Evolving Investment Management Regulation

Clarity leads to opportunity
June 2014

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ABOUT THIS REPORT
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This is the age of asset management. That is the view of the Bank of England and an increasing consensus of analysts and commentators. Andrew Haldane, a director at the Bank of England, coined the term ‘age of asset management’ in a speech he gave in London in early 2014. He was alluding to the fact that the shrinking of the banking sector has thrust asset management to the heart of global capital flows. That creates huge opportunities for investment managers. But it also means a step-change in the scrutiny of the sector. Participants in the so-called shadow banking sector are well aware of the growing regulatory focus: KPMG’s Investment Management Industry Outlook survey 2013 shows that the world’s biggest investment management firms overwhelmingly believe that political and regulatory uncertainty pose the biggest threat to their business models.

However, over the last year, there have been signs that the burden on the investment industry is starting to lift. It may just transpire that 2014 is the year the wheel turned and regulation became less of a minefield and more of an opportunity.

Why do we say this? Well, many regulatory proposals that have been working their way through the system for years have finally came to fruition in the last year. Think PRIIPs, UCITS V, the Volcker Rule and FATCA. Others still are on the cusp of being finalized. Where proposed new rules once seemed perpetually stuck in the consultation phase, many are now decidedly in the implementation phase.

Understanding and complying with regulations has been painful and, for many firms, has entailed material cost. But the ending of consultation and the move to implementation has, at last, created clarity around the operating environment. In addition, many regulators around the globe appear to be co-ordinating their efforts as the initial rush of regulation becomes a more thoughtful and streamlined process. Where there was once disparity between regulatory initiatives, pan-regional organizations such as IOSCO, the FSB and the OECD have started to close the gaps in rulemaking in an attempt to create coherence. In time, this should make it easier for the asset management industry to operate globally.

The fact that there is growing clarity and coherence around regulation is not the only positive for investment managers in 2014. Much of the substance of regulatory reform is also beneficial. This substance includes greater investor protection, systemic protection and the opportunity to distribute regulated products to a wider client base.

Of course, the implementation phase poses its own challenges and demands considerable resources to navigate successfully. The costs associated with greater compliance and dealing with intrusive supervision will be significant and recurring. But at least regulators have provided clear signposts and goalposts to frame the operating environment for the investment industry. Those industry participants who realize that the wheel has finally turned will be in a great position to take advantage of the opportunities ahead in the age of asset management.
Executive Summary

In this year’s report, we focus on key areas where regulation, combined with other pressures, is forcing asset managers to make significant changes. These are structural market change; data and reporting; risk governance; and conduct culture and remuneration.

01 Structural market change
Actual change as a result of regulation is now upon us and is altering the way the investment industry and its participants operate. The predicted shake-up stemming from the Volcker Rule, for instance, is no longer a prediction. Some early banking movers have completed their M&A programs, others will follow. The recipients of capital moving from the banking sector have tended to be hedge or private equity funds. This is positive for asset managers, but they are likely to find that scrutiny becomes much more intense as they are increasingly considered systemically important institutions.

Regulation is also placing pressure on the viability of pension plans, particularly smaller schemes with reduced access to advice and resources. The new requirements for risk controls, reporting and governance is leading a number of smaller schemes (and some larger ones too) to consolidate.

In addition, unprecedented changes in the way that funds can be distributed are taking place in both the institutional and retail spheres. In Asia, in particular, retail distribution is set to be transformed as plans are drawn up for passporting arrangements. Fund managers require considerable preparation for these initiatives.

02 Data and reporting
The whole of the shadow banking sector – principally investment firms – is being asked to improve its transparency. The European Commission, for instance, aims to improve financial stability by increasing the transparency of shadow-banking transactions, mainly focusing on securities lending and repos. Meanwhile, in the US pension fund sector, two material accounting regulatory changes – GASB 67 and GASB 68 – have been made that, from early 2014, require substantial cleansing and analysing of data on the part of pension plans. The challenge for the investment industry is to be able to report meaningfully both internally and externally. That is, to be able to report to investors and regulators while also being able to adapt the data inhouse to create a competitive advantage.

On the other side of the coin, however, is cost. With the imperative to use capital efficiently, the impact of rising reporting demands has to be set into a new strategic perspective. A clearly delineated strategic approach based on analysis of existing and potential distribution channels and geographies is now a key requirement. This more granular strategic approach to regulatory impact may lead to discussions over minimum requirements vs full integration of processes and insourcing vs outsourcing. Where outsourcing is the preferred route, partnerships rather than contracts are likely to be the preferred model in order to extract maximum value from data and link it to other value-enhancing data.

03 Risk governance
Regulators are aware that having the relevant data and being able to report it effectively is necessary, but not sufficient, in order to mitigate risks to clients and to the financial system as a whole.

As regulatory complexity proliferates, so the distance lengthens between those developing and using risk systems and those making strategic business and investment decisions. The essence of effective risk governance is about connecting the dots within the organization so that functions responsible for data and analysis effectively communicate to management. In turn, management must be prepared to ask sufficient questions of their risk and compliance executives that they fully understand the implications of the analysis. In the pensions space, the emphasis by regulators on risk governance is unprecedented. In the UK, the Netherlands and Australia – countries with highly-developed and progressive pensions systems – significant changes are underway that may, in time, be adopted more widely in other countries and regions.

High-quality risk governance decision-making facilitates forward-looking strategy and the accurate prediction of future risks, including the management of conflicts of interest. This encompasses factors such as business structure, returns and remuneration. Regulators have started to address conflicts of interest, but any firm that looks after client money, yet has objectives other than as a fiduciary to its clients, may
need to re-examine its strategy. Regulation that governs conflicts of interest is far from comprehensive, but it is reasonable to assume that as conflicts surface they will be addressed by regulators on an ongoing basis, in some cases retroactively.

Regulatory and compliance risk will continue to mutate. As regulation proliferates, there are likely to be overlaps and gaps between systems and processes. If these overlaps and gaps are not successfully navigated across jurisdictions and regulations, the possibility of costly error arises. Regulators recognize the importance of technology: new technology risk requirements in Singapore, for instance, come into force in July 2014 with the aim of identifying critical systems and reporting systems failures.

Regulators, led by the SEC, have departed from softly-softly approaches and are increasingly prepared to levy considerable sanctions. While upgrading systems and processes to deal with these risks are resource-intensive, safeguarding against reputational risk and minimising the possibility of exposure to large financial penalties, is desirable.

Conduct, culture and remuneration
Just as they seek to influence key processes within investment firms, regulators are also seeking to improve and standardize conduct and culture. They are aware that regulation cannot cover every activity in every part of the investment industry. So regulation is – to some extent – aimed at changing mindsets and the ethos of the industry.

Across Europe, the way that investors’ concerns are dealt with is becoming a hot issue. A Joint Committee Consultation Paper by The European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) has produced draft guidelines for complaints-handling for the securities and banking sectors. Asset managers are also being encouraged to take more responsibility for how they create their products and how these products subsequently perform. The creation of appropriate products has moved up the regulatory agenda amid rapidly ageing populations, a widening pensions and savings gap and the reduced capability of governments to provide financial safety nets.

Asset management firms are effectively being challenged to step into the gap, prove their worth and gain the trust of both policymakers and investors. The key for those planning top-to-bottom reform, is to evaluate every aspect of the business and ask whether the governance structure is justifiable and how it would be viewed if it received regulatory or media attention. Even if there is no explicit regulation proscribing an activity, if it is not readily justifiable to ‘the man in the street’, it has the potential to fall foul of present or future conduct rules.

Growing coherence and co-operation
The signs are that regulation is slowly becoming more harmonized and this may ease the pressure on firms. A striking feature of the current regulatory landscape is the apparent desire of different jurisdictions and regulators to start working in tandem. Groups of regulators are starting, for instance, to oversee and harmonize the huge changes taking place in retail distribution. Coherence is also being created over the vexed issue of how to report and process over-the-counter (OTC) derivatives. Even the Foreign Account Tax Compliance Act (FATCA), originally just a US project, looks like it will now be adopted by much of the wider international community.

That regulators are talking and starting to act in concert can only be positive for the investment industry. The industry must see beyond the difficulties of regulation and plan for how to take advantage of the growing regulatory clarity and coherence.
CHAPTER 1

STRUCTURAL MARKET CHANGE
Sometimes change is an evolution. Today’s change is little short of revolution. Anyone who believed that precious little would change in the wake of political and regulatory moves to try to insulate markets against systemic risk needs only to look at market structure today. After a prolonged period of words and texts, actual change is now upon us and is altering the way the investment industry and its participants operate.

It is clear that regulation is no longer a matter of compliance and costs. It imposes changes on the entire structure of the asset management industry and on the business models of participants. We can break down these structural changes into four discrete categories:

- Ownership structure
- Fund products
- Asset flows
- Distribution.

Ownership structure

In some cases, regulators have deliberately set out to change ownership structures to alleviate conflicts of interest or reduce systemic risk. In other cases, ownership structures are changing as an unforeseen by-product of regulation intended to achieve other aims.

The clearest example of intended ownership change is the Volcker Rule. Volcker Rule zeroes in on its target

The predicted shake-up of both the banking and asset management industries in the wake of the Volcker Rule is no longer a prediction. Regulators have followed through on their promise to restrict trading and private funds within banks. The result is that banks have had to close or spin off tens of thousands of funds with around US$5 trillion of assets under management, about a third of all AUM. Some of the bigger banks have divested thousands of funds each. Proprietary trading has ground to a virtual halt.

The structural impact is an ongoing and massive shift of capital from the banking to the investment management industry. In anticipation of Volcker, many banks started selling off or spinning off their asset management and proprietary trading activities as long as two years ago. The recipients of the capital have tended to be hedge or private equity funds. While some early banking movers have completed their M&A programs, others are still reassessing their operations and analysing potential margins from continuing operations in capital-restricted areas. And their considerations are not just based on capital considerations – brand and reputation are also significant issues.

If the speed of restructuring is uncertain, the direction is clear. Talented traders will no longer have access to bank balance sheets and will increasingly migrate out of banks and end up somewhere in the asset management continuum. This is positive for asset managers, but also brings them closer to the center of the financial wheel. At the center, they are likely to find that scrutiny becomes much more intense as they are increasingly considered systemically important institutions.

The Shadow Banking Debate

Politicians, regulators and central banks around the globe are starting to view shadow banking as the next big battleground.
In May 2014, the head of the Federal Reserve, Janet Yellen said regulation for large, non-bank financial firms such as asset managers, was possible, saying that regulators needed “to really identify clear ways in which the failure of these firms” would pose risks to the financial system. In March 2014, the deputy governor (Pan Gongsheng) of the People’s Bank of China (PBOC), the country’s central bank, said on PBOC’s official website that the bank would improve its supervision over the shadow banking industry. Meanwhile, Ewald Nowotny, a member of the European Central Bank’s governing council, said in May 2014: “There is a danger that intensified regulation in the banking sector might cause important and risky business activities to be shifted into less regulated areas, such as shadow banking entities.”

With so many activities previously housed in banks moving over to asset management (see box on left), and asset managers achieving unprecedented scale, it is inconceivable that the shadow banking industry will escape further scrutiny. Although asset managers argue that assets in funds are ring-fenced and any losses are sustained by investors not by the firms themselves, regulators remain sceptical. They argue that although the risks may be dispersed, the aggregate risk is material and, in the event of further market turmoil, will impact the financial system.

Moves are afoot to address these perceived risks. In early 2014 for instance, the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO) published a proposal for Assessment Methodologies for Identifying Non-bank Non-insurer Global Systemically Important Financial Institutions (NBNIG-SIFIs). These are institutions, including both open-end and closed end investment funds, whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause ‘significant disruption to the wider financial system’.

In the US, the Financial Stability Oversight Committee (FSOC) is working on a similar proposal, given that so much of the credit extended to the US corporate sector is now sourced from the shadow banking sector. The FSOC is currently seeking information on asset managers in order to better assess and understand their systemic importance.

In addition, it is not inconceivable that the ‘Living Wills’ concept could be extended to the asset management sector. Living Wills, conceived in the UK and subsequently adopted by Europe under the title ‘Recovery and Resolution Plans’, may compel investment firms to hold additional capital in order to meet a sudden wave of redemptions. This could impact the performance of both asset managers and the funds they manage.

Money market funds – a dying breed?
After the turmoil of 2008 and 2009, money market funds were identified as being systemically important and their fate is closely linked to that of the shadow banking sector as a whole. Their role as short-term investments for both individuals and companies meant many parts of the global economy suffered when money market funds either collapsed or suffered substantial falls in value during the global financial crisis. The issue is hot both in Europe, where money market funds are widely used by corporate treasuries and in the US, where retail investors frequently use them for short-term savings such as for college funds and to make medium-term purchases.

The US is grappling with the issue and in Europe, an IOSCO paper was published in October 2012 and proposed European Parliament regulation was published in September 2013. The debate centers on whether money market funds should be forced to hold capital to protect against the risk of loss. However, with yields on most money market funds already very low, holding additional capital may render them unviable. It is still unclear whether constant NAV funds have a future, with many asset managers making provisions for their potential demise.

Mutating pension fund ownership
Regulation is placing pressure on the viability of a portion of the pension universe, particularly smaller schemes with reduced access to advice and resources. The requirements for risk controls, reporting and governance is leading a number of smaller schemes (and some larger ones too) to consolidate. This, for instance, is the case in the Netherlands where the number of schemes has fallen from around 600 three years ago to about 300 today. In the same time period, assets have risen from €650 billion to over €1 trillion, demonstrating that
Consolidation is not due to asset shrinkage. Similar consolidation is also taking place among superannuation funds in Australia. In the Netherlands, the first stage was a rationalization of inhouse legacy schemes, followed more recently by the merging of schemes of different companies. Many of these company schemes are becoming part of huge master trusts run by service providers. Most Dutch schemes that are still standalone and that have assets of less than €3 billion are now considering their future as standalone entities.

