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FOREWORD

VINCENT GOUVERNEUR
EMEA INVESTMENT MANAGEMENT CO-LEADER
DELOITTE

TONY GAUGHAN
EMEA INVESTMENT MANAGEMENT CO-LEADER
DELOITTE

January, the translation of the Latin word Januarius, named after the Roman god Janus, who represented beginnings, transitions, and endings. How apt that his image is usually depicted as having two faces, one looking back and one looking forward. Many of us act like Janus in this first month of the year; we not only reflect on the year that has just passed but also contemplate the future and what the year will bring.

This edition of Performance does just that, we reflect on the impact that COVID-19 has had on all facets of our industry and of course our lives, but at the same time consider how our agility, resourcefulness and determination has helped overcome its initial challenges. The future lies in both harnessing and evolving these qualities.

We start with our colleagues from Casey Quirk seeking to demystifying technological success by identifying change catalysts and technological success metrics; not surprisingly their research has shown that those asset managers who are front runners in data and technology, do generally outperform their peers. Delving further into technology, we interviewed Peter Jubber, Managing Director of Fidelity Digital Funds who shared with us his latest thoughts on emerging global trends in digital assets, Fidelity's continued foray into bitcoin mining as well as mainstream investments. Big data and digitalisation will continue to dominate our agenda not just for 2021 but beyond. As harnessing technology is no mean feat, our experts will take you on a journey not only towards 2030 and ManCoTech but also on understanding the value of digital innovation and transformation, two very well-known buzzwords from the last decade.

Despite our physical globetrotting opportunities having been severely curtailed in the last eleven months, through the wonders of technology, Performance continues to travel the world. This time we have stopped off in Asia to delve into the new Hong Kong limited partnership fund regime, considered by many to be the game changer for our industry. A critical factor for success will be navigating through the maze of local regulations including regulatory and tax reporting requirements.

As ever, our professional lives are dominated by regulations; the tidal wave that overwhelmed us during the last decade unfortunately shows no signs of slowing down. A cluster of new rules and a raft of refinements are foreseen, each with their own layers of complexity that will require in depth analysis, technological enhancements, and a coordinated implementation. One of these new rules is just around the corner in March 2021 – SFDR, the Sustainable Finance Disclosure Regulation. This will require any financial market participant who has not yet started their ESG journey to do so. Francois de Varenne, CEO of SCOR Global Investments further provides his insights on the role of double materiality in the facets of sustainability - resilience and the inside-out /loopback effect. Not to be outdone, as part of the refinements' agenda, the AIFM Directive is currently undergoing an industry consultation; we examine the passport's success and what lies in store.

To conclude, as we say goodbye to a tumultuous 2020, let us also look, like Janus, towards a healthier 2021.

EDITORIAL

PAUL KRAFT
PARTNER
DELOITTE

SIMON RAMOS
EDITORIALIST
DELOITTE

It is safe to say that the much-anticipated end of 2020 was greatly welcomed and widely embraced, as 2020 will go down as one of the most challenging years in recent times. The combination of a global pandemic, political chaos, the shift to a work from home environment, market volatility and volumes not seen in a lifetime provided unprecedented need for the human ingenuity, leadership and resiliency. Beyond the devastating human toll of the pandemic, investment managers proved that their businesses are resilient; withstanding these shocks and maintaining their value proposition and focus on investor interests and futures. Aided by a rapid market recovery, aggressive and proactive governance and regulatory steps to freeze and then stimulate the economy, investment managers continued to focus on investor value and service. It is with this backdrop that we wish all a Happy New Year and much success in 2021.

As we find ourselves at the end of January enduring experiences reminiscent of 2020, investment managers continue to keep their eye on the ball and to focus on the strategies, levers and new objectives for a promising future ahead.

Our 2021 investment management outlook focuses on moving beyond the 2020 storylines and on how investment managers can recover and thrive in a post COVID-19 world. This is the expected story of 2021! How investment managers will continue to motivate and engage their workforces and retain their culture will be critical. Investment managers will need to balance a changing workplace with the growing digital organizational changes that accelerated in 2020. Externally, laser focus needs to be maintained on client experience as investors, especially millennials, will demand more digital engagement.

