PerformanceMagazine

Issue 37
January 2022

Deloitte.

WELCOME TO ISSUE No.37

Performance 37

FOREWORD

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Welcome to a new year;
welcome to 2022;
welcome to the latest edition of Performance.

As ever, the beginning of a new year and the emergence of spring is cause for celebration and is a natural reminder for renewed resolution, a time to recalibrate our ideas for the future, and to hope for success and prosperity in all things, including our industry. And there is plenty to look forward to.

Our contributors are definitely stepping up, taking the recent struggles and instead seeing them as chances to adapt and evolve. From cryptoassets to currency challenges, to the opportunities that lay ahead for sustainable business models and ESG in the asset management industry, this is a time to seek out every opportunity.

Unsurprisingly, environmental, social, and governance factors continue to be a topic of major discussion amongst the sector's professionals. Michael Maldener, CEO of Sustaide, explains how credibility and confidence matter and are drivers for ESG product differentiation. He encourages us to put ourselves continuously to the test and to look beyond the traditional when building a sustainable business model. To ensure long-term market relevance, he advises us to commit and invest in products that provide concrete solutions with compelling evidence – not just another product that ticks the relevant boxes.

Keeping to this theme, we join a conversation between Wiebke Merbeth of Bayern Invest and Ingo Speich of Deka Investment and discuss how sustainability will be a key driver of risk and return in the financial industry. We cover how the EU's sustainable finance regulations are setting new standards affecting not only European asset managers, but our global colleagues and analyse the growing importance of reliable data and the need for it to be fully integrated into the portfolio management process. As asset managers profit from an increased demand in sustainable products, we look at how the market has become more regulated and therefore how strategies need to be adapted in order for firms to stay ahead.

Although cryptoassets are by no means a novel concept, their place in investment management is a relatively new field, and so there are still opportunities to be had. The possibility to open up new business areas and win new clients can be realized through distributed ledger technology and the many offerings cryptoassets can be applied to, from payment tokens to securitization via NFTs. There are already regulatory requirements in place so read on to see what needs to be taken into account when integrating cryptoassets into existing business models.

Yet while we strive to create the work environment of tomorrow with increased digitalization of so many aspects of our industry, there are still traditional methods which can never be replaced. In particular, the importance of the personal touch. Deloitte Germany's Christian Boeth and Leif Schönstedt of Union Investment Institutional GmbH agree that although technological implementation and stability did not pose problems at the onset of the pandemic, the inability for direct client contact, did. In an increasingly digital world, it is important to focus on the human aspect and significance of personal customer communication.

We hope you enjoy this 37th edition of Performance.

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EDITORIAL

In December, the Fed and ECB indicated a turnaround in their policy regarding zero-interest rates in response to inflation as well as the economic impact of the COVID-19 pandemic. On 19 January 2022 , the yield on 10-year Bunds rose above zero for the first time in 141 weeks, likely linked to the long-term development of capital market interest rates in the eurozone. The development of inflation in the US and the eurozone will be decisive in the further development of interest rates.

The economic consequences seem clear, and yet for me , the current situation is exceptional and therefore, more challenging than ever before. In addition to geopolitical topics, the following points contribute to this:

01. Uncertainty about the further development of the pandemic and its economic consequences (production including a functioning supply chain, health care system, etc.);
02. Capital market analysts are not only looking at what the central banks are doing, but are also considering the latest developments in the digital assets market, in particular, cryptocurrencies;
03. Supply bottlenecks have reached consumers;
04. Sustainability is driving many areas of the financial industry due to European regulation. The younger generations are driving the true sustainable behavior across the board;
05. Generations Y and Z, together with a growing scarcity of resources, are changing the way we work (e.g. the UN's reference to the New Way of Working or NWOW);
06. Digitalization increases pace in all areas and thus often the complexity. Algorithms determine the information attributed to oneself;
07. Digitalization and automation make many things possible (in particular, continuing to generate economic growth in the last two years despite the pandemic); and
08. New risk fields are emerging. Cyber risk is omnipresent while social media can threaten mental health and have the 'power' to divide people and incite hatred.

Despite these fears, the investment management industry in Germany achieved another record year in 2021. During such unprecedented times, it is quite remarkable that the capital market has benefited from many positive developments, with the pandemic—thus far—only responsible for brief downward movements.
In total, Germany's investment management industry managed assets of €4,272 billion as of the end of November. By this time, €209 billion in inflows had been recorded, divided equally between mutual and special funds, while sustainable funds accounted for 25% of the inflows, mainly in mutual funds.

According to a BVI survey conducted last fall among the executives of its member companies, the fund industry expects 2022 to continue to develop well and even surpass the record year of 2021. To this end, fund companies intend to increase their workforce and invest further in digitization. In portfolio management, the collection and analysis of large volumes of data and the use of artificial intelligence will be an area of investment, while the overall digitization of processes will be driven forward including protection against cyberattacks.

I am excited about what opportunities the year 2022 will bring us. For now, I wish you an enjoyable read.

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The German Fund Jurisdiction Act

WHAT ARE THE CHANGES FOR INVESTMENT MANAGEMENT FIRMS?

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INTRODUCTION

The Fund Jurisdiction Act aims to strengthen Germany as a fund jurisdiction, specifically through expanding its product range, integrating European sustainability aspects, and standardizing regulations on cross-border distribution.

But what are the key points of this new legislation and, as an asset manager, what opportunities can you seize going forward?

In April 2021, the German legislative passed the Fund Jurisdiction Act (the Fondsstandortgesetz, or FoStoG), which came into force in August 2021 with a few exceptions. The FoStoG will adjust several regulations —here is a brief oversight of these changes.

In this article, we will focus on the key changes for investment management firms.

TO THE POINT

The Fund Jurisdiction Act opens a world of opportunities for asset managers. Firms can expand their product range by launching new fund vehicles, such as open-ended infrastructure funds. There are also new opportunities for open-ended real estate special funds or open-ended special domestic AIFs.

Other changes that could require asset managers to adjust their operational models include the digitalization of supervision, the integration of European sustainability aspects, and the standardization of regulations on cross-border distribution.

		KAGB	Various adjustments / changes
Incorporation of EU regulations (Transparency / Taxonomy Regulation)	WpHG	UStG	Extension of the VAT exemption for the management of venture capital funds
Promotion of employee share ownership, especially for start-ups	EStG	DerivateV	Conversion of notification obligations to electronic procedures; establishment of a synchronisation with the ESMA Guidelines for competent authorities and UCITS management companies
Inclusion of EU regulations (Transparency / Taxonomy Regulation)	VAG	FinDAG-KostV	Extension of fee elements
Subsequent changes due to KAGB amendments	BaFin-BefugV	KAPrüfbV	Clarification: BaFin may determine focal points of examination in "normal cases"; consequential changes due to KAGB amendments
Clarification of the treatment under social security law in accordance with the new regulations on employee share ownership	SveV	KAVerOV	Consequential changes due to KAGB amendments
Subsequent changes due to KAGB amendments, facilitation of report submission (electr.)	KARBV	BewG	Clarifications regarding the determination of the standard ground value

Expansion of product range for fund managers

For fund managers, the most interesting point of the new legislation is probably the expansion of permitted products. With the open-ended infrastructure fund, a suitable fund vehicle is created that enables smaller investors to invest in infrastructure project companies. The regulations in this regard are based on those of open-ended real estate investment funds.

The specifics on the permissible assets, investment limits and redemption principles are set out under sections 260a to 260d KAGB. For example, the redemption of units is only possible on certain redemption dates, once every six months at the least and once a year at the most.

In addition to the corporate form of the investment fund, fund managers are able to set up the open-ended infrastructure investment fund as Investmentkommandit-Gesellschaften (investment limited partnerships). However, this is only possible for special AIFs. This corporate form can also be used for open-ended real estate investment funds.

The FoStoG also introduces master-feeder structures for closed-ended funds. The regulations for these are largely based on those of open master-feeder structures.

As well as the fund vehicles already mentioned, closed-ended special AIFs may also be launched as special assets in the future (section 139 KAGB). The regulations that already apply to open-ended investment funds also apply to closed-ended ones, insofar as they apply to (German) special AIFs. The exception is section 98 KAGB regarding the redemption of units, as units cannot be redeemed for closed-ended funds before the end of their term.

Finally, the expanded product range includes a separate fund category for development promotion funds, which can be launched as open or closed domestic special AIFs. These special AIFs may only invest in assets that measurably contribute to achieving sustainable development goals in developing countries and territories. The specific regulations are from section 292a ff KAGB. And, section 28a KAGB imposes additional organizational requirements for the asset management firm that manages these development promotion funds.

Increased product design flexibility

The FoStoG provides fund managers more flexibility in the design of their fund vehicles.

In the case of open-ended real estate investment funds, the granting of shareholder loans to wholly owned subsidiaries is made easier. Before, these funds needed to hold properties themselves to be able to grant loans to wholly owned subsidiaries. this requirement no longer exists; therefore, loans can now also be granted to so-called holding companies. Investment limits have also been removed pursuant to section 240 para. 2 KAGB. It is now possible for this fund vehicle to enter into joint ventures with a 100% participation, as well as indirect participation in Germany. Previously, this was only possible abroad and joint ventures could not be entered into.

Likewise, there are also changes to the open-ended domestic special AIFs with fixed investment conditions. Section 284 KAGB allows the possibility of investing in infrastructure project companies. The permissible borrowing limit has been raised from 50% to 60%, and fund managers are also given more flexibility in granting loans to real estate companies. Finally, open-ended domestic special AIFs with fixed investment conditions pursuant to section 284 para. 2 KAGB can now invest in crypto securities within the meaning of section 1 para. 11 sentence 4 KWG, provided their market value can be determined. It should be noted that a maximum of 20% of the value of the open-ended domestic special AIF with fixed investment conditions may be invested in this asset class.

Digitization of supervision

Due to the digital transformation of supervisory bodies, electronic communications will soon be the rule for investment management firms, with the relevant regulations coming into force on 1 April 2023. The Federal Financial Supervisory Authority will provide a procedure with which investment management firms can electronically transmit notifications, applications, notices, documents and information, as well as evidence. The specific regulations are covered in section 7b KAGB. The switch to electronic communication will result in cost savings for investment funds and, therefore, also for investors.

Cross-border distribution of investment funds

During the transposition of Directive (EU) 2019/1160 into national law, regulations on the cross-border marketing of investment funds were introduced in the KAGB by the FoStoG. Sections 295a, b KAGB set out the revocation requirements of the cross-border marketing of EU UCITS and AIF in Germany, as well as the associated information obligations to investors. Similar provisions were also included for UCITS, EU AIFs and domestic AIFs in the case of revocation of marketing in EU or EEA member states with sections 313a, 331a KAGB.

Another element of Directive (EU) 2019/1160 was included in section 306a KAGB—requiring an investment management firm to provide a distribution facility for private investors. This facility must, among other things, process subscriptions, payments, redemptions and conversion orders from investors and inform investors about their rights. It also serves as a point of contact for communications with the Bundesanstalt.

Furthermore, when a domestic investment management firm markets domestic UCITS or AIFs to private investors, a separate institution does not need to be provided. In this case, the investment management company itself can assume the tasks of the institution.

Electronic transmission of:

Announcements
E.g., appointment/resignation of members of the advisory board/ supervisory board (section 18 (4) sentence 2 KAGB); acquisition/ relinquishment of significant participation (section 19 (1), (5) KAGB); appointment/resignation of the management board (section 34 KAGB); and notifications of the marketing of UCITS, AIF in Germany

Application
E.g., permission; registration; approval outsourcing portfolio management, risk management; and approval selection/change of depositary

Notifications
E.g., appointment of external valuers for open-ended public AIFs (section 216 (5) KAGB) and exceeding/falling below thresholds for shares in unlisted companies (section 289 (1) KAGB)

Documents and information
E.g., submission of annual financial statements, management reports and audit reports (section 38 (1) sentence 2 KAGB), investment terms and conditions of sub-funds and their material changes, and sales prospectuses and material investor information for UCITS KVGs (section 164 (4), (5) KAGB)

Evidence
E.g., cessation of the distribution of units or shares in AIF (section 315 (1) sentence 1 KAGB), and restrictions regarding external valuers - max. 3 years, max. 30% (section 250 (2) sentence 3 KAGB)

to the Bundesanstalt, via an electronic communication procedure
Cost savings for the investment funds and, therefore, also for investors

Pre-marketing
The Directive (EU) 2019/1160's pre-marketing regulations were also transposed into the KAGB. Pre-marketing refers to the direct or indirect provision of information or communications on investment strategies or investment concepts to potential professional and semi-professional investors. This process aims to determine investors' potential interest in an AIF or sub-investment asset that is either not yet authorized in the state, or is authorized but has not yet been notified for marketing.

The definition of pre-marketing also applies to UCITS management companies, provided they act as third parties for an AIF management company pursuant to section 51 (4) sentences 1, 4 in conjunction with section 306b (6) KAGB. Until now, the measures of a capital management company in the run-up to the actual marketing were not covered by law. Now, the provisions must be considered accordingly, particularly for activities carried out before marketing begins.

Integration of European sustainability aspects
The (EU) 2019/2088 ("Transparency Regulation") and (EU) 2020/852 ("Taxonomy Regulation") were adopted as part of the European Commission's Sustainable Finance Action Plan. The FoStoG anchors the resulting environmental, social and governance (ESG) information requirements into the KAGB. This overview shows where these regulations' provisions have been inserted into the draft KAGB.

