

# Performance

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not hurt financial advisers**

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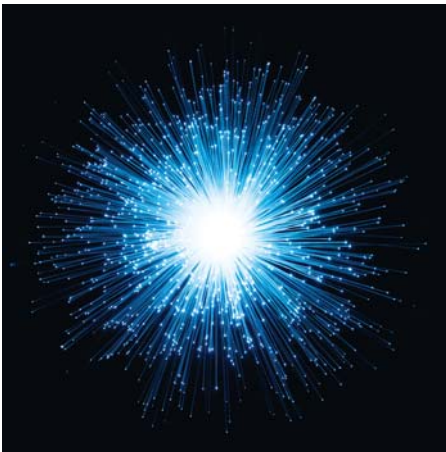
May 2018

# Deloitte.

A triannual topical digest for  
investment management  
professionals



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# Foreword



Despite dominating global headlines, a word that features less than five times in this particular edition of *Performance* is Brexit... Instead, in the spirit of the forthcoming World Cup, our globe-trotting takes us across three continents—Africa, Asia and Europe.



Over the last few months, although our regulatory landscape has been continuously dominated by PRIIPs and MiFID II, the FinTech revolution has continued its steady march into the financial sector. In this edition, Eugene Maree, CEO of Wealthport shares his company's visionary transaction-based technological solution, which he describes as the "*Amazon of Investment Products in South Africa*." Is this the dawn of a new era for independent financial advice? Continuing on this theme, we examine the different degrees of automation in relation to financial advice and present the results of our South African automated financial advice survey, making for a very interesting reading.



Turning our focus to China, we learn that it was only approximately five years ago that the first nationwide industry self-regulating body AMAC was established—a landmark event. Interestingly, because of this well-defined regulatory framework, total AuM has increased despite a reduction in the number of fund managers with data pointing towards a young and booming Private Securities Investment Funds sector. Deloitte China will continue its pioneering work with AMAC on a national survey of the sector and we will share the 2018 results with you in due course.

Returning to Europe, following the release of ESMA's opinion, delegation and delegation oversight dominate the discussions within the asset management industry. Both in-house and third-party management companies are now required to introduce greater scrutiny into their delegation model with more stringent due diligence requirements on their delegates. Is this one of the key drivers behind the evolution of management companies and third-party providers? Potentially yes, when coupled with the prohibitive costs faced by smaller entities of providing governance and oversight, the third-party model is emerging as the accepted model for small to mid-sized investment firms.

To conclude, as some of you may know, Nick Sandall and Paco Celma will step down as EMEA FSI co-leaders at the end of this Deloitte fiscal year after eight fantastic years of co-leadership. During this tenure, we not only created a €3.6 billion practice, but also made an impact that matters. Working together with our colleagues as one, they helped drive numerous key growth initiatives, making EMEA FSI an engine of growth for the firm. I would like to thank them for their fantastic work and guidance, and to take this opportunity to wish their successors, Olivier de Groote and Hans-Jürgen Walter, all the best in their new roles as joint leaders of the EMEA FS industry as of June 2018.

All that is left to say now is enjoy the summer, the action-packed football, and see you again in September.

**Vincent Gouverneur**  
EMEA Investment  
Management Leader

**Nick Sandall**  
EMEA Co-Leader  
Financial Services Industry

**Francisco Celma**  
EMEA Co-Leader  
Financial Services Industry

# Editorial

Dear Readers,

The South African, and indeed the African, investment management landscape has grown exponentially over the past few years. With varied offerings across asset management, private equity and management of retirement funds, we have seen a number of new entrants into the market. While returns have been somewhat subdued owing to lower-than-expected economic growth, we believe we are at a turning point and anticipate that the next few years will see increased disruption (supported by technology), increased urbanization across the continent, and a new wave of optimism and investor confidence. The changing regulatory environment and tough economic conditions create an environment for the industry to be disrupted. Finding mechanisms to increase asset-gathering opportunities and delivering this at a lower cost will create value for stakeholders.

In this edition of the *Performance* magazine, we look at the trends in automated advice, the future of investment management portals, and private equity across the African continent against the backdrop of political and macroeconomic change. The past year has seen significant changes in governance across Southern Africa and a renewed commitment to fighting corruption and strengthening public services. This should result in more efficient value chains and a decrease in the cost of doing business.

The continent's potential is largely driven by a growing population base, accelerated urbanization, recovering

commodity prices, investment in social and infrastructure, and increased public investment. The impact of fluctuations in currency makes managing returns a little more onerous and therefore the return for international investors less predictable. Currencies have, however, shown an improvement and are expected to continue to stabilize.

The investment management industry is at varying stages of maturity across the continent, with asset management being the least mature and retirement funds representing a core part of the financial services industry. Private equity remains one of the strongest investment vehicles in the African continent. In the article *Unlocking the potential of the "Africa Rising" narrative through private equity*, we detail some of the themes underpinning the resilience and optimism in the private equity sector in Africa.

We are fortunate to have Eugene Maree, CEO of Wealthport, give us his thoughts on FinTech within investment management. Eugene highlights inefficiencies within the current investment management infrastructure (LISPs) and the need to cater for different investment vehicles to

In summary, "while change can produce uncertainty, even anxiety, it also offers great opportunities for renewal and revitalization, and for progress"—South African State of the Nation Address, February 2018. The investment management sector in Africa remains resilient and well positioned for the wave of disruption and innovation affecting global economies.



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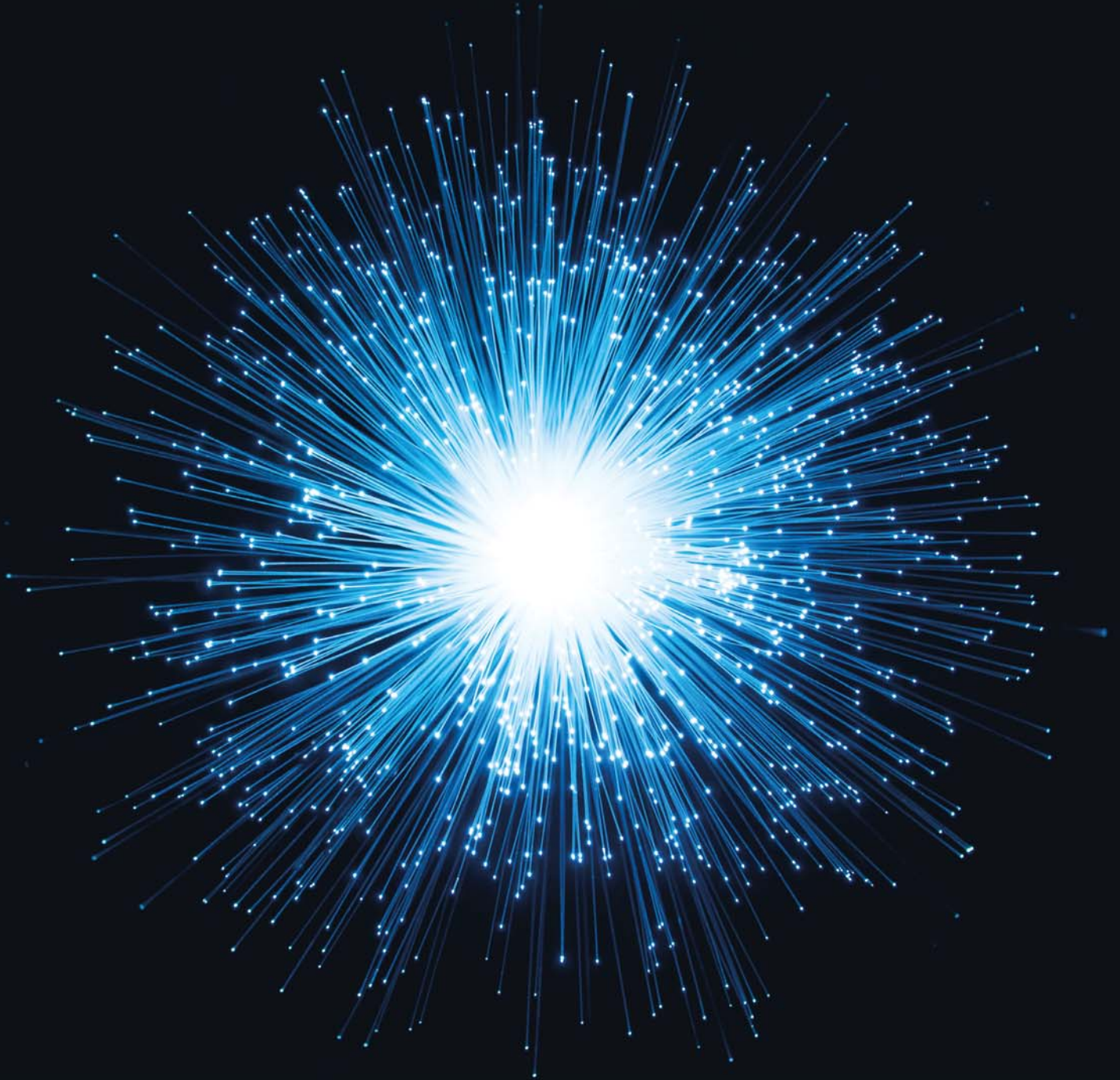
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# Technology is here to help, not hurt financial advisers

Interview with **Eugene Maree**, Chief Executive Officer (CEO) of Wealthport.



## Eugene Maree—Wealthport CEO

Eugene is the founder and CEO of Wealthport, a FinTech company with financial services licenses. It has developed a pioneering transaction-based technological solution aimed at modernizing and future-proofing independent financial advice practices in the new era of financial services.

### **Deloitte:** Tell us about your business

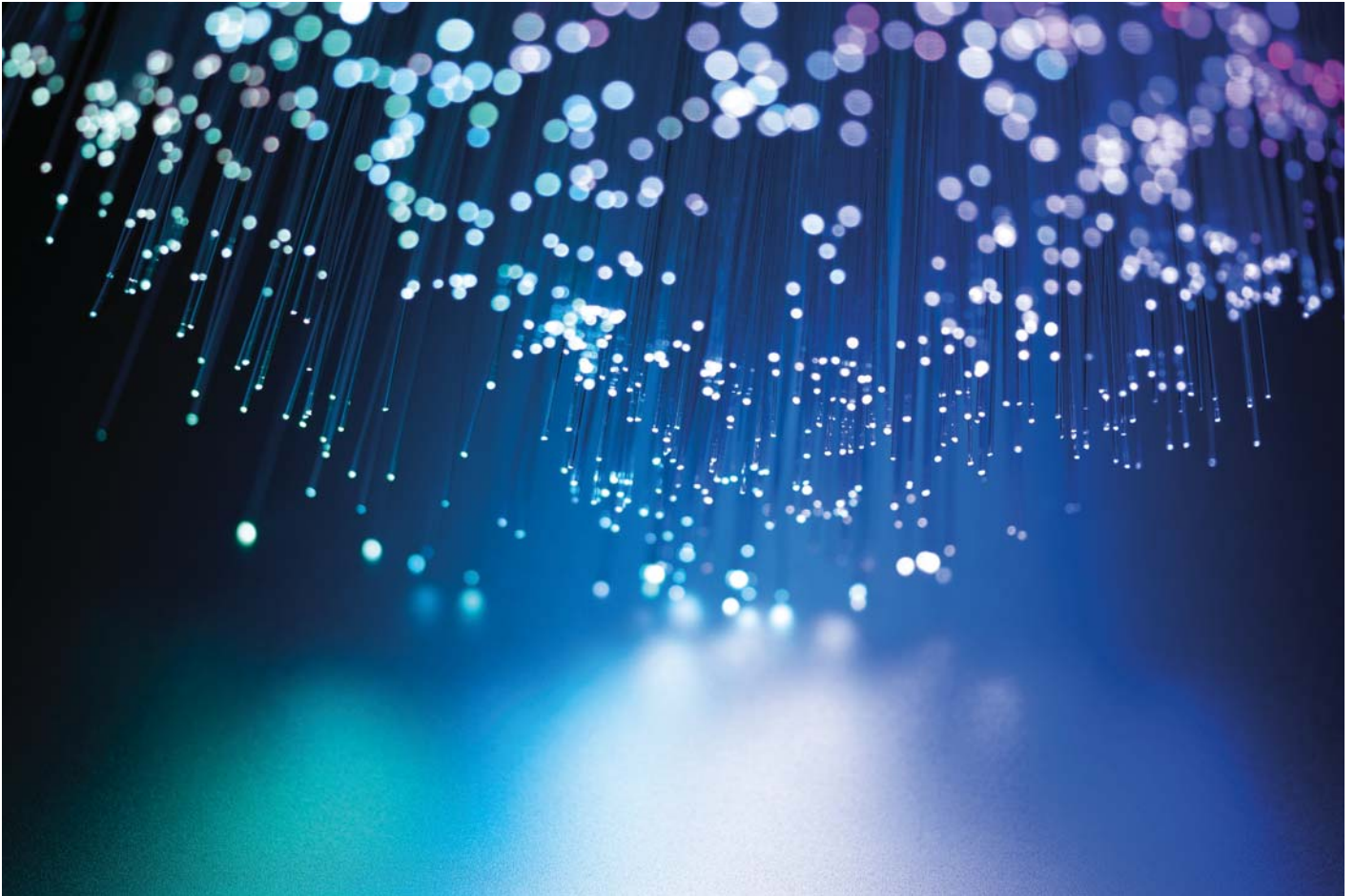
**Eugene Maree:** In essence, Wealthport is an adviser-led investment management portal. We don't like to be seen as a LISP (Linked Investment Service Provider) platform, as they are primarily only unit trust platforms. We see ourselves as a technology partner for investment managers. We are a FinTech business that has planning, reporting, and execution capabilities, across all investment products, through one investment portal.

### **Deloitte:** Who do you see as your main competitors?

**Eugene Maree:** It's quite interesting when you ask about our competitors. We don't really see the other platforms as competitors because, as I previously mentioned, they are only unit trust marketplaces, facilitating the unit trust industry. This is because they're owned by unit trust or life companies. We see ourselves as an investment portal that allows you to gain access to anything you want. Besides that, we see ourselves as more of a FinTech player that provides the tools to facilitate planning, execution, and reporting in a single environment.

Nowadays there are lots of good planning tools, but the problem with them is that you can plan, but when you want to execute, there is no way to execute. That has been one of the failings of a number of FinTech models. You can plan, but in order to execute in a regulated environment you need to comply with a whole lot of licensing requirements. We have the Category 3 license that allows us to bulk-trade in the market, with all investment providers, allowing our clients to access wholesale pricing.

This, coupled with our comprehensive planning and work-flow tools, means you can come in, plan, and execute, buying whatever you need. Think of us as the Amazon of investment products in South Africa. You come into one portal, you go to the cart, you say what you want, we give you exposure to the whole investment market, then you buy all the things you want, add them to your cart, and off you go to check out. Being independent and product agnostic (we don't make products), our only focus is on giving the client the best pricing, and the ultimate user experience. In this sense we are unique, and we don't really have any competitors in South Africa. ➔



**Deloitte: How does Wealthport differentiate itself from other platform providers?**

**Eugene Maree:** When we started Wealthport, we were able to use newer technology compared to what was available back when most of the current platforms were built. This gave us the ability to automate, streamline, and incorporate any product on the market. Our system isn't as people-heavy as others and has never had any administration errors, as our workflow takes care of processes more reliably than humans, with humans just having to verify processes.

We don't like to be referred to as a LISP, as that is the old fund supermarket model and is only a part of what we do. We will be adding other products to this portal that traditional LISPs will never be able to offer, or that their owners would prevent them from offering, as it would involve cannibalizing their existing business. Administration fees are going to go down, and margins are going to get narrower, and the better the technology, the better your chances of being sustainable. Besides offering anything advisers or their clients want in South Africa, including ETFs, structured products, and more, we also offer access to 2.5 million instruments offshore, through our partnership with Swissquote Bank in Geneva. So you have

the broadest investment offering in South Africa in one place at the lowest overall cost on the market.

There are so many investment options available today. If you look at the South African unit trust market, compared to the South African share market, there are currently around 500 shares on the market, of which probably around 110 are actually liquid, and yet there are over 1,500 unit trusts. When it came to creating our platform, we knew that we needed to consider being able to cater for ETFs, unit trusts, and other investment vehicles such as structured products. We also realized we needed to make it easy for advisers to sift through these options for their clients and trade these instruments.



Our platform has an entirely integrated back-office management system in the back-end and it also has document storage so you can manage all your documents, and it has transactional processing capabilities that keep the whole workflow on file for compliance, as well as tracking and recording clients' investments. All of this takes place in one environment, plus you can service a client remotely through screen-sharing technology.

We are trying to move away from the LISP stereotype, because LISPs haven't changed in ten years. They haven't evolved. In just two years, our business has evolved immensely, and if we look at what's coming in the next year or so, it's going to evolve even more. I'm not sure whether traditional LISPs will follow what we're doing—that will depend on their corporate strategy, and whether they choose to move from a business that serves shareholders to one that serves clients.

**Deloitte: What is your view on the current investment management landscape, and what do you see happening in the future?**

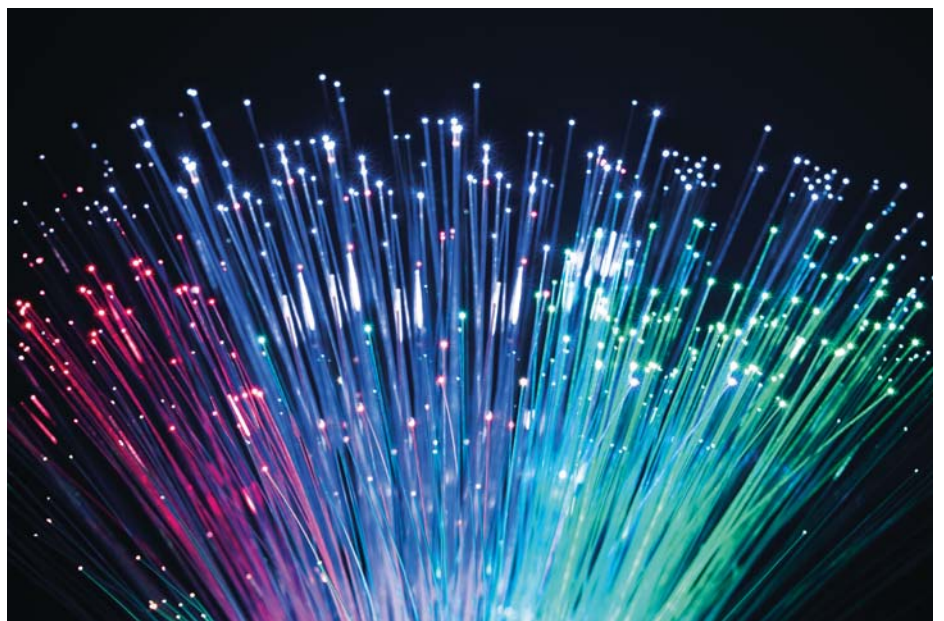
**Eugene Maree:** Wealthport was born out of my concerns about what I saw happening in the industry. We have some big, industry-dominant players that have established a huge amount of trust with clients, and who have had money to spend on advertising, giving them the spotlight. However, they are becoming bigger and clumsier and, in terms of pricing, I don't think that clients are always getting the best deal. I don't think it's always transparent, so it's very seldom that you see a client get to ask them, "What is it that I'm paying for? What is your exact fee?"