As a result of this consolidation and likely continued consolidation, the provider market is shifting too. The number of fiduciary providers has fallen to 30 today and competition is no longer about winning new clients, but about enticing smaller schemes to join forces with larger ones. Size is likely to be key to providers seeking to increase their market share in the Dutch pensions market.

**Fund Products**

Regulation is changing the types of funds that can be created and sold, and is leading to opportunities for new types of products and strategies.

The starting place for regulators is the desire to ensure a better fit between investor needs and available products. In many countries, regulators are conducting research to understand the objectives of products and investors’ ability to understand them. At the same time, investors’ expectations of products are evolving. These shifts will necessitate greater interactivity with both regulators and investors. For example, if simpler products are more welcome to regulators and investors in certain jurisdictions, then firms may wish to develop or create a range of ultra-plain vanilla funds with high levels of transparency and simple reporting. Vanilla funds may attract lower fees, but if that is where the market is heading, the savvier asset managers are likely to track it.

These kinds of products are likely to be increasingly sought in the UK, where pensioners have been given far more power over how to invest their savings. The UK Budget in April 2014 overturned all DC pensions thinking, with legislation allowing far greater flexibility over savers’ pension pots. Whereas in the past, retirees have had to purchase annuities, this is no longer the case. The UK system will thus move closer to the pensions industry in Australia, where retirement assets can be managed as savers see fit. Interestingly in Australia the self managed superannuation industry is the fastest growing superannuation sector providing members who are often the Trustees more control and attracting a lot of attention from potential members and regulators alike. This has enormous consequences and provides huge

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**Pension Schemes in the Netherlands**

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<th>Year</th>
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<td>2011</td>
<td>600</td>
<td>€850 bn</td>
</tr>
<tr>
<td>2014</td>
<td>300</td>
<td>€1 trn</td>
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In Europe, the European Long-Term Investment Fund (ELTIF) may set the tone for years to come.

opportunities for the asset management industry. Savers will be looking to invest in longer term products where the potential risk and return are transparent and lend themselves to simple illustration by financial advisors and investment platform providers. One product theme that is starting to dominate the regulatory agenda is that of sustainable and long-term investments, which – policymakers hope – will provide greater systemic stability, more certainty for investors and less trading friction. In Europe, the European Long-Term Investment Fund (ELTIF) may set the tone for years to come. The first draft of the ELTIF left asset owners and asset managers cold because retail and professional investors were expected to invest in a single product. The ability of retail investors to exit the fund at will turned off many institutional investors, who were concerned about the opportunity cost of liquidity buffers. However, the latest proposal to launch separate funds for each of the two investor classes has potentially solved the liquidity issue. It also reduces the risk of misselling that existed before whereby retail investors may not have fully understood that their assets would be locked in for many years. Other long-term investments are also being promoted:

the EU authorities introduced marketing passports for the managers of European Social Entrepreneurship Funds (EuSEF) and European Venture Capital Funds (EuVECA), which target longer-term investments with social value.

Assets flows rerouted by regulation
Regulatory proposals may not have the objective of altering flows of capital, but that is sometimes the (unintended) consequence of some of the new rules impacting the investment industry.

Take UCITS V and its provision for a strict depositary liability regime. While firms operating under AIFMD can contractually discharge their liabilities, this does not exist under UCITS V, meaning that some depositary banks will not wish to accompany asset managers in all emerging and frontier markets. The result could be a slowing of innovation in the industry as firms err on the side of vanilla strategies. There is little evidence of this so far, but any ‘blow up’ of a sizeable emerging or frontier market could expose faultlines.

‘Safer’ assets and vanilla strategies may also be more sought in the wake of the revised Institutions for Occupational Retirement Provision Directive (IORP) for Occupational Pension Funds, which places the emphasis on long-term income rather than short-term gains. In deciding if an investment is ‘prudent’ as per the Directive, regulators may force funds to invest predominantly in lower volatility assets. In this case, equity strategies will become less attractive. However, the Directive also favors investment in unlisted companies, which may stimulate the VC and PE sectors as well as providing finance to SMEs.

There is reason to believe that flows into pensions may slow on both sides of the Atlantic. In the US, the Moving Ahead for Progress in the 21st Century Act – commonly referred to as MAP-21 – changes the discount interest rate that pension plans use to measure their liabilities. The Act has been in the pipeline for more than two years but has recently taken effect. It also increases pension premium rates for both variable and flat rate premiums paid to the Pension Benefit Guaranty Corporation and establishes a cap on the variable rate premium. In effect, it decreases scheme liabilities, meaning that fewer contributions will be necessary going forward.

Meanwhile, in the Netherlands, under domestic regulation anyone earning more than €100,000 will be excluded from tax.
Government Pension Investment Fund (GPif) has received permission to use its state pension fund. Permission has been granted for the fund to make monetary flows to equities via its state pension fund. The impact on flows to pension funds in the UK, again under the lifetime cap breaks in second pillar pensions. This is mirrored by the reduction in the lifetime cap of the total pension pot in the UK, again under domestic rules. This will have a small, but meaningful, impact on flows to pension funds and the asset managers who serve them.

On the other hand, Japan is encouraging greater flows to equities via its state pension fund. Permission has been granted for the Government Pension Investment Fund (GPif) to invest in higher risk products. New active fund managers have been selected and a working group panel has been tasked with reviewing investment strategy, benchmarking, performance and allocation targets. GPif has begun to reduce its exposure to domestic JGB bonds and increase its exposure to international equities. Portfolio allocation as at December 2012 for domestic bonds was 60 percent and international equities was 13 percent. By December 2013, the asset allocation was 55 percent and 15 percent respectively.

Distribution structure
Unprecedented changes in the way that funds can be distributed are taking place in both the institutional and retail spheres. The institutional changes are designed primarily to mitigate systemic risk, while the retail changes are aimed at protecting the interests of investors.

Retail structure
On the retail side, the updated Markets in Financial Instruments Directive (MiFID II) – which bans inducements to independent advisors – is a genuine gamechanger. The regulation aims to remove the conflict of interest present when intermediaries advise investors on suitable products. In the past, fund promoters were allowed to offer inducements to the intermediary. This is no longer the case (see table above). Bans on inducements were introduced unilaterally in the UK – through the Retail Distribution Review (RDR) – last year and are due to be introduced in the Netherlands next year. Similar provisions are in place, or soon to be in place, in Australia and South Africa. The result is that retail investors in a number of jurisdictions will now have to pay for advice. This throws up a number of issues for asset managers, including:

- Will they need to reduce management fees to allow room for advisors to take a fee directly from investors?
- If passive investments become more popular, how will these be sold and is advice necessary?

Regulatory proposals may not have the objective of altering flows of capital, but that is sometimes the (unintended) consequence of some of the new rules impacting the investment industry.

### INDEPENDENT ADVISORS CANNOT RECEIVE ANY THIRD PARTY INDUCEMENTS

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<th>MIIFID I</th>
<th>MIIFID II Art 24</th>
<th>Will be addressed by Level II</th>
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<td>→ Firms are currently prohibited from making or receiving payments or other non-monetary benefits in connection with any investment or ancillary services provided to professional clients or retail clients.</td>
<td>→ First case: The Investment firm informs the client that investment advice is provided on an independent basis (Art. 24 (5)). Bans third party inducements altogether.</td>
<td>→ A modification of the disclosure requirement to require detailed prior disclosure, abolish the possibility of disclosing inducements in summary form and introduce an ex-post reporting obligation.</td>
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<tr>
<td>→ An exemption for third-party inducements is available where (i) clear, prior disclosure of the inducement has been made to the client, (ii) the inducement has been designed to enhance the quality of the service to the underlying client of the firm, and (iii) the payment or benefit does not impair compliance with the firm’s duty to act in the client’s best interests.</td>
<td>→ Second case: The Investment firm provides portfolio management (Art. 24 (6)). Bans third party inducements for a firm providing independent advice.</td>
<td>→ Clarifying the technical details to be disclosed and defining templates in order to harmonize the disclosures to clients.</td>
</tr>
<tr>
<td></td>
<td>→ Third case: The Investment service is offered with another service or product as part of a package (Art. 24 (7)).</td>
<td></td>
</tr>
<tr>
<td></td>
<td>→ Information disclosed to the client whether it is possible to buy the different component separately. The firm shall also provide for a separate evidence of the costs and charges of each component.</td>
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Source: KPMG in Luxembourg, 2013
Separate regulation, under the guidance of IOSCO, will affect how retail structured products, which are popular in many parts of continental Europe, are created and distributed (see box on left).

The Packaged Retail and Insurance-based Investment Products (PRIIPs) initiative, which was finalized in April 2014, demands that non-UCITS funds produce a standard pre-sale document. Although many firms have been readying for PRIIPS for over a year now, the end of the consultation phase means work on them can start in earnest. The only outstanding PRIIPs item is technical advice from ESMA. Otherwise, it must be implemented and become part of the distribution process by Q1 2016.

Another key retail proposal is the updating of the AML Directive to enshrine a risk-based approach. While this may be more complicated to implement, it is surely beneficial for firms to know where the risks are in their distribution channels. As part of the draft legislation voted in March 2014 by the European Parliament, firms will have to contribute to the creation of a public central register to identify ultimate owners of assets.

In Asia, retail distribution is set to be transformed as plans are drawn up for passport arrangements. Three separate passporting schemes are planned, each of which is in differing stages of development:

1. Regulators in Hong Kong and mainland China are working on mutual recognition so funds managed in one territory can be distributed in the other. Funds in scope are initially of the plain vanilla variety but the direction of travel suggests this may expand in time. For Hong Kong managers, the key is to make sure funds are authorized by the Securities & Futures Commission (SFC) and domiciled in Hong Kong in order to qualify for the mutual recognition agreement. For China-domiciled funds, authorization must be obtained from the CSRC. The regulators announced in December 2013 that the project was close to being finalized with only a few details remaining to be worked through. A major impact of the agreement could be a trend away from UCITS as the dominant force in Hong Kong retail distribution to a domestic variant.

2. In September 2013, the finance ministers of Australia, South Korea, Singapore and New Zealand signed a proposed Asia Region Funds Passport. The so-called APEC Passport, was initially proposed by Australia back in 2009, and may come to include more countries, with the Philippines and Thailand joining most recently. A consultation paper was issued by APEC in April 2014 and it is expected that arrangements will be finalized in late 2014 to early 2015. Proposed operational and regulatory requirements are expected to cover the following areas: the experience of the manager, capital adequacy, minimum AUM, annual audit and compliance audit requirements, custody arrangements and investment restrictions, distribution and marketing, regulatory reporting and supervision. The projected implementation date is 2016.

3. The most imminent passport is the so-called ASEAN Passport. South-east Asian countries have been discussing a cross-border Collective Investment Scheme (CIS) for several years as part of efforts to create an ASEAN Economic Community by 2015. In October 2013, the securities market regulators of Singapore, Malaysia and Thailand, at a meeting of the ASEAN Capital Markets Forum in Bangkok, agreed terms for the cross-border offering of collective investment schemes. Investment managers must have a track record of at least five years to qualify and AUM of at least $500m. The target implementation date, set in late 2013, is in the first half of 2014.

The three proposals offer investment managers the opportunity to sell a product in more than one market of the region, creating economies of scale. But a minimum requirement will be local domicile and perhaps local management, which both come with costs. These conditions would also exclude UCITS vehicles from the new regime. With all three schemes, fund managers require considerable preparation, with many rushing to ensure they are in a position to meet the requirements.

Institutional structure

One of the biggest changes impacting the institutional space is the possible phasing out of private placement regimes.

The Alternative Investment Fund Managers Directive (AIFMD), in return for firms becoming compliant entities, offers a pan-European passport. Although private placement regimes in some European...
countries will still persist, the likelihood is they will start to recede as viable distribution channels. As things stand, private placement regimes are expected to be phased out around July 2018. The marketing passport should be available to EU AIFMs marketing non-EU AIFs and to non-EU AIFMs marketing EU or non-EU AIFs in the EU from July 2015. However this is subject to positive advice and opinion from ESMA and enabling legislation being adopted by the Commission.

AIFMD has been in force since July 2013 and already some firms have applied for and obtained a marketing passport for their funds. The evidence so far is that obtaining the passport requires persistence and that the time lag is exacerbated by a lack of standardization of documents and processes. However, the challenges are far from insurmountable, as a number of fund managers who have already obtained the passport for their alternative fund ranges will attest.

Some managers have indicated that in the short term they will continue to use private placement regimes, which are tried-and-tested, quicker to market and give greater certainty. However, for funds that fit the eligibility criteria and are targeting several countries at the same time, obtaining an AIFM licence appears a rational course of action.

As the AIFMD gets transposed into national regulation in more countries, more data will be available at a pan-European level. This will lead to increased ability to enforce the requirements. So while the Directive may appear light-touch at first, the requirements may well become more stringent and rigidly-enforced over time. This is no bad thing. Investors will appreciate the stringency of regulatory oversight and will be increasingly ready to allocate funds to well regulated alternative fund managers, with all the safeguards they provide.

### SUMMARY – MARKETING REGIMES AND TIMELINES

| EU AIFM + EU AIF | From 2013 | Passport for marketing National private placement no longer allowed |
| EU AIFM + Non-EU AIF | 2013–2015 | National private placement regime only |
| | From 2015* | Passport for marketing may become available |
| | 2015–2018 | National private placement regime and Passport will co-exist |
| | Post 2018** | Private placement regimes may end and marketing may only be possible with the Passport regime |
| Non-EU AIFM + EU AIF, or Non-EU AIF | 2013–2015 | National private placement regime only |
| | From 2015* | Passport for marketing may become available |
| | 2015–2018 | National private placement regime and Passport will co-exist |
| | Post 2018** | Private placement regimes may end and marketing may only be possible with the Passport regime |

* ESMA to provide advice and opinion to the EU Parliament, Council, and Commission of their assessment to introduce the marketing passport.
** Subject to ESMA’s prior analysis and adoption of delegated act by the Commission.