Technology has been and will continue to be a differentiator among profitable growth firms. Front runners in this journey have strong technology leadership, clear vision, and a robust execution approach. This is critical as the disruptive speed, potential and impact of data and technology is immense as is the opportunity to adapt into operating models to gain a competitive advantage.

Beyond the current health and economic crisis, very few topics enjoy greater attention than digital assets and blockchain. The opportunity for a new asset class to emerge for institutional and retail investors has created incredible excitement. Both traditional players and startups look to position themselves for success along the digital asset and blockchain ecosystem. Headwinds to traction and engagement are real but so is the growth potential as digital assets such as Bitcoin become more mainstream.

As the world looks to a better 2021, the investment managers have once more demonstrated their resilience in the face of major disruption. The prospect of a new normal and better tomorrow will drive investment managers to learn from the past eleven months and sharpened their focus to strengthen their position. In this edition, we provide several focus areas that will go a long way in deciding the investment managers that win in the future.

PLEASE CONTACT

Simon Ramos
Partner
Advisory & Consulting
Deloitte Luxembourg
20 Boulevard de Kockelscheuer
L-1821 Luxembourg
Grand Duchy of Luxembourg

Tel: +352 451 452 702
Mobile: +352 621 240 616
siramos@deloitte.lu
www.deloitte.lu

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CASEY QUIRK - DELOITTE

BENJAMIN F. PHILLIPS
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CASEY QUIRK - DELOITTE

JUSTIN R. WHITE
PRINCIPAL
CASEY QUIRK - DELOITTE

Leadership takes foresight to make bold decisions. In the past, investment management Chief Executive Officers (CEOs) confidently dictated their firm vision, tapping deep experience earned as investment or distribution leaders. The disruptive speed and impact of data and technology, however, challenges today's executives. CEOs are beset with ballooning technology costs, an explosion of new applications and data sets, and a shortage of internal expertise.

Asset management is in its adolescence when faced with how to unlock the transformative potential of data and technology. The industry spends US$51 billion annually on data and technology. But firms are assembling a range of technological capabilities that lack a cohesive recipe.
As technology moves to the core of the business, asset management CEOs must evolve and set a clear vision for how data and technology will drive competitive advantage. Those who have the road map and skills to act will leapfrog the competition.

This article aims to demystify the essential ingredients for success, working from the top down to link technology capabilities with firm business objectives.

Tech budgets: Spending a growing budget more wisely

Asset managers historically viewed data and technology solely as enabling functions. Firms benchmarked their technology budgets to median spend, sought to adopt universal best practices, and largely mirrored competitors. As technology shifts to the core of the business, firms are taking increasingly divergent approaches—leading to markedly different results in terms of spend, process, and, ultimately, business impact.

Source: 2020 Casey Quirk CIO/CTO Survey; 2019 Casey Quirk/McLagan Performance Intelligence Survey, Casey Quirk analysis

Change catalysts for investment management technology

	Change Catalysts	
Just-in-time expectations Increased importance of providing instantaneous and accessible data and information	**57%**	of investors note providing 'anytime, anywhere access' as the most important attribute of their financial providers
Personalization Heightened buyer and employee demands for on-demand, self-service capabilities	**44%**	of asset owners citing that they expect service customization
Expanding Ecosystem C-suites must increasingly leverage ecosystem partners to build the business of tomorrow	**28%**	of CTOs expected growth in external vendor spend
Data Proliferation Abundance of traditional and alternative datasets – both structured and unstructured	**5.3%**	annualized increase in total market data and third-party research spend as % of revenue (2014-2018)
Risk & Compliance Importance of mitigationg risk in an increasingly litigious environment	**1.6x**	increase in asset manager median legal & compliance costs (2015-2018)