Very often it's vague and it hasn't been shown. I think this kind of vagueness and the general greyiness in the financial industry, as well as the personal financial planning space, have served the industry well. The industry is driven largely by the big brands, and a lot of people have a lot of faith in them. They've had it easy, but I think they're going to have to start digging deeper, particularly when they start looking

into indexation, structured products, and that sort of thing. In many cases banks are building better and more transparent products than those that asset managers and life companies are building. I believe the investment banks are going to start playing a bigger role, and we saw the need to cater for them, as the traditional platforms don't have the capability or will to do it.

I think a digital format will level the playing field a lot more. People can actually go and look up the facts rather than just believing the hype. I think there is going to be a change and that we'll see some newer players, that are innovative, and that are doing better things. Players that are prepared to come in and offer real value will find their niche. But if you fail you will also be exposed, which is really nice, and I think that is something that the industry has to watch out for, because this is a matter of 'when' rather than 'if'. We're starting to see that now, especially with younger clients who are so much more informed. ➔

Administration fees are going to go down, and margins are going to get narrower, and the better the technology, the better your chances of being sustainable.



**Deloitte: What do you believe will be the next wave of innovation to affect the IM environment?**

**Eugene Maree:** I think that the next two years are going to be the big, telling years. I think you're going to see a boost in what's happening in the technology space, and I think you'll see that some advisers will miss this opportunity, whereas others will use it to leapfrog their businesses, because we all know for a fact that clients are going to demand more for less, and that we're going to have to serve more clients for less. The only way you're going to do that is with technology.

There are only so many working hours in the day. Technology can help you with the administration of your client base; help you to manage your clients' investments and other products; help you to understand where to apply your time and effort; and to understand what is profitable.

If you want to run your business more efficiently, you're going to need technology, there is no doubt about it. The way that we've built this technology, incorporating well-designed data architecture, as well as transactional tools, will allow you to mine and manage your database of clients to give them the ultimate solutions to meet their needs.

We're starting to see the first phase now where you get those who are going to embrace technology, and those who are going to come after the fact. People have seen this on the horizon, people are talking about technology, but not everyone is taking it seriously. Many people think not much is happening, but a lot has been developing without them knowing, and it's constantly building.

I think in terms of some of the other trends that will come out in the next few years, you're going to see algorithmic trading where people can build models, and where they can optimize portfolio risk by taking historical measures into consideration. I think you're going to see a lot of it happening around the creation of investments. I also think a lot is going to happen around administration.

**Deloitte: How is the industry responding to increased technology?**

**Eugene Maree:** The wonderful thing about technology is that it's creating a much more transparent industry. There are a lot more competitors like us, that are newer and growing, that have no product allegiances, and that want to create a better deal for the client. I think that will be a catalyst for change. We've already seen, since we entered the industry, how platform fees have come down. Providers used to charge massive platform fees, and we've started to put pressure on them. We're one of the new players and everyone is starting to react and having to drop their platform fees and I think this is not the end of it. So I do think that is going to be a good thing for the industry, and that greater transparency will come as a result.

I think our biggest challenge is going to be getting those who manage the investment landscape to embrace technology, and not see it as a threat, but rather as an enhancement.

People are afraid of change. You know people say that computers will take over from humans. Funnily enough, there are some jobs you don't need to worry too much about if you do them properly. I think our biggest challenge is going to be getting those who manage the investment landscape to embrace technology, and not see it as a threat, but rather as an enhancement. The people who get that right, who decide that it's a combination of technology and touch, they are going to win this race. Those who resist it are going to fall by the wayside. I think that anyone who believes this will never happen just hasn't really taken a good look at what's happening in the world around them.

**Deloitte: What impact is robo-advice having on the industry?**

**Eugene Maree:** The challenge of adopting any of new system is embracing change. We're operating in a heavily intermediated market, where the broker or adviser is dealing with the end client and in most cases there is a huge amount of resistance to new technology. You can understand why, because the industry has pitted technology against the adviser. What they've actually done is said to the adviser, 'It's a choice between robo-advice and you'. In actual fact there is little reason to fear robo-advice because it can only provide a very small part of the solution.

Robo-advice could become better at picking funds, it could be a facilitation tool, and it could act as some sort of planning tool, but it doesn't understand the human issues around legacy planning, estate planning, or understanding what the client's needs are, or the risks to which the client is exposed. That's where the real advisers step up. A real adviser will never be threatened by robo-advice because it will be very difficult for robo to deal with the human interaction aspect of a client's needs and journey, because money means different things to different people. However, if you are a product salesman and all you do is select products for your client, a robo advice tool will do a better job as there would be less emotion involved.

So I think what you'll find is that robo-advice will become a blended environment where you will have high-quality advisers who may have a robo-advice component to their business for clients who want self-service, but that the high-end clients who need more sophisticated trust estate planning, offshore planning, or offshore structuring will stay in the same environment.

One of the reasons that robo-advice has faced a challenge with adoption is because client acquisition cost is very high, and you have to work hard to win a client's trust. The robo-advice space has attracted a lot of smaller, new investors, so you've got a lot of investors with very low-volume businesses. Lots of clients with low values are very costly to administer: it means you carry the client and have to pay relatively high costs to make it work.

Then as the client grows, unless you provide some other value-added advice, like estate planning or offshore investment access, the moment the client gets to a certain size, the client will probably look for an adviser offering a fuller, more holistic plan. So I think the real opportunity is bringing robo and technology into the independent intermediated advice landscape, where you've got technology and touch combining, and I think that is going to be the driving force.

**Deloitte: What opportunities should advisers be chasing going forward?**

**Eugene Maree:** If I were an adviser today, I'd embrace technology and focus on improving the human interaction side of the business. The people element will differentiate the true wealth manager. The days of the product salesman are over. The future is about independent advice, not salesman selling products for their companies. Advisers should constantly focus on improving their skills in terms of estate planning, in terms of structuring offshore investments, and staying in touch with the regulatory environment. The good news for clients is that the industry and regulators are increasingly concerned about their needs, and ethical, independent advisers will thrive in this new era while the others will battle to stay in business. ●

# Automated financial advice in South Africa

## Morne Fischer

Associate Director  
RPA Practice Leader for Africa  
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## Simon Schaefer

Manager  
Africa Services Group  
Deloitte

**Cognitive technologies used in the automation of business processes, for gaining insights through data analysis, and in engaging with customers and employees are starting to demonstrate real and significant business value in the financial services industry. These emerging technologies are shaping the way financial services are bought, sold, and consumed. They have not only allowed financial services providers (FSPs) to tap into new markets and offer new products but also to reduce the cost of service provision, respond more swiftly to regulatory changes, increase speed to market, and ultimately improve customer experiences.**

The adoption of advanced technologies in the financial services industry has led to the emergence of innovative and agile FinTech companies that are able to challenge traditional FSPs in what used to be a market with high barriers to entry. While the incumbents still enjoy significant scale and access to customers, the rise of FinTechs has forced them to reassess their business models and align their strategies to embrace technology more effectively.

In investment management, investment advice is a knowledge-based service, so cognitive technologies are appropriate for supporting its delivery. Automated advice (also known as robo-advice) can take over many of the tasks associated with investment advice, including the

construction of customized portfolios, the rebalancing of portfolios over time and tax-efficient investment selection. For advisers, this new working process allows them to take on a new role as more of an investment coach who encourages healthy financial behavior.

Compared to the United States and the United Kingdom—markets with sizeable automated advice offerings—South Africa's investment management market is very small. Only a few market players have a large enough customer base and investment portfolio to achieve the required economies of scale that justify the implementation of automated advice solutions. ➔



The different degrees of automation of financial advice

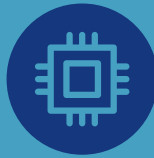
Degree of automation

Low

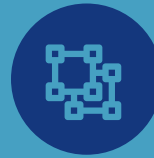
High



**Traditional face-to-face**  
Customers interact with a human, who generates advice, investment decisions or information (depending on the service provided), without the aid of a computer algorithm



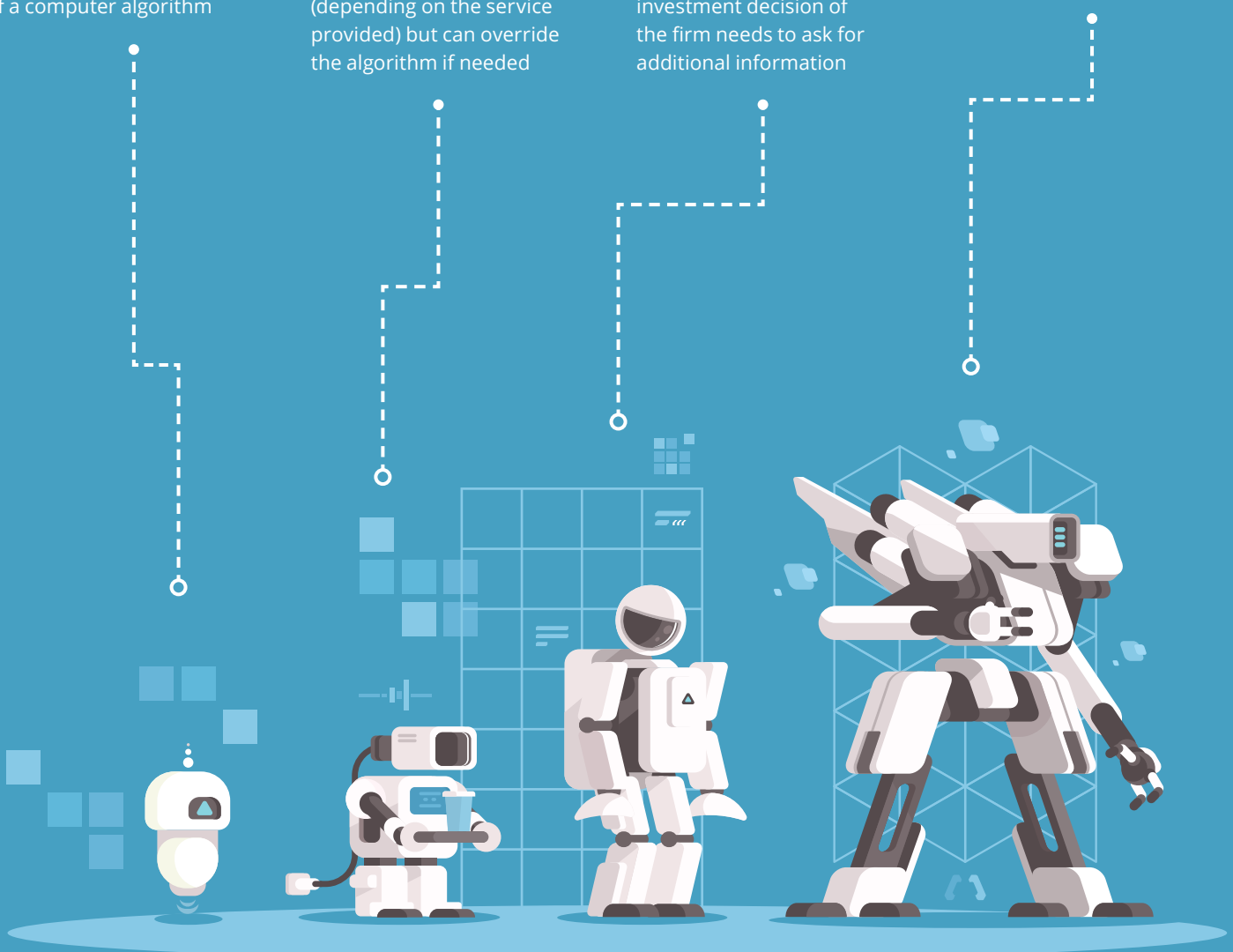
**Face-to-face assisted by algorithm**  
Customers interact with a human, who uses a computer algorithm to generate advice, investment decisions or information (depending on the service provided) but can override the algorithm if needed



**Hybrid**  
Customers interact with a website but may also interact with a human (e.g. via a webchat or by phone), for example if customers have questions about their investment decision of the firm needs to ask for additional information



**Fully automated**  
Customers normally interact with a website only, They may still be able to speak to resolve any IT issues, make a complaint or clarify terms and conditions



**South African consumers seek affirmation from financial advisers**

While only about two percent of South Africans have an annual income of more than R400,000<sup>1</sup>, most people in this pool have bought a financial product in the last three years, reflecting the huge appetite for these products.

The vast majority sought advice—whether professional or informal—prior to purchasing a financial product and it is common for consumers to pay for this advice. This indicates that South Africans rely on advice and are prepared to pay for it.

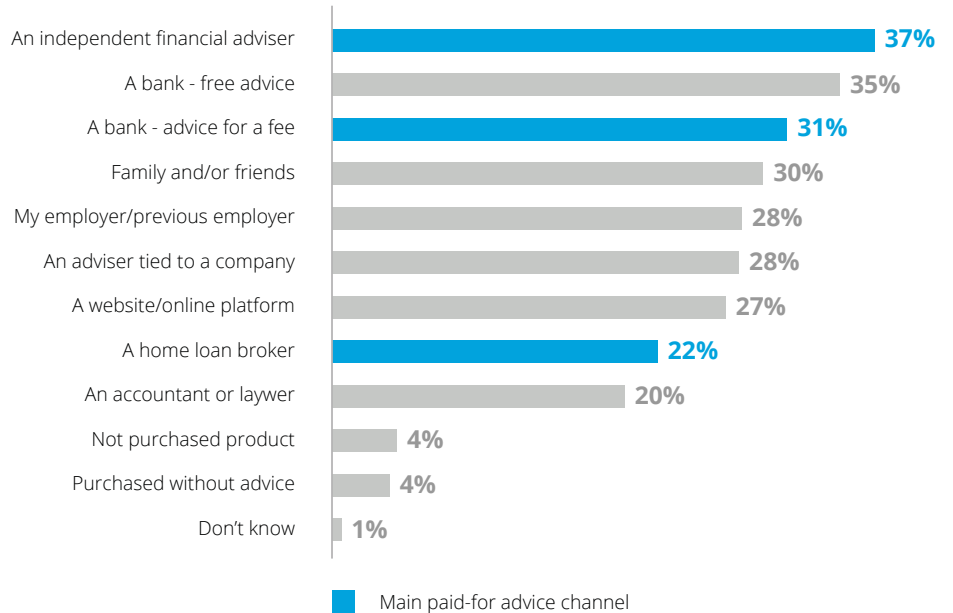
Among the consumers who had bought a product in the last three years, professional financial advice was used to confirm that the choice of product was correct or to identify the right product once the type of product had been chosen.

Affirmation from a financial adviser is particularly important for consumers over the age of 55, as well as affluent or high-income South Africans.

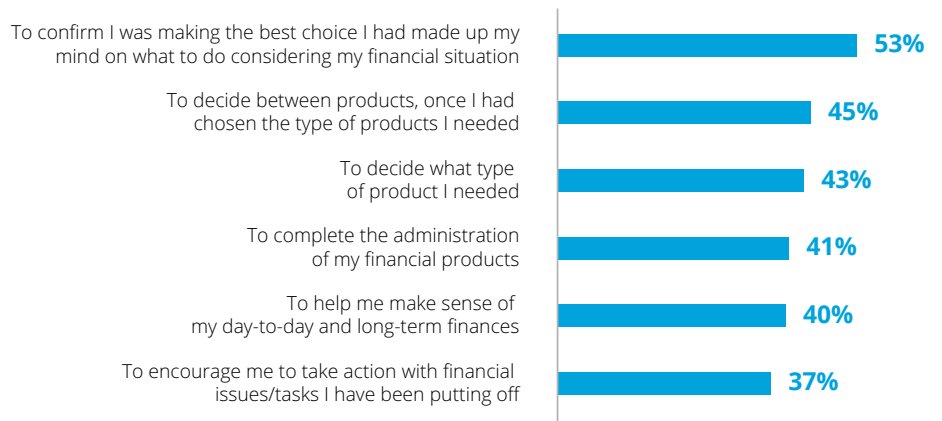
Consumers with an annual income above R1.5 million call on financial advisers to encourage them to act and stop procrastinating on matters related to financial planning.

In contrast to other age groups, young millennials use financial advisers to make sense of their day-to-day and long-term finances and to get assistance with the administration of their financial products.

**Usage of advice on product purchases, 2015-2017\***



**Why financial advisers were used**



\* All graphs are taken from Deloitte, Automated Financial Advice Survey, 2018

Affirmation from a financial adviser is particularly important for consumers over the age of 55, as well as affluent or high-income South Africans.

1. South African Revenue Service, 2017 Tax Statistics 2017

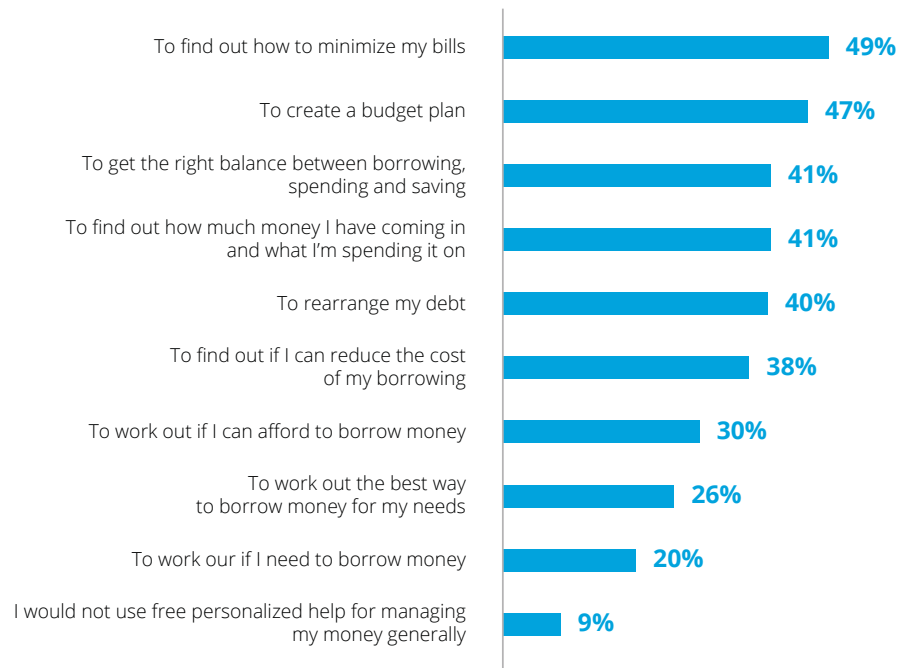
### Simple financial planning

While most South Africans, irrespective of income, wealth or age, are open to using automated advice for simple financial planning, the type of advice they are looking for differs. It ranges from help with minimizing bills to creating budget plans, striking the right balance between saving and spending, and rearranging debt.