Source: KPMG in Luxembourg, 2013

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One of the biggest changes impacting the institutional space is the possible phasing out of private placement regimes.
Regulators and politicians have recognized that if they want to protect the financial system and safeguard investors, they need considerably more data than they have had access to in the past. It is not yet clear exactly how they will process the mountains of data they are soliciting, but they nonetheless expect full compliance from the investment industry.

The result is that investment managers must now corral and report their data as never before. This involves considerable strategic planning and a topdown review of cost structure, which is likely to look very different in the age of asset management.

**Shadow banking in the spotlight**
The whole of the shadow banking sector – principally investment firms – is being asked to improve its transparency and the reporting of securities transactions. For example, alongside the proposal for structural reform of the EU banking sector issued in January 2014, the European Commission also proposed measures to improve financial stability by increasing the transparency of shadow-banking transactions, mainly focusing on securities lending and repos. The aim is to ensure the reporting of all transactions to a central trade repository by any EU entity, including UCITS, AIFs, pension funds, banks and insurance companies. Reporting would be based on the existing reporting framework for derivatives reporting under European Market Infrastructure Regulation (EMIR).

**AIFMD sets out detailed requirements**
Some measures that impose additional data and reporting demands on asset managers are already being enacted. The AIFMD, for example, sets out the following detailed reporting requirements:

- The principal markets and instruments traded.
- The main categories of assets held by each AIF, including principal exposures and concentrations.
- The percentage of assets subject to special arrangements due to illiquidity, any new liquidity arrangements and results of liquidity stress tests.
- Risk profile of the AIF, risk management systems employed and results of stress tests.
- For AIFs using leverage on a substantial basis, reporting on the level of leverage in each AIF.
Phasing in FATCA
The Foreign Account Tax Compliance Act (FATCA), too, is now in the implementation phase, after much of the detail was clarified in 2013. Bilateral agreements proliferated in 2013 and early 2014 in Europe, which require firms to submit data to their national regulators, who in turn share it with US authorities. Much of this work is now done in Europe and Asia countries are following closely behind. Asian countries that have reached agreement in substance in bilateral agreements with the US are: Hong Kong, Australia, Japan and Singapore.

Perhaps the bigger news on FATCA is that an OECD version (as opposed to the US version) is now under development. Cross-border reporting requirements will become even more substantial than under the US FATCA alone, so the ability to streamline investing in US assets will be captured by FATCA alone, so the ability to streamline even more substantial than under the US border reporting requirements will become that an OECd version (as opposed to the US agreement with the US are: Hong Kong, Australia, Japan and Singapore.

US pension funds
Meanwhile, major reporting requirements have just washed up on the shores of the US pension fund sector. Two material accounting regulatory changes – GASB 67 and GASB 68 – have been made that, from early 2014, will require substantial cleansing and analysing of data on the part of pension plans.

First, all US government pension schemes will be required to record their pension obligations and assets at regular intervals. In the past, this was not always the case. For instance, universities that have their pension assets managed by agency schemes (such as Calstrs), have not had to report separately up until now. But, in order to provide more visibility to regulators around state pensions, they must now report individually. This will involve obtaining information from the agency funds and creating their own IT infrastructure and reporting processes.

The second change relates to how government funds report their investments. The rationale is to create a fair value reporting regime which more accurately reflects the true value of assets. This will create greater convergence with accounting conventions to which most other corporate and financial entities adhere. This is quite a task, but the good news for pension plans is that corporations have already been through the process so the infrastructure to deal with it already exists. It should ultimately represent a beneficial change in that plans will be able to identify exactly which assets and risks they are exposed to and tailor their risk management accordingly.

Impact on Asia
Some regulations that have their origins in the US and Europe have an impact on Asia too. Most notably, these include FATCA, the Volcker Rule and UCITS V. In addition, Asian regulators are also imposing their own rules which have, in some cases, considerable data and reporting implications. For instance, while OTC derivatives rule changes are imposed by Dodd-Frank in the US and EMIR in Europe, in Asia there are individual country-specific regulations. These already exist in Japan, are currently being enacted in Singapore and Australia and will be implemented in Hong Kong in 2015 after legislation was passed in March 2014.

In Japan, there is great emphasis on increased reporting, especially for pension funds, which are coming under regulatory pressure to strengthen audits. This is due in large part to the AIJ scandal of 2012, which contributed to the erosion of public confidence in Japanese pensions.
With the imperative to spend capital efficiently, the impact of rising reporting demands has to be set into a new strategic perspective.

The data challenge ahead
The challenge for the investment industry is to be able to report meaningfully both internally and externally. That is, to be able to report to investors and regulators while also being able to adapt the data inhouse to create a competitive advantage. Industry participants are increasingly asking themselves: how can we use our data in a more proactive and predictive way? That is, the need is growing to adapt data to produce risk information and enrich the governance dashboard. Then participants need to be able to extend these processes to reporting and client requirements across multiple jurisdictions and also develop the flexibility to respond to rapid and frequent changes in these requirements.

On the other side of the coin, however, is cost. With the imperative to spend capital efficiently, the impact of rising reporting demands has to be set into a new strategic perspective. A clearly delineated strategic approach based on analysis of existing and potential distribution channels and geographies is now a key requirement.

This more granular strategic approach to regulatory impact may lead to discussions over minimum requirements vs full integration of processes and insourcing vs outsourcing. Where outsourcing is the preferred route, partnerships rather than contracts are likely to be the preferred model in order to extract maximum value from data and link it to other value-enhancing data.
Regulators are well aware that having the relevant data and being able to report it effectively is necessary, but not sufficient, in order to mitigate risks to clients and to the financial system as a whole.

Many of the risk governance issues are much broader in their scope and impact than technology and processes. There is, for instance, a gap between the risk appetite framework and the risk function in some parts of the industry. Many provisions within existing and proposed regulation are intended to address potential risk governance failings.

In the pensions space in particular, the current emphasis by regulators on risk governance is unprecedented. In the UK, the Netherlands and Australia – countries with highly-developed and progressive pensions systems – significant changes are underway that may, in time, be adopted more widely in other countries and regions.

The Australian government, for instance, introduced what is known as ‘Stronger Super’ reforms, which became effective in July 2013. These are the biggest risk governance reforms in the history of the Australian superannuation industry. They cover three broad areas – governance, prudential standards and Super Stream – a comprehensive package of reforms designed to enhance the back office. The prudential standards include risk management, investment governance, governance, conflicts of interest and operational risk reserve requirements. The risk management standard includes the requirement for a superannuation fund to have a risk management framework and strategy and a risk appetite statement. The concept of a risk appetite statement is a new one for pension schemes and could represent a blueprint for future pensions regulation worldwide. It typically presents the need for a dedicated risk management function which can identify and assess material risks.

More information and analysis on these reforms can be found in the ASPAC chapter.

Changes to Dutch pensions regulation relate primarily to outsourcing and supervisory board risks. Most schemes in the Netherlands have long outsourced their activities to fiduciary managers and the regulator is now demanding that the relationship with the fiduciary manager is formally evaluated on a regular basis. This evaluation examines the quality of the outsourcing entity and the quality of processes used by fiduciary managers. Fee structures are also within scope. The regulator is seeking to ascertain whether schemes are fully aware of the activities undertaken by the fiduciary manager and whether these activities fit with the aims of the scheme and its beneficiaries. Similar to the Australian reforms, there is clear evidence that the Dutch regulator regards pension schemes in the same light as other financial institutions and thus imposes the same obligations and responsibilities on them.

Regulations relating to the supervisory board include the requirement that Dutch pension scheme boards must contain representatives of retirees and that internal supervision must be put in place and reviewed by a separate body. This entails considerable restructuring of governance and, most recently, an industry-wide search for candidates with the appropriate mix of skills to become supervisory board members.

Meanwhile, in the UK, the Pensions Regulator is encouraging schemes to reduce investment risk by moving from being predominantly short-term lenders to becoming long-term investors. Given its objectives to protect members’ benefits
The essence of effective risk governance is about connecting the dots within the organization so that functions responsible for data and analysis effectively communicate to management.
Regulatory and compliance risk will continue to mutate. Operational and investment risks tend to occupy minds far more than regulation. But as regulation mushrooms, there are likely to be overlaps and gaps between systems and processes.

**GOVERNANCE STRUCTURE AND RISK MANAGEMENT FRAMEWORK**

Aligning basic tenets/leading practices – guiding principles

1. **Risk Management Framework and System**

2. **Culture and Behavior**

3. **Guiding Principles**

   How do we ensure that the board’s expectations for risk management are communicated to and followed by the employees in the company?

Regulators have started to address conflicts of interest but any firm that looks after client money, yet has objectives other than as a fiduciary to its clients, may need to re-examine its strategy. Regulation that governs conflicts of interest is far from comprehensive, but it is reasonable to assume that as conflicts surface they will be addressed by regulators on an ongoing basis, in some cases retroactively.

Regulatory and compliance risk will continue to mutate. Operational and investment risks tend to occupy minds far more than regulation. But as regulation mushrooms, there are likely to be overlaps and gaps between systems and processes. If these overlaps and gaps are not successfully navigated across jurisdictions and regulations, the possibility of costly error arises. Regulators, led by the SEC, have departed from softly-softly approaches and are increasingly prepared to levy considerable sanctions against companies and individuals that do not meet standards of behavior expressed or implied by regulation. While upgrading systems and processes to deal with these risks are resource-intensive, safeguarding against reputational risk and minimising the possibility of exposure to large financial penalties, is desirable.
Just as they seek to influence key processes within investment firms, regulators also seek to improve and standardize conduct and culture. They are aware that regulation cannot cover every activity in every part of the investment industry. So regulation is – to some extent – aimed at changing mindsets and the ethos of the industry.

Fostering greater responsibility and ethics may seem to many an ambitious aim, but it is nevertheless high up the regulatory agenda.

Conduct and culture
Asset managers are being encouraged to take more responsibility for how they create their products and how these products subsequently perform. Policymakers’ desire is to see the creation of products that do ‘what they say on the tin’. The creation of appropriate products has moved up the regulatory agenda amid rapidly ageing populations, a widening pensions and savings gap and the reduced capability of governments to provide financial safety nets.

Asset management firms are effectively being challenged to step into the gap, prove their worth and gain the trust of both policymakers and investors. If evidence were needed that regulators see conduct and culture as a major issue, the SEC has provided it in spades in recent times, with greater scrutiny and regulatory litigation against both firms and individuals. In the UK and Europe, the focus on ethical behavior is shifting from narrow definitions focusing on, say, the offering of gifts and entertainment, to much broader definitions. Fund creation, distribution, seeding and management are all under the microscope. Investment firms are required to respond, but unearthing and correcting unethical behavior is never easy for organizations because practices and cultures have often grown up over decades and generations.

Across Europe, the way that investors’ concerns are dealt with has become a hot issue. A Joint Committee Consultation Paper by the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) has produced draft guidelines for complaints-handling for the securities and banking sectors. It will apply to activities carried out by UCITS managers, AIFMs that provide investment services, payments institutions and banks.

Some asset managers recognize they need to change their cultures from top to bottom to satisfy and get ahead of regulatory demands, while others will meet minimum levels of compliance only. It may be resource intensive to change an organization’s culture, but the longer-term competitive advantages may be significant.

The key for those planning top-to-bottom reform, is to evaluate every aspect of the business and ask whether the governance structure is justifiable and how it would be viewed if it received regulatory or media attention. Even if there is no explicit regulation proscribing an activity, if it is not readily justifiable to ‘the man in the street’, it has the potential to fall foul of present or future conduct rules.

Remuneration
Remuneration is very much on regulators’ radar. Regulatory approaches to remuneration are a combination of seeking greater transparency, imposing restrictions and encouraging alignment of interests.

In terms of transparency, European proposals to improve shareholder rights will reveal how institutional investors pay asset management houses. The proposal to revise the Shareholders’ Rights Directive, which was unveiled by the European Commission in early 2014, demands that...
institutional investors disclose publicly how they pay asset managers. Pension funds and endowments will also be expected to explain how they evaluate a fund manager’s performance.

In terms of restrictions, under UCITS V at least 50 percent of variable remuneration must be paid in shares of the managed UCITS and 40 percent of the variable remuneration (rising to 60 percent if the bonus is very high) must be deferred for at least three years.

AIFMD remuneration rules roughly tally with UCITS V. Under AIFMD, remuneration policies should discourage any risk taking that is inconsistent with the risk profile or fund rules of the AIF managed. In addition, the assessment of performance should be over a number of years, appropriate to the lifecycle of the AIF managed. The payment of any performance-based component should be spread over a period taking into account the redemption policy of the AIF managed and the investment risks. The fixed and variable components of remuneration under AIFMD must be appropriately balanced and at least 50 percent of any variable remuneration should consist of shares/units in the AIF. As with UCITS V, at least 40 percent of variable remuneration must be deferred for a minimum of three to five years. Lastly, AIFMs that are significant in terms of size or assets should have a remuneration committee.

One of the biggest challenges in AIFMD is the portion of the variable remuneration that needs to be deferred. For example, the UK Financial Conduct Authority (FCA) has included in its Rulebook that at least 40 percent of variable remuneration must be deferred for somewhere between three to five years; if variable remuneration is above £500,000, the proportion needing to be deferred must be at least 60 percent. Across the European Union, however, most jurisdictions have set their remuneration threshold much lower (often at just €100,000 meaning that a significant number of managers will fall into the 60 percent category for variable remuneration deferrals.

There is particular difficulty in cases where payments are required to be made in instruments (such as shares) of the fund itself. Funds that are closed-ended, for example, will need to do significant work ahead of the deadline to structure vehicles that satisfy the AIFMD requirements (by, for example, linking cash payments to the performance of the portfolio or the AIFM itself).