Further innovations for fund managers
Alongside the significant innovations already discussed, the following two areas are also worth mentioning. The FoStoG abolishes numerous written form requirements and the use of a durable data medium to inform investors (unless prescribed by EU law) within the KAGB. This reduction in bureaucracy increases the flexibility of investment management firms.

Likewise, the disclosure period of closed-ended public investment companies with fixed capital and closed-ended public investment companies was extended from six to nine months. Therefore, asset managers need only prepare an annual report six months after the end of the financial year, which should be submitted to the auditor for auditing purposes and presented in the general meeting or to investors for approval. The actual publication in the Bundesanzeiger can take place nine months after the end of the financial year.

Regulation (EU) 2019/2088 (Transparency Regulation)
Sustainability-related disclosure requirements in the financial services sector
> Entered into force on 10 March 2021

European Commission tightens sustainability criteria (ESG)
Sustainable Finance Action Plan
> Regulations have been published that make legal adjustments necessary:
Regulation (EU) 2019/2088
Regulation (EU) 2020/852

Regulation (EU) 2020/852 (Taxonomy Regulation)
Establish a framework to facilitate sustainable investment
> Staggered entry into force

The FoStoG anchors the ESG regulations in the KAGB
In particular, sections 101, 121, 136, 165 and 307 of the KAGB are supplemented or amended to include the corresponding ESG requirements.

§ 121 KAGB, § 136 KAGB
Additional points KVG audit inter alia fulfillment of transparency obligations in the strategies for dealing with sustainability risks as well as in pre-contractual information at the level of the financial product, etc.

§ 121 KAGB, § 136 KAGB
... Compliance with the disclosure obligation (information on the impact of sustainable financial products/information on whether, how and to what extent ecologically sustainable economic activities are taken into account in investment decisions.)

§ 165 Abs. 2 Nr. 42 KAGB
Prospectus: transparency regarding sustainability risks, adverse sustainability impacts on the fund, promotion of environmental/social features, sustainable investments, etc.

§ 165 Abs. 2 Nr. 42 KAGB
... transparency as to whether, how and to what extent environmentally sustainable economic activities are taken into account in the investment decisions of a financial product.

§ 307 Abs. 1 S. 2 Nr. 20 KAGB
Professional and semi-professional investors must be provided with pre-contractual information on how to deal with sustainability aspects in accordance with the EU regulations.

§ 101 Abs. 1 S. 3 Nr. 7 KAGB
Annual report of an investment fund shall contain findings on the disclosure of information on the impact of sustainable financial products.

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CONCLUSION

Summary of your opportunities as an investment fund manager
The FoStoG creates many new opportunities for investment management firms. Below, we have listed the essential questions that firms should ask themselves, and how we at Deloitte can support you in this regard.

01. Do you want to expand your product range and be a pioneer in launching new fund vehicles? We look forward to providing you full support for this project, from extending your license to fund distribution.

02. Do you have open-ended real estate special funds or open-ended domestic special AIFs with fixed investment conditions in your product portfolio? We would be happy to examine new possibilities for you, e.g., concerning joint venture investments.

03. Once the Bundesanstalt provides its electronic communication procedure, you will need to act. But what is the best way to integrate this procedure into your existing processes? We will work closely with you to establish the necessary IT precautions and the required process adjustments to ensure seamless integration.

04. Do you market foreign UCITS or AIFs? If so, you will need to provide a separate facility for distribution to private investors. We will also work closely with you to make the necessary arrangements.

05. Do you want to market a product to semi-professional or professional investors and wish to test the market's interest beforehand? If so, the legal obligations regarding pre-marketing are set to change. We are looking forward to helping you review your pre-marketing processes to make the necessary adjustments.

06. The Sustainable Finance Disclosure Regulation (SFDR) apply from March 2021 for Level 1 and for Level 2 from January 2022. Are you prepared? Deloitte has already successfully supported some companies to implement these new regulations. You can rest assured that you can count on our know-how in this regard.

Opportunity awaits

CRYPTO-ASSETS IN INVESTMENT MANAGEMENT

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INTRODUCTION

Bitcoin has become a popular investment following its rapid increase in value. In addition to Bitcoin, which is the largest cryptocurrency in terms of market capitalization, there are now over 10,000 different cryptocurrencies worldwide, creating a new asset class for investors. With the increasing number of cryptocurrencies, the current market capitalization of €1.517 billion (as of 27 July 2021) is also rising.

With the growing importance of crypto-assets, the regulatory framework is also being adapted continuously. The introduction of both the Amendment to the Money Laundering Act and the MiCA regulation, for example, represent a significant step in the regulation of these new forms of investment, which is likely to have a strong influence on the financial world in Europe. Furthermore, the technology behind cryptocurrencies—the blockchain—is increasingly influencing the regulatory environment. For example, since the law on the introduction of electronic securities was passed, it is possible to process the paper certificate, that was required as a part of the documentation of a securities transaction, optionally in digital form, e.g. via a decentralized crypto securities register.

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Overview

In response to the global financial crisis of 2008/2009, a computer scientist or group of computer scientists who called themselves Satoshi Nakamoto published a white paper on a digital currency called Bitcoin. It was supposed to allow people all over the world to exchange monetary values without having to rely on banks, accounts, or credit cards.

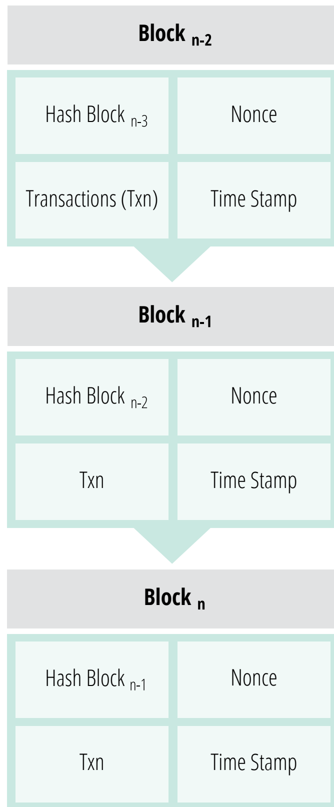
Before the rapid rise of Bitcoin, the internet was mainly used for communication and as a source of information. It absorbed the previous sources of information such as radio, newspapers, and television and bundled them into an Internet of Information. Information could thus be exchanged and shared worldwide via the internet in a matter of seconds. Bitcoin follows on from this principle. Unlike a bank transfer abroad, which takes several days and incurs high fees, Bitcoin now also offers the possibility of exchanging values over the Internet almost instantaneously and at manageable costs, and has thus heralded the development of an Internet of Value.

Instead of relying on banks or other financial service providers as intermediaries, Bitcoin uses a network of computers distributed around the world to keep a common log, called a distributed ledger, of all past transactions. Due to the general accessibility of this ledger and the accompanying decentralization, the digital currency is completely independent of external third parties or central authorities.

Distributed ledger technology using the Bitcoin Blockchain as an example

The Blockchain is a form of a distributed ledger technology in which the respective transaction information, time stamps, and a random number, 'number only used once' (nonce), are stored in blocks. Each block also contains information from the previous block like a fingerprint, the so-called 'hash'. The chaining of these blocks represents the blockchain:

Figure 1. Linking the information blocks to the blockchain



The mode of operation outlined refers to the Bitcoin blockchain (other blockchains may differ in their mechanism).

The hash of a block is derived from the information within a block — the input —using a hash function such as MD5[23] or SHA-256[24]. In simple terms, hash functions are mathematical operations that calculate a specific result of always the same size from the respective input based on an algorithm. For example, the SHA-256 hash of the word "Deloitte" is:

„f3f5cc986b466b373e36cd7ae0091abe13bcbb26b6fd79e520a66d7e2ef3758c",

while the SHA-256 hash of "Deloitte DCE" is the following:

„d6c24f045e89265a3cbd855acb0b04d93bf95ab3fa0d7d2e6cc1a595273f9905".

Although the changes to the input were marginal, the results are completely different. As a result, even the smallest changes from past transactions would trigger a domino effect and therefore cannot be carried out unnoticed.

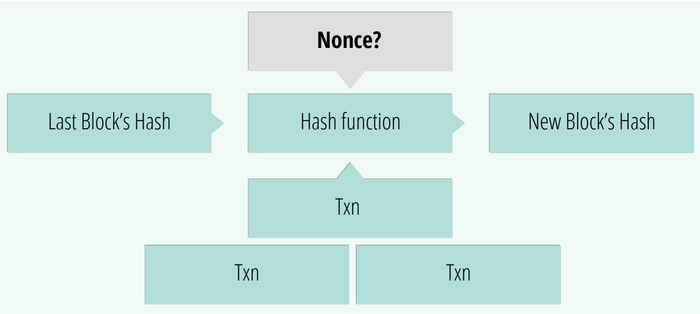
In order for the transactions to actually be attached in a block to the blockchain, confirmation by the network participants is required. This confirmation is done by generating the hash of the new block that has to be confirmed. However, the hash to be calculated must meet certain criteria specified in the Blockchain protocol. Since the nonce is the only variable input, it must be selected so that the new hash of the block to be confirmed meets this criteria. From a technical point of view, it is currently impossible to infer the input of the hash function

TO THE POINT

01. Crypto-assets and services in the field of distributed ledger technology (DLT) offer various opportunities to open up new business areas and win new clients. There are many different types of crypto-assets which can be used in a wide range of applications, for example as a payment tool (payment tokens) or as a securitization of a work of art with an NFT, while the DLT can replace intermediaries such as securities clearing.
02. Despite being a relatively new field, some regulatory requirements have already been established and must be taken into account when integrating crypto-assets into existing business models. At the European level, the markets in crypto-assets (MiCa) is the first step towards a uniform regulation.

from the output in a reasonable amount of time, so the correct nonce must be found by trial and error:

Figure 2. Confirmation of new blocks



This process is called mining. Guessing the correct nonce is extremely time and energy consuming but is rewarded with a certain number of Bitcoins. The incentive is not to do this for blocks with invalid transactions since the confirmation process for the next block to be confirmed would expose them as invalid and thus the Bitcoins received for guessing the correct nonce would also become invalid. This mechanism is called proof-of-work (PoW) and helps to find a consensus between all participants in the Blockchain network about the transactions.

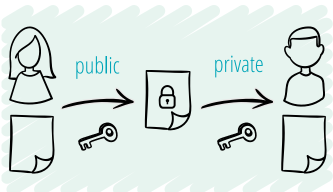
Digital signature on the Bitcoin blockchain

For every transaction that takes place between two participants on the Bitcoin blockchain, it is precisely documented which path the transferred cryptocurrencies take. This ensures that the entire system remains reliable and trustworthy. This is achieved with a unique so-called pair of keys for every participant, which consists of a private key and a public key. Both keys are mathematically related which ensures that encryptions done with one key can only be decrypted with the other key and none of the two keys can be derived from the other one. The key pair allows each participant to sign his or her transactions clearly verifiable by all other participants.

For example, if Alice wants to make sure that she is sending a transaction to Bob and no one else in Alice's name, Alice encrypts her transaction with her private key. Bob then verifies this transaction by decrypting it with Alice's public key which is – as the name says – publicly available. The decryption only works with Alice's public key, if it was encrypted by Alice's private key and so Bob can be sure that Alice send this transaction.

According to this procedure, Bob is able to receive encrypted

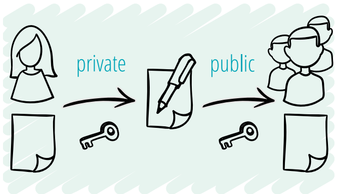
Figure 3. Digital Signature



transactions with his public key, which can only be decrypted with his private key, but any other person in the network who has Bob's public key can also send encrypted transactions to Bob in Alice's name.

This circumstance is solved by Alice also **signing** the transaction with her private key. Bob can thus ensure that the respective transaction was actually initiated by Alice by verifying Alice's signature with Alice's public key.

Figure 4. Signature by private key



Types of token

A token can be defined as a unit of value in an ecosystem based on a technological platform. It can be equated with a kind of container for the most diverse use cases. Depending on the properties and characteristics of the respective token, a more granular classification is made. The technical application possibilities of a token are almost unlimited. For example, rights or real objects can be securitized in the form of a token and made tradable via the technological platform using the distributed ledger technology. This process is called tokenization. Depending on the design of the token, it is categorized as a fungible or non-fungible token (NFT). The following categorization of tokens is based on the discussion paper of the European Financial Reporting Advisory Group, "Accounting For Crypto-Assets (Liabilities)".

Fungible tokens

Fungible tokens are identical in their design and are fully interchangeable. Similar to fiat money, a 50 cent coin always has the same value as another 50 cent coin. Fungible tokens can in turn be divided into the categories of payment, asset-backed, and utility.

01. Payment tokens:
While a payment token, such as Bitcoin, exists independently on its own blockchain, other token types each operate on a dependent blockchain. The payment token is the most original form of cryptocurrency and is not backed by any value. Similar to gold or cash, the payment token is intended to serve as a medium of exchange and enable all kinds of purchases, sales, and other financial transactions without involving a third, regulating party. A special form of payment token is the so-called **stablecoin**, which aims to mirror as closely as possible the value of a corresponding fiat currency, such as the US dollar, and is often backed by it as an underlying asset. They are used to counteract the volatility of the crypto markets.