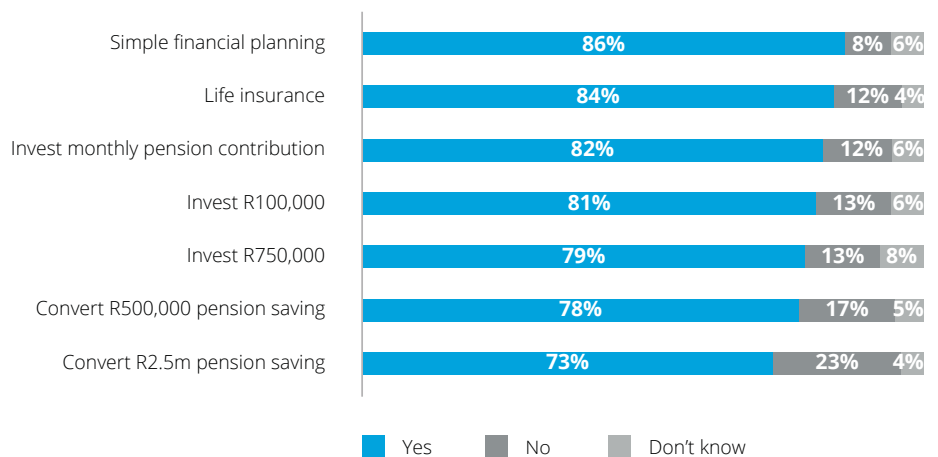
Consumers aged between 35 and 44 and low-income earners are mostly interested in minimizing their bills. Millennials and high-income earners are least concerned about minimizing bills. While millennials are more interested in assistance with creating budget plans, high-income earners are looking for assistance with rearranging their debt.

Considering price sensitivity among consumers in the low wealth segment, a digital-only solution is more likely to be successful for simple advice aimed at this segment and is something FinTech companies are looking to develop. Cases that are more complex and involve less price-sensitive and more affluent consumers could be handled using hybrid solutions that combine digital with face-to-face advice. ➔

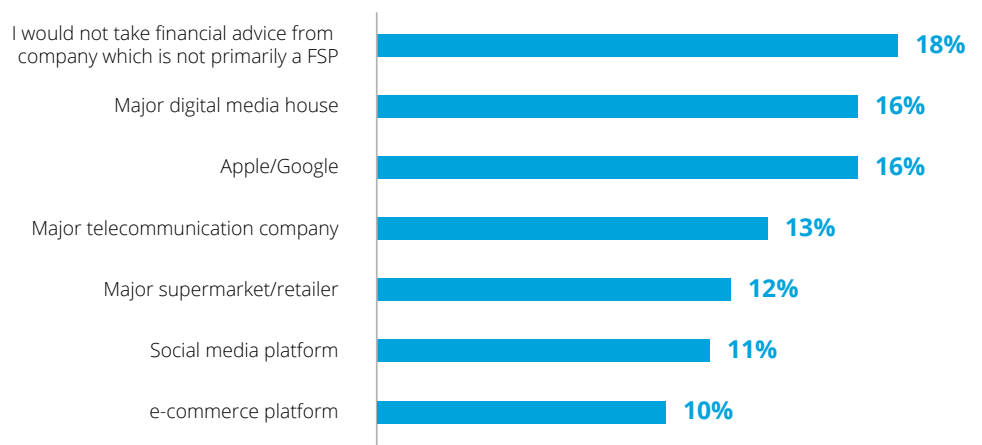
### What would you use your free automated advice for?



### Would you be willing to use automated advice for...?



### Willingness to accept financial advice from non-FSPs



### Investing

South Africans have significant unsatisfied demand for efficient and cost-effective ways to invest small sums of money. Automated advice is seen as a suitable solution to service this market segment. Our survey results show a strong bias towards using automated advice for small sums.

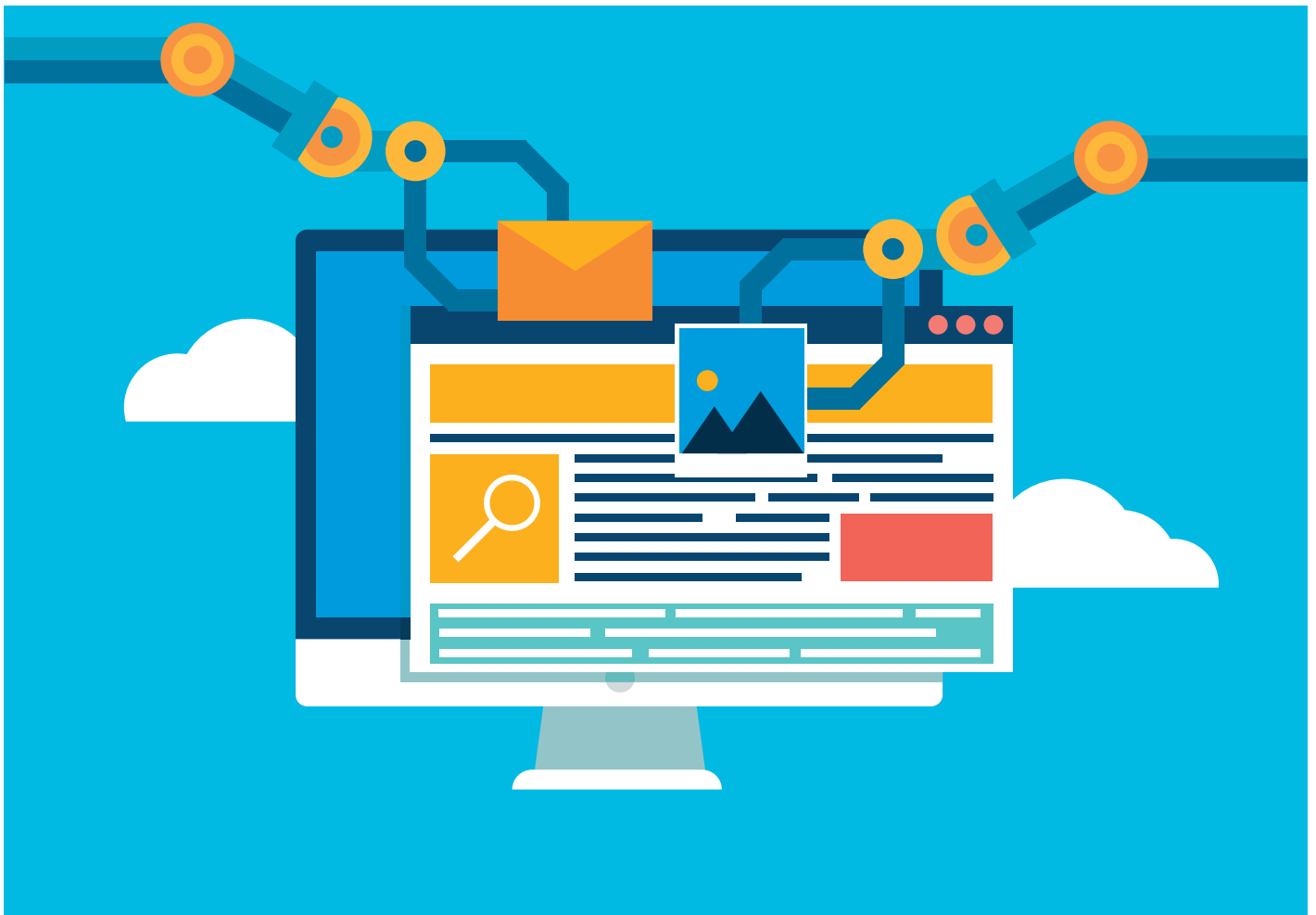
The low margins in the mass market and the looming introduction of the new retail distribution review (RDR) regulation in the second half of 2018 are expected to increase the attractiveness of automated advice for price-sensitive segments.

Cost consciousness occurs across the various wealth segments; however, compared to UK consumers, it seems to be

less pronounced among South Africans. The willingness to pay automated advice fees that are close to fees for face-to-face advice is relatively high.

Passive investment management is likely to be the best approach to offering low-fee automated advice for those investing small sums of money. However, even for managing larger sums, which typically earn higher margins, deploying passive automated advice for a certain portion of the overall investments of increasingly cost-conscious wealthy consumers might be a viable solution. A hybrid model that combines face-to-face or over-the-phone advice with automated advice is likely to be a viable option for servicing the wealthier market segment that is fee sensitive but invests amounts above a certain threshold.

Passive investment management is likely to be the best approach to offering low-fee automated advice for those investing small sums of money.





### Saving for retirement

As in the UK, the dominant occupational pension providers are large insurers and asset managers. Given their unrivalled access to a large consumer pool, the deployment of automated advice tools would help them to drive down their cost of service provision and hence expand their customer pool.

While the FSB describes acting in the best interest of the members of the fund to ensure that they receive the best return on their investments as a key role of pension fund trustees,<sup>2</sup> giving members the choice of where and how to invest within the parameters set by the pension scheme is becoming increasingly commonplace. However, the majority of occupational pension fund members do not make use of member choice and hence end up in default funds that are not aligned to their specific needs or current life stages. Automated advice could be a powerful tool to increase the engagement of members and advise them on how to optimize their pension contributions.

Furthermore, automated advice is a cost-effective way to provide members with in-fund advice. Dynamic visual tools, which are more engaging than descriptive text-based communication, could be used to illustrate key points of members' savings journeys such as the build-up of funds at specific intervals, the impact of risk on returns, and progress towards goals.

In addition to increasing engagement, automated advice could also make advice more affordable and hence more accessible to a larger pool of people. While willingness to engage is high, South Africans are not prepared to pay high fees for automated retirement saving advice. This high level of price sensitivity presents a challenge for providers. Developing a workplace pension portal with minimal human intervention could prove to be a viable option to overcome price sensitivity issues.

### At retirement

Consumers experience the greatest need for financial advice when they enter retirement. They have to decide how to fund retirement with the savings that they have accumulated over their lifetime. Consumers are faced with tough decisions—such as how much cash to withdraw while leaving enough invested to provide a suitable income—and complex products. Overall, South Africans are most interested in using automated advice that provides them with options to minimize their tax bill when they have retired.

Willingness to convert pension savings using automated advice declines with age. Consumers who are closer to retirement age are the least willing age group to replace a human adviser with automated advice.

To make automated advice attractive, many consumers would demand a large discount on face-to-face advice. In our sample, among those who would pay for it, almost 80 percent would only do so if they paid less than one quarter of the typical fee charged by a human adviser.

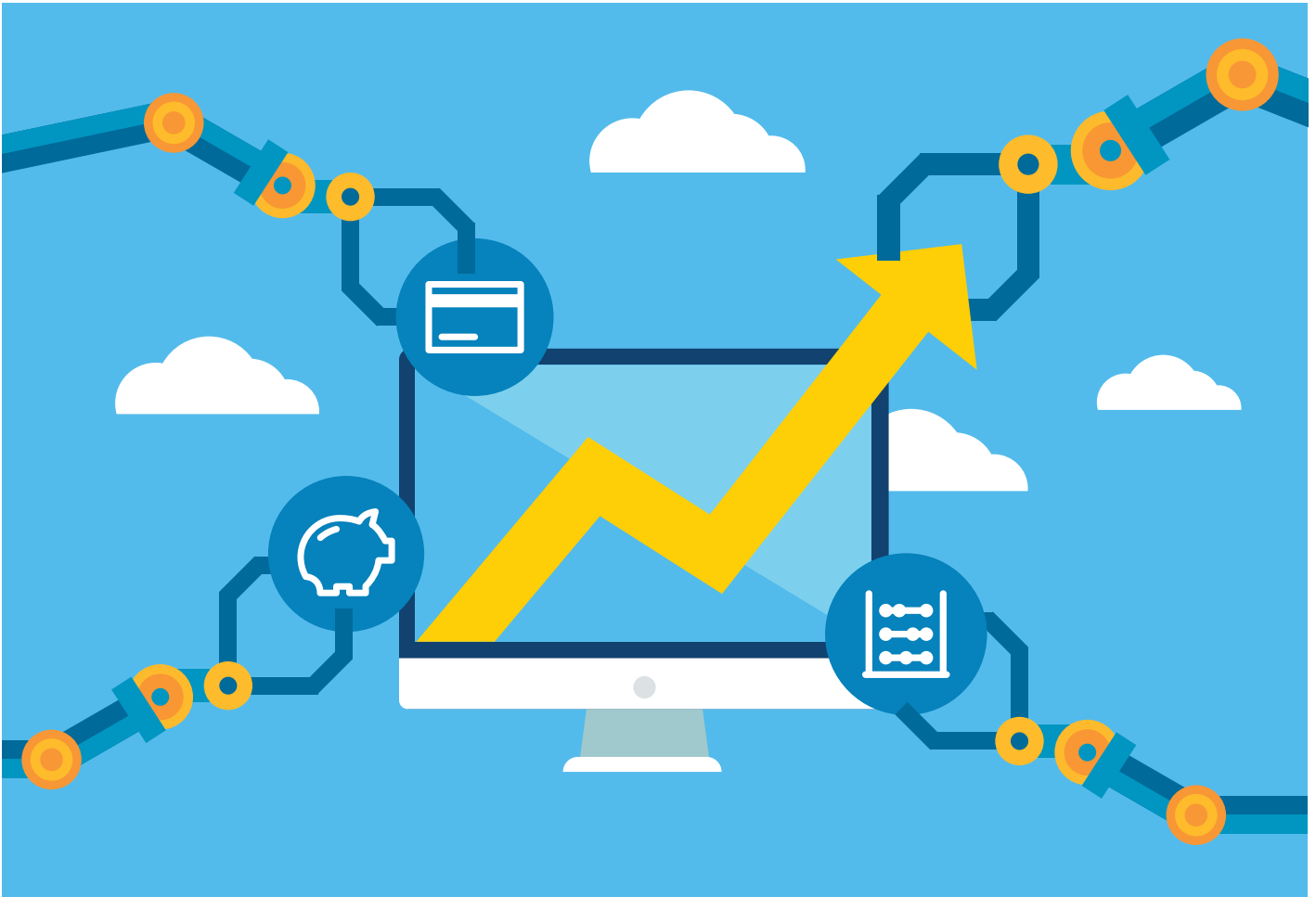
Given that both customer circumstances and retirement options are often complex, it is likely that FSPs will need to supplement their automated advice solution with an option of human interaction. In these cases, a human adviser can check the customer's understanding and clarify any points if the firm needs additional customer-specific information.

Over the longer term, as machine learning and artificial intelligence mature, we may see firms developing more fully automated advice solutions that can meet regulatory requirements and handle complex cases, but in the short and medium term, a hybrid model is more likely to be effective. A hybrid model could also put customers at ease as our survey indicated that South Africans are concerned about the capability of automated tools to deal with complex questions and situations.

Automation can allow advisers to spend less time on the more straightforward parts of the process, such as data capture, and instead focus on the high-value areas such as tax considerations in more complex cases—an area of significant concern for South African consumers. ➔

Automated advice could be a powerful tool to increase the engagement of members and advise them on how to optimize their pension contributions.

2. Financial Services Board, Role of Trustees, 2011



### Individual protection

According to the Association for Savings and Investment South Africa, the insurance gap has tripled over the last ten years to about R30 trillion<sup>3</sup>. Financial literacy and affordability are key reasons for this large gap. Around two million risk policies lapsed within their first year in 2016, mostly because policyholders were unable to afford to pay their premiums<sup>4</sup>.

Our survey suggests that South Africans are very open to using automated advice for selecting personal protection. This might be linked to the existence of web-based insurance quotation platforms, which are widely known and used for car insurance comparison services. Automated advice can contribute to consumer education by demonstrating

the need for protection and the risk related to non-payment in a proactive way and could help close the protection gap. Consumers at risk of missing a payment could be targeted with timely communication explaining why they need protection, what the implications of non-payment are, and what to do about it, with a link to an automated advice portal. We would envisage this as being provided by life insurers or face-to-face advisers in partnership with another organization with access to a wider pool of customers, such as a bank or retailer.

Leveraging automated advice tools can help to encourage more advisers to recommend protection by giving them quicker, light-touch sales channels. Two opportunities for advisers stand out.

First, by using existing data that was captured in, for instance, a bond application process, application forms for the protection to cover this bond could be prepopulated. This would free up valuable adviser time on the phone asking customers for basic information. Second, websites could be used to guide customers through the relatively simple steps in the advice process before speaking with an adviser to complete the process.

3. I.e., the aggregate cover that is needed by South Africans is R30 trillion less than the total cover provided by the insurance industry.

4. Personal Finance, Times may be tough, but don't cancel your life cover, 2017

### The future of automated advice in South Africa

While it is now common for traditional FSPs in South Africa to use computer algorithms to automate their financial advice process and to embed this into their overall digital strategy, the degree to which the automation has been implemented differs among providers.

Most providers have put digital tools into the hand of their advisers to empower them to serve clients more efficiently. Initial concerns that sophisticated algorithms might crowd out human advisers seem to be unfounded. On the contrary, in an environment where the margins of FSPs have come under pressure due to factors such as changing regulations, these powerful tools enable human advisers to serve a larger client base at lower cost.

Leveraging technology also enables advisers to be better informed about a broader range of products, serve more clients than normal, and decrease their own business overheads—thereby mitigating against margin pressures. Better-informed advisers are an important step towards customer-centric advice.

Some advisers have started to put digital tools directly into the hands of their clients through online platforms or mobile applications. These tools provide FSPs with new ways to engage their customers and, by cutting out face-to-face interaction, financial advice is becoming more affordable and accessible even for lower-income earners.

While acceptance of digital tools has increased, fully automated advice still faces certain limitations and is usually only used for single-goal or simplistic investments. Given the novelty of fully automated advice, market players have observed that most clients still require a human “nudge” such as a phone call or webchat with an adviser to complete an investment decision online.

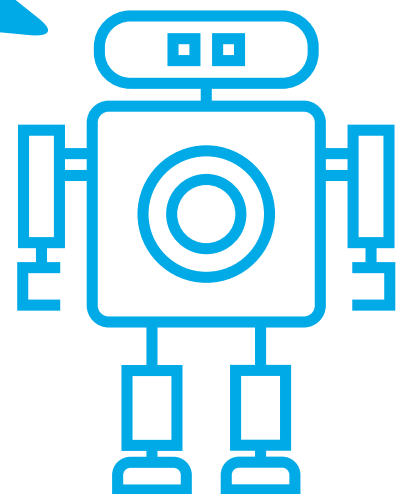
The introduction of automation in the financial advice space affects the relationships between various industry players. FinTech companies are often seen as agile and innovative players that have spearheaded the disruption in the industry. However, due to factors such as scalability, trust, and brand recognition, some FinTechs find themselves stretched to their limits and have to consider forging new alliances and partnerships to become or stay viable.

Partnerships between FinTechs and FSPs tend to be mutually beneficial. FinTechs are able to leverage the brand power of traditional FSPs—an important advantage in a trust-based industry—and hence are able to reduce customer acquisition costs and scale their operations faster compared to a stand-alone offering. On the other hand, by collaborating with FinTechs, traditional FSPs are able to implement automated advice platforms faster and at a lower cost. ●

Leveraging automated advice tools can help to encourage more advisers to recommend protection by giving them quicker, light-touch sales channels.

#### To the point:

- South African consumers seek affirmation from financial advisers
- South Africans are open to using automated financial advice and are prepared to pay for it
- The smaller the amounts involved, the more prepared South Africans are to use automated financial advice
- Digital tools provide FSPs with new ways to engage with their customers and, by cutting out face-to-face interaction, financial advice is becoming more affordable and accessible





# Unlocking the potential of the “Africa Rising” narrative through private equity

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### The “why” for private equity and Africa

Private equity as an asset class has, for a number of years, been widely viewed as preferred over traditional asset classes. The removal of a large degree of the market risk and volatility created by market perception and macro-economic factors from private equity investments, and even sensationalism through the media, is likely to be behind this investor preference.