For most firms, tax and other commercial implications will almost certainly come into play, as will the need to pay close attention to how claw-backs are enacted once deferred awards have been made or even paid. Given all the changes at hand, why have so many fund managers been reluctant to make a start on their AIFMD-compliant remuneration policies? It may be because some managers believe that since the remuneration policy won’t come into effect until 2015 at the earliest, the issue can be put on the back burner. But many jurisdictions now require an AIFMD-compliant remuneration policy to be submitted at the same time as the authorization application. That leaves precious little time for managers to properly look at the implications of tax-efficient remuneration structures and deferrals.

Others are focused on building a convincing case for not applying some of the more onerous requirements under the proportionality models in their relevant jurisdictions. But in many cases this will prove risky, especially if their case is later rejected by the regulator, leaving little time to effectively ensure proposals are commercially viable.

In the retail space, many firms are making the right noises about fair pricing, value for money and risk assessment, but if fund managers continue to be rewarded solely on performance, behaviors are unlikely to change.

In the retail space, many firms are making the right noises about fair pricing, value for money and risk assessment, but if fund managers continue to be rewarded solely on performance, behaviors are unlikely to change.
GENERAL CONDUCT OF BUSINESS PRINCIPLES

The AIFMD sets out the following general conducts of business principles:

- Has and employs necessary resources and procedures
- Acts with due care, diligence and fairly in the conduct of its affairs
- Acts in the best interests of the AIF and integrity of the market
- Treats all AIF investors fairly, with no preferential treatment to investors unless disclosed in fund rules
- Takes all reasonable steps to avoid or manage conflicts of interest that cannot be avoided
- Complies with all regulatory requirements

Given all the changes at hand, why have so many fund managers been reluctant to make a start on their AIFMD-compliant remuneration policies?
Perspectives: Americas region
Seeking the right regulatory balance
In the aftermath of the financial crisis, regulators throughout the Americas have attempted to balance the economic benefits of private investment with the need to contain the systemic risk inherent in the market’s ‘animal spirits’. There is also rising concern about income inequality and whether the tax system should be more progressive. FATCA represents a step in this direction.

The United States is at the forefront of the drive towards greater oversight. These efforts are closing off profitable lines of business for financial institutions while significantly raising compliance costs. Alternative investment managers are seeing greater scrutiny as well.

The US’s new regulatory stance is reverberating throughout the region. In Canada, there is increased emphasis on asset management fee transparency and growing recognition that FATCA and AIFMD compliance is inevitable. Chile plans to address income inequality through higher taxes on corporations and private investment funds. Brazil, however, is streamlining its regulatory environment to keep investors firmly engaged.

Investment management firms that go beyond mere compliance and build out efficient risk management systems ultimately will enjoy greater efficiency, reduced examiner scrutiny, and competitive advantage as more regulations are imposed nationally and worldwide.

The CSA also appear committed to increasing competition in the investment management market. The big banks control 80 to 90 percent of the asset flows through their broker-dealer arms and trailer fees have created a lot of incentive to push investors into proprietary products. The CSA also wants to see more perspective-based investing. One proposal would require alternative products to be sold via prospectus and raise the net worth threshold for the creditor investor exemption.

Adjusting to global regulatory changes
In contrast to the never-ending but measured changes occurring locally, the sweeping transformations taking place in the US and EU are forcing Canadian managers and their advisors to take notice as well. At first glance, regional initiatives like the AIFMD and SEC/CFTC registration would seem to have little impact on fund managers outside those jurisdictions. However, these regulations are far-reaching and border-agnostic, and will impact many Canadian managers as well. In addition, regional initiatives such as FATCA are designed to capture market participants outside of the home country’s immediate control.

There is a feeling of general regulatory creep in the industry, regardless of the jurisdictions in which a manager operates. It remains challenging for a manager to keep on top of the ever-changing global regulatory landscape. While many managers may agree with certain of the changes underway (and most would agree that the change is inevitable and compliance a must), the cost of compliance is being felt by everyone.

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The 2012 JOBS Act (Jumpstart Our Business Startups) gave hedge funds and other alternative asset managers the opportunity to market their funds to a wider audience. But surveys show only 4 percent of hedge fund managers and 5 percent of private equity managers have registered to do so. One limitation has been cost. The other issue is concern over increased regulatory scrutiny. Investment management companies should consider building out systems that allow for maximum flexible reporting and technology. Greater agility will allow them to comply more quickly and to develop a repeatable reporting model that can be sustained over time.

High-tech enforcement
Examiners appear more prepared and have a new toolbox from which to work. In 2010, the SEC created the Office of Market Intelligence (OMI), a specialized unit to collect and review thousands of tips, referrals, and complaints about alleged fraud. OMI is supported by two technology systems.

The National Exam Analytics Tool (NEAT) enables SEC examiners to access and systematically analyze massive amounts of trading data from firms in a fraction of the time it had taken in years past. The SEC recently used NEAT over a 36-hour period to analyze 17 million transactions executed by one investment adviser. The Market Information Data Analytics System (MiDAS) is a multipurpose tool for reconstructing market events. The SEC is expected to use it to uncover front running, window dressing and other improper allocations.

Money market reform
Further market pressures are expected once the SEC finalizes money market reform. The most recent proposal would require certain money market funds to (1) price and transact at a floating NAV and/or (2) impose liquidity fees and permit the fund to suspend redemptions temporarily when a liquidity threshold is reached.

AIFMD
Investment management clients are also greatly concerned about forthcoming European directives, such as AIFMD. They are uncertain whether to rely on EU member state level provisions or become AIFMD compliant. They are also considering the feasibility of marketing or not marketing in certain countries rather than rely on reverse solicitation.

Déjà vu all over again?
To prevent another crisis, supervisory bodies are requiring financial institutions to improve the quality, availability and analysis of their data, as well as the technology and processes supporting the information. Yet, behind the scenes, clients are drowning in overlapping regulatory requirements and the pace at which they are coming. That disconnect was the pre-crisis problem: systems were built to meet compliance needs and deadlines rather than to provide risk management insight.
Streamlined regulation and increased taxation
Growing income inequality and the October 2013 presidential election of Michelle Bachelet may bring decades of investment reform to a close. However, the tide may now be turning. The tide may now be turning. The tide may now be turning. The tide may now be turning.

For more than 30 years, Chile has prided itself on its treatment of foreign investors under the law. Foreign investment enjoyed strong protection under The Foreign Investment Statute (DL 600) and Article 47 of the Constitutional Organic Law of the Central Bank (Chapter XIV). In addition, treaties such as the 2004 US-Chile Free Trade Agreement and the Trans-Pacific Partnership further encouraged foreign investment.

Chile went further in November 2013, passing the Investment Funds Act (LUF). Its goal was to eliminate distortion and shortcomings within existing funds legislation and remove certain tax obstacles through a more simplified tax system. The LUF also provided for a withholding tax rate of 10 percent on capital gains and dividends and a pass-through exemption if locally registered funds invested in certain assets.

A new tax plan to address social inequality
However, the tide may now be turning. The newly-inaugurated president has proposed a US$15 billion spending program to overhaul education, improve health care and reduce the wealth gap. A recent OECD survey rated Chile the fourth-poorest country among its peers, a recent OECD survey rated Chile the fourth-poorest country among its peers, a recent OECD survey rated Chile the fourth-poorest country among its peers, a recent OECD survey rated Chile the fourth-poorest country among its peers.

In May, Chile’s lower house passed a tax bill designed to raise US$8.2 billion to fund social programs and overhaul public education. The legislation would raise corporate taxes from 20 percent to 25 percent by 2017 and base shareholder taxes on total company earnings rather than dividends. The Taxable Profits Fund (FUT), a mechanism by which companies can obtain tax exemptions on part of their profits, would be eliminated. The bill would also end DL600, which provides investors from abroad with certain tax guarantees.

The proposed tax rates for investment funds also appear to vary by type. Private funds would pay the corporate rate of 25 percent. Prior to this proposal, private funds served as pass-through entities. Taxes were paid by investors once in constructive receipt of any gain. There has been some confusion regarding tax payments by public funds, which appear to be subject to a 10 percent tax. However, the finance minister recently suggested that pension funds would not be subject to the tax.

A further proposal to create a government-run retirement fund to compete with private sector providers is expected later this year.

New government embraces FATCA
In March, the new government in Chile and the United States signed a Model 2 FATCA Agreement, a reciprocal arrangement in which Chile will direct foreign financial institutions in Chile to register with and report tax information directly to the IRS. Under prior governments, American institutions could rely on Chilean domestic law. Article 154 of the General Law of Banks prohibited Chilean banks from disclosing information about deposits without customer authorization. A court order had previously been required to override this rule.

BRIC by BRIC improvement of investment regulation
In 2001, Goldman Sachs named Brazil as one of four countries that would experience advanced economic development during the 21st century. For a country that had just tamed runaway inflation and suffered extensive capital outflows, such rapid development was a dream come true. Yet the “BRIC” designation also put Brazil under a harsh global spotlight.

With the economy slowing, Brazil is determined to learn from past mistakes. One step in this direction has been to keep investors happy by fostering a slow and steady improvement in the regulatory environment. Brazil’s investment management industry is a strategic powerhouse, ranked sixth in the world with more than US$11.1 trillion in assets under management. In 2014, the Brazilian funds industry included nearly 13,000 investment funds with a total net worth of about BRL2.172 trillion, according to the Brazilian Financial and Capital Markets Association (ANBIMA).

Cleaning up “Instruction 409”
The Brazilian Securities and Exchange Commission (CVM) has submitted a draft proposal that would update its rules regarding the set-up, management, operation and disclosure of information related to investment funds (Instruction 409). The updates are intended to reduce fund maintenance costs and allow for greater use of electronic communications, such as holding shareholder meetings electronically.

A boon for private equity
One of the most prominent options for capitalizing on investment opportunities in Brazil is through a Brazilian Participation Fund, or “FIP”. FIPs are closed-end investment funds that can acquire shares, debentures, subscription bonds, convertible securities and derivatives (for hedging purposes only) of any Brazilian publicly- or privately-traded company. Regulation 540 would amend Regulation 391 to allow private equity funds to invest up to 35 percent of its owners’ equity in companies in which the fund does not have a management role. This change is intended to boost investments in small- and medium-sized companies.

Completing the transition to IFRS
Another upgrade is a new set of rules to align and adapt tax rules to IFRS-based accounting. MP 627 extinguishes the RTT (Transitory Tax Regime), aligns tax computation with IFRS and introduces relevant changes to the tax rules. Law 12,973 is applicable primarily as of January 2015, but taxpayers may choose to follow it in 2014.

Cautious on FATCA
On 2 April 2014, the United States and Brazil reached an agreement on a Model 1 International Governmental Agreement (IGA). The text of the IGA has not been released, and is dependent on amendments to the Brazilian Federal Constitution.

1“Chile’s Bachelet stands by reform despite slowdown,” Luis Andres Henao, AP, 12 March 2014.
Perspectives:
ASPAC region
Structural and market change: Asian Funds Passporting Initiatives
Funds passporting has been a key area of focus for many regulators, governments and key industry players in the ASPAC region. In 2013, three separate fund passport initiatives were announced. We assess the implications of each initiative for the asset management industry in the ASPAC region in turn.

Hong Kong-China Mutual Fund Recognition (Mutual Recognition) was the first of the three initiatives to be announced. The Hong Kong Securities and Futures Commission (HK SFC) and China Securities Regulatory Commission (CSRC) released a broad overview in January 2013. Under this cross-border arrangement, SFC authorized Hong Kong-domiciled funds may be sold to retail investors in mainland China. In addition, CSRC authorized China-domiciled funds could be sold to retail investors in Hong Kong. This has been promoted as a ‘win-win’ situation for both jurisdictions: Hong Kong will consolidate its position as the gateway to mainland China’s cash-rich economy and China will benefit from capital investment flow, exposure to local and international clients, best practices and global standards which, combined, could transform China’s asset management industry.

Meanwhile, the Asia Region Funds Passport (ARFP) is an Asia-Pacific Economic Co-operation (or APEC) initiative announced by the Finance Ministers of Australia, South Korea, Singapore and New Zealand in September 2013. More recently, the Philippines and Thailand have also joined the ARFP. Under the ARFP initiative, cross-border distribution of collective investment schemes established and regulated in one passport member country (the home economy) would be permitted to be offered to investors in other passport member countries (host economies), under a clearly defined framework.

A consultation paper on the ARFP scheme has been issued by APEC in April 2014 for feedback from market participants regarding the initial operation of the passport arrangement. It is envisaged that countries which decide to be passport member economies of the ARFP scheme will finalize arrangements in late 2014 to early 2015. Proposed operational and regulatory requirements for participation in the scheme are currently being evaluated and are expected to cover the following areas: the experience of the manager, capital adequacy, minimum AUM, annual audit and compliance audit requirements, custody arrangements and investment restrictions, distribution and marketing, regulatory reporting and supervision. It will then be up to passport member countries to implement the arrangements domestically. The projected implementation date is 2016.

The ASEAN Collective Investment Scheme (CIS) initiative was announced in October 2013 by the regulators of Singapore, Malaysia and Thailand. Under this initiative, CIS Operators (fund managers) must be licensed or registered by a participating home regulator, must possess a minimum 5 year track record, have a minimum of US$500 million in AUM globally and maintain shareholders’ equity of at least US$1 million and incremental of 0.1 percent for every dollar that is in excess of US$500 million.

In general, funds passporting in Asia offers local, regional and international fund managers unprecedented benefits in securing access to various ASPAC markets via a common platform and framework. While Asia has 60 percent of the world’s population, it has 12 percent of the worldwide AUM market. In comparison, the US has 13 percent of the world’s population and has 57 percent of AUM. Hand-in-hand with growing investment appetites of an increasing middle class in the emerging markets of Asia, fund passporting allows fund managers to access multiple markets via set-up and domiciling of the fund and operations in a single passport jurisdiction.