02. Security tokens: Security and utility tokens are each located on a dependent blockchain. The best-known example on which such tokens operate is the Ethereum blockchain, on which a large number of tokens exist and use the existing infrastructure of the Ethereum blockchain as so-called E**thereum Request for Comments (ERC)-20 tokens.**

A security token connects a cryptocurrency with the real world by representing a real asset in the form of a token generated on the blockchain and thus making it tradable. This describes the so-called process of tokenization, whereby the newly created tokens are comparable to traditional securities. In addition, security tokens also exist, which in turn are backed by other cryptocurrencies. Depending on the underlying asset, the security token can be further divided into equity, deb,t or real assets.

03. Utility tokens: A utility token is linked to a specific use and is therefore also called a usage token. The utility token is similar to those used in earlier arcades, where certain coins were required to use the machines. It can also be used as a voucher to be redeemed in a certain shop. At the same time, there must be no financial incentive to hold the corresponding token.

04. Hybrid tokens: A hybrid token combines the characteristics of the aforementioned tokens. Depending on the design, it can embody certain rights similar to security or utility tokens or, if accepted, be used as a means of payment like a payment token. This is particularly the case for some utility tokens if the issuers also aim to use the token as a payment or means of payment over time.

05. Pre-functional tokens:
A pre-functional token is the preliminary form of another token. This is issued before the start of the respective network or service and can already be traded, but not yet used, for the intended purpose. Accordingly, they offer no benefit in this form.

Pre-functional tokens are usually, but not necessarily, converted into utility tokens when the network or service is launched.

Non-fungible tokens

Unlike fungible tokens, each NFT is unique. This means that a NFT can represent the ownership of an asset with certain characteristics, such as a work of art or a patent, and can be made tradable via blockchain. On the Ethereum blockchain, these types of tokens can be found as **ERC-721** and **ERC-1155** tokens. One of the best-known use cases of the ERC-721 standard for creating NFTs is the game, CryptoKitties, in which the purchase of ownership and trading of unique 'crypto-cats' is available. The ERC-1155 standard goes

one step further by allowing the creation of both fungible tokens and NFTs. For example, it makes it possible to use an NFT as collateral for taking out a loan in non-fungible tokens.

Regulatory framework of crypto-assets in investment management

Due to the increasing number and importance of crypto-assets, the regulatory framework is also being continuously adapted and expanded. The EU's proposal to regulate the crypto market and the subsequent MiCA as part of the package for the digitalization of the financial sector, are intended to create uniform, EU-wide rules for dealing with digital currencies and crypto-assets. With the introduction of the Electronic Securities Act (eWpG) at national level, a step has also been taken towards the digitalization of securities law, and further regulatory measures will have to follow. For example, associations such as the German Investment and Asset Management Association (BVI) have recently criticized that too little is currently being adopted to create a 'level playing field' in existing laws.

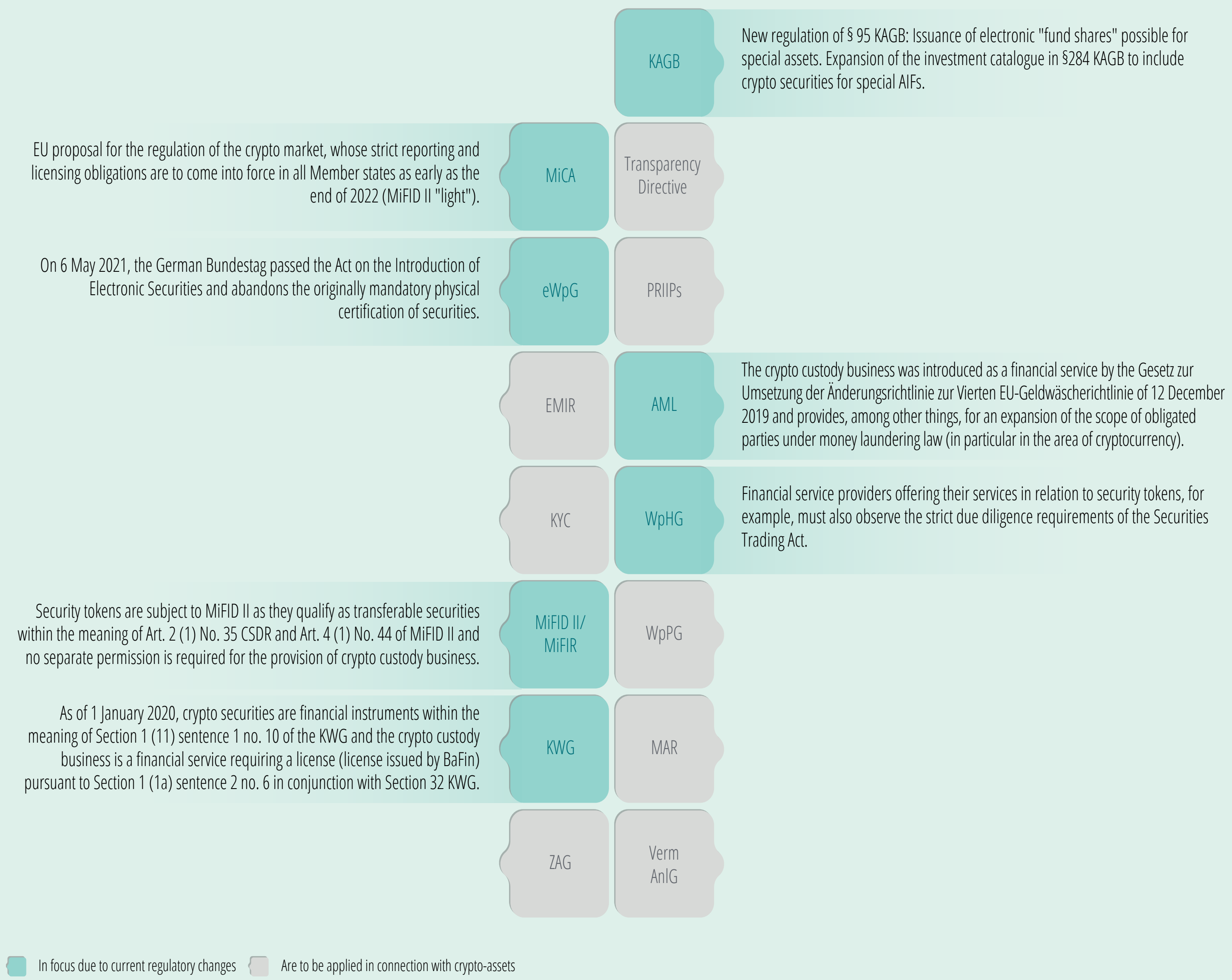
Nevertheless, various laws relevant to crypto-assets must already be applied. An overview of the applicable regulations can be found in Figure 5.

MiCA

With the Markets in Crypto-Assets regulations (MiCA), a proposal for an EU-wide regulation of crypto-assets was published on 24 September 2020. The MiCA is to apply equally to crypto issuers and service providers from the end of 2022.

The aim of the regulation is the homogeneous treatment of crypto-assets in the European economic area

Figure 5. Overview of applicable regulations in the context of crypto-assets



in order not to create any locational disadvantages through a common basis in the emerging market worth billions. With this regulation, the European Commission is trying to capture and categorize the diversity of the crypto landscape. For this purpose, it provides detailed rules that are integrated into the existing financial market regulations. In this way, market manipulation and insider trading can be punished accordingly in the future. The aim is to protect trading in cryptocurrencies against accusations of money laundering and terrorist financing and thus gain further trust among investors.

MiCA will be accompanied by further legislative proposals in the future. For example, the Commission proposes that the term "financial instrument" according to MiFID II should also include such financial products based on DLT. A pilot regulation for DLT market infrastructures is also being discussed. The pilot regulation would enable a test phase in a secure environment and is intended to provide indications for possible further changes. This should drive the further use and exploitation of the potential of crypto-assets.

The Electronic Securities Act (eWpG)

In addition to EU-wide regulation via MiCA, existing laws are also being changed and new regulations created at the federal level. The eWpG was passed by the German Bundestag on 6 May 2021 and opens up new possibilities for issuers with the introduction of digital securities. In the future, as an alternative to the traditional securitization in a certificate, bearer bonds can also be issued digitally as crypto securities using an electronic securities register. According to the eWpG, electronic securities are treated as property in the sense of civil law (§ 2 para. 3 eWpG). This leads to legal certainty in the transfer of electronic securities and makes them negotiable. According to the eWpG, a distinction must be made between two types of electronic securities and registers:

01. Electronic securities and a central electronic register managed by a CSD authorized in accordance with Article 16 CSDR; or

02. Crypto securities and crypto securities registers managed by a licensed crypto-custodian or a licensed issuer.

In order to ensure a harmonized integration of electronic securities into the existing regulatory framework, the eWpG introduces amendments to, among others, the KAGB, the KWG, the Securities Prospectus Act, the Custody Act, and the Stock Exchange Admission Ordinance.

The KAGB

On the German level, crypto-assets are not permissible assets for UCITS according to §§ 193-198 KAGB. Consequently, UCITS are not allowed to invest in crypto-assets. For public AIFS, there is generally increased flexibility in terms of permissible assets when compared to UCITS. However, crypto-assets are not permissible assets under sections 219, 221, 261 of the KAGB either. As a result, private investors are currently unable to invest indirectly in crypto-assets via funds. An exception here are the electronic securities which were issued according to the eWpG described above (§95 KAGB). However, there are already some funds, generally based on synthetic solutions, that offer private investors the opportunity to invest in cryptocurrencies. For professional investors, however, there is now a corresponding change in the KAGB. With the enforcement of the Fund Jurisdiction Act, cryptocurrencies have been added to the investment catalogue as a permissible asset for open domestic special AIFs with fixed investment conditions in accordance with §284 KAGB.

The KWG

A further step was taken in the regulation of crypto-assets within Germany with the Gesetz zur Umsetzung der Änderungsrichtlinie zur Vierten EU-Geldwäscherichtlinie, which stated that crypto-assets were incorporated into the KWG and MiFID/MiFIR. This law expanded the circle of obligated parties and had an impact on the KWG, among other regulations.

According to Section 1 (1a) Sentence 2 No. 6 of the KWG, crypto custody business is now defined as the custody, administration, and safeguarding of crypto-assets for others, as well as for the safeguarding of private cryptographic keys used to hold, store, and transfer crypto-assets.

Furthermore, crypto custody is now considered a financial service for the purposes of the KWG, as crypto-assets are digital representations of value. This value is not issued or guaranteed by any central bank or public body and does not have the legal status of currency or money, but can be accepted by natural or legal persons on the basis of an agreement as a means of exchange or payment. They can serve investment purposes and be transferred, stored, and traded electronically.

Possible applications for investment managers

Investment

For investment managers, cryptocurrencies as a new asset class offer new investment opportunities. Cryptocurrencies are currently en vogue and market capitalization of the best-known coins has risen sharply in recent quarters. The interest of investors in cryptocurrencies, or products that invest in cryptocurrencies, offers investment managers the opportunity to expand their business. Furthermore, investing in digital securities potentially offers additional benefits such as increased speed, liquidity, transparency, and security.

Tokenization of assets and funds

In addition, assets and funds can be tokenized. In particular, tokenization of illiquid alternative assets tends to have the greatest impact on price and market efficiency due to higher liquidity and trading volumes and thus lower spreads. When tokenizing funds and issuing digital tranches, issuers benefit from higher transaction speed through faster settlements and generally enable a reduction in fees. Thus, it would be conceivable that in the future smart contracts automatically check and validate the rules before each transaction (e.g. whether the investor is allowed to invest in this asset class up to this amount).

