based on assets under management and asset values remain depressed, it may take some time for firms to restore their financial positions. This, coupled with changing investor demands, could lead to mergers, a re-focusing of businesses and changes to outsourcing practices.

In autumn 2019, regulators highlighted the persistently low interest rate environment as a key risk.[2] Subdued profitability poses challenges for firms and incentivizes search-for-yield strategies, giving rise to financial stability concerns. Recent events have brought efforts to manage **liquidity and leverage risk** into sharp relief. They have also re-ignited debates about whether certain trading practices or fund types contribute to systemic risk. Some policymakers suggest that computer-led trading strategies, short selling and certain types of investment funds exacerbate market volatility. Others think these things are not to blame and that they make it easier for everyone to buy and sell at more accurate prices. Global bodies concerned with systemic risk will debate these points well into the future, leading to further scrutiny of the sector.

The pandemic has accelerated moves to a digital society. Regulators are seeking to take advantage of **technology** to improve the efficiency of their own processes, while they grapple with the question whether rules designed for a paper-based world are still fit-for-purpose. They are keen to enable technology that makes investing simpler and cheaper for investors, but they wish to protect the investment ecosystem from technology that facilitates crime or can lead to poor investor choices. Will virtual board and stakeholder meetings (especially cross-border) be allowed to continue despite regulatory and fiscal concerns about substance? Will the opportunity be seized to convert static paper-based disclosure documents into dynamic online presentations that promote consumer understanding and engagement?

[1] KPMG's Evolving Asset Management Regulation report
[2] Source: ESAs Joint Committee Risk Report, Autumn 2019

Strong governance and good conduct have long been regulatory imperatives, but firms' **duty of care** is being re-articulated. Regulators are requiring firms always to put clients' interests before their own and are asking questions about stewardship and "short-termism". Firms must ask themselves not "can we?" but "should we?". Regulators are threatening enforcement action if firms' culture and conduct do not meet regulators' and clients' expectations.

> … not "can we?" but "should we?"

The perennial search for better disclosures – especially **costs** – continues and there is a wider debate on value for investors. There are reviews of capital markets rules and increasing pressure on asset managers to transition to the new **risk-free rates**.

The pandemic has also highlighted that all business sectors are deeply interconnected across borders, that societies of all types and wealth levels are vulnerable, and that the planet and environment are under increasing strain. It has accentuated demands for climate-aware investing and the ethical treatment of individuals. **Sustainable finance** (or "ESG") is a strategic issue that must be embraced across every aspect of firms' business models, operations and communications. Consistency of definitions and data remain elusive, but regulation is spreading.

There are **opportunities** in the form of new fund vehicles, a loosening of rules on underlying assets, and increased opportunities in the retirement savings market. Regulations that prevent **cross-border** distribution, registration and foreign ownership are being eroded, and there is an easing of the extra-territorial impacts of national rules. On the other hand, regulatory and fiscal demands for firms to have "substance" in a jurisdiction have increased, and the UK's departure from the EU – "Brexit" – has created new borders that the industry must navigate. Firms will have to navigate these developments, which may present both opportunities and challenges.

Questions for CEOs

- **Are we reviewing all aspects of our liquidity management framework and enhancing our stress testing scenarios?**
- **Are we reviewing our organization's financial, operational and commercial resilience? Are we identifying what lessons need to be learnt and how we will evidence to regulators that we have learnt them?**
- **Does our duty of care take first place across our organization: at all levels, in all our activities and in all our business decisions?**
- **Are we challenging ourselves on the value we provide for our investors and whether our disclosures are transparent and meaningful?**
- **Are we preparing for the move to risk-free rates?**
- **Have we developed a robust ESG strategy? How are we implementing it in practice?**
- **Are we identifying and taking advantage of new product and market opportunities?**
- **Are we well-placed to navigate rising and falling borders, and the opportunities and challenges they will bring?**

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The full report is available to download on kpmg.com/eamr2020

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