Sources: 2020 Casey Quirk CIO/CTO Survey, 2019 Casey Quirk/McLagan Performance Intelligence Study, Casey Quirk/Top1000funds.com Global Investor Survey, Casey Quirk Financial Advisor Study

Pressed on issues of technology, executives often assume those that deploy a greater volume of spend win. Median technology spend among asset managers hovers at 10% of operating expenses, representing an estimated US$51 billion in industry spend based on 2019 numbers. Despite this increase in spend, most managers struggle to prioritize, track, and determine the value of projects. More than three-quarters of chief technology officers (CTOs) say they lack clearly defined business metrics around technology projects. Only 15% have a structured process for measuring the value of technology initiatives, and only one-third indicate they have a process for prioritizing technology investments. We assessed industry participants based on spend and approach to technology.

This assessment included surveys and interviews from leading CIO/CTO's and was informed by our annual benchmarking study conducted in collaboration with McLagan. In the study, we found that front-runners in asset management share two characteristics:

Empowered and adept leadership

- Elevated technology leadership that has the perspective to engage in business strategy.
- An enterprise-wide culture of innovation that emphasizes new skills and pivots funding to support new development.
- A capital allocation process that invests in the foundation, as well as defined business use cases.

Mature technology operating model

- Modern and flexible data, systems and applications, enabling analytics.
- A cohesive approach to talent to attract, develop and retain in-demand technology and business leadership.
- Leading technology development and implementation processes, such as agile development; capital allocation that is more iterative and considers shared service investments; rigorous impact measurement and rationalization; and mature change management.

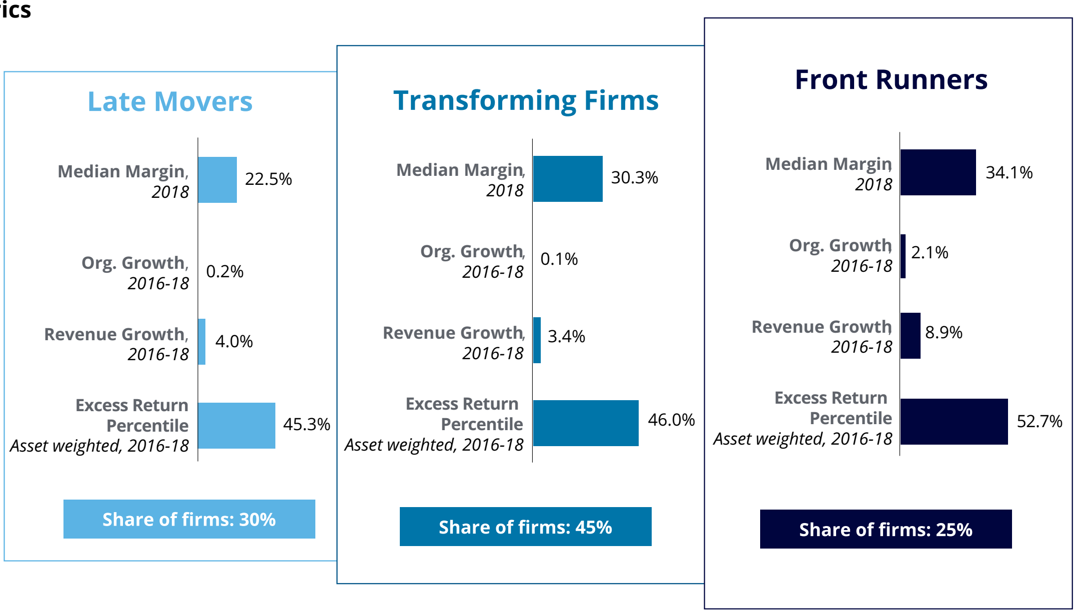
Most asset managers lack these features. An analysis of budgets and capabilities among asset managers indicates that firms fall into one of three categories when it comes to data and technology.

