Evolving Asset Management Regulation Report

Executive summary

Policymakers and industry are looking at issues through a new lens. The pursuit of economic growth, changing investor demands and behaviors, and environmental and social concerns are influencing regulatory agendas. Of paramount importance are financing sustainable recovery and adjusting regulation for an increasingly digital world and hybrid working models.

Market events in 2020 and ongoing concerns about stability in the capital markets are causing regulators to reassess risks and redefine resilience. Good governance and appropriate investor protection remain regulatory imperatives and are being reinforced and recalibrated. There is even closer supervisory scrutiny in retail markets but an easing of regulations for professional clients.

Regulation is also enabling new market opportunities. New fund vehicles are being introduced as jurisdictions compete for share of market growth, private and real assets are being accommodated to aid economic recovery, and newer capital markets are opening further to foreign investment and firms.

Sustainable finance is the issue most discussed by regulators, industry and investors around the world. International policymakers are focused on sustainability risks, especially of climate change, and want more data and more consistent reporting. Specific requirements for asset owners and asset managers about their processes, and regarding disclosures to investors and beneficiaries, are being introduced or are under discussion. Meanwhile, investor demand for sustainable investment strategies and products continues to rise, along with supervisory scrutiny. Regulators are concerned about "greenwashing", and some are underlining the need for diversity and inclusion within firms.

The pandemic has been a technological catalyst. Initial lockdown measures to manage the pandemic caused years of change to take place in months, as firms moved quickly to large-scale remote working. The pandemic has also provided added impetus to policymakers' plans to encourage moves towards **digital** finance and the widening use of technology. Regulators are attuned to new and emerging risks, as well as the benefits, and are considering how to adjust regulation accordingly.

The asset management and investment funds industry has remained broadly resilient, despite the most extreme market conditions in living memory, and has seen remarkable recovery since the "dash for cash" in March 2020. However, a small number of open-ended funds had to suspend dealing temporarily, in the face of heavy redemption activity and difficulties in selling assets in volatile and sharply falling markets. Regulators are concerned that lessons should be learned and **risks reassessed.** There is special focus on liquidity management in open-ended funds and asset valuations, with bond funds, money market funds, exchange-traded funds and real estate funds all coming under increased scrutiny.

In the new post-pandemic reality, operational **resilience** is being redefined. It is seen as the outcome of effective management of operational risk and is becoming a key driver of investment and business strategy. When identifying potential disruptions to business, firms need to consider not if, but when. Additional demands on systems and processes arising from prolonged and large-scale remote working, and increasingly digitalization, have increased the focus on firms' technological resilience. Some jurisdictions are introducing new capital requirements for investment managers, with the aim of better defining minimum financial resilience.

Supervisors are reinforcing the need for **good governance** of firms, including board composition and engagement, clear management responsibilities and individual accountability. Traditional risk management, oversight and controls are challenged by large-scale remote working. The trends towards sustainable investment strategies, alternative asset classes and digitalization bring with them added complexity to business models and challenges to current operational processes. Product governance is also under the spotlight, together with firms' behavior in the capital markets and stewardship of client assets.

The perennial question for regulators about the optimal level of **investor protection** is now set against the backdrop of the social impacts of the pandemic, the need to encourage greater private investment to aid economic recovery, and the widening use of technology and increased digitalization. These drivers are calling into question whether investor protection rules need to be recalibrated, to capture better the broad spectrum of investors. Disclosure of costs and charges remains a regulatory imperative and is joined by concerns about advertising and marketing, and the treatment of vulnerable customers. While much of the regulatory focus is on the mass retail markets, some regulations are being eased for professional or accredited clients.

New fund vehicles are being introduced, or existing structures adjusted, to compete for market share and to cater for private investment in long-term assets. Many jurisdictions continue to open their capital markets to foreign firms and investment, providing **new investment opportunities.** On the other hand, the commercial and operational implications of the new EU-UK border continue to evolve and could have wider impacts on the industry's global delegation model.

Firms need to reconsider all aspects of their business models to ensure they are fit for purpose in the evolving new reality.

> “... firms need to consider not if, but when”

Questions for CEOs

— Do we have a clear, robust and nimble ESG strategy, supported by our governance arrangements, risk management, investment process, data capabilities and disclosures?

— Are we identifying, measuring and managing risks arising from new technologies and increased digitalization? Are we using technology effectively, to enhance client services and run our business more efficiently?

— Have we critically analyzed experience during the 2020 market stress and reassessed liquidity risk management for each open-ended fund? Do our policies, controls and documentation meet supervisory expectations?

— Is operational resilience a business priority and integral to our business strategy? Have we identified critical business services, from the perspectives of the firm and potential impacts on stakeholders, and are our third-party relationships well-managed?

— Do we have effective Board engagement and supporting governance arrangements? Are our risk management framework and controls fit-for-purpose given continued remote working? Are our product governance arrangements subject to robust and objective challenge, and delivering good customer outcomes?

— Can we evidence a client/investor-centric approach throughout our business? Do we seek to minimize costs incurred by clients/investors and to maximize the value of our services and funds? Are all our disclosures and marketing clear, fair and not misleading, and would they stand up to independent scrutiny and challenge?

— Are we considering opportunities to invest in new markets and asset classes or to use new fund vehicles? If yes, do we have the necessary skills and resources?

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