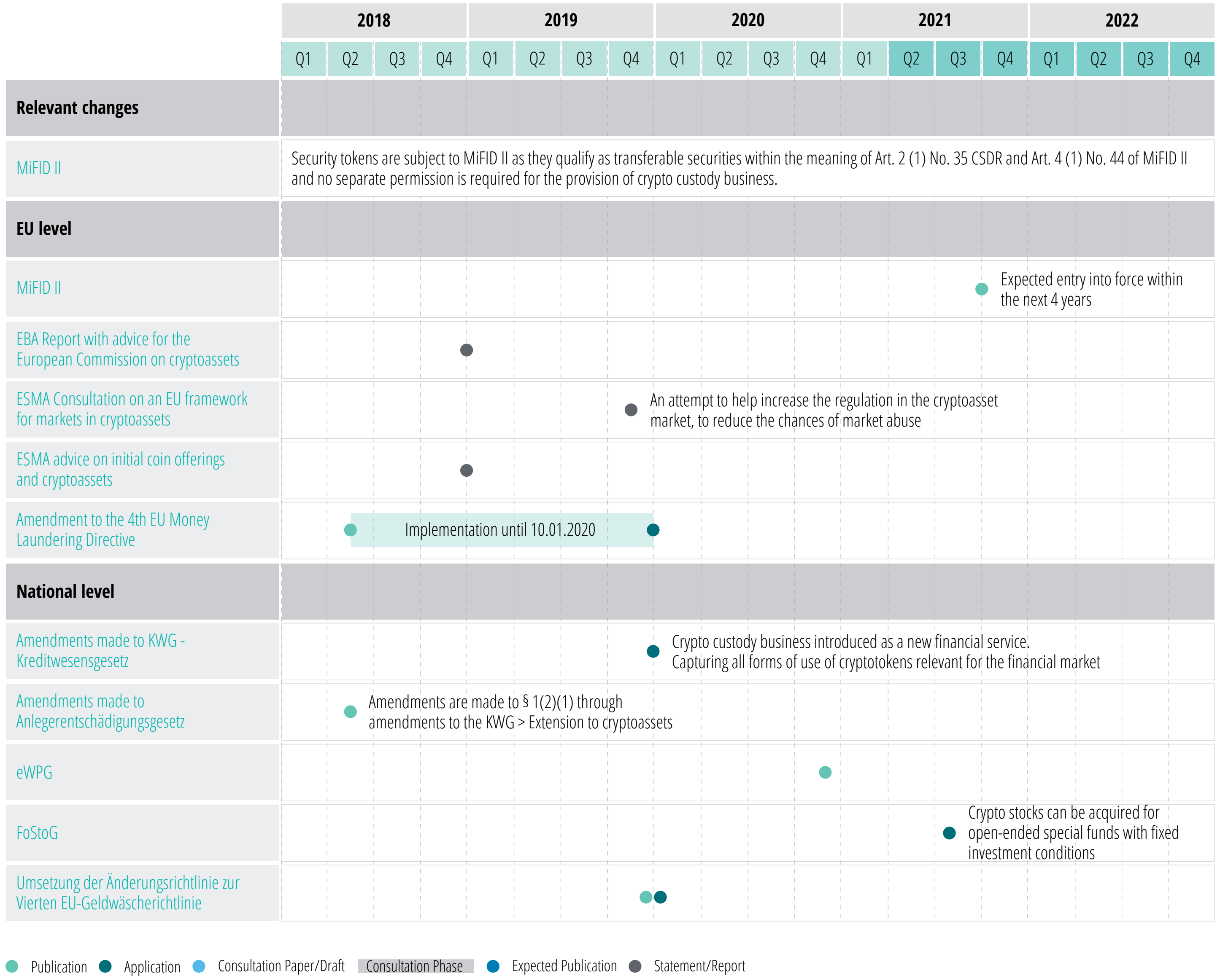
Crypto custody

There is also the possibility of profiting from the custody of crypto-assets. This business can take several forms. First, by building an infrastructure, tokenization and digital trading can be supported. By setting up a custodian for digital assets, these can also be used for the custody of one's own assets or offered as a service to others.

Further application possibilities

DLT also offers many other potential areas of application. All business activities in which an investment manager currently relies on a third party for the settlement of client transactions can be mapped via a distributed ledger. It is conceivable, for example, that securities clearing through a central entity could be eliminated, similar to the concept of the Australian Stock Exchange. Through decentralized clearing, an investment manager could have a direct business relationship with each client and save the costs of intermediaries, while being able to rely on an immutable distributed ledger.

Figure 5. Regulatory roadmap at national and EU level



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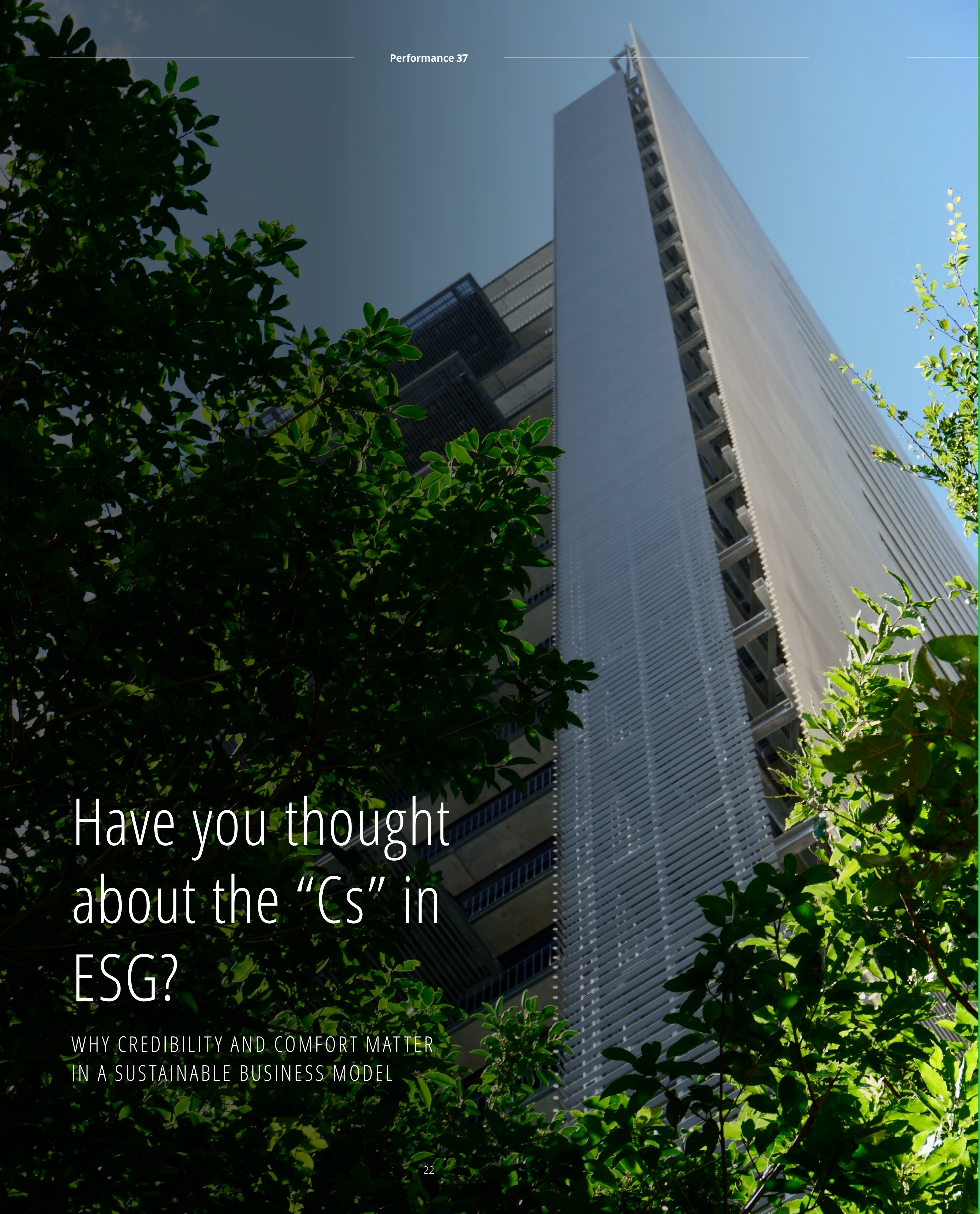

Have you thought about the "Cs" in ESG?

WHY CREDIBILITY AND COMFORT MATTER IN A SUSTAINABLE BUSINESS MODEL

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INTRODUCTION

No surprise: environmental, social and governance (ESG) is one of the hottest trends for actors in the financial product market. The figures speak for themselves – outstanding growth rates in funds' assets under management (AuM) on a quarterly basis as well as total AuM close to USD 4 trillion[1] globally. This sky-rocketing demand, especially in Europe accounting for 88% of the Global AuM, has created a crowded marketplace, with fierce competition to attract the attention of investors and distribution partners.

So far, so good, you could say. However, since the growth of available capital for investments is not keeping up with the growth in products offered, market positioning, branding and marketing are increasingly helping market players set themselves apart. For firms to win this race, they must stand out from the crowd, especially when regulatory guidance and clarity are still in their infancy.

This is where Credibility and Comfort start to matter. Not only for manufacturers of financial products, but for all stakeholders across the entire value chain to the (end) investor. It is about firms being willing and able to constantly test their ESG value proposition claims. And, it is about providing proof points that underpin these claims to earn long-term Credibility and provide Comfort to all stakeholders accordingly.

Synonyms for Credibility, which derives from the Latin word credibilis, are trustworthy and trust. Similar to Credibility and Comfort, trust must be constantly earned and maintained over time to be sustainable in the long term. So, this is not a one-off exercise — it is permanent and requires constant attunement and investment across the value chain to materialize.

MICHAEL MALDENER
CEO SUSTAIDE

TO THE POINT

01. "Credibility" and "Comfort" are drivers for ESG product differentiation but require commitment and investment.
02. Looking beyond the traditional and inward-looking agenda is an opportunity, not just a cost.
03. A willingness to put yourself to the test, again and again, is the key to long-term market relevance.
04. Keep it simple with relevant and compelling evidence that proves the solution, instead of offering just another product.
05. Distribution and clients' needs matter, especially in ESG.

A lot is being said about the challenges asset managers and other financial product manufacturers face regarding ESG—including integrating ESG aspects into their investment processes, the ESG data challenge, the need for internal upskilling, and the growing compliance burden with every new or changing regulation.

But often, this ESG effort is an inward-looking approach, covering only the first part of the above equation. Manufacturers are not always in a position to consider the value chain all the way to distribution. This can be due to regulatory uncertainty, a lack of internal ESG competence, or a shortage of specialized talent. However, make sure the distribution side and investors are not left out of sight!

But who are the stakeholders, and what is the value chain?

Why does Comfort matter?

Supervisory boards, senior executives and other top-level management are naturally motivated to grow their business, in compliance with applicable rules and to benefit investors. They are especially motivated to ensure sound internal governance, often looking to internal control functions to provide Comfort that this governance is being maintained in a changing and growing business.

> To grow mainstream, integrated, living and breathing ESG, there must be non-financial benefits for investors.

However, the development and implementation of regulatory guidance have been, to be generous to the lawmakers and regulators, somewhat sub-optimal.

This situation is arguably improving with the European Supervisory Authorities (ESAs) having delivered the final regulatory technical standards (RTS) for the Taxonomy and Sustainable Finance Disclosure Regulation (SFDR).[2] However, implementing these standards, which will include new product "classes", will take time and has been postponed further until 1st of January 2023—and must be done under the watchful eye of regulators, press, institutional clients and distribution networks, the latter of which needs the information to be delivered under the RTS already earlier than 2023, namely by August 2022!

Recent examples have publicized the effect external scrutiny can have on a firm's brand, reputation and share price when its ESG capabilities are in doubt. Such scrutiny does (and should) cause concern among leaders, driving firms to enhance their assurance efforts to boost internal governance Comfort and satisfy external stakeholders. However, enhancing oversight and boosting Comfort levels potentially generates increased costs and distraction in the value creation process.

Consequently, Comfort in processes and procedures is crucial for firms to operate efficiently, especially in the ESG domain. It is a vital part of how reporting should be handled, especially when challenged through external scrutiny. Firms need to be able to prove that they walk the walk as well as talk the talk. Therefore, the stronger the proof points, the better the constant overview, and the higher the stakeholders' Comfort.

However, it is not enough to only find Comfort in some teams or certain people. Each manufacturer could ask itself, can I put my organization to the test? Is our sustainability value proposition understood? Does everyone know what we stand for and how they individually, or as a team, contribute to our firm's overall ESG strategy?

When a firm and all its internal stakeholders speak with one voice and understand as well as embrace the firm's ESG agenda, it inspires Comfort in clients and distribution partners. The latter may quickly realize that ESG is more than just lip service from a few employees; it is truly embedded in the firm.

Lastly, generating Comfort is not just about stakeholders' peace of mind—it can also drive efficiency. If everyone has clear access to all relevant information and an aligned understanding of its meaning across the value chain, data will become living knowledge—and, therefore, more efficiently processed.[3]

Figure 1. Stakeholders in the asset management value chain (simplified)

Credibility to complete the virtuous circle

Credibility is the "intangible" currency that asset managers or financial product manufacturers is paid by the market.

Net flows and AuM increases, decreases and retention determine and dictate financial and tangible success, and are often supported by strong brand recognition. While this is no different in the world of sustainability, ESG is a very vivid field—it is not just a new asset class or investment approach, it must be integrated into everything we do. So, while brand recognition, net flows and AuM are relevant in the short term, what about the long term?

In the long term, clients, distribution partners, auditors and probably even regulators will test the Credibility of product manufacturers, including the way products are promoted. Promotion is an essential piece of the puzzle, since often (very) sophisticated ESG approaches must be explained in an understandable and meaningful manner. So, firms should ask themselves, do our promotional materials meet these criteria? Do they describe the core of the offer in such a way the target audience will get?

> In the words of Albert Einstein: "If you can't explain it simply, you don't understand it well enough".

While keeping it short and simple is near impossible given the lack of aligned definitions, taxonomies and understanding, the amended Markets in Financial Instruments Directive (MiFID) has required this for many years. It is about being fair, clear and non-misleading, which are essential criteria regarding ESG. While admittedly not as relevant for certain products that are exclusively directed to well-informed institutional investors, keeping it understandable to the target investor will undoubtedly add Credibility.

As another consequence, the virtuous cycle of Credibility and Comfort is complete once more. Why a virtuous circle? Because firms cannot sustain one without the other in the longer term. When firms are credible in the "what" and "how" of their ESG strategies, it provides Comfort to all stakeholders, whether internal or external. It will facilitate communication and the provision of solutions, not just products. Distribution partners will see firms as trusted advisers and not just another manufacturer. In other words, it will help players stand out in a fiercely competitive marketplace.