Returns in the private equity industry support this preference. In the March 2018 edition of the RisCura-SAVCA South African Private Equity Performance Report<sup>1</sup> (which tracks the performance of a representative basket of South African private equity funds with the aim of establishing and maintaining an authoritative benchmark for the measurement of private equity performance in the South African market), one of the most notable statistics reported was that, in the most recently measured period, the 5 and 10-year IRR returns were 13.6 percent and 12.9 percent respectively, outperforming listed metrics over a 3-year period, and earning positive direct alpha

(i.e., active return on investment). This was despite the political uncertainty and corruption scandals that have unsettled the South African market over the past couple of years.

Statistics such as those in the RisCura-SAVCA report are not as readily available for the continent as a whole. This is coupled with South Africa not being the most accurate reflection of the picture painted by the African continent overall, given South Africa's maturity profile with respect to the private equity space compared to that of other countries in Africa, and its lesser degree of reliance on hard commodity prices such as oil, which slumped in recent years and brought some of the traditional African power houses (such as Nigeria) to their knees.

Nevertheless, the “Africa Rising” narrative is one that is familiar to investors around the world. Real GDP growth for sub-Saharan Africa as published by the IMF<sup>2</sup> slowed to below 2 percent in 2016 and was up to just below 3 percent in 2017.

Forecasts for 2018 also show an increase, to between 3 and 4 percent, as oil prices are expected to continue on a recovery path from the 2016 slump. In the 2017 edition of the AVCA Annual Africa Private Equity Data Tracker<sup>3</sup>, the UN was cited as expecting Africa to grow by 3.5 percent in 2018 and 3.7 percent in 2019, due to higher external demand, rising commodity prices, and improved domestic conditions. ➤

1. [http://savca.co.za/wp-content/uploads/2018/03/RisCura\\_SAVCA-PE-report\\_March2018.pdf](http://savca.co.za/wp-content/uploads/2018/03/RisCura_SAVCA-PE-report_March2018.pdf)

2. International Monetary Fund (IMF). 2017. World Economic Outlook (WEO) database, October update. Available [Online]: <http://www.imf.org/external/pubs/ft/weo/2017/02/weodata/index.aspx>

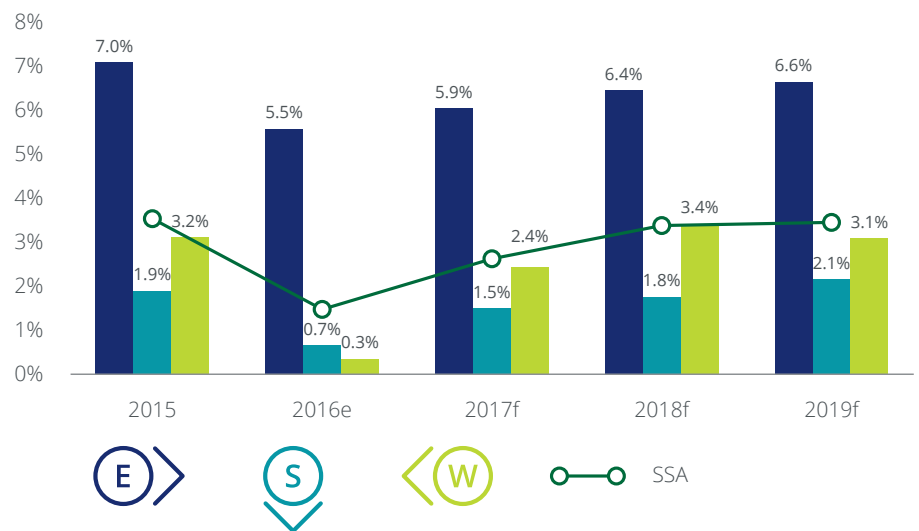
3. <https://www.avca-africa.org/research-publications/data-reports/2017-annual-african-private-equity-data-tracker-and-regional-spotlights/>



### Drivers of potential

Africa fits into many of the recent global trends that have been rapidly evolving. Demand for the most basic of services such as education and healthcare will continue to increase as the growing population of most African countries outweighs most developed economies. In the most recent World Population Prospects revision document published by the UN<sup>4</sup>, Africa outweighed each of its continental counterparts in terms of population growth between 2017 and 2030, with a cumulative average growth rate per annum of 2.4 percent, compared to the second largest continent in terms of such growth (Oceania) at 1.2 percent.

Figure 1: Real GDP growth, 2015-19f (%)



Source: IMF, 2017

4. [https://esa.un.org/unpd/wpp/Publications/Files/WPP2017\\_KeyFindings.pdf](https://esa.un.org/unpd/wpp/Publications/Files/WPP2017_KeyFindings.pdf)

Consumer-based services and sectors may be seen as secondary to services such as healthcare, education, and other social services; however, another global trend that is well documented is that of accelerated urbanization, and changes in economic power. Africa's poverty struggle has been widely considered to be its biggest challenge. Overcoming this challenge is very much dependent on FDI to create growth. The prospect of private and government collaboration continues to be debated, opening up further untapped opportunities, in light of the changing economic landscape of the African continent.

As the continent continues to battle and often partially overcome this challenge, albeit in pockets of areas, a consumer-based society will begin to become more prevalent. One of the trends noted in the 2017 Deloitte Africa PECS<sup>5</sup>, highlighted hereafter, is the expected focus on consumer-based services in terms of private equity investment.

### The 2017 Deloitte Africa PECS

To achieve and exceed the potential that for some has almost completely disappeared since the "Africa Rising" narrative was first coined, private equity most certainly should be considered as one of the strongest levers.

In the most recent edition of the Deloitte Africa Private Equity Confidence Survey (PECS), the overarching themes were the resilience and optimism of the private equity sector despite micro and macro economical challenges faced by the continent over the past three years. The survey collates the responses from practitioners across the three regions within sub-Saharan Africa (namely Southern, East, and West), and presents a summarized view of sentiment for the coming 12 months. Although there have been a number of key developments since the survey was completed (i.e. a new ruling party president in South Africa, renewed political stability in Kenya after the elections in December that had to be re-held, and the resignation of Robert

Mugabe from his long tenure as president of Zimbabwe), these developments have not seemed to trouble investors globally and, if anything, have only heightened the opportunism that was once synonymous with Africa.

To achieve and exceed the potential that for some has almost completely disappeared since the "Africa Rising" narrative was first coined, private equity most certainly should be considered as one of the strongest levers.

Amongst the standout themes, the following have been summarized to best capture the prevailing optimism:

### Country focus

A key driver of continental growth for Africa is the rapid growth of countries within each region. Despite South Africa, Kenya, and Nigeria being the key regional powers in Southern, East and West Africa respectively, a number of other countries in the regions are beginning to show signs of maturity in developing their economies, which may start to attract more foreign investors. In West Africa, Ghana was considered a preferred investment destination over the traditional choice of Nigeria, as noted in the 2017 Deloitte Africa PECS. Similarly, East Africa, Tanzania and Rwanda were investment destinations that respondents viewed more positively when questioned about preferred investment destinations, compared to responses received in previous years. As economic conditions improve and political stability increasingly becomes the norm, the contribution to overall growth and positive sentiment for Africa is expected to become more widespread. ➔

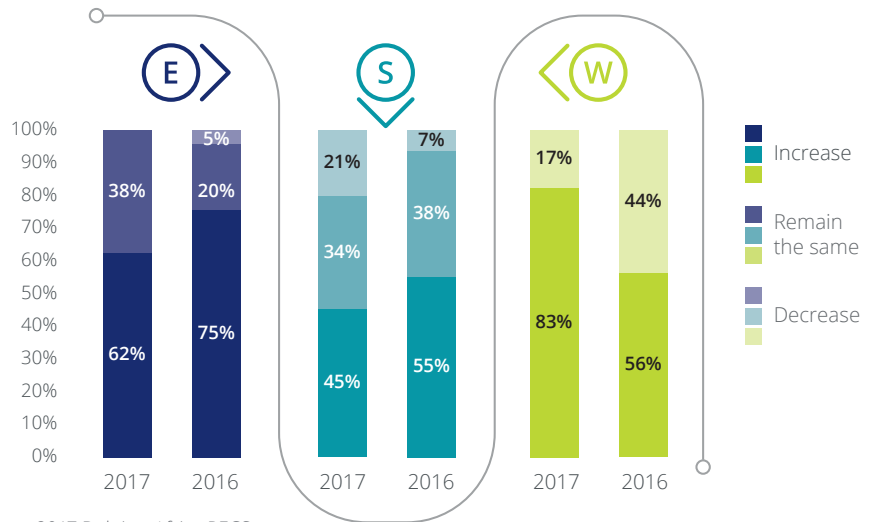
5. <https://www2.deloitte.com/za/en/pages/finance/articles/2017-deloitte-africa-private-equity-confidence-survey.html>

**Deal activity**

The majority of respondents to the survey across each region expected private equity activity to increase over the next 12-month period, with the highest level of optimism in this regard coming out of West Africa. Expectations that the region has bottomed out since the commodity price slump are quite bullish.

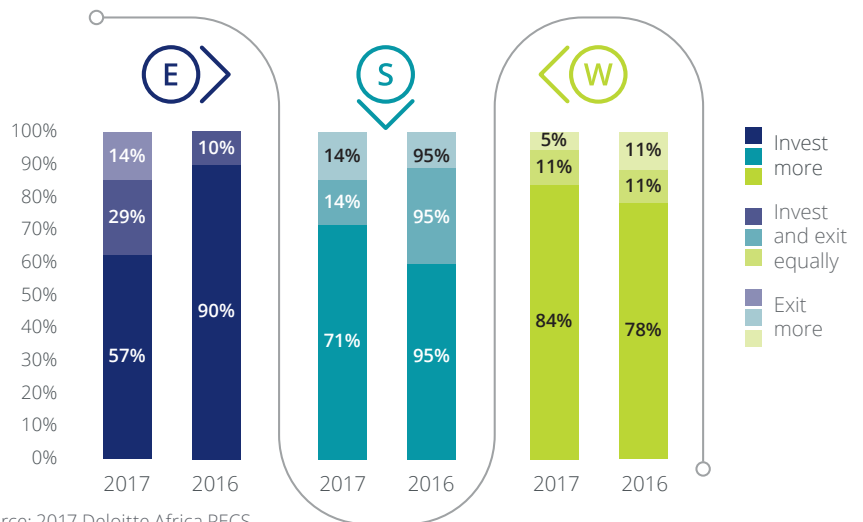
Respondents across each region also expected to invest more in the next 12 months, and this finding is underpinned by an increase in funds under management as reported in the AVCA Annual Africa PE Data Tracker<sup>3</sup>.

**Figure 2: Over the next 12 months we expect PE activity in the region to**



Source: 2017 Deloitte Africa PECS

**Figure 3: Over the next 12 months we expect to**

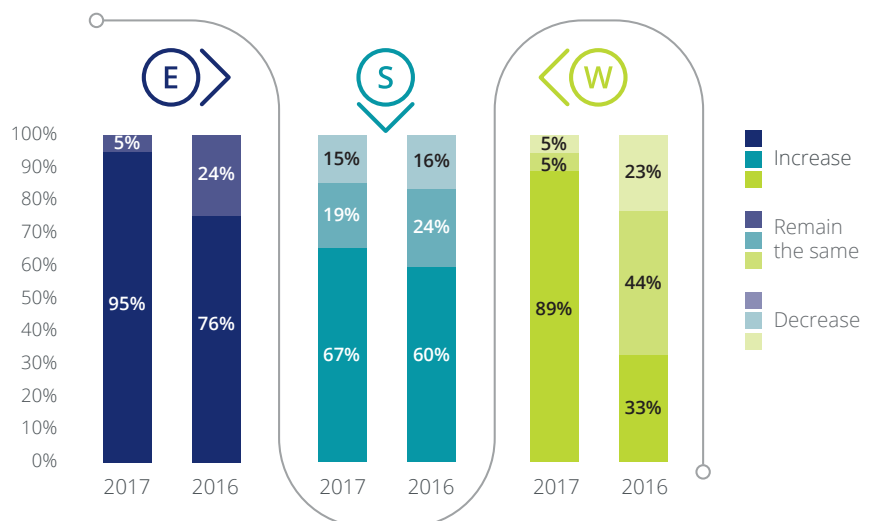


Source: 2017 Deloitte Africa PECS

**Competition**

Competition was another metric that respondents to the survey expected to increase over the next 12 months, leading to an increase in entry multiples on transactions, particularly in East and West Africa.

**Figure 4: We expect that competition for new investment in the region will**



Source: 2017 Deloitte Africa PECS



**Sector focus**

Another standout observation from the survey was the sector focus component touched on earlier, which effectively required practitioners to provide a view on sectors that are expected to offer the most opportunities for returns and will therefore warrant increased focus. Food and beverages had the highest average focus, followed by agriculture and the healthcare industries, all seemingly driven by higher populations and a burgeoning middle class.

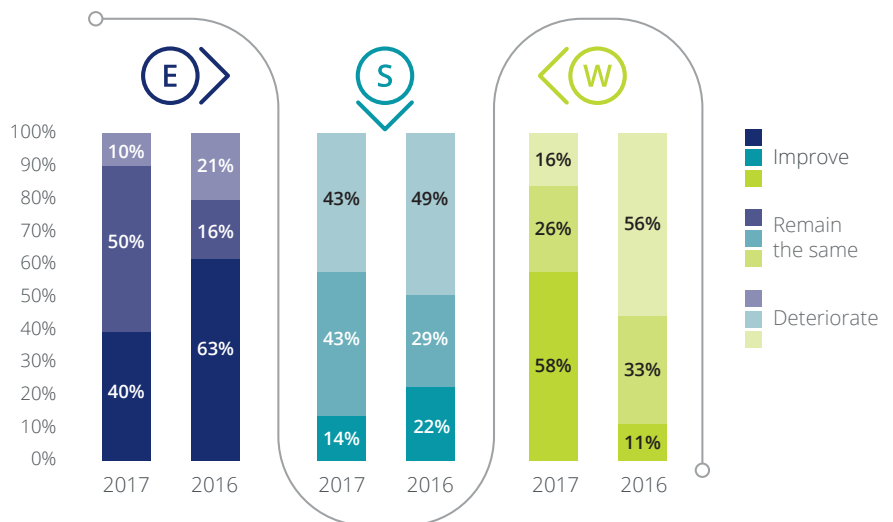


**Fundraising environment**

Expectations around the fundraising environment were mixed in each region, largely as a result of the factors mentioned earlier, the key factor being the political state of South Africa. West Africa had the most notable positivity in sentiment as the majority of respondents expected an improvement in the fundraising environment.

The last standout point to be highlighted is the source of funding on which practitioners provided their expectations. Europe and the USA were the two regions in which the most funds were expected to be raised, particularly for East and West Africa. With a more positive outlook on South Africa as a result of more perceived political stability, we expect the views of practitioners in Southern Africa to align with those of their East and West Africa counterparts, and fundraising to be sought across borders with more vigor and optimism. ➔

**Figure 5: Over the next 12 months, we expect the fundraising environment for private equity to**



Source: 2017 Deloitte Africa PECS





### Practitioner updates

Since the survey, which was launched in November 2017, SAVCA (Southern Africa Venture Capital and Private Equity Association, an industry body that serves to advocate private equity and venture capital as an asset class, amongst other purposes) hosted a private equity conference in February 2018 where practitioners were invited to share their views through a host of panel discussions.

The theme throughout the conference was the topic of fundraising and the benefit of using hindsight, insight, and foresight to better unlock the potential of the asset class and continent.

FDI is key for the industry and practitioners' views suggest that unlocking funds across borders has been a particular challenge. On a continent with such potential, but

one that has been plagued with both huge market and country risk, building investor confidence in the team managing the funds being sought is critical. Getting creative in the means by which funds are raised, and utilizing impact and corporate social responsibility, by which all large organizations must demonstrate commitment, were key discussion points that were passionately debated. Investors often want to know that an investment will reap financial rewards first and foremost, and assess opportunities primarily on this basis, before considering the social impact that an investment may have. Africa allows for the achievement of social impact on most if not all investment decisions, given the high levels of unemployment and poverty, poor infrastructure across the board in most countries and political unrest that stunts the growth potential that the continent embodies.

Making an impact that matters is a key concept for every "Deloittean". It is the purpose for which we as a firm exist, and it is more readily achieved in Africa than in developed countries.

Common challenges are measuring the impact and deciding upon the desired effect. Various metrics do exist, but they are often too complex to track. Impact investments therefore require a conscious decision in the investment strategy of all practitioners. This needs to closely relate to the environment in which a business operates and an investor invests. Whatever one's view is on impact investments, practitioners are more often than not in unison about its importance and Africa certainly has plenty to offer in this regard.