Investment manager firm technology models

Archetype	Late movers	Transforming firms	Front runners
Tech spend as % of total costs	9%	12.5%	12%
Stage in tech modernization journey	• Heavily reliant on legacy systems and processes (i.e. Excel, in-house data) • Disjointed data infrastructure and limited governance • Some use of enabling technologies, but limited integration and adoption	• Early stages of modernizing foundation (i.e. cloud migration, integrated data) • Some use of enabling technologies, but without a cohesive strategy on how they will drive business value • Piloting analytics use cases, with pull-through and broad adoption still a challenge	• Modernized infrastructure and data with clear governance • Robust use of enabling technologies, with clear strategic objectives and tracking of business value • Analytics deployed and adopted across key processes to enable decision-support

Technology model success metrics

Asset managers that are front-runners in data and technology materially outperform peers across all facets of the business.



Larger managers, unsurprisingly, invest more heavily in technology than their smaller peers. That said, an asset manager's size provides less insight into how budget is spent across three levels of data and technology.

- **Business as usual**, defined as the run-rate costs of maintaining existing technology;
- **Process improvement**, which includes improving or replacing systems to improve efficiency; and
- **Innovation**, data and technology that supports differentiated competitive advantage. Innovative spend is a spectrum, but for asset managers it usually involves technologies directly linked to expanding capabilities. These capabilities may be linked to new product and service capabilities, creating new revenue streams, redefining client experience, or reinventing business lines.

A breakdown of technology spending reveals that, regardless of size, front-runners dedicate a greater share of investment toward value-generating activities like process enhancement or innovation.

Most importantly, asset managers that are front-runners in data and technology materially outperform peers across all facets of the business.

Maximizing return on technology investments

Leadership: owning enterprise technology transformation

If asset managers increasingly compete on the basis of data and technology, then decisions regarding both fall onto the shoulders of CEOs and their executive teams, not simply the chief information officer (CIO) or CTO. The scope of changes required demands an enterprise-wide initiative involving top-down leadership and typically requires three elements to succeed:

- A compelling vision to inspire change, guide decision-making, and clear objectives around timelines to realization;
- New skills and representation across the leadership team; and
- A different approach to capital allocation that aggressively redirects funding, emphasizes foundational investments, and monitors capital allocation more frequently.

Vision

Innovation requires integrating new technology and industry perspectives. Applying new technologies to existing and emerging business challenges helps firms advance their existing capabilities and discover new growth drivers. There is a range of existing use cases that are driving not only optimization of firms' existing business, but also an expansion of their capabilities.
Select firms are monetizing their intellectual property through risk systems, seeking new paths to market with direct-to-consumer and business-to-business (B2B) offerings, evolving products with new vehicle structures, delivering customization, and harnessing data-driven client feedback. Leaders of tomorrow will define a vision that not only addresses the core operating capabilities, but also extends the purview of their firm's capabilities and revenue opportunities using new technology.

Asset management CEOs can take four steps to define their visions for data and technology:

- First, define existing competitive advantage. A corporate strategic refresh can help revalidate existing plans regarding where to play and how to win.
- Second, clarify how technology can extend existing advantage. This involves all leaders, not just technology officers, helping define the key use cases that support differentiation.
- Third, identify how data and technology can shape new offerings. Examples include new ways to monetize intellectual property, new platforms or partnerships, and new paths to market.
- Fourth, create clear ownership amongst team leadership, with specific timelines and incentives to motivate the team to deliver.

Executive team composition

Fulfilling the transformation road map will require different dynamics, and potentially different skills, across the executive team. One primary change involves CTOs, who will need a seat at the corporate leadership table if they do not have one already. Currently, only 48% of CTOs report to the CEO and just 55% have direct involvement in strategic planning with the leadership team. Additionally, the skills that previously comprised an asset manager's executive committee may prove necessary but insufficient. Leaders have a few options to upskill or reinvigorate their executive teams:

- **Additional team members:** talent and data officers become more important factors in creating competitive advantage and should join leadership workgroups.
- **Hires from outside the industry:** recruiting new officers from industries with more mature data and technology approaches (particularly adjacent financial services such as consumer banking or securities) injects needed transformational skills.
- **Secondments:** shifting CTOs into business-line positions, and vice versa, to structure more well-rounded executive teams.
- **Incentives:** aligning business case expectations and metrics on technology investments into executive compensation creates more accountability.
- **Corporate development:** mergers and acquisitions (M&A) exercises (including prospecting, diligence, and integration) in financial technology provides a crash course for leadership.