Hong Kong will consolidate its position as the gateway to mainland China’s cash-rich economy and China will benefit from capital investment flow, exposure to local and international clients, best practices and global standards which, combined, could transform China’s asset management industry.

**WORLD POPULATION**

- **Asia**: 60%
- **USA**: 13%

**WORLDWIDE AUM MARKET**

- **Asia**: 57%
- **USA**: 12%

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AUM source: ICI worldwide Mutual Fund Market Data, Q1 2013.
For regional and international fund managers alike, direct access to the future growth engine of the world, combined with cost savings from a single home base and economies of scale are clear benefits.

In addition, for jurisdictions such as Singapore and Hong Kong, where offshore UCITS funds dominate the domestic market, funds passporting initiatives propel the growth of an end-to-end asset management industry. Rather than having capital flow back to offshore fund centers such as Luxembourg and Dublin, funds passporting can recycle savings locally and deepen Asia’s capital markets. Additional potential benefits are the diversification of investments, greater product and investor choice, and more competitive manager fees.

While all three schemes have their merits, the ARFSP scheme is seen by some to offer the greatest long-term potential with the widest reach across the ASPAC region. The ultimate success of the ARFSP scheme will be measured by the expansion of its membership across the ASPAC region. Currently, it has six passport members, up from the original four. If more were to join, this could potentially be Asia’s answer to Europe’s UCITS.

Data and reporting: FATCA across the ASPAC region
Countries across the region are in different stages of discussion and agreement with the US government. Fund managers across the region are assessing whether they are FATCA-compliant ahead of the upcoming July deadline. The current status of each country is discussed below:

• Hong Kong has been included in the IRS website as of 9 May 2014 as one of the jurisdictions that have reached agreement in substance with the US. However, the content of the Model II IGA has not been publicly released at the time of publication. The market expects that there will be exclusions for MPF and potentially some ORSO schemes registered with the Hong Kong Mandatory Provident Fund Schemes Authority, as well as certain investment managers and advisors in Hong Kong.
• Australia has signed a Model I IGA with the US. However, no local enabling legislation nor guidance has been publicly released to date.
• Japan has signed a Model II IGA with the US. However, no local enabling legislation nor guidance has been publicly released to date.
• Singapore has been included in the IRS website as of 5 May 2014 as one of the jurisdictions that have reached agreement in substance with the US. However, the content of the Model I IGA and/or any local guidance has not been publicly released to date.

Risk governance
Across the region, there is a continued focus on investor protection and education, ongoing KYC and AML requirements and enhancing risk capital requirements for fund managers as a consequence of the spill-over from Basel III regulations which were originally intended for banks and financial institutions.

Singapore’s aspiration to become the leading asset management hub in Asia has seen significant progress this year with Singapore’s participation in two fund passporting initiatives in the ASPAC region. Under the planned ASEAN Collective Investment Scheme (CIS), Singapore-based fund managers will be able to offer their funds to investors in Malaysia and Thailand in a streamlined process, with potential cost savings. As the proposed standards for the ASEAN CIS Scheme are likely to be broadly in line with Singapore’s domestic requirements in relation to fund offerings, Singapore-based managers are expected to be able to offer their existing range of retail funds to investors in Malaysia and Thailand without having to make significant modifications.

Under the proposed Asia Region Funds Passport (ARFP) scheme, Singaporean established and regulated collective investment schemes will be offered to investors in other passport member countries (host economies). If more member countries join the ARFP scheme, Singapore could strengthen its position as an asset management hub of choice for international fund managers setting up in Asia, as it would allow direct access to the ASPAC region whilst offering well-established and robust legal and regulatory systems and various tax incentives for the fund management industry, such as tax exemptions for onshore funds.

In addition, the notice requires IT controls to prevent unauthorized access or disclosure of customer information.

The details of the mutual fund recognition scheme between mainland China and Hong Kong, announced in January 2013, have not yet been released. However, during the HKIFA 7th annual conference on 4 December 2013, HK SFC and CSRC indicated that under the scheme, fund managers will be able to sell CSRC-authorized Hong Kong domiciled funds to retail investors in mainland China, and Chinese fund managers will be able to sell their CSRCAuthorized China domiciled funds to retail investors in Hong Kong. The first approved products will be regular and plain vanilla type funds, with other products to follow.

New RBC requirements introduced in April 2013, effective for capital markets (CMS) licence-holders, are in operation. Fund management companies have a 24-month transition period until 2 April 2015 to comply with the new requirements, which aim to improve the overall quality of the capital base.

Similarly, the MAS TRM guidelines introduced in June 2013 and a Notice on Technology Risk Management (Notice No. CMG-N02) with an effective date of 1 July 2014, are applicable for financial institutions. This notice requires financial institutions to have a framework and process to identify and maintain critical systems with procedures to be followed when a relevant incident occurs. In addition, the notice requires IT controls to prevent unauthorized access or disclosure of customer information.

Overall, the funds management industry in Singapore is facing increasing costs of compliance with existing and new regulations. Banking regulations are finding their way into the investment management sphere and establishing a strong compliance and risk management platform is a pre-requisite to entry in the industry. Despite these pressures, the development of the two Asian passport initiatives offer significant business opportunities for Singaporean-based fund managers, and will enhance the competitiveness of the island city state as an international asset management hub. This is likely to attract more international fund managers to use Singapore as a home base as they seek access to ASEAN and the wider ASPAC region.
Mutual recognition represents a gateway to tap mainland China’s cash-rich economy, where the household savings rate exceeds 50 percent of GDP and capital market development is still in its infancy. In the wake of this initiative, the fund management industry has witnessed a scramble by Hong Kong and international fund managers to set up SFC-authorized Hong Kong domiciled funds and build a track record in performance.

Currently, foreign investment managers in mainland China are restricted to teaming up with local Chinese local fund managers in the form of joint venture structures, where foreign ownership is restricted to 49 percent. The scheme presents international fund managers with an opportunity to enjoy direct access to mainland China without high set-up costs of joint ventures with local Chinese fund managers or loss of management control.

The HK SFC and industry players are hopeful the initiative will progress Hong Kong from being a distribution and sales center of fund products, to an international end-to-end asset management hub, where a full suite of world-class services from investment portfolio management to fund administration, custodial and trustee services are offered.

For China, the scheme will offer greater diversity in the investment landscape for Chinese investors, and will allow Chinese investors to access international products. More importantly, the scheme will allow Chinese fund managers to use Hong Kong as a platform to offer Chinese fund products to the international community and attract capital investment flows into China.

Complementing the mutual recognition scheme, is the pilot program announced in April 2014 by the HK SFC and CSRC. Known as Hong Kong-Shanghai Stock Connect, the pilot program aims to establish mutual stock market access between mainland China and Hong Kong. Trading under the program will initially be subject to a maximum cross-boundary investment quota. The Northbound Trading Link will be limited to an aggregate quota of RMB300 billion and a daily quota of RMB13 billion, and the Southbound Trading Link will be limited to an aggregate quota of RMB250 billion and a daily quota of RMB10.5 billion.

Shares eligible to be traded through the Northbound Trading Link will comprise all the constituents of the Shanghai Stock Exchange (SSE) 180 Index and SSE 380 Index, and shares of all listed companies which have issued both A-shares and H-shares. Shares eligible to be traded through the Southbound Trading Link will be comprised of all the constituents of the Hang Seng Composite LargeCap Index and Hang Seng Composite MidCap Index, as well as shares of all companies listed on both the SSE and the Hong Kong Stock Exchange. While all Hong Kong and overseas investors will be allowed to trade SSE Securities through Shanghai-Hong Kong Stock Connect, mainland investors participating in the Southbound Trading Link will be limited to institutional investors and individual investors who hold an aggregate balance of not less than RMB 800,000 in their securities and cash accounts.

The initiatives represent a step forward towards liberalizing the Chinese economy and internationalization of the RMB as a global trade settlement and reserve currency. For Hong Kong, it offers the jurisdiction the opportunity to become a major international asset management hub and consolidate its position as the key offshore RMB center and the gateway to mainland China.

**AUSTRALIA**

**Funds passporting**

The Asia Region Funds Passport was a recommendation of the 2009 Johnson Report, ‘Australia as a Financial Centre’. Under the cross-border arrangement, Australian fund managers can offer their managed funds to other passport member countries in the ASPAC region and vice versa. This holds large, untapped opportunities for the Australian Financial Services industry, which has long held ambitions to export its financial products into Asia and provide a larger regional market with which to distribute their fund offerings and products. For investors in the ASPAC area, the ARFFP scheme will offer greater product choice for investment and exposure to the expertise of Australian fund managers who operate in a well-established and mature market.

The Future of Financial Advice (FOFA)

In response to local events that shook consumer confidence, such as the 2009 collapse of Storm Financial (financial advice) and Opes Prime (securities lending) in 2008 the Future of Financial Advice reforms were launched in Australia. The key reforms include:

- Banning conflicted remuneration, such as: commissions paid for recommending financial products with a move towards fee for service models; soft dollar benefits; and restricting the web of volume-based payments between investment platform operators, fund managers and financial advisors.
- More transparent advice fee disclosure in the form of an annual statement.
- Enhancing retail investor protection with a higher statutory duty, requiring financial advisors to act in the best interests of their clients and not put their own interests first.

These reforms have resulted in the unbundling of product and advice fees, changes to remuneration/fee structures and significant improvement of advice processes, quality standards and governance models.

While the FOFA reforms took effect on 1 July 2013, further amendments by the new government are being debated. These include:

- Scaling back of some of the fee disclosure provisions.
- Clarification of the statutory best interest duties.
- Amendment of the ban on commissions to allow payments to representatives of the product issuer.

Also, from 1 July 2014, financial advisers will be caught by the Tax Agent Services Act 2009 (TASA). The amendments introduce a new tax agent service – tax (financial) advice services, new Tax Practitioner’s Board registration requirements and new civil penalties. This legislation sees the blurring of accounting and tax advice for the financial advice profession.

**Superannuation and Self Managed Superannuation Funds (SMSFs)**

Australia is the fourth-largest private pension market in the world with mandated superannuation. Self Managed Super Funds are seen as one of the fastest growing areas of the Superannuation industry which now accounts for more than a third of superannuation savings in Australia. This is attracting increased focus from regulators and investors seeking greater control of their investments and taxation.

Regulatory developments within the SMSF segment raising the bar for gatekeepers include:

- The registration of SMSF auditors to apply minimum industry standards and raise the standard of SMSF auditor competency.
- Proposals to set out specific disclosure requirements for Australian Financial Services licensees and their authorized representatives who give advice to clients on establishing or switching an SMSF.

3 JPMorgan, Framing 2014: Concessions, Consolidations and a Return to Growth, Q1 2014.
• Licensing of accountants who give advice on SMSFs.

The retail, industry and public sector funds are also now more heavily regulated following the progressive implementation of the Stronger Super reforms and the Superannuation prudential standards.

Regulation on the horizon

Australian legislators have implemented a raft of financial industry regulations in the last few years (including FoFA, Stronger Super, FATCA, privacy, capital changes) with further changes anticipated with OTC derivative reform, GATCA, AML 3, National Consumer Credit Code on the horizon. Moving forward the financial systems inquiry (the Inquiry) presents an opportunity to examine and improve on the regulatory architecture and make further enhancements to improve a broadly sound financial system. The Inquiry will lay out a "blueprint" for the financial system over the next decade.

Impact of regulatory change on operating models

Wealth managers are juggling increased competition, regulatory pressures and driving structural and technology transformation agendas to optimize their businesses. KPMG member firms are seeing an increasing trend of organizations moving towards a more customer centric operating model, more agile decision-making and revisiting their operating models with a close examination of profitable business models and segments. Capturing an increasing share of the retirement segment amid a demographic shift of baby boomers moving from accumulation to decumulation phase, via retention drivers and targeted customer segments aligned to their distribution channels and businesses, is key.

The viability of small independent advice businesses, given the volume of regulatory change and withdrawal of commission-based income streams, is questionable and provides opportunity for further market consolidation across financial planning entities. The TASA obligations could see further integration of accounting and financial planning businesses, the embedding of more accounting and tax specialists into these organizations and greater use of referral models between these types of organizations.

Our KPMG member firm in Australia sees a range of market opportunities for market participants to increase scale, from administration to superannuation and investment managers.

JAPAN

Structural and market change

Since April 2013, as part of the quantitative easing measures put in place by the new Japanese Prime Minister, Shinzo Abe, the Bank of Japan (BOJ) has bought JPY 7 trillion of Japanese Government Bonds (JGB) each month. BOJ hopes that by reducing bond yields, this will encourage banks, financial institutions and pension funds to diversify away from holding JGBs and instead to invest in other, relatively high-risk, assets. These measures are aimed at reviving the economy and increasing inflation.

Banks, financial institutions and pension funds are now reallocating their traditional investment in JGBs to domestic equities, foreign bonds and foreign equities. One of the most significant structural changes in Japan is the announcement of the overhaul of the management and governance structure of the Government Pension Investment Fund (GPif). The proposed reforms are aimed at shifting investments away from low yielding JGBs and into higher yielding investments to drive economic growth and to cope with Japan’s rapidly ageing population.

GPif, Japan’s public pension fund, is the world’s largest retirement savings pool with US$1.26 trillion in AUM. As part of the restructure of GPif, the investment committee has been overhauled with only two of the previous ten members remaining. In addition, new active fund managers have been selected and a working group panel has been tasked with reviewing investment strategy, benchmarking, performance and allocation targets. Some panel recommendations have already been implemented, such as benchmarking passive investments to the new JPX 400 index. GPif has also pledged to introduce a performance-based fee structure for active managers and to replace its fixed fee approach. Plans are also underway to select a consultant to review the remuneration structure of GPif’s staff.