### Conclusion

The continent has suffered a whirlwind of political and market-based wounds over the past two years. Despite growth in pockets of areas across the continent, the overwhelming impact of low commodity prices and political instability have been the biggest contributors to slowed growth. Recent political developments and an upwards trajectory after hitting rock bottom have since renewed hopes of Africa realizing its potential in the medium to long term. Private equity has been a proven asset class in terms of returns, and practitioners in the industry have always been more positive than not with regards to unlocking returns on the continent. The future is always uncertain. With the hindsight of the lows experienced across the continent over the past few years, Africa is surely now better positioned than ever to continue its once obvious and envied growth trajectory. ●

### To the point:

- The “African Rising” narrative has been subdued in recent years as a result of a slump in hard commodity prices and political instability in key economies on the continent, such as South Africa and Kenya
- Private equity as an asset class for investment has outperformed traditional asset classes, particularly in South Africa
- Key drivers of the potential that was captured by the narrative still exist and include many global trends such as technological advancement and increased urbanization, which continue to develop
- The performance of the private equity industry coupled with the potential of the continent supported the optimism from the majority of practitioners across sub-Saharan Africa, which was demonstrated through the 2017 Deloitte Africa PECS





# An overview of the private funds industry in China

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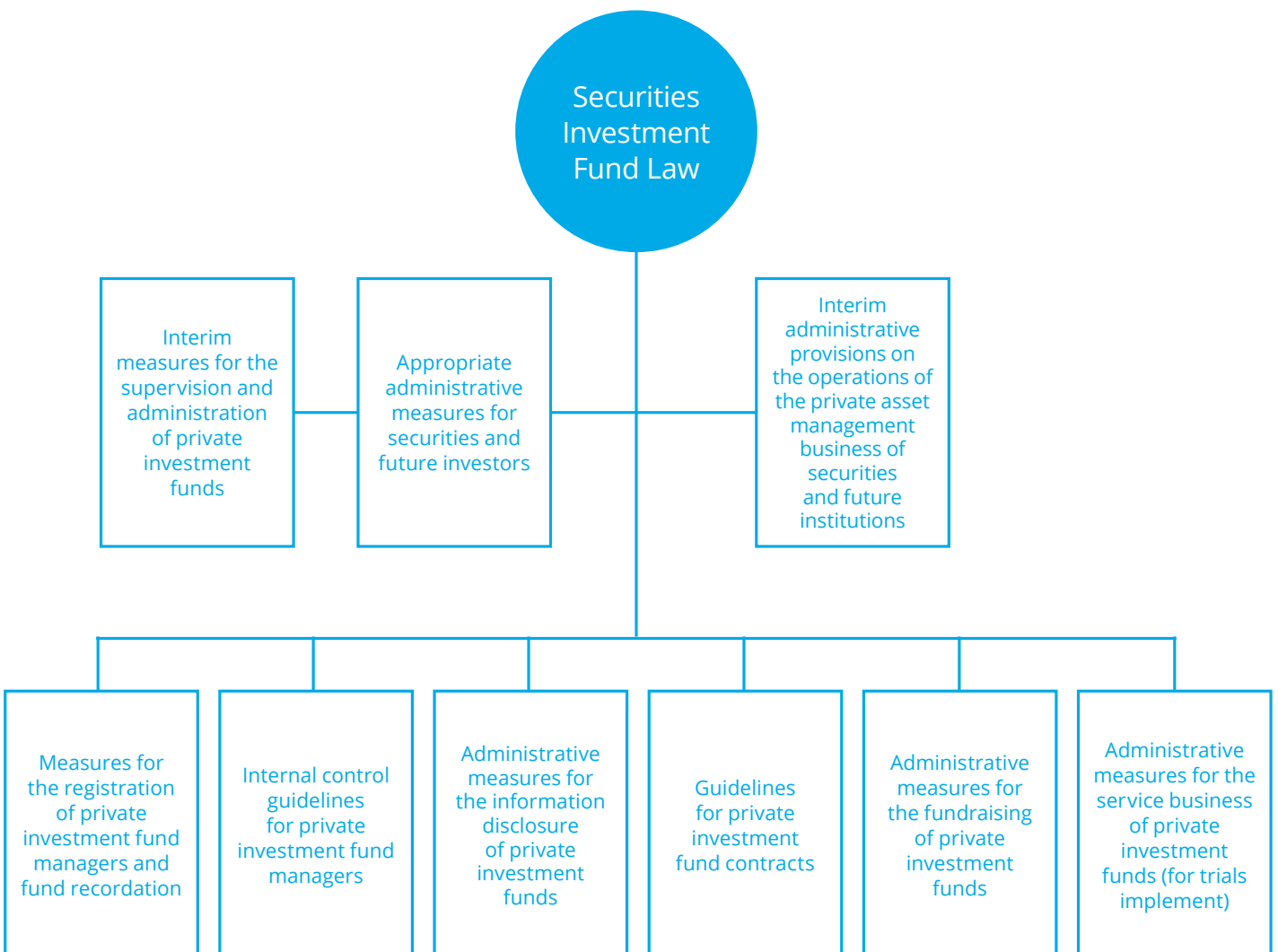


The term private funds used to be quite confusing in China as it only refers to the fund-raising channel without specific reference to the asset type the funds will be invested in. In general, private equity funds, venture capital funds, and private funds focusing on investments in secondary markets for bonds and stocks can be all loosely referred to as private funds. Part of the confusion stemmed from the complex regulatory regime, as private equity funds and venture capital funds were primarily registered with and regulated under the guidance provided by the National Development and Reform Commission, while private funds focusing on investments in secondary market instruments were regulated under the “Trust Act”, coupled with regulatory framework guidance provided by the China Securities Regulatory Commission (CSRC). ➔

In June 2013, the enactment of the revised Securities Investment Fund Law created the first nationwide industry self-regulatory body: the Asset Management Association of China (AMAC). This was a landmark event as, for the first time, there was a specific requirement for all funds to be regulated by AMAC. In February 2014, AMAC started accepting the registration of all private funds and fund management companies.

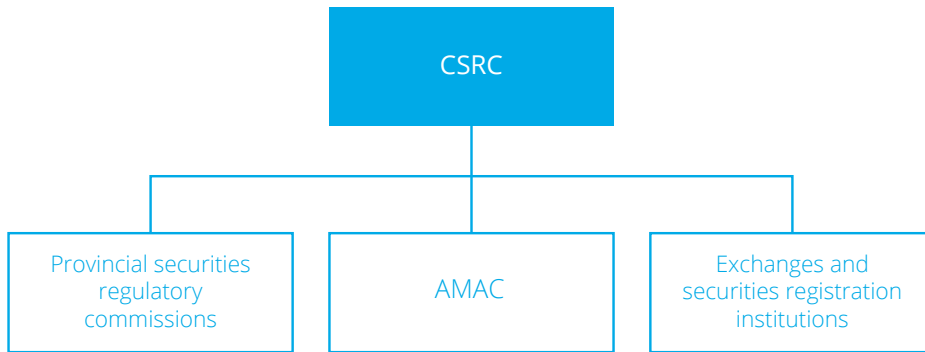


By the end of 2016, a well-defined regulatory framework was in place in China.





The regulatory agencies are structured as follows:



Two years after the enactment of the revised law and after continual refinement of the regulatory framework, in 2017, AMAC decided to publish its inaugural official reports for the sector. Deloitte China was invited to take part in the design, data collection, and analysis of the survey to provide an overview on the private funds sector in China, with a focus on private securities investment funds (“PSIF”), which predominantly invest in secondary market instruments. This was the first national review on the entire sector and the survey provided some interesting insights.

By the end of 2016, a total of 7,996 PSIF managers were registered with the AMAC, of which 29 were foreign managers under the Qualified Domestic Limited Partners (“QDLP”) program. QDLP is a program introduced by the Finance Service Office of Shanghai, which offers foreign managers the opportunity to raise funds from domestic Chinese institutional investors and qualified individual investors to feed offshore investment funds.

As illustrated in figures 1.1, the PSIF sector grew steadily throughout 2016. This is despite the fact that the total number of registered PSIF managers fell sharply in Q4 2016, primarily as a result of a clean-up of domestic fund managers that did not open or close a single fund within a year of registering as fund managers. However, the amount of total assets under management still increased despite the reduction in the number of fund managers. ➔

Figure 1.1a: Changes in manager numbers and AuM from 2014 to 2016

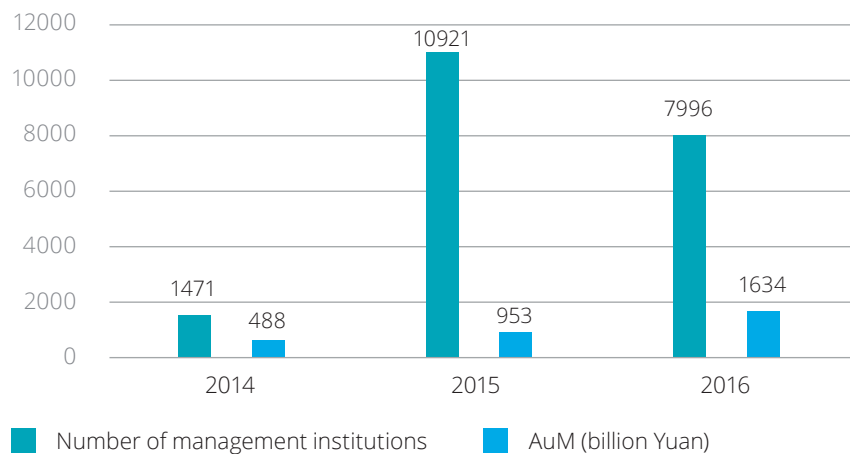
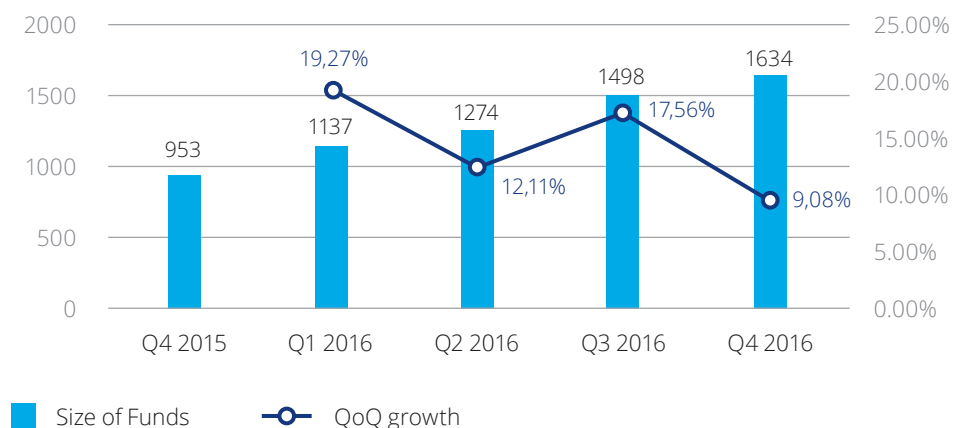
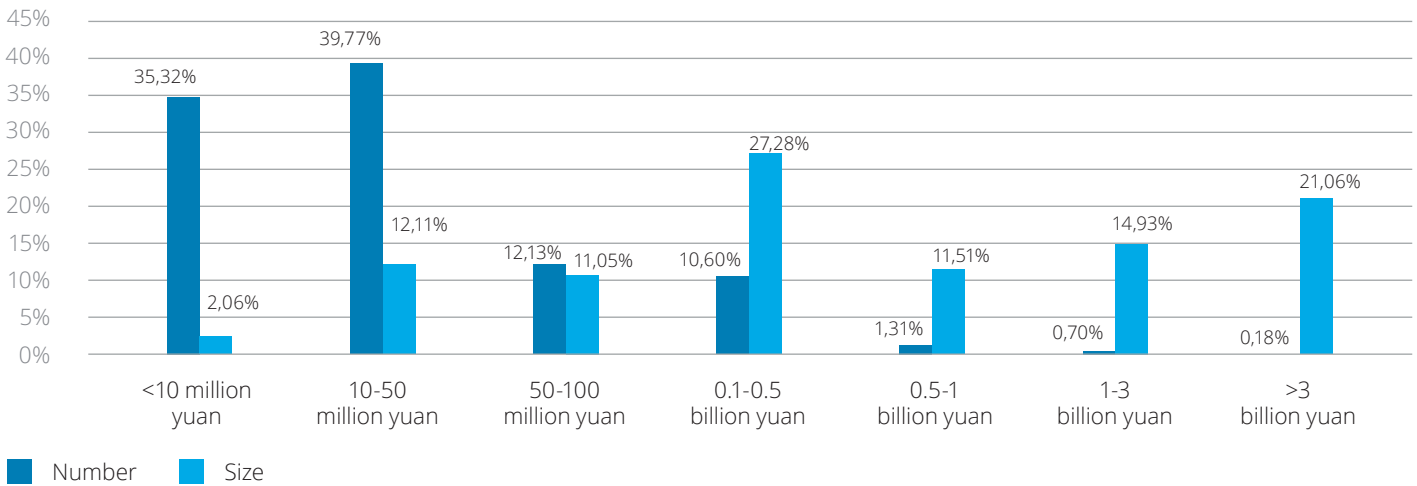


Figure 1.1b: Growth of the scale of filing for PSIFs (total asset under management in billions)



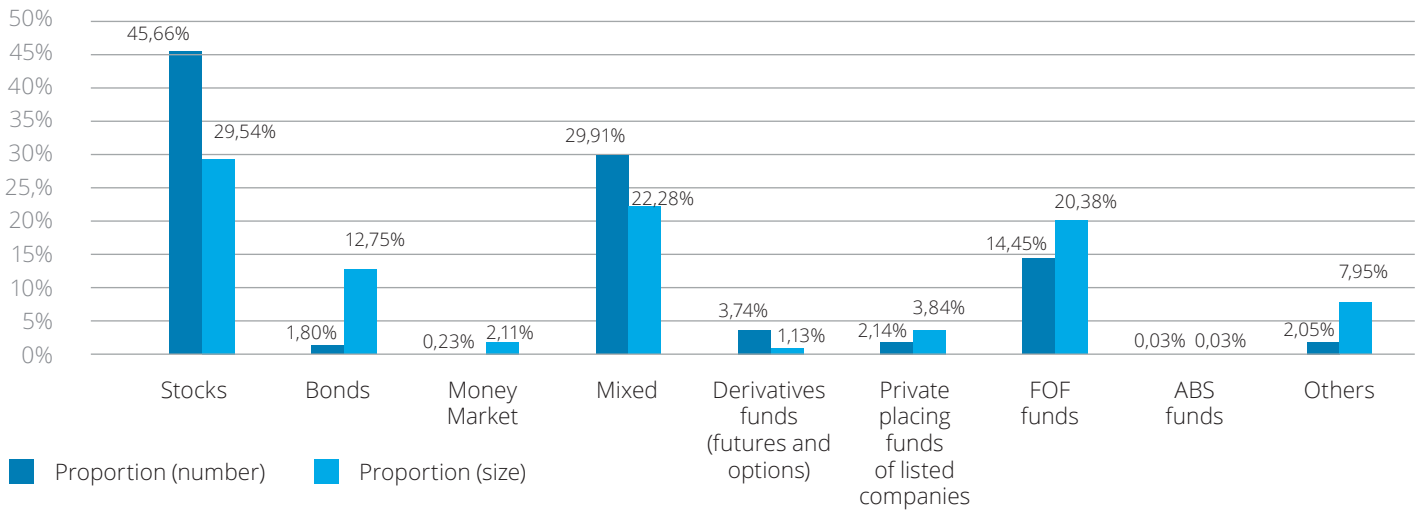
**Figure 1.2: Proportions of the number and assets of PSIFs in terms of size by 2016**



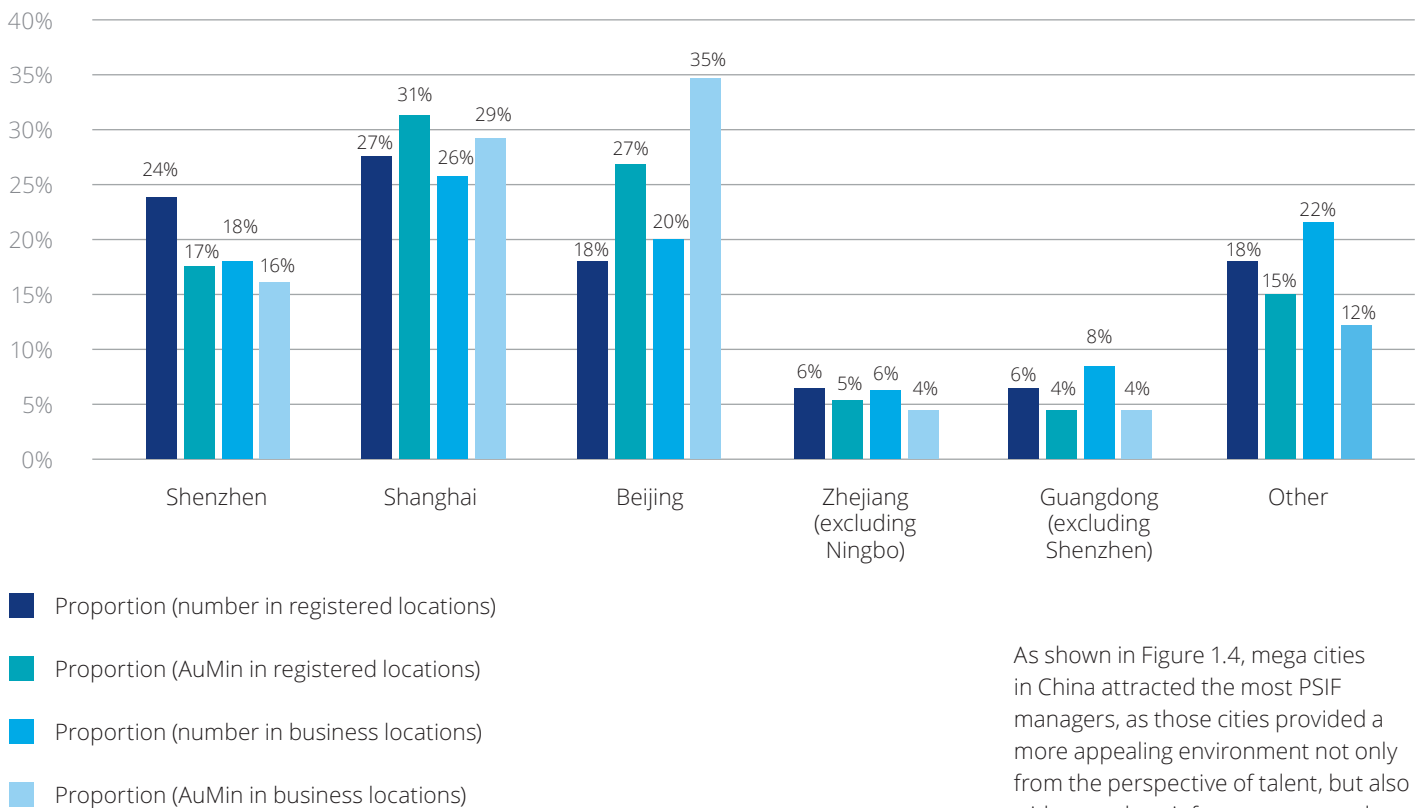
As illustrated in Figure 1.2, at the end of 2016, we started to witness a polarization of PSIF managers in China—a handful of managers were managing 21 percent of the total assets, while almost 75 percent of managers managed less than 15 percent of total assets. The large population of managers with low levels of AUM might be an indication that there are high numbers of young managers who have recently set up their businesses, since the enactment of the new law provided a more benign and transparent environment for PSIF fund managers.

Almost 65 percent of all PSIF funds were invested in stocks and bonds if we add funds invested in stocks, bonds, and mixed together. We also notice from Figure 1.3 that, even as a young sector, FOF grew quickly to account for 20 percent of all funds, which may indicate that reliance on professional intermediaries by qualified investors and institutional investors was on the rise.

**Figure 1.3: Proportions of the number and size of different PSIFs**

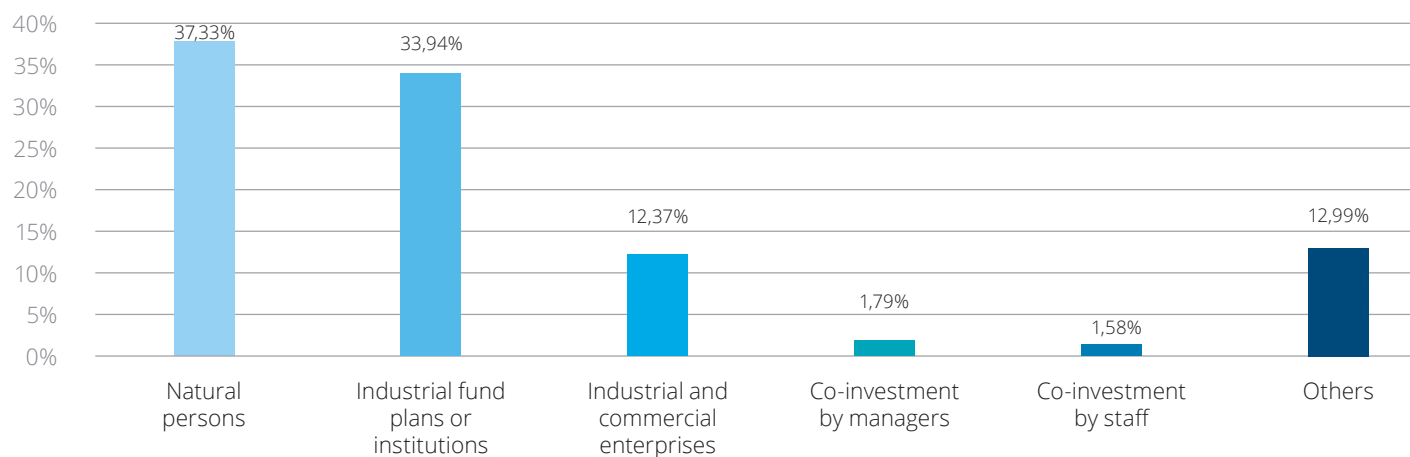


**Figure 1.4: Top five operational regions in terms of number and AuM in 2016**



As shown in Figure 1.4, mega cities in China attracted the most PSIF managers, as those cities provided a more appealing environment not only from the perspective of talent, but also with regards to infrastructure, pool of funds, and business community, among other factors. ➔

**Figure 1.5: Source of funds**



Products	Number	Size (billion yuan)	Proportion (number)	Proportion (size)
Asset management plans of securities companies and their subsidiaries	165	53	4.23%	5.76%
Special fund account and fund subsidiaries	1,533	428	39.28%	46.80%
Asset management plans of futures companies and their subsidiaries	531	49	13.60%	5.39%
Trust plans	1,596	359	40.89%	39.19%
Asset management plans of insurance companies and their subsidiaries	18	13	0.46%	1.40%
Other	60	13	1.54%	1.46%
<b>Total</b>	<b>3,903</b>	<b>915</b>	<b>100%</b>	<b>100%</b>

As shown in Figure 1.6, over 3,900 funds were using investment advisors with total assets over RMB900 billion.