Capital allocation

Increased technology spend presents asset managers with new challenges to their traditional capital allocation and budgeting processes. A new approach to capital allocation can optimize technology spend and accelerate transformation. These five key decisions can help:

- First, determine the amount of capital required and sequencing of spend to meet the needs of the strategic vision. Using business cases and timelines, identify the absolute cost of the required projects that are necessary to unlock firm objectives.
- Then, decide how you will fund transformation. Chief financial officers (CFOs) have a range of options to fund transformation, from compressing margins, funding new projects via cost-cutting, or issuing equity or debt. Consciously choosing a funding mechanism to improve data and technology and effectively communicating such choices to stakeholders helps frame intent and protect transformation initiatives.
- Third, expand the criteria used to measure investments. Adjust capital allocation to factor sequencing of cornerstone projects that create leverage for downstream efforts, ensuring they add value.
- Next, adapt the balance sheet to shift data and technology investments from capital expenditures to operating expenses. Doing so not only better reflects the “software-as-a-service” format of cloud technologies and outsourcing arrangements, but also allows CFOs to calculate the profit and loss impact of technology investments more quickly.
- Finally, define your sell discipline. Good portfolio managers cut losing positions; the same rationale applies to technology projects.

Maximizing return on technology investments

Operating model: Turning transformation plans into reality

Front-runners among asset managers in data and technology not only create strong transformation plans, but also consciously change their operating models to support a new culture and work environment. These changes fall into four big categories: modern platforms, analytics, workforce, and execution.

Modern platforms, applications, and data

A majority of managers struggle with their data and technology platforms, applications, and data: 56% of CTOs noted that legacy, outmoded infrastructure was the greatest challenge to transformation, more than any other potential roadblock to change.   Platforms consist of a range of capabilities, including financial systems, workflow tools, data storage servers or cloud, trading systems, client-facing websites, and client and market data. Overhauling the range of platforms in use can appear a gargantuan task at the outset, but yields a range of organizational benefits:

- **Faster deployment:** front-runners manage more programs and deliver faster than peers. Modernizing legacy platforms relieves firms of "technical debt" that impedes organizational agility. The advantage of speed and productivity enables front-runners to extend their lead over competitors.
- **Streamlined costs:** despite spending 33% more than lagging firms on technology overall, front-runners spend 14% less than laggards on business-as-usual costs because they have proactively addressed outdated systems.
- **Increased resiliency and risk reduction:** firms reduce their risk profile by connecting siloed systems and automating manual processes. Additionally, cybersecurity programs are becoming increasingly important to meet regulatory responsibilities and safeguard client information and intellectual property.
- **Improved innovation**: in particular, shifting from on-premises servers to cloud computing allows developers to access new applications and coding tools within the native cloud environment rather than retrofitting new tools into a proprietary server system.
This accelerates innovation and attracts and retains developer talent.
- **Enhanced client experience:** better-organized data, more responsive systems, and integrated applications improve both client and work experience by supporting digital conduits such as automated reporting, websites, and distribution touchpoints.

Five best practices can help asset managers modernize their platforms:

- Assess existing systems, data, and applications
- Set business metrics for new system adoption
- Decommission systems as part of new build projects
- Aggressively integrate systems post-acquisition or merger
- Invest in training and change management

Analytics

Data-driven insights will enable better decision-making and outcomes—particularly if those insights align with initiatives that the corporate strategy prioritizes. Front-runners prioritize setting up analytical systems to help inform those decisions. Strong analytics for asset managers has three ingredients:

- Clean data, which is the fuel for decision-making. Unstructured, disorganized, and fragmented data creates costs in the form of manual intervention and reduces the impact of downstream applications. Leaders in asset management technology build a "single source of truth" by creating integrated data repositories, imposing data governance, and clarifying data ownership.