GPif has begun to reduce its exposure to domestic JGB bonds and increase its exposure to international equities. Portfolio allocation as at December 2012 for domestic bonds was 60 percent and international equities was 13 percent. By December 2013, this had changed to 55 percent and 15 percent respectively.

For existing fund managers in Japan and prospective international fund managers wanting to set-up in Japan, the GPif developments signal increased appetite by institutional investors and pension funds for relatively risky investments. The upshot is greater demand for the services of foreign fund managers, who have expertise in foreign equities and bonds.

Remuneration for managers of pension funds and investment trusts is low compared to global standards. With GPif in the process of revamping fee remuneration of its active managers and the overhaul of its structure, this might be the catalyst the asset management industry in Japan was waiting for.

Conduct, culture and remuneration

The Council of Experts Concerning the Japanese Version of the Stewardship Code (the ‘Council’) was established in August 2013 and has met six times since inception. The Council published the ‘Principles for Responsible Institutional Investors’ (Japan’s Stewardship Code) on 26 February 2014. Japan’s Stewardship Code aims to promote medium to long-term sustainable corporate returns based on seven principles to guide investors on their stewardship responsibilities. These principles are aimed at ensuring institutional investors are responsible for their investment decisions and to open up dialogue and communication between clients, institutional investors and investee companies.
Perspectives: EMA region
Initiatives proliferate across Europe
With the transition period to the AIFMD regime ending on 22 July 2014, the task of implementing the new regulations and working on license applications has been considerable for both regulators and the asset management industry across the European Union (EU) over the past year. New laws and regulations transposing the directive have been enacted and regulators are busy processing a flurry of license applications, with some issuing very welcome and useful guidance on entities falling under scope of the AIFMD and the application of the remuneration provisions. The first regulatory reporting dates for AIFMs are looming and asset managers are spending a lot of time to ensure the regulators receive the high data quality expected.

In France, the main focus has been the transposition of the AIFMD into domestic law and the mirroring of the EU text as closely as possible. At the same time, France took a series of measures to improve the attractiveness of the asset management sector, such as streamlining the range of collective investment vehicles available to managers into the following six categories:

- UCITS
- Retail non-UCITS
- Professional funds
- Employee savings funds
- Securitization vehicles
- Other collective investment funds.

France also introduced swing pricing as an option, the setting of zero minimum investment for retail investors and €100,000 for professional investors, and the requirement for all retail funds to appoint a depositary.

New structuring vehicles
In late December 2013, a bill was published in Ireland to introduce a new corporate structure called the ICAV for Irish investment funds. The ICAV, which was expected to be enacted by mid-2014, increases the range of fund vehicles available for both UCITS and AIFs. The ICAV will have its own legislative regime and will not be subject to aspects of company law that are not relevant or appropriate to a collective investment scheme. One of its primary features is that, unlike existing public limited company (PLC) structures, it can elect to be classified as an eligible entity for US ‘check-the-box’ rules, allowing it to be treated as a partnership for US tax purposes and thereby avoiding certain tax consequences for US taxable investors. Existing Irish PLC structures will have the option to convert to ICAV.

Integrated Rulebooks
The Central Bank of Ireland (CBI) has launched a number of consultations, including one on a new UCITS Rulebook to replace the existing UCITS Notices and Guidance Notes with a single rulebook, in line with the approach taken in the AIFMD Rulebook. Also linked to the transposition of the AIFMD, the CBI launched a consultation on the requirements that should apply to manage conflicts of interest where a fund administrator proposes to provide administration services and depositary services to the same non-EU AIF. To address the potential conflicts of interest, the CBI would require the functional and hierarchical separation of the depositary and administration services by requiring the depositary services to be performed through a separate subsidiary, and a direct reporting line to the parent company at senior management level.

Loan origination by funds
The CBI opened up the debate on whether funds could fill the funding gap that has been left by the financial crisis by launching a discussion paper on direct loan origination by non-UCITS funds. The paper looks at the risks and how could these be mitigated to permit funds to become a viable credit channel.

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Revamped limited partnership regimes
While transposing the AIFMD into national law in 2013, Luxembourg took the opportunity to increase its attractiveness as a platform for fund-raising vehicles by modernising its limited partnership regime. This was done by (i) improving the common limited partnership regime (société en commandite simple (SCS)) and (ii) introducing a new form of special limited partnership (société en commandite spéciale (SCSp)). The main difference between the two structures is that the SCSp is not vested with legal personality. These sophisticated and flexible contractual regimes, which are broadly similar to Anglo-Saxon limited partnerships, are expected to appeal to investors, in particular in the fields of private equity, hedge funds and real estate.

AIFMD-inspired provisions implemented in Switzerland
Switzerland comes under the ‘third country regime’ when it comes to the AIFMD and given that many EU funds are either managed or distributed in Switzerland, questions of market access and distribution are of crucial importance. Swiss fund law was significantly amended in 2013, spurred by the introduction of the AIFMD. AIFMD-inspired provisions were implemented in the Swiss Collective Investment Schemes Act (CISA) and the Swiss Collective Investment Schemes Ordinance (CISO), to allow the Swiss legal framework to be considered EU-equivalent and thus permit Swiss asset managers to continue to manage AIFs in the EU and prepare the groundwork to allow Swiss AIFs access to the EU passport in 2015. The new law contains various transitional periods. For instance, asset managers and representatives of foreign collective investment schemes, as well as distributors (which are all subject to the CISA since the revision), must meet their respective statutory requirements by 1 March 2015 (see articles 158b and 158c of CISA).

As part of the revision, the requirements on fund distribution – notably in respect of foreign funds marketed in Switzerland on a private placement basis – were substantially amended. A new FINMA Circular 2013/9 on the Distribution of Investment Schemes entered into force on 1 October 2013, replacing the Circular on Public Advertising. The concept of a public offering was removed and replaced by a distribution concept, which is broadly defined by the Circular as ‘any offer or advertisement for CIS which is not exclusively addressed to regulated financial intermediaries’. Distribution therefore includes marketing to both qualified and/or non-qualified investors and all kinds of offerings, apart from reverse solicitation and discretionary portfolio management, will trigger the application of Swiss law and FINMA regulations.

If a foreign collective investment scheme is distributed to non-qualified investors in or from Switzerland, both the distributor and the foreign collective investment scheme must be authorized by the FINMA, and a Swiss representative and paying agent must be appointed. However, distribution to qualified investors does not require FINMA authorization.

New record keeping requirements of client meetings
In March 2014, the provision regarding the preparation of minutes of client meetings entered into force. The licensees and third parties engaged to distribute units must record in writing the client’s requirements and the reasons for each recommendation for investment in a specific collective investment scheme. This written record has to be provided to the client. Both the form
and content of the minutes must comply with rules of conduct issued by a self-regulatory organization recognized as minimum standard by the Swiss Financial Market Supervisory Authority (FINMA). In November 2013, the Swiss Bankers Association (SBA) released guidelines regarding these record-keeping requirements.

**Retrocessions/Inducements**

In a number of recent decisions, the Swiss Federal Supreme Court clarified the legal framework applicable to retrocessions (e.g., commissions, finder’s fees, kickbacks). According to the Supreme Court, asset managers and banks are liable to pay any commission received in the context of management mandates to their customers or investors. Advance waivers by the customers are void, unless they were provided with detailed information on both the scope and the amount of the payments to be obtained. It goes without saying that this practice, besides the general trend towards more disclosure and transparency in financial activities, has a major impact on the Swiss financial industry. In particular, it is assumed that this restrictive ‘retrocessions-practice’, as well as the general lack of their own distribution networks will make it burdensome for foreign providers of funds to distribute their products in Switzerland.

**UK**

**More supervisory scrutiny into conduct**

A focus on ensuring good outcomes for consumers has become a top agenda item for the Financial Conduct Authority (FCA) over the past 18 months and the heightened supervisory scrutiny is being felt across the UK investment management industry. In a series of conduct-focused thematic reviews across a cross-section of the industry, the FCA has looked at the management of conflicts of interest, product governance and design, the implementation of the Retail Distribution Review (RDR), market abuse controls in asset managers, and the manager’s role in product design and governance. The ongoing supervisory work has also included deep-dive visits to individual firms to analyze specific topics, which has resulted in some hefty fines being levied for non-compliance with regulatory requirements.

**Review of the use of dealing commission by investment managers**

After a period of consultation, the FCA published final changes to the use of dealing commissions regime that takes effect from June 2014. The changes should ensure that investment managers control the costs of dealing in the best interests of investors and that goods and services acquired in return for dealing commissions satisfy the regulatory conditions. The rule change will impact how investment managers acquire research and services, such as corporate access from brokers or third parties in return for client dealing commissions, and whether the charges can be passed on to their clients. Firms will need to have sufficient systems, controls and records to demonstrate that they act in compliance with the new rules and make proper disclosure to their clients on the use of dealing commissions.

**Retail distribution and independent advice**

The FCA is currently in the process of carrying out a three-stage thematic review of RDR implementation to assess how firms are satisfying the new requirements. The findings to date have shown fairly widespread non-compliance in areas such as clear disclosure on cost of advice and whether advisers offer independent or restricted service. The FCA has responded with additional guidance on how firms should comply with these rules and more detail on their expectations from independent advisors in terms of the requirements to conduct a fair, comprehensive and unbiased review of products. Advisers need to speed up progress as the FCA is expected to pursue enforcement action for continued non-compliance with expected standards.

The FCA is also focusing on suitability at wealth management firms and intends to probe the use of in-house funds. It will assess how effectively wealth managers and private banks control conflicts of interest when client assets are invested in these funds.
Hedge Fund Regulation in South Africa

Hedge fund regulations have varied globally, with focus ranging from reporting requirements to governance structures aimed at prohibiting manipulation and fraud. Since 2008, South African hedge fund managers have been required to hold a CFA license under the Financial Advisory and Intermediary Services Act (FAIS) which was considered by the industry to be sufficient given that these alternative asset classes were only open to the wealthy private individual. However, amended regulation 28 asset limits were released under the Pensions Funds Act in 2011, allowing pension funds to allocate 10 percent to hedge funds, part in recognition of the diversified returns they offer (more than half of hedge funds in South Africa manage equity long-short strategies) and in order to stimulate growth in an industry which now has approximately R42bn in assets under management (2008: R30bn).

As the hedge fund sector becomes increasingly institutionalized, investment managers have come under greater scrutiny, particularly from regulators, and it was in the wake of the credit crisis that South Africa, as a member of the G20, committed to enhance and expand regulatory oversight of hedge funds. This culminated in the release by Treasury and the FSB of a proposed framework for hedge funds in South Africa. The process has been transparent, with standing committees and industry participants invited to assist in the drafting process. Final regulations will be effected through the Collective Investment Schemes Control Act, No. 45 of 2002 (CISCA). The FSB noted that the declaration will also include those provisions of CISCA that will be applicable to hedge funds which have been issued for public comment by the Registrar, with enactment anticipated in the third quarter of 2014.

For the sector to achieve growth through this era of fundamental change, fund managers will need clear insight into the challenges posed and solutions being offered in the market today. In a recent global survey, KPMG in South Africa found that more than 7 percent of total operating costs were attributable to compliance technology, headcount or strategy. The rising cost of compliance is pressing margins and influencing product and operating model decisions. Given the size and nature of the industry in South Africa, managers are more likely to absorb the cost of compliance rather than pass it on to their funds. In light of this, many traditional hedge fund managers will be looking for cost-effective ways to outsource compliance, likely creating greater white-labeling of funds.

National Treasury released two papers during March 2014 which are likely to impact on the Investment Management industry.

2014 Budget update on retirement reform

The proposals relating to retirement reforms in South Africa aim to improve the coverage and preservation of retirement funds, and to lower the costs relating to retirement funding. The key proposals include:

• Auto-enrolment or mandatory contribution to retirement funds.
• Improving pre-retirement preservation.

KPMG in South Africa ("KPMG") comments: We expect that both of these measures will increase the savings pool and should be positive for providers (investment managers, insurers, etc.) that manage retirement fund monies.

• Improving disclosure of costs by retirement funds.

KPMG comments: We expect that more transparent disclosure relating to costs will be required by providers and retirement funds alike. Draft regulation is expected late 2014/early 2015.

• Reducing the number of retirement funds to achieve economies of scale for members.
• Simplifying retirement savings products and making them portable between providers.
KPMG comments: We expect that this will influence product design, increase competition and ultimately put pressure on the fee margin of providers.

- Ensuring effect intermediation and reducing conflicts of interest within the intermediary industry.

KPMG comments: Draft proposals regarding intermediary remuneration and rebates on investment platforms will be published in the Retail Distribution Review (RDR). We expect the RDR report to be published by the Financial Services Board (FSB) during Q2 2014.

- Tougher market conduct regulation and improved supervision.

KPMG comments: We expect that this will result in more effective and intrusive regulation which will impact on retirement funds and providers alike. Draft regulation dealing with trustee training, fit and proper requirements and governance is currently being prepared.

Non-retirement savings: tax free savings accounts

The key focus is the proposed introduction of tax-preferred savings accounts. These savings accounts are intended as a measure to encourage household savings.

The key proposals in this paper include:

- Individuals will be allowed to open a maximum of two tax-free savings accounts, where they may invest in either interest-bearing or equity instruments, or a combination of both, in each account.
- Total contributions for each tax year may not exceed the annual limit, initially set at R30,000.
- Unnecessary withdrawals will be discouraged, by not permitting replacement of withdrawn amounts.
- A lifetime contribution limit, initially set at R600,000, will apply.
- Institutions that have a banking, or collective investment scheme licence, as well as government, will automatically be eligible to offer products through the tax-free savings accounts. Stockbrokers that are registered with the FSB and the Johannesburg Stock Exchange (JSE) will also be eligible to provide investment products through a tax-free savings account, provided that the products offered comply with the stated principles and characteristics.

Treasury has indicated that most collective investment schemes will therefore be included in the tax-free savings accounts, along with bank savings accounts, fixed deposits, retail savings bonds, REITs and insurance investment products that meet the stated principles.