The data shown above points to a young and booming PSIF sector in China. Undoubtedly, it is one of the fastest growing sectors in China with ever-increasing levels of personal wealth and more experienced professionals leaving traditional financial institutions to start their own PSIF firm. However, the sector is not without challenges: barrier of access to insurance funds, pension funds; limited ability to structure financial products for differentiation; lack of third-party professional service providers to enable efficient operation, etc.



2018 will be another interesting year for the PSIF market as the regulator continues to announce new measures for further sector standardization. Some of these measures are more restrictive, while others open up more possibilities for product innovation. Some of the measures for socially responsible investment are also at the top of the regulatory agenda. While the full English text of the 2016 report will be released by the Chinese regulator in late April, Deloitte China is already in the process of preparing for the 2017 sector report, which is scheduled to be released in late 2018. By that time, we will work with the Performance Editorial again to share the most up-to-date information from China with our readers. ●

### To the point:

- A well-defined regulatory framework is now in place in China
- Total AuM has increased despite the reduction in the number of fund managers
- A handful of managers manage 21 percent of the total assets, while 75 percent of managers manage less than 15 percent of total assets
- Reliance on professional intermediaries by qualified investors and institutional investors is on the rise
- Mega cities in China attract most PSIF managers
- The booming sector also faces challenges



# The new era of delegate oversight

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On 13 July 2017, the ESMA published an opinion on delegation by EU authorized entities to asset management companies located outside of their homeland, and more precisely in non-EU jurisdictions, in the context of Brexit. This opinion covers several aspects of the delegation process from policies and procedures around delegation to delegation oversight, governance, and substance, and some aspects of the investment process and risk management. Our focus here will be on the first two topics: policies and procedures relating to delegation and delegation oversight. While the opinion has been published in the context of Brexit, the underlying idea could most probably become an industry standard aiming at enhancing requirements around delegation and oversight. The ESMA describes this opinion as establishing the minimum standard required in the context of delegation and has repeatedly stated that existing regulations already stipulate that oversight must be organized. The difference is that the minimum requirements have been clearly defined and as the ESMA has

expressly specified that these rules apply to white-label entities (also known as third-party management companies) as well as entities that belong to a corporate group. The most interesting change is that the requirements are now clearly expressed in writing and in fact, are mostly repeated several times. It is also worth underscoring the fact that these requirements are seen as minimums. In other words, every authorized entity is expected to fulfil the delegation requirements detailed hereafter, but larger entities, and most probably newer ones, may be asked to go further.

### Delegation: policies and procedures

All authorized entities must draw up policies and procedures to select and monitor delegates. This means that specific policies and procedures have to be written, adopted, and applied in practice. These procedures should ensure that the delegation process is based on objective reasoning and carried out with the best interests of investors in mind. Objective reasoning is the first sensitive issue here, as the process is not without risk. The

second challenge is that monitoring should be carried out on an ongoing basis. The fact that this idea of continuity recurs a couple of times in the document confirms the importance of continuous monitoring of specific items.

A third key element to note in relation to the delegation process is that arrangements between the parties should take the form of written contractual documents precisely detailing the individual tasks and activities that are delegated to ensure that authorized entities have the right to inquire, inspect, have access or give instructions to their delegates. Again, we can infer that the key idea is that the authorized entity should play an active role. This section ends by stating that the delegating entity should be able to terminate the contract at short notice. Contingency planning policies and procedures should also be implemented. A direct corollary to these elements is that appropriate records should be kept of all due diligence and delegation monitoring activities and contractual arrangements. ➔







During the due diligence process, every aspect of the fund and the fund management company is analyzed in detail.

**Delegation: oversight**

The elements presented in the previous section indicate that there are extensive requirements in relation to simply organizing oversight. However, expectations regarding oversight itself go even further.

The first requirement simply states that delegation arrangements must be subject to appropriate oversight. The opinion goes on to state that appropriate oversight must be underpinned by a due diligence on the delegate, among other factors (to be documented in writing).

Possible alternative delegates should be considered and the process around them documented. This documented due diligence should be performed on an ongoing basis, and should also be supported by regular on-site visits to delegates. These visits should be organized to monitor delegates and also to constructively challenge them where necessary. Authorized entities should play a key role in the process rather than being mere passive observers; this raises a number of issues including effective access to data on the delegated function.



### Delegation: corporate entity

There is nothing in the opinion to suggest that white-label or in-house delegation processes should be any different. To prevent readers from inferring this, the regulator even mentions rules specific to entities that are part of a corporate group on multiple occasions. These include the fact that conflict of interest policies and procedures should, where relevant, reflect the fact that potential conflicts are specified in the policies and procedures. In addition, but independently of that, the governing or management body of the authorized entity should have the ultimate decision-making power over the business conduct of the authorized entity even where the entity is part of a corporate group.

Two more potentially sensitive elements are firstly that where authorized entities intend to delegate functions to entities within the same corporate group, due diligence should be carried out by the authorized entity and the selection of a group entity should be based on objective reasoning. Secondly, no reporting lines to group functions or other individuals within the group should contradict the independence principle or impair the independence of internal control functions.

### Due diligence: a definition

Due diligence is defined as the process of carrying out quantitative and qualitative analysis on a delegate. Historically, it has been performed by institutional investors prior to an investment. During the due diligence process, every aspect of the fund and the fund management company is analyzed in detail. Due diligence also typically involves one or more meetings with the management team. The due diligence requirement comes from the world of hedge funds and it is driven by three main factors. Firstly, hedge funds were typically smaller structures with a limited infrastructures. Secondly, the nature of the strategies implemented by hedge funds meant that investors needed to work harder to fully understand the investment strategy and the risk associated with it.

Finally, several fraud cases have affected the industry and its reputation, leading potential investors to be more profound in their analyses.

While this definition is probably slightly reductive today, it still conveys the main elements that should be included in the due diligence process. First and foremost, due diligence is the process of analyzing a fund management company, investment fund, and/or administrator (broadly defined as “counterparties”). This means that the focus and checks to perform will vary depending on the specific objective of the due diligence process. In the context of delegating the management of a product (for example in the context of a mandate given by an institutional investor or in the event of delegation of the management of a fund by a management company), the focus will be the delegated asset management company and not the product, as the product is owned either by the institutional investor or the management company. This means that aspects regarding the fee structure or liquidity terms are not covered by the diligence process in this context. Conversely, before investing in a third-party fund, a multi-manager or—more broadly—any entity investing in third-party funds (including, for example, family offices or discretionary private banking entities) must perform due diligence on the investment product under consideration. This process will cover the asset management company first and foremost, but also include a set of questions on the product under review. This is crucial if the entities in question are investing on behalf of third-party clients. The reason for this is clear: multi-managers must have adequate knowledge of the products they are investing in on their clients’ behalf. Depending on the fund structure and the jurisdiction, the expected level of due diligence to be performed will vary. The investment part is typically analyzed by a professional third-party investor to enable the team to take an investment decision and justify their choices. The operational part of the process may or may not be covered as it is not yet a regulatory requirement in every jurisdiction for every player. ➔





Operational due diligence involves in-depth analysis of the operational aspects of the management company or investment product. This process focuses on unwanted risks. When investing with an asset manager or in an investment fund, investors are taking risks. These risks can be classified in two categories: risks that are consciously taken and those that are unwanted. Any investment that aims to offer returns will naturally entail a certain degree of investment risk. Such risks are (or at least should be) consciously taken by investors in order to maximize their chances of achieving an expected level of return. On the other hand, there are risks that may lead to losses that are not directly linked to the investments themselves or the investment strategy implemented. These include operational issues, IT-related issues, and unclear trading procedures. Unwanted risks should be minimized and, to that end, professional investors typically perform operational due diligence on these operational unwanted risks.

In the context of non-regulated products, operational due diligence is a requirement, but even for regulated investment funds, there is a tendency to perform operational checks for every counterparty. In France for example, the AFG (Association Française de la Gestion, French Asset Management Association) has recommended performing due diligence covering a series of operational aspects in its code of conduct since 2009. In the United Kingdom, while the FCA does not formally require operational due diligence to be performed on every single counterparty, the regulatory body does in practice check what due diligence is performed by regulated entities during visits, and it has become obvious over the last couple of years that expectations regarding due diligence and oversight are becoming increasingly rigorous.

The full due diligence process is typically required when the portfolio management of a product is fully delegated to a third-party asset manager.

The last part of the definition states that the due diligence process relies typically on a series of meetings with the management team. This was key in the past when due diligence procedures in the asset management world were performed on alternative investments and hedge funds in particular. In the early 2000s, the typical hedge fund was run by a small asset management company created by smart portfolio managers and the product proposed was an offshore fund with very limited investor protection. In addition, the strategies implemented were new and complex relative to what had been available previously. This is why a series of meetings was necessary, firstly to gain an understanding of the investment strategy and secondly to perform all the checks necessary on the asset management company and the investment fund structure. As the financial community becomes increasingly educated and as regulations become increasingly protective, a single meeting may be seen as sufficient.

#### Full Asset Manager Due Diligence (AM-DD) versus Operational Due Diligence (OP-DD)

So far in this article, we have introduced the concepts of asset manager due diligence on the one hand and operational due diligence on the other hand, but we have not fully explained the differences between the two. Asset manager due diligence aims to cover every aspect of the asset management business including corporate overview (e.g., organization or human resources), regulatory overview, investments (e.g., team, investment process or portfolio management), operations (e.g., IT, execution, and trading or outsourcing) and corporate governance (e.g., internal, compliance, risk management, internal audit or remuneration policy). In contrast, operational due diligence can be seen as a subset of full asset manager due diligence. The focus is the unwanted risks linked to operational systems as well as regulation. It focuses on the corporate overview, regulatory aspects, operations, and corporate governance.

The full due diligence process is typically required when the portfolio management of a product is fully delegated to a third-party asset manager. This makes sense as the investment process, the investment resources and the operational aspects should be covered. Specific operational due diligence is typically performed to check that the operational risks are limited and that the risks inherent to the corresponding investment are limited to investment risks. This is best understood as one component of full asset manager due diligence.

#### Concluding remarks

Delegation has grown in prominence over the last decade and as a consequence, the regulator expectations regarding delegate oversight have also evolved. This was formalized last summer in an ESMA opinion. This publication sets the standards expected by the regulator and confirms how such a process can and potentially should be structured. We are no longer in a world of basic questionnaire-based approaches. This new era for the oversight of delegates should be organized and structured around policies and procedures that rely on a selection of elements including objective reasons to select the delegate, a written due diligence, on-site visits, detailed contractual arrangements, recordkeeping, data access, alternatives and replacements, and contingency planning. This evolution shouldn't be seen as an issue but more as an opportunity, presenting itself as the ideal moment for entities that are not yet aligned to these new standards to ensure all their bases are covered. ●

Delegation has grown in prominence over the last decade and as a consequence, the regulator expectations regarding delegate oversight have also evolved.

## TO THE POINT



- In July 2017, the ESMA published an opinion that covers the delegation process. It covers third party and in-house management companies that are subject to the same requirements
- Policies and procedures to select and monitor delegates based on objective reasons have to be written, implemented and applied on a continuous basis
- Documented and on-site due diligences have to be performed and possible alternatives should be considered
- Authorized entities need to be able to inquire, inspect, have access or give instructions to their delegates and be ready to potentially change delegate



# Investment Management Risk: 2017 Deloitte Survey

## Shedding light on South African risk management trends

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In the current climate of macro-economic volatility and ever-increasing regulatory focus, asset managers are compelled to enhance their investment management risk identification, measurement, mitigation, and monitoring processes and frameworks.

This article presents the results from Deloitte's recent investment management risk survey. We define investment

management risk as the risk of losses arising from errors, negligence, and incompetence on the part of asset managers in charge of financial portfolios. Inadequate management of client assets may have an unexpected financial or non-financial impact on the value of client investment assets or portfolios, and consequently may have an unexpected impact on an investment management firm, its earnings, and its reputation. [▶](#)





Investment management risk mainly arises from:

- Client portfolios that are inappropriately benchmarked or not managed in line with client risk-return expectations as per the agreed mandates
- Unfavorable movements in market variables (such as interest rates, inflation rates, currency exchange rates, equity, or property prices) creating asset price risk in client portfolios, which, if inadequately evaluated or monitored, compromises effective investment risk management activities
- Operational issues stemming from investment management business operations. These include losses caused by inadequate or failed processes, people, systems, or external events in relation to client interaction, client registry, unit registry, and asset registry activities. This includes third-party risk arising from outsourced middle or back office duties or functions

Broadly speaking, an asset manager's activities can be classified as either operational or investment management related. In line with this, our survey comprised the following two sections:

• **Investment management activities**

This section encompasses all processes associated with investment decision-making and mainly includes:

- Setting the investment strategy (asset allocation and security selection)
- Investment research and analysis
- Risk management

• **Operational activities**

This section refers to operational and administration processes that facilitate investment activities and includes:

- Capturing and storing client data
- Executing and recording client instructions and transactions
- Financial reporting


This article should be read in conjunction with our recent publication on investment management risk, *Change is on the Horizon*<sup>1</sup>, where we explain investment management risk in greater detail.

**1. Objectives of the survey**

Our survey examined the level of sophistication of South African asset managers in the execution of investment risk management and operational activities.

Given the lack of formal South African regulations in this regard, the survey was based on the ERM process from "Risk Principles guidance". This guidance was published in February 2009 by

the Committee of European Securities Regulators (now ESMA—the European Securities and Markets Authority) and outlines the general risk management principles that underpin the UCITS (Undertakings for Collective Investment in Transferable Securities) regulations. Using this document as a reference, we have determined:

- The level of sophistication of South African asset managers' investment risk management practices
- The state of readiness of South African firms with regards to the adoption of a regulatory regime similar to the UCITS framework 

Inadequate management of client assets may have an unexpected financial or non-financial impact on the value of client investment assets or portfolios, and consequently may have an unexpected impact on an investment management firm, its earnings, and its reputation.

1. <https://www2.deloitte.com/za/en/pages/financial-services/articles/changes-in-the-horizon.html>



The output from the survey is grouped into the following themes:

INVESTMENT ACTIVITIES				OPERATIONAL ACTIVITIES
Governance and organization	Identification and measurement of risks	Risk management	Monitoring and reporting	
<ul style="list-style-type: none"> <li>• Risk management policy</li> <li>• Risk management function and risk management practices</li> <li>• Remuneration</li> <li>• Outsourcing of risk management functions or activities</li> </ul>	<ul style="list-style-type: none"> <li>• Identification of risks relevant to the fund</li> <li>• Risk measurement techniques</li> <li>• Risk models and back-testing</li> <li>• Links between risk measurement and asset valuation</li> </ul>	<ul style="list-style-type: none"> <li>• Risk limits</li> <li>• The effectiveness of the risk management process</li> </ul>	<ul style="list-style-type: none"> <li>• Reporting to the board of directors and the senior management</li> <li>• Monitoring of the risk management process</li> </ul>	<ul style="list-style-type: none"> <li>• Risk governance and organization</li> <li>• Identification and measurement of risks</li> <li>• Risk management</li> <li>• Risk monitoring and reporting</li> </ul>

## 2. Key results and analysis

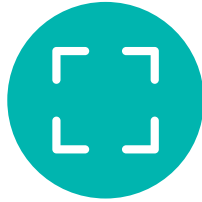
Generally, the results from the survey indicate that risk management practice levels are well developed and that South African asset managers appear to have made meaningful progress towards UCITS preparedness. There are, however, key gaps that need to be addressed.

### Investment activities

Investment activities are a crucial part of an asset manager's operations and distinguish it from competitors. While we expect each participant's investment activities to be unique, some broad principles should be followed in terms of risk management.

The survey participants for this section represent about R2.7 trillion in assets under management (where the total market size for South Africa is about R4.6 trillion as at December 2017<sup>2</sup>) and manage about 620 funds in total.

### We had fair representation across a variety of fund types:



#### Type A—Vanilla funds

Traditional long-only non-leveraged, single or multi-asset funds. These funds were further segmented between retail and institutional funds.



#### Type B—Moderately complex funds

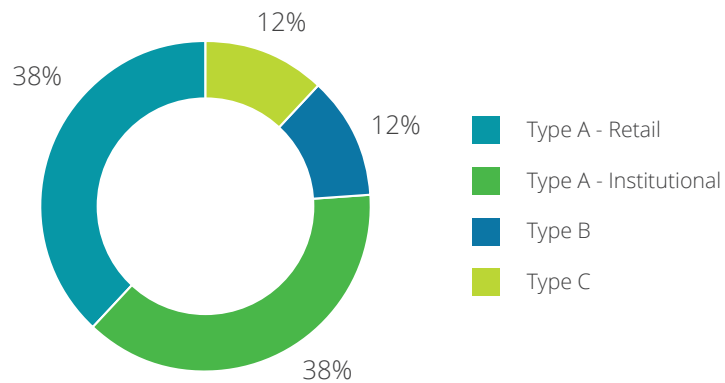
Single or multi-asset funds with embedded guarantees.



#### Type C—Complex funds

Funds primarily based on complex financial instruments or strategies e.g., hedge funds.

### Fund type distribution



Generally, the results from the survey indicate that risk management practice levels are well developed and that South African asset managers appear to have made meaningful progress towards UCITS preparedness.

The key results from the survey are summarized below in terms of governance and risk management.

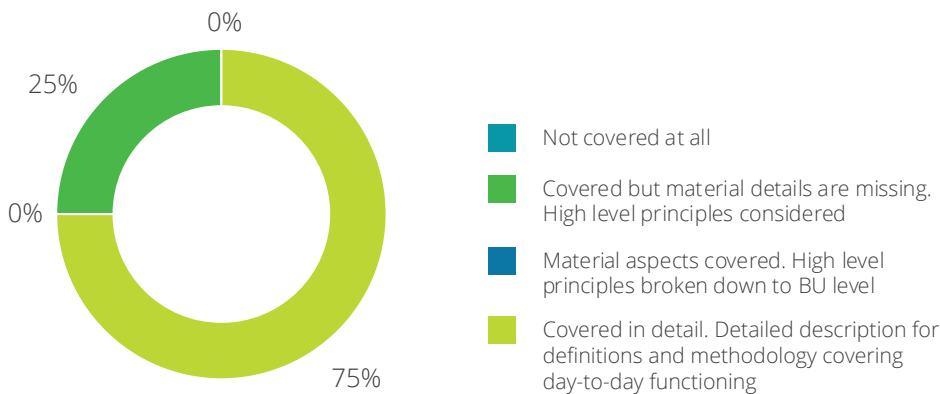
**Governance and organization**

The ESMA ERM guidance principles state that the risk management policy must establish a robust and transparent framework for managing risks and ensure that there is appropriate segregation of duties, effective utilization of resources, and accountability. Ideally, the risk management policy should be a separate document.