CONCLUSION

Market players could be tempted to view ESG for funds or financial products in general as a straightforward equation. You look at the product and its ESG potential, and make sure you have the proof points and evidence in terms of verifiable (external) data or research. Then, you manage and market the product accordingly. But this equation does not always reflect the reality, unfortunately.
To integrate ESG considerations into financial products, the "Cs" must be a key consideration. They are less tangible than quant-driven data; they require engagement with stakeholders that surpasses the traditional agenda of understanding short-term financial and business needs, urging manufacturers and distributors to look beyond the end of their noses. After all, achieving Credibility and Comfort by truly embracing ESG across the entire value chain will definitely be rewarding.

Understanding the drivers that define a firm's sustainable business model is not always easy, and boards and senior management will struggle to achieve this from time to time. Regardless, whether you are an asset manager, bank, insurer or another type of distributor or intermediary, do not be afraid to put yourself to the test. And, do it regularly, using complete overviews or dashboards.

This continual testing will likely reveal that, due to shifting results and parameters, you must remain agile and constantly adjust plans and strategies. While it is an intensive job, it is a must to achieve a sustainable business model that provides and secures Comfort and Credibility in your ESG approach.

Endnotes

1 Source: Morningstar, Global Sustainable Fund Flows Q3 2021, November 2021 – updated version

2 ESAs have delivered to the European Commission their Final Report with draft Regulatory Technical Standards (RTS) regarding disclosures under the SFDR as amended by the Regulation on the establishment of a framework to facilitate sustainable investment (Taxonomy Regulation). However, the European Commission has communicated end of November 2021 that the application will be deferred to January 2023.

3 „From Dead Data to Living Knowledge", Nicolas Buck, Deloitte Performance Magazine, 2021.

Deloitte 2021 FX Hedging Survey

HOW THE CURRENCY OVERLAY INDUSTRY IS FACING 2021'S CHALLENGES

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INTRODUCTION

Deloitte performed two surveys on FX Hedging market practices back in 2011 and 2015. We recently launched a third version of this survey among 16 of the largest global asset managers and asset servicers having offices in Luxembourg, France, Switzerland, UK or the US. Areas covered included general information, size, product offering, target operating models, systems, detailed processes and control framework.

Since our last survey in 2015, this year's survey findings shed light on the profound transformation of the hedging overlay services offered by both asset managers and servicers. New major market players have also launched their own currency overlay solutions, further crowding this constantly evolving market. As a result, currency overlay has become more common and accessible to all kinds of investors.

The industry has faced many challenges over the last few years, including regulatory transformation, automation, increase in volatility, a reduction of transaction costs and the opening of new markets and currency types.

Regulatory transformation

In recent years, regulations have targeted a vital aspect of the FX market: transparency for the investor. ESMA's opinion on Undertakings for the Collective Investment in Transferable Securities (UCITS) share classes, along with the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation and the amended Markets in Financial Instruments Directive (MiFID II), have profoundly impacted the industry.

> ESMA's opinion on UCITS share classes introduced several principles related to currency overlay.

With the "common investment objective", ESMA clarified the type of hedging that should be applied to UCITS funds by defining the scope of applicable hedging practices at the class level. And, the "non-contagion" principle sets boundaries to mitigate the contagion risk across share classes—for example, ESMA has set some maximum thresholds for the hedge ratio.

The PRIIPs Regulation and MiFID II added further transparency. With its "best execution" disclosure requirement, MiFID II guided the market towards better trade efficiency. With PRIIPs, Hedging transaction costs are now disclosed to investors, allowing the performance impact of these services to be reported.

Over the last 6 years, the average hedging transaction costs have dropped from 12 basis points (bps) per year to 5 bps for a monthly roll G10 currency overlay.

We have observed a strong link between the level of costs and the hedging thresholds disclosed. The drop in costs has enabled asset managers to tighten the hedging thresholds applied, as they could allow more frequent adjustment trades.

Technical and operational improvements

Another market trend is the growth of process automation, together with the controls and risk monitoring related to hedging.

Asset managers are replacing manual processes with internally integrated or automated solutions to prepare the trades to instruct—or by solutions from asset servicers. FX hedging providers have developed tools allowing asset managers to monitor and adjust their hedging parameters, including web-based solutions.

In recent years, the number of automated tools assisting different stakeholders to closely monitor hedging has mushroomed. As a result, the percentage of respondents monitoring critical hedging KPIs daily has surged from 25% in 2015 to 85% in 2021. These daily controls not only improve the quality of the hedging applied, but also reduce tracking errors of the hedge classes.

Figure 1. Daily monitoring of KPI - 2015

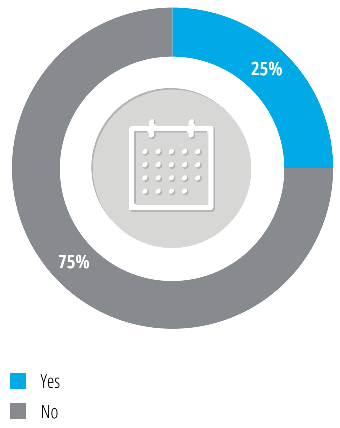
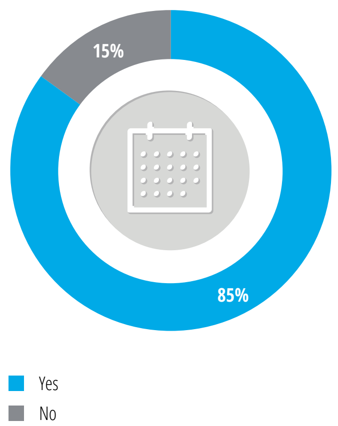


Figure 2. Daily monitoring of KPI - 2015



In our 2021 survey, 78% of asset managers received a performance attribution analysis, compared with 42% in 2015. The quality of the reporting has also grown, with respondents considering more types of hedging impacts.

TO THE POINT

Since our last survey on FX hedging in 2015, our 2021 survey findings have uncovered new industry trends:

01. As a result of cost disclosure regulations and growing market competitiveness, FX hedging transaction costs have plummeted. This reduction allows for stricter hedging ratio thresholds.
02. Currency overlay is now more automated, especially for asset servicing firms, which are subject to stricter controls.
03. Communication improvements between asset managers and FX hedging providers have resulted in more responsive hedging.
04. Performance attribution through reports or web platforms has become more critical in monitoring the application of hedging.

In the coming years, the challenge for market players will be to provide the same quality of hedging services and reporting that we now observe regarding NAV hedging, as well as for other hedging strategies such as multicurrency hedging or look-through benchmark hedging.

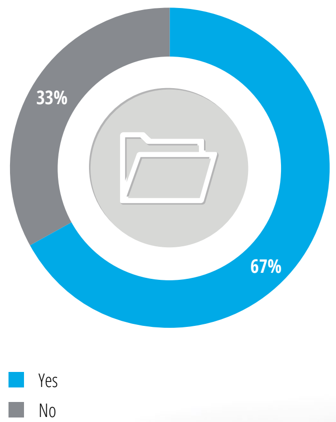
FX hedging processes used

This year's findings also uncover significant improvements in participants' hedging procedures compared with 2015's survey, with technical and operational enhancements reducing tracking errors.

Asset servicers are offering new features to asset managers to reduce different hedging effects. For example, trade splits are offered to reduce the market impact of rollovers, especially on less liquid currency pairs.

The early realization of forwards allows asset managers to reduce the unrealized profit and loss (PnL), which could significantly affect performance if the hedging PnL represents a large portion of the portfolio. Of our 2021 respondents, 67% said they were able to close in anticipation of the current hedging position to crystalize the unrealized PnL. Some asset servicers or hedging providers allow asset managers to set up a threshold that will trigger an automatic realization.

Figure 3. Early realisation of the P&L on forwards



New challenges on the horizon

This year's survey has uncovered some new challenges for our respondents.

> Assets managers are increasingly eager to understand and track the various effects on hedged classes, either through a detailed reporting solution or a digital dashboard with interactive features.

Asset servicers and hedging providers have begun offering more frequent reporting to improve the flexibility of their offering. While most currently available solutions only provide performance attribution for share class hedging, asset servicers are looking to provide performance attribution for other types of hedged products.

As asset managers broaden the scope of hedging offered, such as portfolio hedging at the class level and benchmark exposure hedging, FX hedging providers are set to develop additional controls over the next few years to monitor the impacts of these new types of hedging.

The different stakeholders involved are looking for integrated hedging tools, such as the computation of hedging adjustments, trading and reporting.

Another challenge faced by asset servicers is the increase of active/discretionary hedging by some clients. While ESMA's opinion on UCITS share classes has prohibited this hedging type for UCITS funds, alternative funds are seeking more flexible hedging strategies. Such hedging can be passive and rule-based, or active and based on the investment manager's view of the FX market.

CONCLUSION

Since our last survey in 2015, the currency overlay market has matured and benefited from the different technological improvements seen in recent years. Hedging is becoming more flexible to meet evolving client needs. Investors can now manage their currency exposure through products with lower transaction costs and higher reporting transparency.

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COVID-19: a silver lining for marketing?

THE ROLE OF MARKETING IN INVESTMENT MANAGEMENT FIRMS

TO THE POINT

01. The role of marketing in investment management firms has fundamentally changed due to the COVID-19 pandemic.
02. Many marketing teams have stepped into a new role with greater responsibility for business-relevant outcomes and have proven they are up to the challenge.
03. Senior leadership teams should build on this sea change to further develop their marketing functions and improve the efficiency and effectiveness of their go-to-market strategies.
04. Developing the ability to cater to various clients' specific segments and geographic needs is the next frontier, offering firms an opportunity to gain a hard-to-replicate competitive advantage.

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COVID-19 has been transformative for marketers in the asset management industry. Before the pandemic, marketing played a subordinate role to sales in many firms across the sector. While the emergence of digital marketing slowly began to change the tide, the marketing function's role had not substantially evolved over the last 25 years. However, with the onset of COVID-19, what was previously a glacial progression suddenly became an avalanche.

> More than 50% of business-to-business (B2B) purchase decisions are made before meeting the salesperson.

In our article "Are we getting left behind by our clients?"[1], we argued that clients in the asset management industry were outpacing investment management sales teams in adopting digital information sources. The proliferation of data sources means clients can filter their selection criteria and generate shortlists of potential providers before even reaching out to a salesperson. Indeed, as long ago as 2012, a Conference Board[2] survey found the average B2B customer completes more than half of the purchase decision-making process before engaging a salesperson and that, in some cases, this may be as high as 70%.

Furthermore, an MIH study from 2015[***] found the number of decision-makers involved in typical buying decisions increased to 5.8 people from a 5-year average of 4.7. The result is that we have gradually seen customers adopting new ways of engaging with sales representatives. You could even argue that the role of sales in the industry is fundamentally changing.

Lastly, from our discussions with salespeople across the industry, we have generally seen clients limiting their discussions with sales representatives due to:

01. Fund selectors imposing strict terms of engagement, which materially impacts firms' ability to connect with the relationship management teams of large wholesale groups.
02. Institutional clients developing web-based sales meeting booking tools as a firewall to reduce the burden of sales meetings.
03. Governments and institutions resorting to database-driven searches to ensure objectivity and combat potential corruption.
04. Weakening event attendance and the rise in popularity of the multi-manager event platform.

Are you really part of the conversation?

All these indicate that clients are demanding or imposing (and being technologically able to) their preferred engagement approach on the armies of salespeople that besiege them daily. Clients can inform and educate themselves, track market trends, assess product options, and shortlist strategies and suppliers—and all this before sitting down with a single salesperson.

The questions we asked ourselves back in 2018[*] were, if more than 50% of buying decisions are completed before the client contacts the salesperson:

1. How do you influence the client in the early stages of their buying process?
2. How do you make sure your product is on their long list?
3. How do you ensure your newly launched product is considered, despite its short track record?
4. How do you speak to investment committee members that are unwilling to meet with you?
5. How do you engage with influencers in the client's firm who would like to see your competitor's strategy selected, even if you do not know who they are?

Our conclusion even then, was that if you are not in front of the client, how do you make sure that you are even "in the conversation"?

Such was the situation at the start of the pandemic.

Marketing shows its ability to deliver and demonstrate commercial impact

The pandemic accelerated these buying decision trends in a matter of weeks. Salespeople could no longer be in front of the client, and firms needed to find an alternative. The result was that marketing was finally given license to bring modern digital marketing techniques and technologies to bear. An epiphany, watershed, transformation—call it whatever you want. However, it took the biggest non-wartime event in history for marketing functions in the asset management industry to finally play a new role: lead generation and scoring, marketing automation, virtual event platforms, experimentation with formats and channels—test, learn, adjust and repeat. Resources permitting, marketing teams were able to develop their role almost exponentially.

Transformation goes warp speed...almost

The result has truly been transformational. Marketing is now invited into the boardroom to discuss lead generation and market development, segmentation, and customer experience. The Chief Marketing Officer (CMO) of a prominent bank-owned asset manager recently told us she was able to achieve her 24-month digital marketing development roadmap in only 6 months; such was the support and urgency for change. Another regional head of marketing for a US asset manager explained how the role of marketing had changed entirely—the function was now responsible for identifying new leads as well as existing clients' interest in topics as a means of driving commercial efficiency.

This change is enormously encouraging. Having seen how marketing teams have risen to the challenge and added commercial value (and to demonstrate that value, something that is often extremely hard to do), senior leadership teams will be encouraged to invest more in their marketing teams in terms of skills and technology development.