- Valuable insights: mature organizations provide their leaders with tools and functional skills to not only access and manipulate data, but also search for actionable insights. The search for insights should begin with a clear use case and be refined to improve quality over time.
- Action: asset management firms can take two steps to improve analytics adoption. Prioritize collaboration between data scientists and functional areas, potentially through reorganization. Secondly, managers should embed analytics education and usagre in training, feedback and incentive structures to accelerate adoption.

Workforce

Human capital maximizes the value of technology; consequently, the people needed to drive technology cannot reside in a silo. Several challenges face workforce transformation. New applications, coupled with the ever-doubling volume of data, have created more diverse talent requirements. Individuals can specialize along a continuum that extends across front-to-back-end systems, databases, application programming, or middleware. Leaders can take the following steps to drive evolution:

- **Rethink professional development and rewards:** training (not just on existing applications, but also both technology fundamentals and the process of change management) supports a culture of innovation. Qualitative scorecards tied to incentives, driven by measurable project key performance indicators (KPIs), can reward adoption and development of technology initiatives.
- **Tap into external talent:** a growing network of outsourcers, consultants, and contractors will complement the internal workforce and accelerate the completion of deliverables. Oversight, workflow management, and risk controls will maximize the potential of third parties.
- **Adapt promotion criteria:** asset managers must build talent programs that balance technology centers of excellence and reward functional collaboration in order to cultivate leaders that can deliver change within the organization.

Execution

Lagging firms approach technology development with a waterfall approach, building end-to-end from the ground up. Front-runners increasingly view development in a modular, agile approach. Each new capability is an extension of the existing platform. This enables firms to start further downfield toward their objective, enhancing speed of delivery. Asset managers characterized as "front-runners" support nearly twice as many high-priority technology initiatives compared with late movers. Agile processes emphasize:

- Iterative development centered on minimum viable products;
- Cross-functional working teams, with representation from business and technology;
- Distributed accountability and ownership of the working team, reducing bureaucratic barriers;
- User feedback and transparency to stakeholders; and
- Performance monitoring and incentives that track and reward team members.

Done right, the adoption of agile will improve productivity, support a culture of rapid delivery, and establish clear accountability.

Where to start

As asset management executives begin to grasp the magnitude of data and technology's impact on their future organization, many are struggling to find a place to start. A clear-eyed assessment of the organization's current leadership and operating model against the best practices outlined can identify both the short- and long-term changes necessary. Additionally, leadership can gain a sense of their current state versus peers in key dimensions such as empowered technology leadership, culture of innovation, technology operating model, and leading development processes that distinguish front-runners from the rest of the industry.

As the applications of technology expand and the consequences of its use ripple throughout the industry, leaders face a new competitive equilibrium. Success in the next generation will come to those who harness the power of data and technology to deliver the best tools that drive efficiency and competitive advantage to their asset management organizations.

TO THE POINT

- **Data and technology are increasingly central to competitive advantage amongst asset managers.**
- **Data and technology budgets are growing rapidly, but only a narrow set of industry players are benefiting.**
- **Successful data and technology programs begin at the top, not within siloed functions.**
- **Front-runners adapt their operating models to maximize the impact of data and technology.**