Products with contractual periodic contribution obligations (such as insurance contracts) or excessively high early termination charges are not considered by Treasury to be appropriate products for these accounts.

KPMG comments: We expect that these proposals will increase the number of collective investment schemes in the South African market. These proposals will, however, increase the administrative burden of tax reporting (including dividend withholding tax) and the monitoring of the contribution limits of each investor.

Tax free savings accounts are expected to be introduced during 2015.

Collective Investment Schemes Control Act (CISCA)

Foreign collective investment schemes

The Financial Services Board in South Africa released Board Notice 257, which came into operation on 1 January 2014. This notice sets out the conditions for which a foreign collective investments scheme (CIS) may solicit investments in South Africa.

The key conditions are summarized as follows:

- The person or entity that administers a foreign CIS scheme (operator) must be authorized and supervised by a regulator which has a regulatory environment of similar standing as the regulatory environment in South Africa.
- The foreign CIS scheme must be available for investment in its domicile of registration and be promoted to the same type of investors under the same or substantially similar requirements and conditions relating to the type of investors as in its domicile of registration.
- The foreign CIS scheme must be available for investment in its domicile of registration and be promoted to the same type of investors under the same or substantially similar requirements and conditions relating to the type of investors as in its domicile of registration.
- The operator applying for approval of a scheme must either enter into a representative agreement, or establish and maintain a representative office. Where the operator has established a representative office, it must satisfy the FSB that its
representative office maintains paid-up share capital and reserves of no less than R2 million. Where the representative office conducts business other than representing the scheme, such business may only be a financial services-related business. Where this is the case, capital of R2 million must be dedicated to the scheme and at all times be invested in assets which are capable of being liquidated within seven days.

- The operator applying for approval of a scheme must satisfy the registrar that:
  - the scheme is sufficiently liquid to meet investor redemptions.
  - the scheme allows redemptions at regular intervals.
  - the scheme does not permit investment in an instrument that compels the acceptance of physical delivery of a commodity and the scheme particulars or prospectus prohibits it from accepting physical delivery.
  - the assets of investors are properly protected by application of the principle of segregation and identification.

KPMG comments: We expect that these conditions will result in an increase in foreign CIS schemes in the South African market.

**Protection of Personal Information Act (POPI)**

The Protection of Personal Information Act (POPI) was enacted on 27 November 2013 and seeks to promote the protection of personal information processed by public and private bodies. POPI is broad in its application and, while some exceptions exist, every person or entity that collects, stores and otherwise modifies or uses personal information (i.e. processes information) must comply with the conditions.

Certain provisions of POPI, relating to the establishment of the Information Regulator and regulations to the Act, became effective on 11 April 2014. The Information Regulator will undertake a number of duties under POPI, including dealing with consumer complaints, and monitoring and enforcing compliance with POPI. Fines of up to R10 million or imprisonment for a period of up to 10 years may be imposed on companies and other persons who fail to adhere to the provisions of POPI.

Provisions governing the conditions under which personal information must be processed, are not yet effective. However, once an effective date for the remainder of the Act is published, companies will have one year to become compliant.

**FACTA**

With the FATCA effective date of 1 July 2014 looming large on financial institutions’ regulatory horizons, KPMG member firms have recently seen a number of interesting releases from the US Treasury and the IRS. The recently released Announcement 2014-17 says although South Africa has not yet signed an IGA with the US, on the basis that South Africa has reached agreement ‘in substance’ with the US in respect of the IGA, South Africa is to be considered an IGA jurisdiction from 2 April 2014. This has provided much-needed clarity for South African financial institutions, who now have the certainty of being able to focus on the provisions of the IGA, and not on the more onerous FATCA Regulations published by the IRS. South African financial institutions will now be taken out of the realm of the FATCA Regulations entirely, barring circumstances of significant non-compliance. South Africa must have finally signed an IGA with the United States by 31 December 2014.

However, considering the SARS media release of 3 April 2014, we would expect a signed IGA well before this deadline.

South African financial institutions await the imminent issue of the final Business Requirement Specification (BRS) from SARS, which will enable the development of the financial reporting systems necessary to facilitate the transfer of relevant information. SARS are also working on the IGA Guidance Notes which will give much needed clarity on the implementation of the IGA obligations, but at this stage there is no clear view as to when these will be finalized.

Notice 2014-33 issued by the IRS on 2 May 2014, announces the intention of the Department of the Treasury and the IRS to further amend the FATCA Regulations. The notice says that a FFI may treat an entity account opened after 1 July 2014 but before 1 January 2015 as a pre-existing account. This effectively extends the effective date by 6 months in respect of entity accounts, which gives FFIs additional breathing space to meet the FATCA onboarding obligations.

2014 and 2015 will be regarded as a transition period for purposes of IRS enforcement and administration with respect to the implementation of FATCA Regulations by withholding agents, foreign financial institutions and other entities within scope of FATCA. Importantly, the IRS will take into account the extent to which such an entity has made good faith efforts to comply with the FATCA regulations. An entity that has not made a good faith effort to comply with the FATCA regulations will not be given any relief from IRS enforcement during the transition period.

Revision of Board Notice 80 under CISCA

In January 2014, the FSB released a draft notice to replace Board Notice 80, which determines types of securities and limits for collective investment schemes. The draft notice mainly deals with technical corrections to the current conditions.

**Pension Funds Act 1956 – Regulation 28**

The third draft of the Regulation 28 Notice containing the conditions for the use of derivative instruments was published for comment on 6 November 2013.

A second draft Regulation 28 Notice with Conditions for Investment in Hedge Funds by SA retirement funds was released by the FSB at the end of October 2013. Investment managers, through the Association for Savings and Investment South Africa (ASISA), responded to this notice. The Financial Services Board (FSB) released its response to industry comments and extended the time period for comments until later in 2014.

In a recent global survey, KPMG in South Africa found that more than 7 percent of total operating costs were attributable to compliance technology, headcount or strategy.
Regulation opens up Middle East markets

Although still in its infancy by global standards, the Middle East is increasingly an important region for asset management firms around the world and offers a compelling market opportunity.

Strong economic growth and financial liquidity resulting from buoyant oil and gas prices should ensure that the asset management industry in the region is presented with many exciting opportunities. In addition, recently-awarded events such as the Global Expo 2020 in Dubai will facilitate capital inflows into the region. The demographic profile of the region is also positive – 60 percent of the population is under the age of 30. 6

Consistent and moderate growth

Economic growth in 2014 is expected to be nearly 5 percent. The Oman Budget acknowledges the dependence on crude oil as the country's major source of revenue and aims to achieve the following:

• Curb the rise in government spending.
• Develop non-oil revenues and further diversify the economic base.
• Promote private sector involvement – and activate public-private partnering – to establish joint economic projects and greater career opportunities.
• Encourage domestic and foreign investment.

Guidelines on regulatory capital under Basel III

Basel III has recommended that the predominant form of capital shall be Tier 1 capital of which Common Equity Tier 1 (CET 1) will be the predominant component. Accordingly, based on the presently prescribed level of capital adequacy, banks operating in the Sultanate will be required to maintain at all times, the following minimum capital adequacy ratios:

- Common Equity capital ratio: 7 percent of Risk Weighted Assets (RWA)
- Tier 1 Capital ratio: 9 percent of RWA (Going concern capital)
- Total Capital ratio: 12 percent of RWA (Gone concern capital)

Capital Buffer requirements

Additional capital buffers are intended to encourage the build-up of capital buffers by individual banks during normal times that can be drawn down during stress periods. The Countercyclical Capital Buffer is intended to protect the banking sector as a whole from systemic risk that is often developed during an economic upswing, when there is a tendency towards excessive aggregate credit growth. These buffers, collectively referred to as the Buffer Requirements, comprise of:

- i. a Capital Conservation Buffer (CCB), which shall be 2.5 percent of total RWA
- ii. a Countercyclical Capital Buffer (CCyB), which will lie between 0 percent and 2.5 percent of total RWA.

The capital conservation buffer was implemented on 1 January 2014 and will take full effect by 1 January 2017. CBO plans to circulate a concept paper during 2014 providing further guidance on implementation.

CBO requires banks to allocate 5 percent of their total credit to SMEs

CBO has mandated all the banks operating in the Sultanate to allocate 5 percent of their total credit portfolio to Small and Medium Enterprises (SMEs) in the country by the end of December 2014. The associated Circular also advises banks to create separate...

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5 ICÆW Economic Insight: Middle East, Q1 2013
6 Calculation is based on total global financial assets of US$225 trillion (Global Capital Markets 2013, McKinsey Global Institute) and total Islamic finance assets of US$1.8 trillion (ISLAMIC FINANCE INDUSTRY: Malaysia International Islamic Financial Centre).
departments for SMEs to better cater to their needs, ensure improved credit flow and facilitate entrepreneurship through project formulation, finance and business management, leads in business initiatives, technical support, sourcing of raw materials, process management, marketing and so on.

**Guidelines on credit exposure to non-residents and placement of bank funds abroad**

CBO issued renewed guidelines on 31 March 2014 in respect of credit exposure to non-residents and placement of bank funds abroad. The banks, which are in excess of the prudential limits prescribed under the Guidelines, are granted a grace period of six months from the date of this Circular to bring down their exposures to within the prudential limits or maturity of their exposures, whichever is earlier.

**Islamic banking regulatory framework**

In pursuance to the Royal Decree 69/2012 which amended the Banking Law 2000, CBO issued the much-awaited Islamic Banking Regulatory Framework (IBRF). The IBRF is a detailed and comprehensive document covering all aspects of Islamic banking. Islamic banks and windows performing investment banking business must comply with certain requirements and conditions stated in the IBRF.

In 2013, two Islamic banks and six Islamic banking windows of local conventional banks were launched.

**QATAR**

After the 2008 financial crisis, the Gulf Cooperation Council’s (GCC) asset management industry is slowly picking up. The asset management industry in Qatar is set to grow strongly over the coming years, with an opportunity to generate emerging market returns in a comparatively low risk environment.

Qatar is home to a nascent but fast-growing fund management industry of US$156.6 million, spread across six managers and 11 fund vehicles. The majority of these assets are placed in equity vehicles, which account for approximately 99 percent of the assets under management (AuM). The funds are managed by Qatar’s five largest asset management firms.

GCC Sovereign Wealth Funds (SWFs) have also grown their asset bases significantly over the last few years, accounting for half of all foreign assets held by the GCC. Qatar’s SWF, managed by the Qatar Investment Authority (QIA), accounts for about US$170 billion of global SWF assets (SWF Institute).

MSCI’s reclassification of Qatar from frontier market to emerging market with effect from May 2014 is a highly significant development and is expected to attract capital inflows to the Qatar Exchange of over US$400 million.

**A new regulatory framework**

There are three regulatory bodies in Qatar: Qatar Central Bank (QCB), Qatar Financial Centre Regulatory Authority (QFCRA) and Qatar Financial Market Authority (QFMA), which regulate the financial and capital markets. In December 2012, a new financial regulation framework was enacted by the unification of the regulatory regimes. That is, the three regulatory bodies will function under one umbrella. The law lays the foundation for increased co-operation between the regulatory bodies in Qatar, as they develop and apply regulatory policy and implement international standards and best practices to deliver the objectives of the Qatar National Vision 2030 and Qatar National Development Strategy 2011–2016. QCB acquires responsibility for the licensing and supervision of insurance companies, reinsurance companies and insurance intermediaries that were previously licensed by the Ministry of Business and Trade.

In December 2013, a three-year strategic plan was introduced which is the result of intensive collaboration between Qatar’s financial sector regulatory authorities. This aims to position Qatar as a leader in the region in financial sector regulation, and supports Qatar’s ambition to be a global financial center. The strategic plan is a comprehensive document containing six mutually re-enforcing goals, each supported by specific strategies and work plans. The goals are:

- Enhancing regulation by developing a consistent risk-based micro-prudential framework.
- Expanding macro-prudential oversight.
- Strengthening financial market infrastructure.
Enhancing consumer and investor protection.
• Promoting regulatory cooperation.
• Building human capital.

The asset management regime of the QFC has benefited from a number of regulatory initiatives that have paved the way for a strong, dynamic and progressive asset management sector. The QFC Regulatory Authority Collective Investment Schemes Rules 2010 (COLL) and the Private Placement Schemes Rules 2010 (PRIV) are the primary rulebooks pertaining to the asset management sector. The new regime complies with international standards while providing for a diverse range of schemes that meets the needs of all categories of customers. Additionally, the QFC Regulatory Authority’s Conduct of Business Rulebook (COND) publishes requirements and standards in respect of financial promotions conducted by the QFC, including the marketing and sale of collective investment schemes. Minimum capital requirements by the Qatar Financial Centre Regulation Authority for fund managers range from $250,000 (for operating a collective investment fund if restricted to providing fund administration) to $2 million for dealing in investments as principal.

Regulatory changes from the QF CRA

In 2013, QF CRA introduced the following changes to further strengthen the regulations for financial institutions:

Corporate governance. The new rules on Governance and Controlled Functions came into force on 1 July 2013. The QF CRA has stated that these new rules will seek to reinforce regulation covering governance and risk management by requiring the governing body of a Qatar Financial Centre (QFC) authorized firm to approve and establish:
• A formal governance framework.
• Risk management and internal controls framework.
• Remuneration policy.

Anti-Money Laundering. In 2010, as part of its commitment to work with the Financial Action Task Force (FATF) to implement anti-money laundering and counter-terrorist financing measures, Qatar updated its anti-money laundering and counter-terrorism financing legislation by issuing Law No (4) of 2010, Combating Money Laundering and the Financing of Terrorism Law. The QF CRA’s new rule changes concerning Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) came into force on 1 February 2013 and reflect Qatar’s wider FATF commitment.