Local relevance is the next frontier

So, where does investment management marketing go from here? We would argue the spotlight needs to shift from technology and digitization back to people—the customer. This means a renewed focus on developing, adapting and delivering content that is specifically tailored to the customer—including their industry (think insurance company versus Independent Financial Advisors versus direct customers), geographic differences (not just their language) and context (e.g., regulations), location in the sales funnel and, accordingly, the information they need in the format best suited to their requirements.

CMOs in the asset management industry must balance the mid-to-long-term challenges of building a strong, differentiated brand and meeting the short-term demands of their sales and investment teams, all across multiple markets and client segments.

The popular model has been to establish a centralized production function to support and meet the needs of segment or country marketers.

However, the outcome, especially for local country marketing managers, is often one of uncomfortable compromise—using centrally produced propositions and materials with a generic client profile that fail to meet the actual needs of their segments, regions and salespeople. In our discussions with country marketing managers at top asset management firms across continental Europe, it is evident that few asset managers have so far cracked this nut.

The challenge is balancing the synergies offered by central production functions with the demands of local sales teams and clients for propositions, content, campaigns and collaterals adapted to specific local needs. Teams need to break away from the gravity and demands of the home market sales teams to find a model that allows local marketers (and non-core segment marketers) to adapt and respond to their clients' needs.

Allow us to provide an example. The Netherlands is one of the world's most progressive and advanced pension markets and, after the United Kingdom, Europe's second-largest institutional market with over EUR1.7 trillion in assets under management (AuM) and approximately 300 decision-makers. However, when compared with other European markets such as Germany, Italy or France, it is often considered small—resulting in a constant struggle to acquire dedicated institutional marketing resources. Indeed, many local marketers must make do with centrally produced propositions and collaterals aimed at the company's core segment, which for many Anglo-Saxon firms tends to be wholesale.

We would argue this is the next maturity frontier for marketers in the asset management industry. Firms must build their commercial functions (sales, marketing, and customer servicing) to reflect the complexity of the international markets they serve—the benefits will far outweigh the challenges or costs of striving for the right model. Indeed, this approach offers the prospect of long-term competitive advantages that are not easily replicated.

Endnotes

* *Are we getting left behind by our clients?* By Patrick Ide published October 2018.

** CEB Marketing Leadership Council, *The Digital Evolution in B2B Marketing*, 2012.

*** Miller Heiman Group Research Institute, *2015 MHI Sales Best Practices Study: Decoding the Decision Dynamic*, 2015.

Data is the new oil!

DOES DATA REALLY FACILITATE TODAY'S CROSS-BORDER INVESTMENT FUND DISTRIBUTION?

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INTRODUCTION

"Data is the new oil !" is the rally call for today's digital revolution. And, as data purveys all aspects of our lives on the world's determined path to total digitalization, there is also the call for greater transparency.

Indeed, the financial industry is not exempt from this "data revolution" topic and its associated euphory. With the approaching launch of the ESMA central fund database as one of the sector's new regulatory requirements, we would like to dig-in to the data opportunities that have been buzzing for the past two decades in the specific context of the cross-border distribution of investment funds.

The cross-border distribution of investment funds implies intense and increased data exchanges between the different players of the investment fund sector, including corresponding regulators. Lines between data exchange and reporting are blurring and it is becoming extremely hard to differentiate one from the other.

Luxembourg and Ireland are the world leaders in terms of cross-border investment fund distribution. Their funds are popular on a worldwide basis and are subject to the ever rising demand for data and reports from regulators across the globe, creating ongoing challenges from on the distribution process.

This article zooms-in on the applicable regulatory requirements related to data and their availability that are already, or will soon be, in place. We discuss the challenges and opportunities related to data and reporting so that the question whether data will—or will not—facilitate the cross-border distribution of investment funds, can be addressed.

Evolution of regulatory reporting requirements constantly demanding for more and more reports/data

Everyone involved in fund manufacturing has witnessed the expansion of regulatory requirements over the last two decades. Reporting factories used to simply prepare funds' annual and semi-annual reports, complemented with some regular accounting reporting.

However, in 2001, the UCITS III[1] Directive set the basis of fund risk management. The introduction of the long form report in Luxembourg added to the strengthening of fund substance and governance and increased transparency with the regulator. This provided the CSSF with more robust tools to allow supervision. As an illustrative example, in addition to the rising of a dedicated risk management function, Luxembourg funds initiated the disclosure of retrocessions and portfolio turnover ratio.

Everyone involved in fund manufacturing has witnessed the expansion of regulatory requirements over the last two decades.

In 2002, the CSSF Circular 2002/77 on Protection of Investors[2] went a step further demanding not only notification to the CSSF of material NAV[3] errors or breaches in the investments restrictions and policy, but additionally imposing reimbursement to shareholders impacted. This information is made public through the annual CSSF report in a summary of NAV errors and investment breach notifications received during the year, as well as their impact.

Since then, an extensive range of supplemental reports have come out - so many in fact, that we could not begin to list them all!

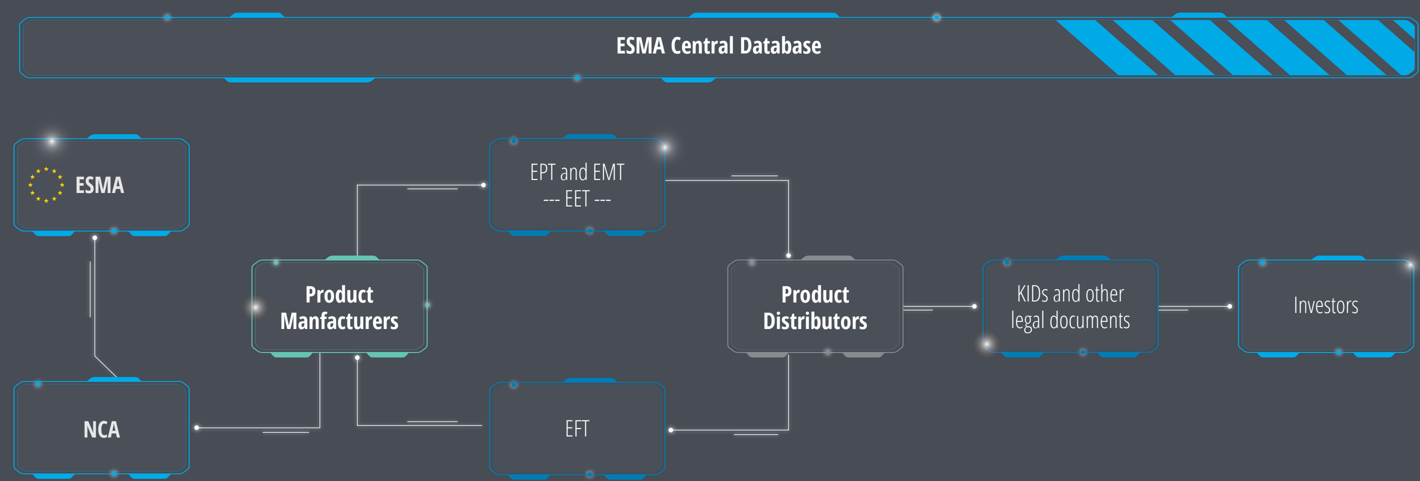
In response and to support international harmonization and use of recent templates, the market has decided to unite their strengths. In 2019, FinDatEx[4] was created and is already maintaining key templates used within the sector across the board.

EPT[5] and EMT[6] are just two of these key templates which have been implemented more recently and are of particular interest as they are not directly communicated to the authorities but, instead, to the distributors, acting as an intermediary with the investors. Distributors may decide to blacklist the manufacturers who do not follow the rules.

One of the most recent templates from FinDaTex, not yet commonly used, is the EFT[7]. In this instance, distributors (or investors) provide their feedback to the manufacturer in terms of transactions and potential deviation on target market objective.

Lately, another template, the EET[8] is currently under discussion.

Figure 1: shows the current data and report flows among the actors of the investment fund industry that are required for cross-border distribution:



The regulatory reporting activity is far from slowing—on the contrary, its seems to in fact be accelerating, but perhaps in more beneficial manner to many. In light of the latest regulatory developments, we can observe the emergence of stronger awareness around sustainability and ESG-related elements. The inclusion of ESG commitment in the investment strategy of investment funds is one of the strongest selling arguments, even more so in the cross-border context. Indeed, the number of socially responsible investment funds are expected to expand.

With the CBD-EU Directive[9], the EU Commission has lately imposed additional publication requirements to the national regulators when it comes to the cross-border distribution of funds. These are not only the publication of fees and charges levied by the national competent authorities, these are investment funds-related data at share class level that the national regulators will communicate to ESMA[10] on a quarterly basis. This data will be used for the creation and maintenance of a central database on the cross-border marketing of AIFs and UCITS and will be available on ESMA's webpage as of 2 February 2022. The aggregation of this data may be seen as a big 'fund registration matrix' as it will publicly expose fund data to an even greater degree than is available today. This development will offer many opportunities to those who consume such data—but piles on far more pressure for those producing it.

The regulatory developments of the last 20 years formulate an increasing demand for data exchange and reports. Historically, the data and reports in the context of the cross-border distribution were provided by the IFMs to the national regulators who kept or exchanged the data among each other for statistical and supervisory purposes as well as to safeguard the best interest of the investor.

In the next few months and for the first time in the regulatory evolution, data collected by the national regulators will become publicly accessible to all interested parties via the ESMA's database.

> The inclusion of ESG commitment in the investment strategy of investment funds is one of the strongest selling arguments, even more so in the cross-border context.

Impacts on the playing field of the investment fund industry

In principle, all these developments should ensure alignment between the different templates or sources, be it prospectus, EPT, EMT, or other documents translated into different languages.

Indeed, a UCITS KIID in German shall have the same content as its original in English. However, a same document in German for Germany may present small differences with its counterpart in Switzerland. There may also be some specificities within the French UCITS KIID for Belgium and France etc.

Such documents require updates, yet this may result in desynchronization between calculated/current and published figures. The documents may not be updated every time the data is changed, but instead once a trigger is activated.

For example, as a generic rule a UCIITS KIID update is triggered after a constant change of value of the SRRI for more than a 16 week sliding window. In Figure 2, the calculated SRRI has changed, but it will only be updated in the UCITS KIID on week 17.

Figure 2. SRRI update

Week number	Calculated SRRI	Published SRRI
Week 1	4	4
Week 2-16 (de-synchronization)	5	4
Week 17	5	5

Depending on processes, investment fund managers (IFMs) could even observe a de-synchronization between reports. For example, the UCITS KIID would show published values whereas EPT or EMT would include calculated ones. All these discrepancies are likely to apply to any data such as SRRI or costs and charges.

In addition, we have until now mostly focused on legal or regulatory documents, but the challenges and complexity also apply for marketing documentation that should, for instance, also satisfy the requirements to be fully aligned with the legal documents. The consistency of information also applies to factsheets. Although, are factsheets or any marketing documents in each language really aligned to legal documents, such as prospectus?

Multiplicity of data to be fed via different channels and templates as well as complexity of reporting processes, requires strong IT and operational infrastructure. However, IFMs in charge of the supervision of their funds' activities, do not always have the necessary technical infrastructure to ensure smooth production of all reports. Either they must invest in data management tools and processes or monopolize resources who will manually and sometimes painfully prepare the reports. Alternatively, they could also opt for outsourcing of their data management and/or reporting process.

This becomes even more complex for IFMs when they must supervise funds allocated to multiple fund administrators, with multiple systems and reports. The first step of gathering and consolidating the data already represents a nightmare.

However, amidst all of this, it is important to highlight that data flows are not one-way. Information must be sent to the authorities or to the distributors, but IFMs may also receive information back. The need for strong data management and automation is paramount.

With the creation of the ESMA central data hub, data related to cross-border investment funds will be publicly available. This is quite a premiere. So far, it has been cumbersome to get structured and reliable data on the market because the national competent authorities were collecting data without sharing them with the public. Now, this ESMA data database represents an opportunity to retrieve data and use it optimally. Strategic decisions could be supported by benchmarking, or any other analysis based on the available data.

CONCLUSION

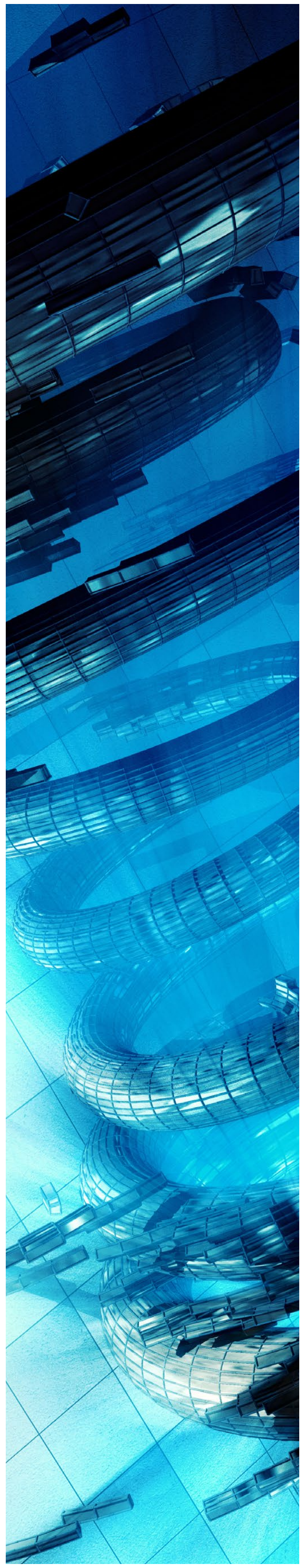
In summary, data has become increasingly weighty in the investment funds cross-border distribution area. Not only within the parameters of the current regulatory requirements of data exchange, but also the upcoming increasing supervisory scope of the regulators and their focus on data triggering this evolvement.