75 percent of firms have a formal stand-alone policy that addresses mandate compliance risk. Of these, 75 percent indicated that such policies establish robust and transparent frameworks for managing mandate compliance risk. This is done by having detailed policies containing:

- Comprehensive descriptions for definitions (i.e. the internal risk taxonomy)
- Methodologies and approaches to identify, measure, mitigate and monitor mandate compliance risks
- Procedures that facilitate the day-to-day application of the risk policy (i.e., exception management, policy breach procedures etc.) [➤](#)

**To what extent does the risk management policy establish a robust and transparent framework?**



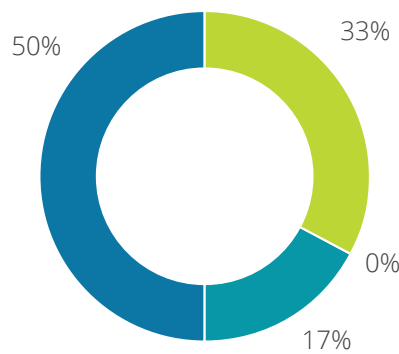




In addition, the following was noted for investment risk within the mandate:

- 83 percent of firms indicate that their policy establishes a robust and transparent framework to identify, measure, mitigate, and monitor investment risks within the mandate
- All participants include an element of risk reporting to the board, senior management and audit committee
- 67 percent of policies ensure that there is appropriate segregation of duties in terms of managing investment risk within approved mandates

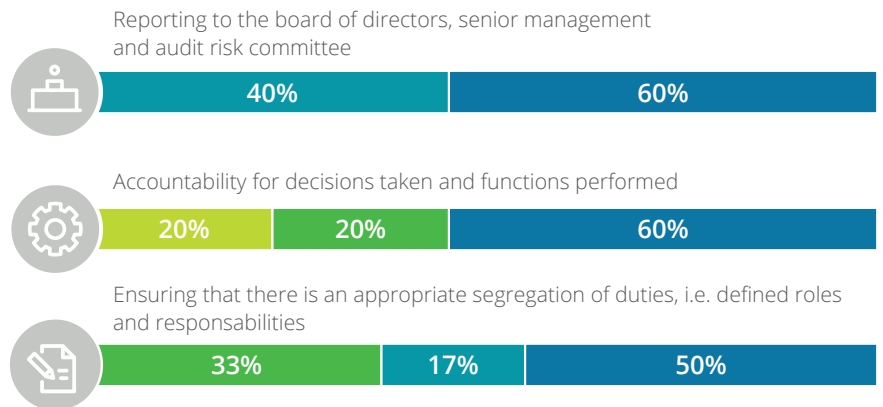
**To what extent does the risk management policy establish a robust and transparent framework for managing investment risk**



- Not covered at all
- Covered but material details are missing. High level principles considered
- Material aspects covered. High level principles broken down to BU level
- Covered in detail. Detailed description for definitions and methodology covering day-to-day functioning

- 40 percent of respondents' policies do not ensure that there is adequate accountability for the risk management decisions taken. This number is concerningly high. A lack of accountability breeds complacency, which is the breeding ground for oversights and unwelcome surprises. South African firms would benefit from aligning their policies with the ESMA guidelines on risk management

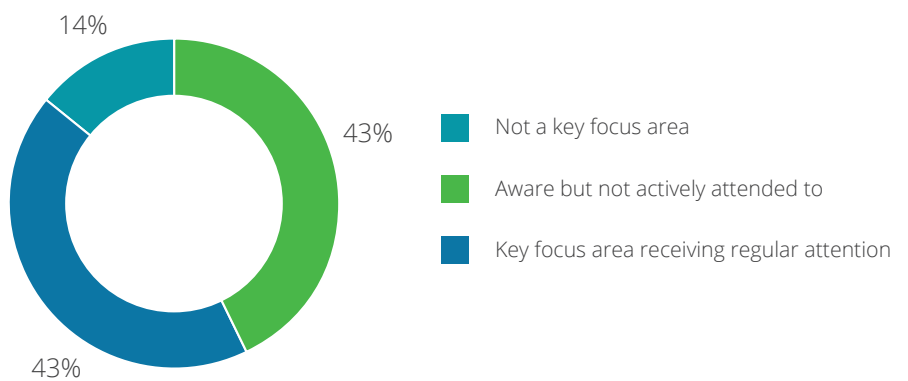
**Scope of risk management policy : front office**



- Not covered at all
- Covered but material details are missing. High level principles considered
- Material aspects covered. High level principles broken down to BU level
- Covered in detail. Detailed description of definitions and methodology covering day-to-day functioning
- Covering day-to-day functioning

In terms of governance, 43 percent of firms indicate that the board, senior management and audit risk committee are aware of but do not actively attend to investment risk and mandate compliance risk. Due to the increasing complexity of financial markets and expected regulatory developments, there will be an increasing demand for senior management to become more involved in investment risk management. ➔

**Extent of senior management involvement with investment risk within the mandate and mandate compliance risk?**

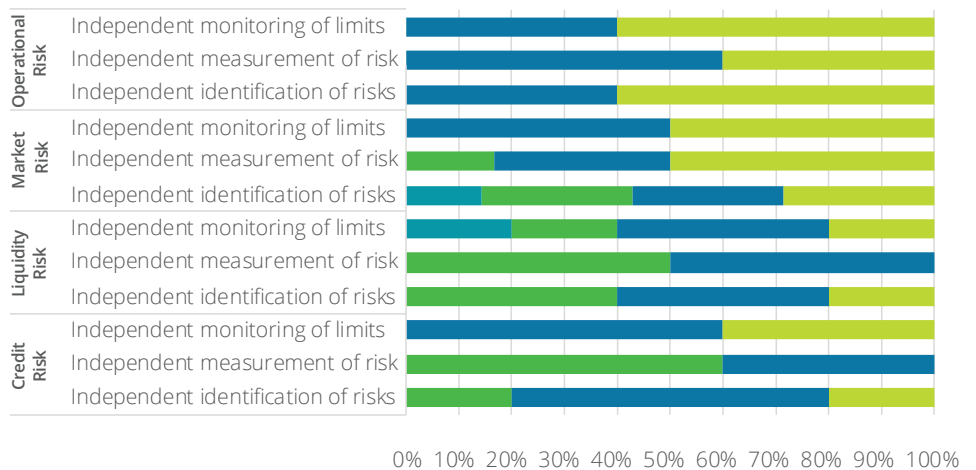




The ESMA ERM guidance principles further state that the risk management function should be appropriately resourced and should operate in accordance with adequate standards of competence, efficiency, and functional independence (reflecting a fund's nature, scale, and complexity).

All participants indicated that there is independent oversight of investment risk and mandate compliance risk management by their middle office functions. In addition, middle office functions independently validate the performance of various components of the risk management process such as risk measurement, risk monitoring, and risk identification.

**Tasks performed the middle office per risk type**



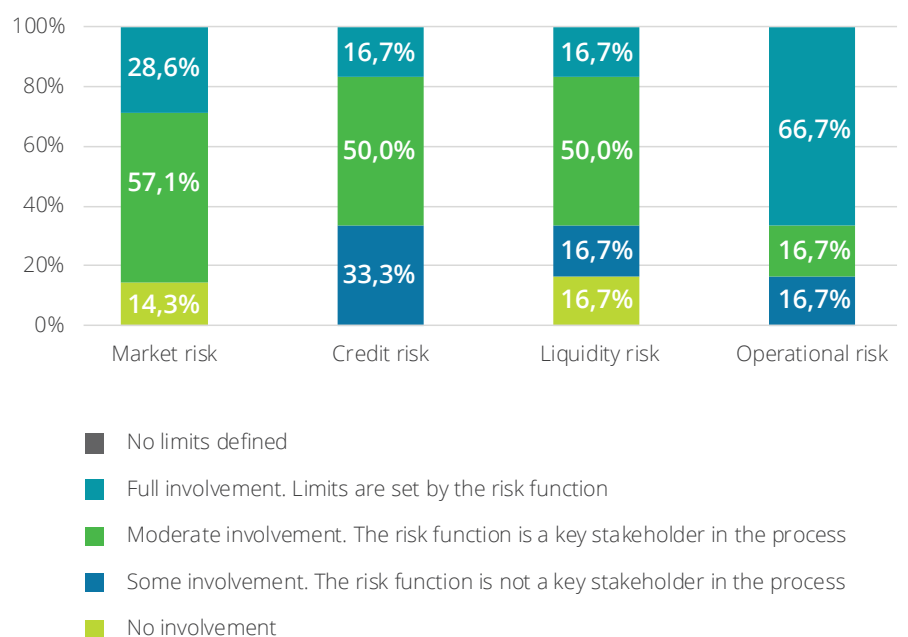
- Not performed
- Performed to some extent but significant room for improvement
- Performed well with some room for improvement
- Performed well. Fully appropriate for nature, scale and complexity of fund



Moreover, all participants surveyed indicated that they use risk limits in their governance framework to manage investment risks. However, the involvement of the middle office in the determination of risk limits differs across risk types.

All participants also indicated that their remuneration policies are structured to ensure that those who are in oversight roles remain independent, and those who are in investment decision roles are focused on clients' interests. ➔

**Level of middle office's involvement in determining and monitoring risk limits**





**Identification and measurement of risks**

The ESMA ERM principles recommend that the risk management policy specify suitable the techniques to measure the risks inherent to the investment strategies and management styles adopted for the fund.

Our survey results indicate that a variety of quantitative risk metrics are used to measure risk. Volatility is a popular metric for market risk. This is to be expected because it is easy to calculate, however, more sophisticated metrics may be required in future (e.g., hedge funds are required to use Value at Risk by the FSB<sup>3</sup>).



The preferred metric for credit risk is total exposure per counterparty—also easily calculable and without significant data availability constraints.

The percentage of a security held relative to the total available on a free-float basis is a popular measure for liquidity risk. This measure is easy to calculate, and the required data is easily available.

Lastly, the use of risk maps (a schematic that maps out the expected severity and probability of operational risk events) is commonly used for operational risk. This measure is simple but is heavily dependent on expert judgement.



**Risk metrics and frequency**

	<b>Market Risk</b>	<b>Credit Risk</b>	<b>Liquidity Risk</b>	<b>Operational Risk</b>
<b>Risk Metrics</b> 	<ul style="list-style-type: none"> <li>• 57%: Asset Price Volatility</li> <li>• 14%: TVaR</li> <li>• 29% Other</li> </ul>	<ul style="list-style-type: none"> <li>• 80%: Counterparty exposure</li> <li>• 20% Credit rating</li> </ul>	<ul style="list-style-type: none"> <li>• 60% : Number of days to liquidate the portfolio</li> <li>• 40%: Instrument level National holding vs Free-float</li> </ul>	<ul style="list-style-type: none"> <li>• 80%: Risk maps</li> <li>• 20%: Other</li> </ul>
<b>Frequency</b> 	<ul style="list-style-type: none"> <li>• 57%: Daily</li> <li>• 43%: Monthly</li> </ul>	<ul style="list-style-type: none"> <li>• 50%: Monthly</li> <li>• 33%: Daily</li> <li>• 17%: Quartely</li> </ul>	<ul style="list-style-type: none"> <li>• 60%: Daily</li> <li>• 40%: Monthly</li> </ul>	<ul style="list-style-type: none"> <li>• 100%: Monthly</li> </ul>

3. FSB Board Notice 52 of 2015

All participants indicated that they have risk measurement frameworks that are appropriate given the nature, scale, and complexity of their funds.

According to the ESMA ERM guidance principles, risk measures should only be computed with up-to-date and reliable data. The risk management function should review and provide appropriate support to the valuation process, especially for complex assets.

Our results show that in terms of systems, half of the participants have full alignment (same systems are used, and data, assumptions, and calculations are acquired from the same source) between their investment risk quantification and front office valuation processes. However, as much as 17 percent use different systems without performing any reconciliations.

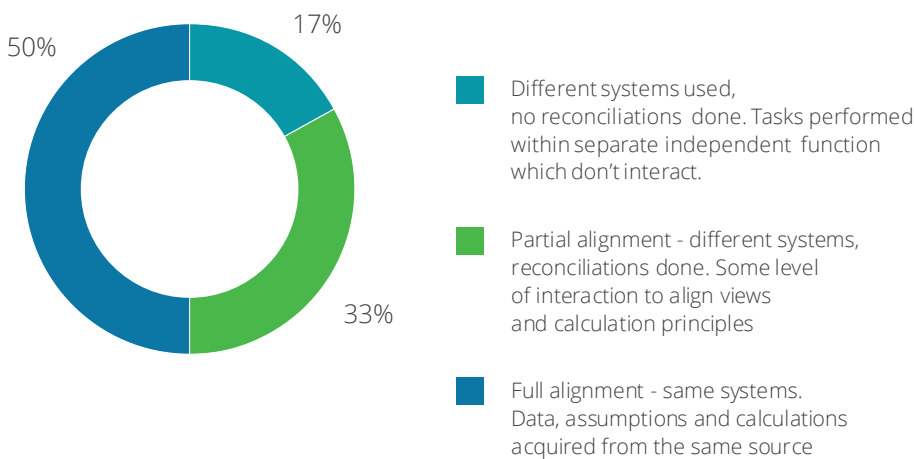
In terms of UCITS readiness, most South African asset managers appear to be aware of the regulations and the key requirements underlying its provisions, with many still having a fair amount of preparation work in order to ensure full compliance.

**Operational activities**

Operational activities support and facilitate the execution of investment activities and can be classified into two components: client registry and asset registry.

**Client registry** refers to all sub-activities and processes involved in capturing and storing client information, such as client onboarding, client advice and expectation management, post-sale administration, and data security management. **Asset registry** refers to operational activities that involve executing and reporting at individual and aggregate level, such as calculating returns and fees, capturing contributions and redemptions, accounting and financial reporting, pre- and post-trade management as well as treasury management. Our survey focused only on **asset registry** activities.

**What is the extent of the alignment between the investment risk quantification and the valuation processes?**



The participants for this section represent about R1.5 trillion in assets under management (where the total market size for South Africa is about R4.6 trillion as at December 2017<sup>4</sup>) and manage about 267 funds in total. ➔

In terms of UCITS readiness, most South African asset managers appear to be aware of the regulations and the key requirements underlying its provisions, with many still having a fair amount of preparation work in order to ensure full compliance.

4. 27 Four Investment Managers 2017 Survey, page 17

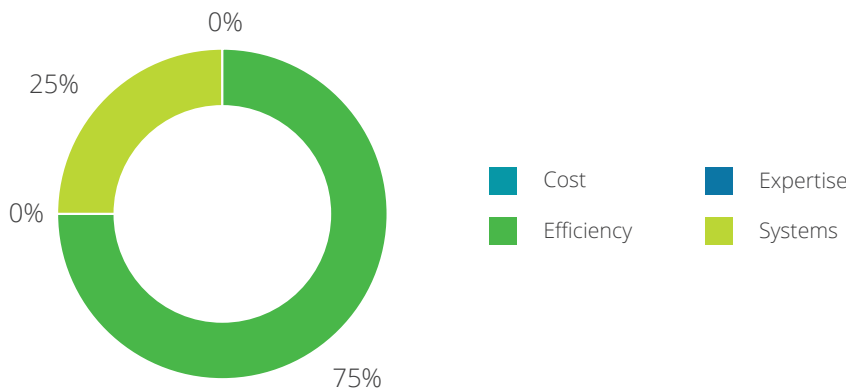
The following key results were observed from this section of the survey:

- All participants indicated that their risk management policy covers risk related to asset registry
- 75 percent of participants indicated that they formally assess registry systems risks on a quarterly basis, while the remaining 25 percent assess these risks on a monthly basis. We expected the frequency of formal assessments to be higher due to the materiality of the risk exposure and frequency with which systems are used

- All participants indicated that they have an independent function or business unit responsible for managing operational risk (which includes asset registry risks). This is to be expected given the specific nature and scale of the operational risks faced by asset managers (i.e., continuous trading, daily reporting on returns and regulatory compliance)
- All participants indicated that they have outsourced some asset registry activities to a third party. The reasons provided for outsourcing were efficiency (75 percent) and not having appropriate in-house systems (25 percent)

- All participants indicated that they formally identify, measure, mitigate, and monitor risks related to outsourcing administration functions or activities to third parties (e.g., Maitland, Silica etc.). Third-party providers' services are generally integrated within asset managers' operational processes and asset managers are materially dependent on them
- 75 percent of participants stated that they perform due diligence on vendors' ability to meet requirements on an on-going basis

**Reasons for outsourcing**



Our main concern in terms of operational activities is asset managers' reliance on third parties, where they do not necessarily have close oversight of such parties' control frameworks.

Our main concern in terms of operational activities is asset managers' reliance on third parties, where they do not necessarily have close oversight of such parties' control frameworks. Given this, we recommend more frequent monitoring of third parties and the formal inclusion of third-party risk in asset managers' risk appetite framework.

**3. Conclusion**

A sound investment management risk framework enables a proactive approach to the prevention of undue or extreme losses in client investment portfolios and thus contributes towards long-term performance and client retention. It also creates a platform for consistent risk management.

Based on international regulatory developments, local regulations are expected to become more stringent, and asset managers who prepare for the additional requirements early on will be at an advantage. ●



**To the point:**

- Investment management risk is the risk of losses arising from errors, negligence and operational incapability on the part of asset managers in charge of financial portfolios
- South African asset managers appear to have well-developed risk management practice levels; however, there are key gaps that need to be addressed
- 43 percent of firms indicate that the board, senior management, and audit risk committee are aware of but do not actively attend to investment risk and mandate compliance risk
- Asset managers have a strong reliance on third parties for their operational activities.
- 40 percent of respondents' policies do not ensure that there is adequate accountability for risk management decisions



# The evolution of the management company and third-party providers

## Jeremy Soutter

Chief Executive Officer  
Carne Global Funds (UK)

### There are thousands of small asset management firms managing US\$3-4 trillion in assets

The Top 500 global asset management firms manage some US\$81.2 trillion<sup>1</sup> in assets worldwide but there are thousands of smaller asset management firms managing another US\$3-4 trillion of assets, taking total global assets under management to just shy of US\$85 trillion (source below). Smaller asset managers (in relative terms) manage assets in both regulated schemes such as UCITS or 40 Act funds, and semi-regulated funds such as hedge funds, private equity, and infrastructure funds. For decades, a large number of the latter alternative fund managers could manage their assets with relatively little scrutiny or regulation. The bigger, more established firms had in-built governance and oversight functions and for a while, at least, new entrants to the regulated market had to factor the costs of providing that governance framework (including capital requirements) into their startup costs.