Islamic windows. A new regulation prohibiting the operation of Islamic windows (departments of conventional banks offering Islamic finance in Qatar) came into force on 1 February 2013. These new rules in essence stop the operation of all Islamic windows by QFC Firms, with the exception of any takful insurance business conducted under the QFC Insurance Business Rules 2006.

FATCA. One of the biggest challenges faced by asset managers is the introduction of the Foreign Account Tax Compliance Act (FATCA), which requires asset managers to identify US persons who have invested in either non-US financial accounts or non-US entities. Significant process and technology changes are needed in order to comply.

The growth of Shariah funds. One of the most exciting growth opportunities for the fund management industry in the GCC region, including Qatar, is in the growth of Shariah-compliant funds, which are becoming increasingly popular. Interest in Shariah funds has been driven by strong performance, their conservative investment approach and a historical shortage of mainstream investment products in the region. Although around 26 percent of the world’s population is estimated to be Muslim, less than 1 percent of the world’s financial assets are Shariah-compliant.

This apparent disconnect provides ample opportunity for asset managers to tap into a thriving sector.

The combination of Qatar’s fast-growing economy and onshore operating environment, as well as a robust regulatory and legal regime, should boost the asset management industry in the years to come.

New SCA regime and its impact

With the shift of regulation of investment and fund management activities to the SCA, all existing entities carrying on such activities in the UAE (including banks and investment companies) will be required to obtain a new license from the SCA by 28 February 2015. Enquiries and applications to the Central Bank prior to 28 February 2015, are directed to the SCA for approval and, now that the IMR are effective, it is possible to obtain a license from the SCA.

The recent amendments create a prudent balance between maintaining retail investor protection, and promoting the UAE as an attractive financial hub for fund sponsors and managers seeking to attract investors.

Consistent with what has been witnessed across the GCC region, the regulatory agenda in UAE, with respect to the investment management sector, has experienced increased activity in the past couple of years. In June 2012, the Investment Funds Regulation (IFR) was transposed into UAE law. The IFR transferred regulatory responsibility for the licensing and marketing of investment funds and a number of related activities from the Central Bank of the UAE (CBUAE) to the Securities and Commodities Authority (SCA). The latter has confirmed that the UAE is considering implementing a ‘twin peaks’ model of financial services regulation and supervision and the IFR represents the first move in this direction. Under this model, the CBUAE will be responsible for systemic stability and prudential oversight, while the SCA is responsible for conduct of business matters (including markets oversight and consumer protection).

A key aspect of the IFR is that investment funds, which are established within UAE free zones, will be considered ‘foreign’. This was a surprise to the market, in view of the direct impact that these regulations could have on the Dubai International Financial Centre (DIFC) and its own regulations, which have successfully attracted a significant number of international financial firms. The main concern is, that by classifying DIFC-based investment funds as foreign, the cost of running a DIFC fund will increase and the benefits reduce. The DIFC has traditionally been seen as the gateway to the Middle East so by offering concessions to DIFC-based investment funds, it is possible that the attractiveness of the UAE as a place to operate investment funds may be impacted.

When the IFR came into force, the SCA had recently released Board of Directors’ Decision No. (1) of 2014 Concerning the Regulations on Investment Management which became effective on 28 February 2014. The new Investment Management Regulations (IMR) provide greater protection for investors in UAE investment funds.
BAHRAIN

The investment management industry in Bahrain is comprised of investment fund licensees and collective investment units (funds). The industry is governed by the Central Bank of Bahrain (CBB).

The investment firms are those CBB licensees that solely undertake regulated investment services and are regulated under Volume 4 – Investment Business of the CBB Rulebook. There have been no major changes to investment firms in the past year.

On the other hand, the mutual funds regulatory landscape experienced a significant change in legislation, with the introduction of the new collective investment scheme rules in May 2012 (the third change since 1992, having been previously revamped in 2007) in response to evolving trends both regionally and internationally. The CBB introduced Volume 7 – Collective Investment Undertakings (CIUs), forming part of the CBB Rule Book after extensive consultation from the investment industry participants.

The mutual funds industry in Bahrain had matured to the extent that it was necessary for the CBB to revamp the regulatory framework, keeping pace with international and regional developments and best practice. It was also investor-driven, as demand rose for new innovative investment products to cater for specific investor needs.

The new regulatory framework has helped expand key areas such as corporate governance, and the role and responsibilities of each relevant party to a fund. This, in effect, has increased the regulatory oversight, with roles now clearly prescribed.

The regulatory framework prior to May 2012 was effectively geared towards the retail investor. The new regulations updated the previous regulations and also provided for a greater range of CIUs to be offered, through provisions on expert CIUs and exempt CIUs. Two new main categories of funds were introduced: the Bahrain Real Estate Investment Trusts (B-REITs), to serve the needs of the local and regional markets; and the Private Investment Undertakings (PIUs), which are a new breed of mutual funds with a high degree of flexibility in structuring. They are designed to facilitate private investments and, as such, can only be offered to high net-worth individuals and institutional investors. This has expanded the variety of funds that can be established in Bahrain. The new rules have addressed investor needs through profiling mutual funds by category, i.e. Retail, Expert, Exempt and Private. Each has a separate set of rules, according to the type of targeted investors and their level of sophistication, as well as an appropriate level of supervision. The regulatory framework in Bahrain does not require the operator wishing to establish a Bahrain domiciled CIU to be domiciled in Bahrain, only that they are domiciled in a reputable jurisdiction that is acceptable to the CBB.

The regulatory framework in Bahrain also allows for overseas domiciled funds that are established in and regulated by jurisdictions recognized by the CBB to be offered to investors in Bahrain. This is subject to being registered/authorized by the CBB prior to being offered to investors and can only be offered to expert and accredited investors. This provides opportunities to local investors to gain exposure to investment opportunities all over the world.

SAUDI ARABIA

Investment banking activities are regulated in Saudi Arabia by the Capital Market Authority (CMA), the sole regulator and supervisor of the capital market, which aims to issue rules and regulations to protect investors’ rights and ensure fairness and efficiency in the market.

Corporate governance standards initiative within CMA

In January 2014, the CMA applied Governance Standards on its Own Work and Tasks whereby the CMA board approved the formation and establishment of several specialized committees within the authority. The board approved the rules and regulations governing those committees, such as ‘CMA’s Internal Audit Committee Regulations’ and ‘Rules of Specialized committees in CMA’. These rules and regulations of the approved committees aim to develop working policies within the authority and enhance internal procedures in order to achieve the highest degree of professionalism in decision-making. The committees are part of CMA’s framework for continuous development to enhance its work and implement the practices in governance, responsibility and taking decisions. This would reflect on its performance and efficiency.

Opening up markets – an increased opportunity

Amid an increase in international investor interest in the region and highly anticipated policy changes, CMA and the local stock exchange are striving to build up investors’ confidence by taking action to better regulate and monitor the market.

In order to introduce and enhance information about Saudi listed companies in the international arena, in May 2014, Tadawul (the Saudi Stock Exchange) and Google signed an information license agreement which allows the global technology and internet search engine leader to distribute delayed and historical data for the 160 companies listed on the Saudi Stock Exchange, which is the largest in the MENA region.

Internet users will now be able to access the information on Google Finance as well as through Google Search. The Saudi Stock Exchange is the first exchange in the MENA region, and is among more than 30 leading Exchanges in the world, to allow the dissemination of its data through Google Finance.

FATCA

FATCA continues to be a challenge for investment companies in Saudi Arabia. FATCA is set to have a significant impact on investment managers in Saudi Arabia. Both registration and compliance are arduous. Many fund management companies will require substantial time in order to become FATCA-compliant since they need to learn about FATCA tax law and to develop processes in order to better understand their US clients.
CONCLUSION: GROWING COHERENCE AND CO-OPERATION
Conclusion: growing coherence and co-operation

Make no mistake, the current wave of regulation creates considerable challenges for investment firms. Yes, regulation provides opportunities, but these opportunities undoubtedly come at a cost. However, the signs are that regulation is slowly becoming more harmonized and this may ease the pressure on firms. A striking feature of the current regulatory landscape is the apparent desire of different jurisdictions and regulators to start working in tandem.

Groups of regulators are starting, for instance, to oversee and harmonize the huge changes taking place in retail distribution. In December 2013, IOSCO published its Regulation of Retail Structured Products report, which provides a toolkit outlining regulatory options that securities regulators may find useful to regulate retail structured products. The toolkit has five sections with 15 regulatory tools that are organized along the value chain of the retail structured product market, from issuance to distribution to investment. They cover:

- A potential regulatory approach to retail structured products, including possible regulatory arbitrage and a whole value chain focus.
- Potential regulation of product design and issuance, including intended investor identification and assessment, use of financial modelling, product approval processes and products standards tools.
- Potential regulation of product disclosure and marketing, including disclosure standards, short-form or summary disclosure, costs and fees, use of fair value assessment, hypothetical scenarios, back-testing and enhancement of informed investment decision-making tools.
- Potential regulation of product distribution.
- Potential regulation of post-sales practices.

Coherence is also being created over the vexed issue of how to report and process OTC derivatives. The Financial Stability Board has issued a Feasibility Study on approaches to aggregate OTC derivatives data. G20 leaders agreed, as part of their commitments regarding OTC derivatives reforms, that all OTC derivatives contracts should be reported to trade repositories (TRs). The FSB was initially requested to assess whether implementation of these reforms is sufficient to improve transparency in the derivatives markets, mitigate systemic risk and protect against market abuse. Since the data will be reported to multiple TRs located in a number of jurisdictions, the FSB has now requested further study of how to ensure that the data reported to TRs can be effectively used by authorities and in particular through enabling the availability of the data in aggregated form. Even, FATCA, widely viewed as a US project, has now been adopted by the international community. In February 2014, the OECD released its global standard for automatic exchange of financial account information. The global standard developed by the OECD and G20 countries in close co-operation with the EU, is part of the project known as the ‘OECD FATCA’. It was endorsed by the G20 finance ministers and central bank governors at their meeting in early 2014 in Sydney. That regulators are talking and starting to act in concert can only by positive for the investment industry. The industry must see beyond the difficulties of regulation and plan for how to take advantage of the growing regulatory clarity and coherence. This will inevitably require further investment and reviews of strategy and resources going forward. But clients will expect them to succeed.
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Abbreviations

AIFMD  Alternative Investment Fund Managers Directive
ANBIMA  Brazilian Financial and Capital Markets Association
APEC  Asia-Pacific Economic Co-operation
ARFP  Asia Region Funds Passport
ASISA  Association for Savings and Investment South Africa
AuM  Assets under Management
BOJ  Bank of Japan
B-REITs  Bahrain Real Estate Investment Trusts
BRS  Business Requirement Specification
CBB  Central Bank of Bahrain
CBI  Central Bank of Ireland
CBUAE  Central Bank of the UAE
CCB  Capital Conservation Buffer
CCyB  Countercyclical Capital Buffer
CET1  Common Equity Tier 1
CIS  Collective Investment Scheme
CISA  Swiss Collective Investment Schemes Act
CISCA  Collective Investment Schemes Control Act
CISO  Swiss Collective Investment Schemes Ordinance
CIUs  Collective Investment Undertakings
CMA  Capital Market Authority
COLL  Collective Investment Schemes Rules 2010
COND  Conduct of Business Rulebook
CSA  Canadian Securities Administrators
CSRC  China Securities Regulatory Commission
CVM  Brazilian Securities and Exchange Commission
DIFC  Dubai International Financial Centre
EBA  European Banking Authority
ELTIF  European Long-Term Investment Fund
EMIR  European Market Infrastructure Regulation
ESMA  European Securities and Markets Authority
EU  European Union
EuSEF  European Social Entrepreneurship Funds
EuVECA  European Venture Capital Funds
FAIS  Financial Advisory and Intermediary Services
FATCA  Foreign Account Tax Compliance Act
FATF  Financial Action Task Force
FCA  Financial Conduct Authority
FINMA  Swiss Financial Market Supervisory Authority
FOFA  Future of Financial Advice
FSB  Financial Stability Board
FSB  Financial Services Board
FsSc  Financial Stability Oversight Committee
GCC  Gulf Cooperation Council’s
GPIF  Government Pension Investment Fund
HK SFC  Hong Kong Securities and Futures Commission
IBRF  Islamic Banking Regulatory Framework
IFR  Investment Funds Regulation
IGA  International Governmental Agreement
IMR  Investment Management Regulations
IORP  Institutions for Occupational Retirement Provision
IOSCO  International Organization of Securities Commissions
JGB  Japanese Government Bonds
JOBS  Jumpstart Our Business Startups
JSE  Johannesburg Stock Exchange
MIDAS  Market Information Data Analytics System
MIIFID  Markets in Financial Instruments Directive
NBNI-G-SIFs  Non-Bank Non-Insurer Systemically Important Financial Institutions
NEAT  National Exam Analytics Tool
OMI  Office of Market Intelligence
OWG  Outsourcing Working Group
PBOC  People’s Bank of China
PE  Private Equity
PF  Private Fund
PIUs  Private Investment Undertakings
PLC  Public Limited Company
POPI  Protection of Personal Information Act
PPF  Pension Protection Fund
PRIIPs  Packaged Retail and Insurance-based Investment Products
PRIV  Private Placement Schemes Rules
QCB  Qatar Central Bank
QFC  Qatar Financial Centre
QFCRA  Qatar Financial Centre Regulatory Authority
QFMA  Qatar Financial Market Authority
QIA  Qatar Investment Authority
RBC  Risk Based Capital
RDR  Retail Distribution Review
RWA  Risk Weighted Assets
SBA  Swiss Bankers Association
SCA  Securities and Commodities Authority
SCS  Société en Commandite Simple
SCSp  Société en Commandite Spéciale
SFC  Securities & Futures Commission
SME  Small and Medium Enterprises
SMEFs  Self Managed Superannuation Funds
SSE  Shanghai Stock Exchange
SWFs  Sovereign Wealth Funds
TASA  Tax Agent Services Act
TRM  Technology Risk Management
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