We see the increased call for transparency as a good evolution although it also brings with it some challenges to all actors within the financial industry. Some have already started or will soon develop in-house data management and reporting activities, whilst others will prefer to outsource them. We may even see some disappearing if they cannot adapt.

The ESMA central database is expected to be used by manufacturers, management companies, and insurances alike to benchmark and make strategic decisions related to products' distribution coverage. It will also possibly be used by marketers and scholars who will rely upon its data for their analysis and research. This may be the first step of a long journey to an all encompassing transparency that may indeed finally reach investors.

Standardized data disclosure like the UCITS KIID/PRIIPS KID promotes opportunities for benchmarking products and actors. With a higher transparency of data and qualified supervision by the authorities, investors are gaining confidence in financial markets. With more confidence, they may wish to invest in financial products worldwide. Hence, we believe that data can facilitate the cross-border distribution of investment funds. The near future will provide the backdrop for an in-depth and unstoppable evolution.

Data is therefore not simply a new oil. Just as oil extraction is difficult and costly and can sometimes result in an explosive environment; so too can the utilization of data. Lack of quality may lead to volatile situations such as non-compliance issues and bad reputation. Therefore, our recommendation is this: make sure your data is available, complete, and consistent.



TO THE POINT

01. Regulators constantly demand for more reports and data points from the investment fund managers, calling for more grip on data management.
02. Data (flows) will become more transparent and for the first time there will be an EU wide public database that consists of investment funds' data related to cross-border distribution.

Endnotes

[1] Undertakings for Collective Investments in Transferable Securities ("UCITS") III Directive.

[2] CSSF Circular 2002/77 on Protection of Investors in case of NAV calculation error and correction of the consequences resulting from non-compliance with the investment rules applicable to undertakings for collective investment.

[3] Net Asset Value.

[4] Extract from FinDatEx: "...a joint structure established by representatives of the European financial services sector with the view to coordinate, organize and carry out standardization work to facilitate the exchange of data between stakeholders in application of European Financial markets legislation, such as MiFID II, PRIIPs and Solvency 2. FinDatEx's mission is to support the development and use of standardized technical templates to facilitate the exchange of data between stakeholders in the application of European Financial market legislation."

[5] European PRIIPS Template.

[6] European MIFID Template.

[7] European Feedback Template.

[8] European ESG Template.

[9] Cross-Border Distribution Directive 2019/1160 (CBD-EU Directive) amends the UCITS and AIFMD Directives and aims to harmonize the cross-border distribution of funds within the EU. The CBD-EU Directive was enforced from the 2 August 2021.

[10] European Securities and Markets Authority.

Performance 37

The future of ESG in asset management

IN CONVERSATION WITH WIEBKE MERBETH OF BAYERNINVEST AND INGO SPEICH OF DEKA INVESTMENT

WIEBKE MERBETH
HEAD OF PUBLIC AFFAIRS
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INTRODUCTION

Sustainability is currently a leading topic in the financial industry. In recent years, client interest and demand have been steadily increasing, meaning sustainable investing has moved from a niche market to mainstream investment. However, requirements and the level of complexity have significantly increased with the latest regulatory wave. The EU Action Plan combined with the EU Taxonomy and the Sustainable Finance Disclosure Regulation (SFDR) are part of an ambitious legislative framework that will significantly shape sustainable investing.

Wiebke Merbeth, Head of Public Affairs and Sustainability at BayernInvest, and Ingo Speich, Head of Sustainability and Corporate Governance at Deka Investment, discuss current trends in sustainable finance and how the EU regulations impact not only the European market, but also the rest of the world.

Deloitte: How has the market for sustainable investments developed in recent years?

Ingo Speich: Growth in the sustainability market was and is extremely high in terms of assets under management (AuM). The annual growth rate over the past decade has been about three to four times higher than in the asset management industry in general. While the market dynamic is high, market penetration is still relatively low, thereby providing a great opportunity for many players to position themselves in a market that has been largely unregulated. Until now, it has been relatively easy for providers to take advantage of this: all that was needed were significant volumes to achieve economies of scale. However, with the new regulations, the business is becoming a lot more complex.

Wiebke Merbeth: There is also a downside to the high demand. The market is under significant pressure to offer sustainable products in almost every asset class. I have seen requests for green bitcoins or green FX derivatives. All business units are now looking deeper into the topic. The difficulty to fulfill the high expectations from clients also leads to discussions whether a Green Bond with low scores on the Freedom House Index can still be sustainable. It will be imperative to remain realistic in the future. Sustainable finance is about a process of transition which has just begun and will take time. Decent conflicts between sustainability objectives, especially between environmental and social will undoubtedly arise.

Deloitte: With the EU Taxonomy and the SDFR, requirements for sustainable products have significantly increased. How does this affect market dynamics?

Wiebke Merbeth: The new requirements have an effect on the entire value chain, from distribution over product and portfolio management, to reporting. Prospects and clients will be asked for their ESG preferences, and sustainable products need to show their actual attainment and impact in the periodic reporting. This requires changes in various existing processes and a sound governance structure. With many different regulations coming into effect in parallel, it will be important to coordinate the various projects and to develop a future business and operating model.

Ingo Speich: The market is transitioning from an unregulated high growth market into an established regulated one. This transformation usually goes along with market consolidation, where larger players increase their market share. They have the infrastructure and research in place to cope with the regulatory requirements. In terms of regulation, large providers could come under pressure in grouping of products. Product conversion may be necessary to comply with the new regulatory framework.

Deloitte: How do you assess the effect of EU regulation on non-European countries and regions?

Ingo Speich: So far, Europe has tried to fulfill a leadership role with a large regulation of the financial market. It will be interesting to see whether the rest of the world adapts the SFDR and the Taxonomy. From the perspective of an asset manager, global regulation is mandatory. It will be difficult for clients to understand why there are hundreds of fragmented regulations all over the world with different levels of ambition. A common sustainability framework for company reporting and institutional investments will be necessary to build a harmonized market for sustainable products and to avoid a clear segmentation. All in all, an internationally harmonized market helps to drive down costs due to fixed standards.

Wiebke Merbeth: With the SFDR, Europe is taking a huge step forward, setting the rules for non-European asset managers as well as for the non-European corporate sector. Non-EU asset managers need to comply with the EU regulation offering their products in the European market. Non-EU companies will need to provide an increased and more reliable set of sustainability data on the one hand and will face an increased engagement on the other. That's exactly the pioneering role that we will be playing. I expect that the EU standards will be integrated into the development of frameworks outside of Europe in the coming years. In addition, the industry is thankful for having the ISSB located in Frankfurt.

Deloitte: Will other countries and regions adopt the very high ambition level of the SFDR and the Taxonomy?
Wiebke Merbeth: Money flows will determine this answer. Countries that are closer to Europe will probably transfer or adapt the standards sooner. Hong Kong has already implemented even higher climate standards and almost copied the BaFin Guidance Notice on Dealing with Sustainability Risks. On the other hand, the UK has so far not committed to SFDR and Taxonomy. On a global level, it is only a question of time before the standards will converge. I would expect that in the medium-term there will be a uniform, global standard for sustainability similar to IFRS for corporate accounting. I think that the investment industry worldwide has understood that sustainability will be a key driver for risk and return.

Sustainable finance is about a process of transition which has just begun and will take time.

Ingo Speich: If China adopts similar standards, it would have a multiplier effect on the entire Asian market. However, the majority of assets are held by Americans. For Europe, the decision by the US will be more decisive. It would be desirable for the US to develop the same ambition as the Europeans.

Deloitte: Can politicians accurately assess the long-term effect of their regulations on the capital market?
Ingo Speich: For us as asset managers, the current question is whether sustainability criteria should be the result of political negotiations or based on scientific findings and inherent risks. We think, it will be important that the EU Taxonomy is not just a political framework, but asset managers can derivate implications on companies, valuations, and risks. In particular, we have to avoid merely transferring brown assets to the private market rather than transferring them . It will be crucial that integration of sustainability factors can lead to better risk-adjusted returns. In this case, other countries will automatically follow.

Wiebke Merbeth: I agree, but would like to add that companies with a lack of sustainability will automatically face a decrease in demand by investors in the future. This will have an effect on stock prices which will also drive management compensation. Even though the European market is not the biggest in the world, the marginal demand will still have an impact. From an economic point of view, this also reflects a pricing of externalities. A good investment management firm will already anticipate this development. Therefore, I appreciate the high level of ambition that the EU is currently targeting.

Deloitte: What are the challenges for product providers?
Ingo Speich: Historically, the sustainable investment market was mainly based on exclusion criteria. Reliable data were hardly available and thus exclusion of sectors, market segments, or issuers were required. This means that the portfolio management process has to change. We need to integrate the new data in our analysis, not only for sustainable products, but for all investment decisions. It will be interesting to see whether the regulation will push for an increase in the niche market with very strict sustainability criteria or if it will try to integrate sustainability criteria in the mass market and tighten the criteria over time. This will definitely influence what our future products will look like and how our investment processes will work.

Wiebke Merbeth: Short-term, we face increasing costs for data providers. Historically, the data was not determined. Now, they are step-by-step, so the demand for well-thought analysis with increasing complexity and conflicts of goals will follow. The integration of sustainability criteria within the value chain is also time-consuming. We need to create a common understanding of sustainability, internally as well as externally. You currently observe this in diverse ESG ratings for the same company by different providers.

It will be crucial that integration of sustainability factors can lead to better risk-adjusted returns.

Deloitte: What developments do you see in the market for sustainable products?
Ingo Speich: In the retail segment, the amendments in the distribution (MIFID II and IDD) will change things quite a bit from August 2022 and create additional demand for sustainable products through requests for sustainability preferences. Asset managers need to set up an attractive product range. Conversely, they need to quickly adapt to the new regulatory requirements. I think that the new framework will significantly drive product conversion.

Wiebke Merbeth: The definition of sustainability has become a lot more challenging. Just to provide an example: Historically, renewable energies were automatically seen as sustainable. With the DNSH criteria of the Taxonomy and the PAIs of the SFDR , we have to consider a lot more factors within the investment process and look at sustainability from a 360-degree view. Besides this bottom-up view, from a market and investor perspective, sustainability is a moving target. Something that is sustainable today, might not be seen as sustainable tomorrow due to new technologies and according to the transition cycle. At the same time, we need to commit to a minimum threshold of sustainable investments. The effort to deliver sustainable products has become a lot higher.

The effort to deliver sustainable products has become a lot higher.

Deloitte: Which providers will tend to benefit?
Ingo Speich: Larger asset managers tend to have an advantage in building the necessary infrastructure Sustainable investing will be largely driven by automated big data systems supplemented by individual high-quality research, which is expensive. The standardization fostered by the European regulation will also make it more difficult for smaller boutiques. We expect to see market consolidation in the sustainable investment market, as we have already seen with ESG data providers.

Wiebke Merbeth: I doubt size matters as credibility and adaptability are key. The requirements will significantly increase over the coming years. Providers that only aim to fulfill the regulatory minimum now, will face difficulties in the future coping with the fast-paced developments in the market. A sound governance structure will also be key in establishing minimum requirements for sustainable products and in developing a harmonized product framework for private as well as institutional clients. This definitely requires the attention and commitment of the management.

Deloitte: How will sustainability affect the role of the portfolio manager?
Wiebke Merbeth: Sustainability will be an integrated topic within portfolio management. Historically, sustainable investment managers were a separate team that managed their own portfolios. In the future, the role of a sustainability analyst might not even exist anymore. The classic research will need to integrate ESG

factors and global compact understanding as well as a regulatory 'new normal'.

Ingo Speich: Sustainability will be incorporated into all products up to a certain degree. The market will also transition away from sustainability ratings to more granular data. Portfolio managers will have access to a large amount of new data that could potentially influence the risk and return profiles of their portfolio companies. Being able to quickly adapt to this new environment and identify the main drivers will be key. This also requires a sound understanding of sustainability. We are transitioning from the collection of data, to the interpretation of it. Some asset managers have already incorporated the importance of sustainability ratings into their investment decisions, as we have seen with credit ratings.

Deloitte: More and more asset managers are also committing to a net-zero-strategy. Can the majority of asset managers simultaneously achieve such an ambitious goal?
Ingo Speich: A long-term net-zero-target can be set. However, medium-term targets are difficult to achieve as we do not know how the capital market environment will develop over the next couple of years. In case of market turbulence, CO2-intensive sectors have been a defensive safe harbor for investors. However, it remains important for us asset managers to continue to be able to diversify and manage risks. Our ability to decarbonize our portfolios will also strongly depend on the commitment of the corporate sector. Here, we need a strong collaboration.

Wiebke Merbeth: I think that we should not underestimate the pricing of CO2 in the future. Independent of the economic cycle, large emitters will face increasing costs. On the other hand, providers with very ambitious CO2 targets may find themselves in a situation where they have to purchase emission certificates. This could create a trade-off between the ability and the costs of actually attaining the CO2-reduction objective.