### Startup costs are prohibitive for smaller firms if all aspects of control are kept in house

We know that since the financial crisis, regulatory frameworks around the world have changed dramatically and, with the introduction of AIFMD and updates to MiFID and the UCITS directive, the world has changed for smaller investment firms. When considered alongside the requirement to create a governance and oversight framework, it is clear that European regulators were paying very close attention to the way this was being provided in practice. In Luxembourg, for example, the concept of having a “self-managed” fund became frowned upon, particularly from the perspective of non-EU countries where the funds could be distributed, such as Switzerland and Hong Kong. In the UK, the Financial Conduct Authority (FCA) struggled to come to terms with investment firms outsourcing their governance framework, particularly in relation to management companies or Authorized Corporate Directors (ACD).

This was highlighted by the FCA in June 2012, in a report entitled Retail Conduct Risk Outlook following a small number of high-profile failures of investment firms, one of which had a third-party management company. However, there was a marked shift in the regulatory view between 2012 and 2017 and it is now perfectly acceptable for managers with assets under management in the tens of billions to outsource the management function to a third party.

It was evident, however, that at the time the FCA felt that investment managers should take full responsibility for the risks they managed including governance and oversight. ➔

1. FCA Market Study Interim Findings 2016  
<https://www.fca.org.uk/publication/market-studies/ms15-2-2-interim-report.pdf>





Even large firms would struggle to build the necessary regulatory framework around such a diversified product model.



For large firms this is still the case, and it is unthinkable that a firm with hundreds of billions in assets under management would outsource its main governance and oversight functions, but for small to mid-sized firms things have changed. During a number of the FCA's roundtables following the launch of the FCA's Asset Management Study in 2016, the topic of innovation was often addressed by both the FCA and asset management firms. Neither party wanted to stifle this important part of business growth, as it has positive consequences for managers and clients alike. Naturally, the smaller independent firms and the diversified growth of the larger firms play a significant role in innovative growth, and it is these managers that feel the financial burden of governance and oversight the most. Indeed, large swathes of the industry would disappear overnight if all managers were forced to have their own governance and oversight models. Following some criticism in the FCA's initial report, it was significant that no mention was made of host ACDS in the FCA's final report issued in June 2017. This view was also influenced in part by the globalization of many firms and the diversification of the assets they manage. Product strategy and domiciliation play an important role in getting the right structures to investors in the right format. This has resulted in firms having products in multiple jurisdictions and in multiple structures and as we see growth continuing in the private market space these will become more widespread. Even large firms would struggle to build the necessary regulatory framework around such a diversified product model.

Another area of intense scrutiny globally has been that of independent oversight, particularly in relation to value for money, and costs and charges. Regulators have long been aware that the investment manager ultimately controls every link in the chain, from managing assets to the composition of the independent board responsible for oversight. For UK workplace pension schemes, the pension

provider must appoint an Independent Governance Committee (IGC) consisting of a minimum of five members, the majority of whom must be independent, including an independent chair. The IGC must also act solely in the interests of the relevant scheme members and must act independently of the provider. The UK pension fund industry has moved a step further than the US 40 Act mutual fund market where at least 40 percent of the board must be independent, but they too play a vital role as watchdogs and serve as a check on fund management and in safeguarding shareholder interests. Indeed, according to the US Supreme Court, independent directors have "the primary responsibility" for looking after the interests of the fund's shareholders and serve as "independent watchdogs" who "furnish an independent check" upon the management of the fund.

This lack of independence for the UK mutual fund market, particularly in the area of performance monitoring, was also brought up in the FCA's Asset Management Study Interim Report published in November 2016:

*5.51 We have found that AFM boards often fail to take appropriate and timely steps to address underperformance. They can also lack the authority within the group structure to challenge the commercial strategy set by more senior boards and executive committees. We found that where AFMs are part of the asset management group's corporate structure, with few or no independent directors, their directors face a significant conflict between their duties to the asset management group and their duties to the funds and their investors. In practice, we have observed that this conflict tends to be resolved in favour of the asset management group.* ➤







It was significant that no mention was made of host ACDs in the FCA's final report issued in June 2017.

The FCA went on to say that outsourcing the regulatory and legal responsibilities of the AFM would result in greater independence as the employees of the company to which responsibilities are outsourced do not work for the manager. They did, however, note that they can be sacked by the manager—so are they really independent?

*5.52 Instead of the typical AFM model described above, the asset management group sponsoring a fund range can approach a third party 'host Authorised Corporate Director' firm to perform the regulatory and legal responsibilities of the AFM.*

*Under this arrangement, AFM board members are unlikely to be employed by the asset management group and so might be expected to act with greater independence. However, the asset management group is clearly the client of the host Authorised Corporate Director firm, with the asset management group deciding on the selection and ongoing appointment of the host Authorised Corporate Director firm. This creates a similar conflict to that in the more typical in-house Authorised Corporate Director model and our supervision work indicates that host Authorised Corporate Directors are no more likely to assess value for money robustly than conventional AFM arrangements.*

On 5 April 2018 the FCA issued their long awaited first set of rules and remedies under the Asset Management Market Study. In this the FCA propose that AFMs appoint a minimum of two independent directors and for them to comprise at least 25 percent of the total board membership. Without creating truly independent oversight committees, it is difficult to see how investment managers could lose complete control over all the parties in the chain. However, the practice of outsourcing the governance and oversight framework is now fully acceptable and has matured.

As responsible entities, there is a new breed of firms rigorously challenging investment firms, providing technology solutions that better manage risks, and working more closely alongside them rather than acting as an external provider. ●

Source: <https://uk.reuters.com/article/uk-global-funds-aum/global-assets-under-management-hit-all-time-high-above-80-trillion-idUKKBN1CZ11L>

Source: <https://press.pwc.com/News-releases/global-assets-under-management-set-to-rise-to--145.4-trillion-by-2025/s/e236a113-5115-4421-9c75-77191733f15f>

### To the point:

- The era in which it was possible to manage alternative investment funds with little scrutiny or regulation is well behind us
- The cost of providing governance and oversight can be prohibitive for smaller entities or new entrants
- Regulators understand that forcing smaller players and new entrants to keep the governance framework in-house would make the market too difficult to operate in and stifle innovation
- The case for independence within the governance framework is now widely accepted
- Third-party management companies have evolved to become the accepted model for many small to mid-sized investment firms

Naturally, the smaller independent firms and the diversified growth of the larger firms play a significant role in innovative growth, and it is these managers that feel the financial burden of governance and oversight the most.

# The impact of new technology on fund distribution in Europe

## Insights from Pierre Davoust and fellow asset managers

**Laurent Collet**, Partner at Deloitte Luxembourg, had an interesting conversation with **Pierre Davoust**, Chief Executive Officer of IZNES, on the new era of digitalization, its challenges and prognosis for the future.

Extending far beyond bitcoin and cryptocurrencies, blockchain technology is bringing disintermediation to practically all industries. A survey from the World Economic Forum highlights that financial services will be transformed by this technology and that at least 10 percent of global GDP is expected to be stored on blockchain platforms by 2025.

The fund sector, which is seeking levers for processing optimization and relies heavily on financial service intermediaries such as transfer agents, fund registries, and fund administration agents, will be particularly affected by this.

Several initiatives and proof-of-concepts have been launched over the last two years to assess and demonstrate how blockchain can be used to reshape the fund distribution value chain for the future.

In this article, Pierre Davoust, CEO of SETL France—one of the founding counterparties of IZNES, along with six other French asset managers— shares his views on how the new technology is re-shaping fund distribution in Europe [➔](#)





**1. If we consider the current fund distribution value chain, which domains or processes might be affected by blockchain/DLT technology?**

A lot of domains in the current fund distribution value chain stand to be affected by blockchain technology. Processes likely to be affected may include, management of AML/ KYC procedures, maintenance of fund documentation, processing of subscription and redemption orders from initialization to settlement, record keeping of fund shares, and the management of corporate actions such as mergers or dividend payments.

**2. Will these new technologies disrupt the current value chain or enhance it? How do you see your role within the value chain?**

Blockchain technology will clearly disrupt the value chain because it will pave the way for the development of new business models and redistribute the different intermediary roles between asset managers and investors (transfer agents, CSDs, custodians, distributors, etc.).

The ambition of platforms like IZNES is to provide efficient fundamental infrastructures for fund unit distribution, on which added-value service providers (distributors, asset servicers, FinTechs, etc.) can connect to provide their services to customers.

Unlike most startups, we are focusing on the back-end, and not on the front-end, because we believe the back-end (i.e., the transaction and record-keeping infrastructure) needs to be rebuilt before efficient front-end services can be provided.

**3. From a customer experience perspective, how would the DLT add value for investors, fund promoters, and/or asset servicers?**

The fundamental added value of blockchain projects like IZNES is the ability to easily access data.

At present, intermediaries in the chain are opaque and a large quantity of information, relevant to the customers, is thus locked in the intermediary chain.

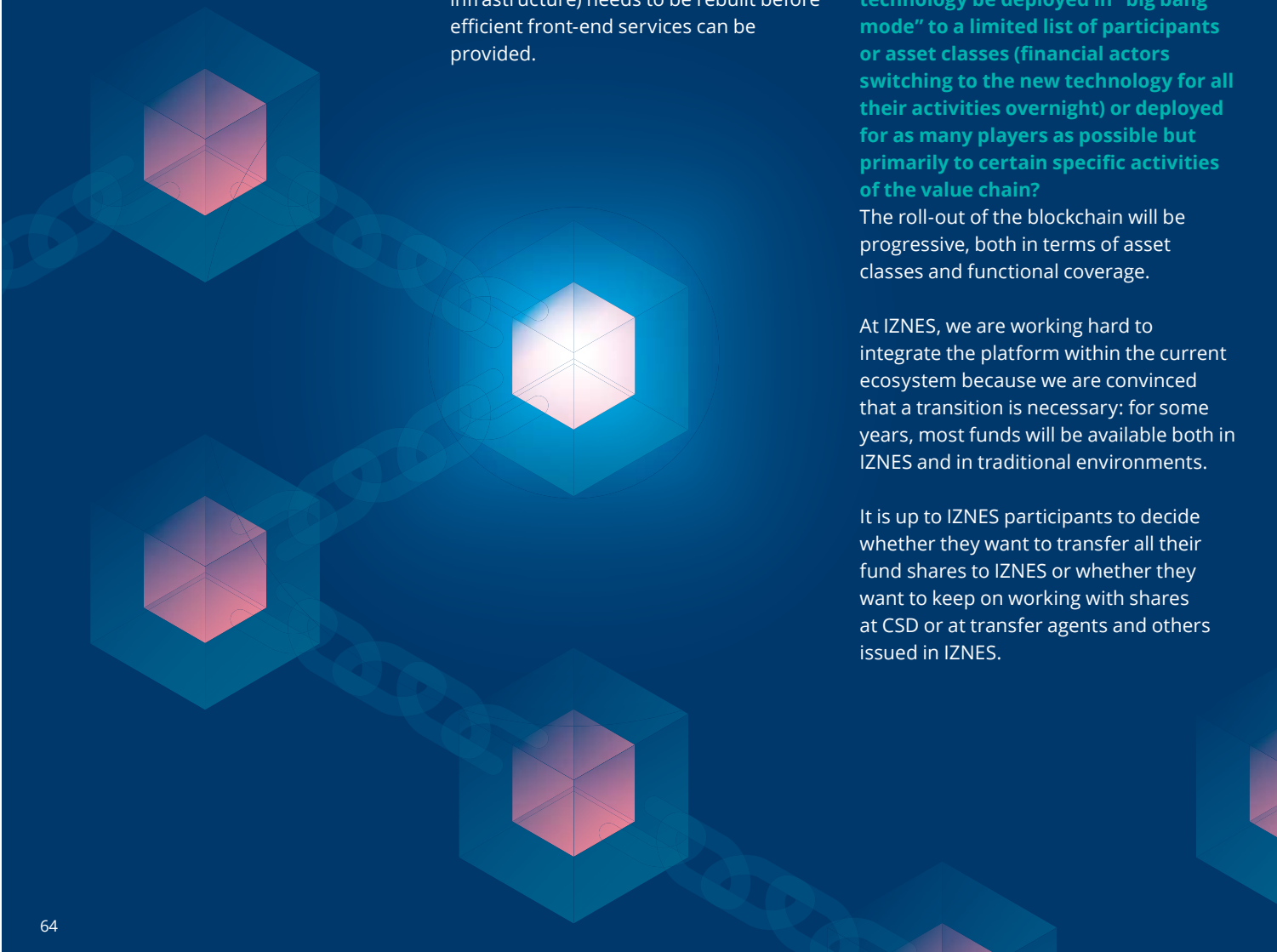
In the future, this information will be shared and ensure an unprecedented level of transparency. Of course, transparency has to be implemented in a wise manner: no market participant would like to see its transaction data shared with a competitor.

**4. How do you expect the roll-out of the DLT within the fund distribution industry to occur? Will blockchain technology be deployed in “big bang mode” to a limited list of participants or asset classes (financial actors switching to the new technology for all their activities overnight) or deployed for as many players as possible but primarily to certain specific activities of the value chain?**

The roll-out of the blockchain will be progressive, both in terms of asset classes and functional coverage.

At IZNES, we are working hard to integrate the platform within the current ecosystem because we are convinced that a transition is necessary: for some years, most funds will be available both in IZNES and in traditional environments.

It is up to IZNES participants to decide whether they want to transfer all their fund shares to IZNES or whether they want to keep on working with shares at CSD or at transfer agents and others issued in IZNES.



**5. We know that regulation has been and will be a key driver in the financial industry. How do you see the role of regulation regarding blockchain technology? Would regulation be a trigger to structure and even standardize the solutions on the market or would it instead be seen as a limitation to the DLT?**

Some regulators are very aware of the promise blockchain technology holds and are actively looking at the potential regulatory changes that the implementation of the technology may prompt.

For example, in France, major regulatory changes are currently being implemented following the adoption of the "Ordonnance Blockchain".

We know the CSSF is also working closely on blockchain topics and trying to foster the best elements of blockchain. Therefore, regulation is and will still be a trigger to structure the solutions on the market.

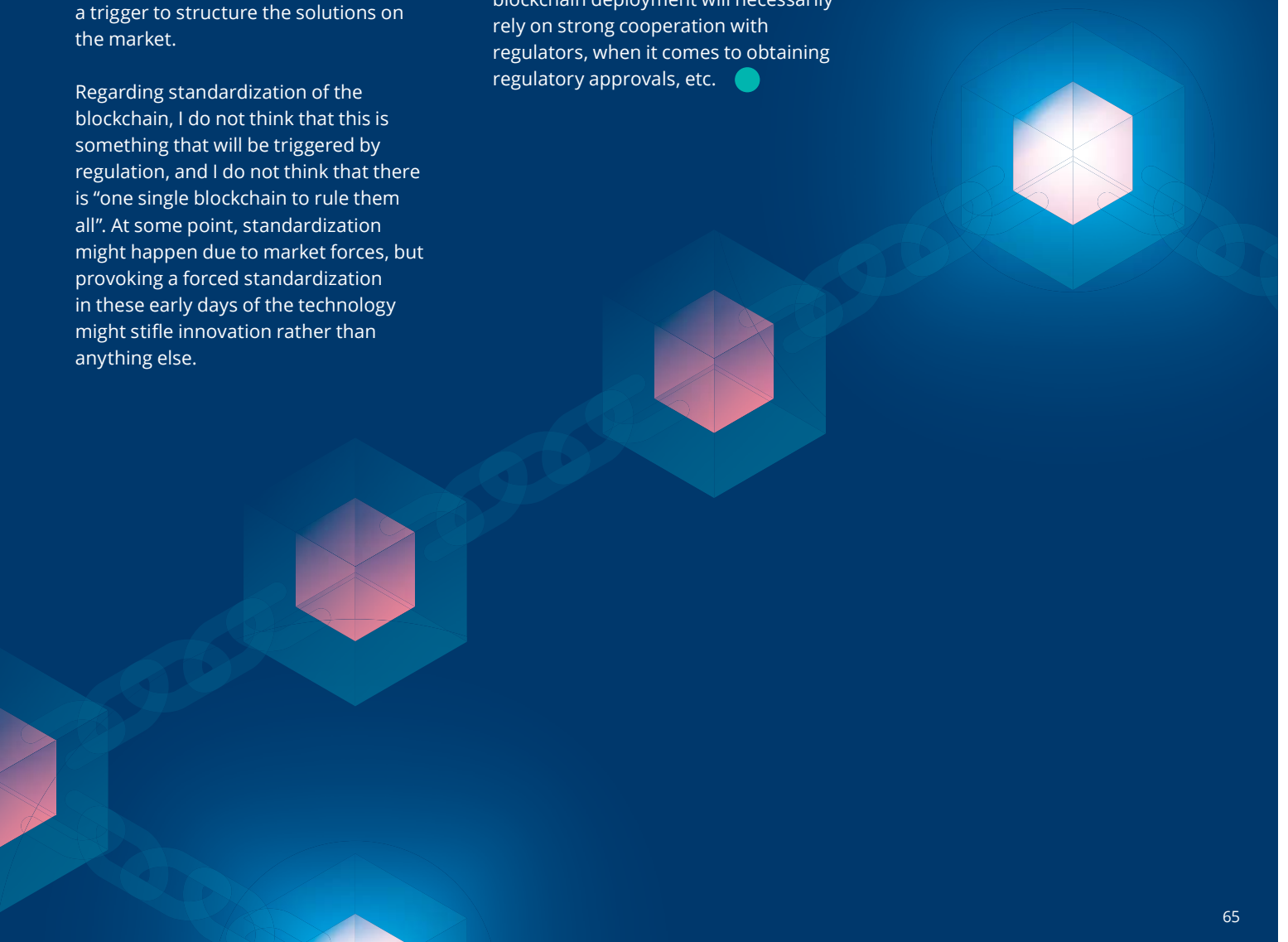
Regarding standardization of the blockchain, I do not think that this is something that will be triggered by regulation, and I do not think that there is "one single blockchain to rule them all". At some point, standardization might happen due to market forces, but provoking a forced standardization in these early days of the technology might stifle innovation rather than anything else.

**6. What would be, on the one hand, the upcoming challenges for the deployment of DLT on the market and, on the other hand, the key success factors for the DLT to be deployed on the market on a mass scale?**

There are three key success factors for the deployment of blockchain technology:

- The ability to gather a critical number of motivated actors around a real production project and to generate a sufficient network effect
- The robustness and stability of the technology: there is a world between developing a proof-of-concept and building a production-ready platform. Yet, most blockchain initiatives so far have been envisaged primarily from the perspective of the PoC. This gives projects with a clear delivery focus a key comparative advantage
- The cooperation with regulators: blockchain deployment will necessarily rely on strong cooperation with regulators, when it comes to obtaining regulatory approvals, etc. ●

Some regulators are very aware of the promise blockchain technology holds and are actively looking at the potential regulatory changes that the implementation of the technology may prompt.





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### Investment Funds

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- Investment Management Funds  
**31 May**
- Outsourcing  
**14 June**
- Regulated PERE funds  
**13 September**
- AML/KYC  
**27 September**
- Cyber Risk - threats and opportunities  
**11 October**
- Derivative Financial Instruments  
**25 October**
- Crypto Funds  
**22 November**
- The Delegated Asset Manager Due Diligence  
**06 December**



### Regulatory

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- PRIiPs and KID  
**17 May**
- Brexit: How this will/could shape/impact the European and Global Asset Management industry  
**28 June**



### Innovation & Technology

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- RPA (Robotics) in IM Industry  
**08 November**

For access to the sessions do not hesitate to contact [deloittelearn@deloitte.lu](mailto:deloittelearn@deloitte.lu)  
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