Deloitte: The EU regulation increases data costs for providers and research is becoming more expensive. In response, the EU is planning an EU Single Access Point. Do you think that this initiative will be a success?
Wiebke Merbeth: I actually believe that the European Single Access Point will significantly decrease data acquisition costs in the medium-term and neutralize the information bias of asset managers against ESG rating agencies. This is a huge opportunity and every asset manager will gratefully accept the better access to data. But we have to go through the 'valley of tears' first and live with increased costs in the short-term.

Ingo Speich: The idea of the EU platform is excellent, but the question is whether it is really feasible in this form. The whole coverage of the big research houses in sustainability, the analytical tools, the networking and also the vertical integration into the IT infrastructure of asset managers are strategic competitive advantages, which cannot be so easily solved by this EU platform. It will be hard to compete against the established big ESG players that are able to leverage the data.

Deloitte: What challenges are arising for research houses?
Ingo Speich: In the future, pure data provision will be a commodity. The new platform makes a significant amount of data freely available. Therefore, the business model of the research houses will be completely turned upside down; away from that of a data provider, to an integrated research house that evaluates and interprets the data on a customized basis. We should not underestimate the expenditures of research companies in R&D and we may see a continued consolidation of the market.

Some asset managers have already incorporated the importance of sustainability ratings into their investment decisions, as we have seen with credit ratings.

Wiebke Merbeth: The marginal benefit of an additional data provider is limited. Providers need to differentiate themselves by the quality of their ESG research or by focusing on niche topics. They will be assessed by the reliability of their forecasts.

Deloitte: Doesn't this create a danger similar to the financial crisis of 2008, where the market relied on headline ratings of a few rating agencies, while they underestimated the risk of certain financial products?
Ingo Speich: The financial crisis or the fixed-income area, where these ratings very much defined their creditworthiness, were different to the current situation. We will look at a large set of granular data points and try to draw conclusions on sustainability. Asset managers will differ in their research approaches to show their added value. We, for example, have already transitioned away from using sustainability data. This can also create a competitive advantage for asset managers if they can identify incorrect classifications earlier and react before the rating agency.

Wiebke Merbeth: Sustainability is a hot topic as bubbles—either green, brown or stranded—may arise. Increasing the definition of risk by underpinning sustainability issues won't lead to an underestimated risk—in fact, it's the contrary.

CONCLUSION

Sustainability is becoming increasingly important for asset managers—from a risk, demand, and regulatory perspective. The market for sustainable finance is extremely dynamic and comes with chances, but also challenges. Investors' demand for sustainable products is high, while the complexity of the market increases due to the latest wave of regulatory initiatives. Asset managers need to establish a reliable data infrastructure as well as adapt their product strategy and portfolio management process to stay regulatory-compliant and competitive. With the EU Taxonomy and the SFDR, the EU sets out an ambitious framework for sustainable finance regulation—which may serve as an example for global standards. We would like to say thank Wiebke Merbeth and Ingo Speich for their time and valuable input.

TO THE POINT

Sustainability will be a key driver of risk and return in the financial industry.

01. Asset managers profit from an increased demand for sustainable products; at the same time the market becomes more regulated. Consequently, asset managers need to adapt their strategy, not only to be regulatory-compliant, but also to stay ahead of the competition.
02. The EU's sustainable finance regulations set new standards and not only affects European asset managers, but also has a global impact.
03. Reliable data is becoming increasingly important and needs to be integrated into the portfolio management process. While data provision will be a pure commodity, analyzing data will be the main asset in the future. Building the necessary infrastructure is key.

The importance of the personal touch

DELOITTE GERMANY'S CHRISTIAN BOETH INTERVIEWS LEIF SCHÖNSTEDT OF UNION INVESTMENT INSTITUTIONAL GMBH

LEIF SCHÖNSTEDT
UNION INVESTMENT
INSTITUTIONAL

CHRISTIAN BOETH
SENIOR MANAGER
RISK ADVISORY
DELOITTE

INTRODUCTION

Leif Schönstedt discusses current challenges faced by asset managers, adapting to new technologies and regulations, and how, despite digital offerings becoming a new norm in a COVID-19 world, you can never underestimate the significance of direct contact with clients.

Christian Boeth: In which of your business areas do you see the greatest need for innovation?
Leif Schönstedt: Cost sensitivity along the entire value chain for institutional clients (IC) remains important. IC margins are tight/getting tighter and must withstand intense competition, therefore, innovations are needed in all business areas of the IC factory. Product-related cost blocks in fund management (securities and real estate) and fund services, as well as non-product-related staff costs must be maintained and reduced through innovations. We're talking about innovations such as platform solutions that are tailored by the specialist departments themselves; new technologies such as blockchain/DLT for processing, customer communication, and contracts; and the ability to become more flexible and connected to customers' systems. Modular product standards can reduce service costs in sales. Plus make-or-buy decisions in the expansion of the asset class range (e.g. alternatives: private debt) or the introduction of technology (e.g. DLT) must be taken into account.

Christian Boeth: Do you see FinTechs as competition and are there areas where you can learn from them?
Leif Schönstedt: Currently, FinTechs are not (yet) competition for institutional business. Regulated customer groups (e.g. banks, pension funds, insurance companies, foundations) rely on the stability of the ownership structure and stability of the infrastructure due to their own outsourcing and regulatory requirements of the regulatory systems. AI and solutions such as Robo Advisor still play a subordinate role in institutional business.

However, FinTechs provide very good service solutions (e.g. reporting, contracting, customer communication, platform programs, DLT solutions) that can be built on top of traditional products (fund solutions, asset management solutions) and help us with make-or-buy decisions. It is therefore conceivable to outsource the technological implementation of new solutions and, as an asset manager, to contribute our own USP, the customer relationships.

> Product-related cost blocks in fund management (securities and real estate) and fund services, as well as non-product-related staff costs must be maintained and reduced through innovations.

Christian Boeth: What are/were the biggest challenges you faced during the COVID-19 crisis? How have you dealt with or will you deal with these challenges?
Leif Schönstedt: The technology and stability of the systems were not a challenge. The lack of direct customer contacts (at home and abroad) was problematic. Digital solutions in communication are not optimal solutions in institutional business and, in my view, can only lead to success as a supplement. As our relationship managers were very busy with our existing clients, we benefited from the efficiency gains from switching to digital communication for a while, but as soon as the opportunity arose, personal client contacts were revived. The same applied to internal cooperation. What used to be discussed through short office channels now took several digital appointments. Even random encounters that led to creative solutions were made more difficult digitally, but were partially compensated for via the newly created digital workplace with agile working methods. Managers were challenged not to "lose" the team, regular exchange formats were implemented across business units, and even the onboarding processes of new employees were partly digital. Cross-functional teams worked cross-business hybrid (digital/on-site) on the most important topics and projects. At the same time, the clients' need for information increased sharply—here, our reorganization of digital events (fortnightly capital market forums) and the reorganization of the social media strategy on LinkedIn helped in a client-oriented way. Digital communication channels will continue to be used in the future, such as for the pure transfer of information. However, personal customer contact cannot be replaced by a digital offering.

Christian Boeth: How do you want to position yourself in the future with regard to sustainability-related products and topics?
Leif Schönstedt: In the past, sustainability was considered as a separate issue—which was important in order to look at the subject in its entirety and identify the challenges. Sustainability also existed in parallel with risk management—our USP in institutional business. In the future, the topics will be more closely integrated— sustainability will be an integral part of everything we do—on the portfolio management side as well as in our internal processes at UIG. This means that the integration of sustainability processes and thinking in portfolio management, product development, marketing processes, settlement, and reporting processes will undergo an evolutionary stage. We want to accompany the transformation process of the economy and direct the capital flows to the right areas within the framework of the transformation. We also will apply our proprietary sustainable transformation ratings in portfolio management. In my view, this will be an important USP for us as an active fund manager.

Sustainability is therefore no longer a state for us, but a process. In order to achieve the sustainability goals of, for example, the UN PRI or the Paris Climate Agreement, more companies and states must participate with even more ambitious efforts. In managing sustainable mandates, Union Investment therefore combines a best-in-class approach with the idea of transformation. This means that for corresponding products, we not only invest in securities that are already sustainable according to our ESG criteria. Rather, we also include securities in which the issuer is pursuing a credible, ambitious, and verifiable transformation strategy in order to be among the best issuers within a defined timeframe.

Our goal: On the one hand, we want to achieve a higher impact by supporting issuers in transforming their business model. On the other hand, we want to participate in the value growth that arises in the event of a successful transformation—and thus generate an attractive return for our investors.

> We want to accompany the transformation process of the economy and direct the capital flows to the right areas within the framework of the transformation.

Christian Boeth: How do you deal with the issue of "greenwashing" in view of the current media coverage?
Leif Schönstedt: Irrespective of the accusations made against our competitors, we are convinced of our sustainability approach and the established processes. For us, sustainable investing is based on three instruments: exclusion criteria, data analysis, and engagement. The investments we manage can be grouped into three categories from a sustainability perspective:

01. General exclusion filters apply to all investments (total AuM volume in the Union Group) such as the prohibition of participation in the production of outlawed weapons, in derivatives on agricultural commodities, or in companies with a share of turnover of more than 5% in coal production. Our engagement activities also cover all investments in principle. However, the data necessary for the application of serious, adequate, and beneficial ESG analyses are not available for all securities—yet. It is an ongoing process

to gather all relevant data. Therefore, we are currently not (yet) 'fully ESG integrated'.

02. Wherever the necessary data is available, we apply the ESG integration approach in the management of our funds. Here, ESG risks or factors are also systematically included in the fundamental securities analysis across all asset classes.

03. In addition, a volume of around €74 billion is managed according to even more comprehensive, explicit sustainability criteria. Proprietary ESG filters (adapted to special and mutual funds) are used for these sustainable investments.

Currently, a complete integration of ESG criteria across all investments is not possible due to the poor but also more complex data situation. ESG data is currently being collected in order to gain full integration , but data is the bottleneck, as it is not always easy to obtain or process, for example due to the monopoly position of data providers.

Christian Boeth: How are you positioning yourself in the area of digital assets and how relevant is the use of AI or alternative data in your investment process?
Leif Schönstedt: As asset managers, we work with large amounts of data that need to be processed. This is not just return data, for example, but also information data. We are already using AI for this purpose. Robots are used at many points in the value chain (front to back) to help us process this data or carry out quality assurance. This is already the industry standard today. In the future, this process will be successively expanded, for example by combining AI and robots or via the blockchain. Solutions such as cloud, AI, and blockchain are currently being discussed and questioned at our company as to what is the right fit for us. In some places we have to start first; in others it makes more sense to wait and be smart followers.

With regard to crypto or digital assets, however, we notice that demand from institutional clients is still very low. This is probably due to uncertainties that still exist, but more and more issuers are looking into issuing digital assets. We have already participated in test transactions and therefore feel well-positioned. However, this does not mean that we see ourselves as capable of connecting to, for example, DLT solutions; this topic will challenge us over the next years.

Robots are used at many points in the value chain (front to back) to help us process this data or carry out quality assurance.

Christian Boeth: What expectations do you currently see among investors that you have to satisfy?
Leif Schönstedt: A sustainable return must be realized that adequately pays for the risks I take with my capital investment. This is no longer possible through working exclusively with the traditional asset classes, but increasingly through the alternative or real estate asset classes. As asset managers, we must therefore be in a position to cover these asset classes. It is possible that crypto will also be one of these asset classes in the future. At the moment, there is a demand for options such as private debt that used to be done by banks to be realized by investors themselves without the involvement of intermediaries.

In addition, the regulatory framework is becoming more and more complex and is a great challenge for our clients if they want to invest in such asset classes. Therefore, as an asset manager, we not only offer the asset class, but also the associated services such as regulatory reporting and direct connection to the clients' systems. This is an important experience for us. When we offer a new asset class, we must also be in a position to offer the associated services on a customized basis. Only the two together ensure investor satisfaction.

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TO THE POINT

01. Product-related cost blocks in fund management and fund services, as well as non-product-related staff costs must be maintained and reduced through innovations such as new technologies like blockchain and the ability to become more flexible and connected to customers' systems.
02. FinTechs are not (yet) competition for institutional business, yet they do provide very good service that can be built on top of traditional products.
03. Technological implementation and stability were not a challenge during the onset of the COVID-19 pandemic, however inability for direct contact with clients has been. Although adaptions were made and digital options realized, personal customer contact cannot be replaced by a digital offering.
04. Sustainable investing is based on three instruments: exclusion criteria, data analysis, and engagement.
05. As regulatory framework becomes more and more complex, it presets a great challenge for clients seeking to invest in alternative asset classes. An asset manager must not only offer the asset class, but also customized associated services. Only the two together ensure investor satisfaction.

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  Accounting: GAAP differences to consider for RE / Alternative funds
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  ELTIF regime

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- **06 April 2022**
  Future of work
- **27 April 2022**
  Commoditization of some banking processes & services leading to outsourcing
- **01 June 2022**
  Private Banking market & trends
- **08 June 2022**
  Governance and organization of the supervision

Investment Funds

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  Cross-border marketing in Europe with a focus on (i) the Directive 2019/1160 and (ii) Brexit
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  Fund Tax update: update on latest trends

Regulatory

- **02 February 2022**
  MIFIID II
- **23 February 2022**
  Regulatory Landscape for 2022
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  Liquidity risk management

Sustainability

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  ESG Disclosure and data challenge
- **25 May 2022**
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