2021 INVESTMENT MANAGEMENT OUTLOOK: PRESSURE CATALYZES CHANGE

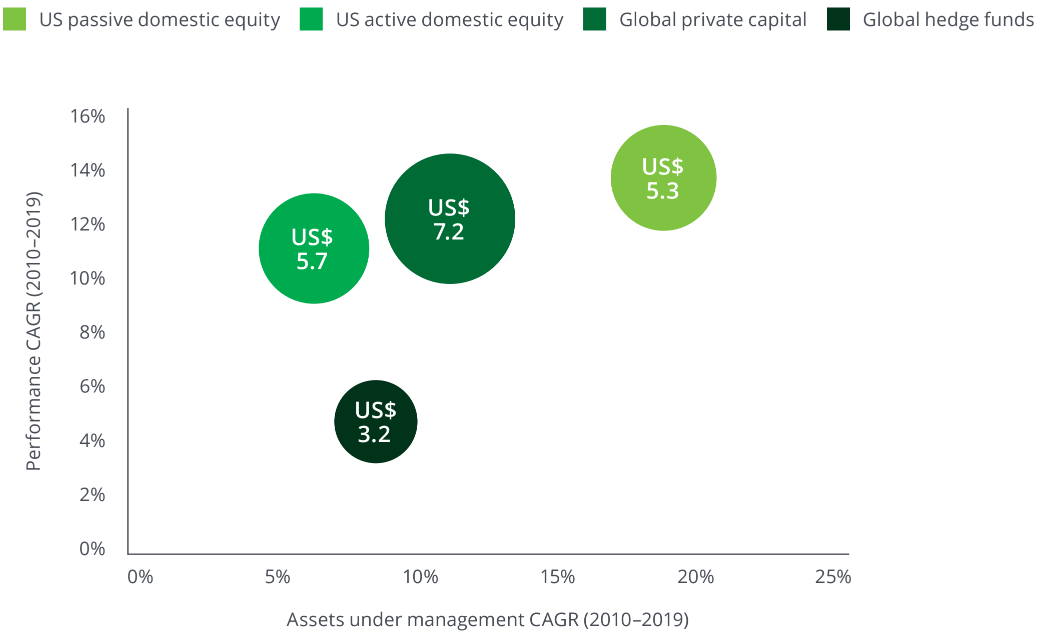
DOUG DANNEMILLER
SENIOR MANAGER
CENTER FOR FINANCIAL SERVICES
DELOITTE SERVICES LP

SEAN COLLINS
MANAGER
CENTER FOR FINANCIAL SERVICES
DELOITTE SERVICES LP

The COVID-19 pandemic was the story of 2020, but how firms recover and thrive in a post-COVID-19 world is expected to be the story of 2021. Before the world turned upside down, the investment management industry was experiencing two important forces: the longest-running bull market in history and shrinking margins at all but the most successful profitable growth investment management firms[1-2]. As we look at the Assets Under Management (AUM) in the investment management industry and their long-term growth rates, the year-end 2019 figures are still instructive for understanding the allocations and historical returns (see Figure 1).

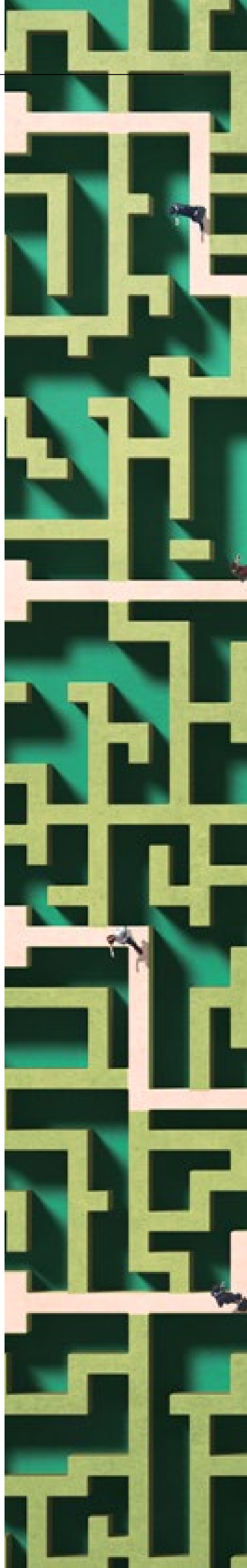
The market correction from February to March ended the bull market run, while operations were simultaneously thrown into turmoil by stay-at-home orders in the face of growing case counts of COVID-19. The market correction was short-lived, but the subsequent recovery activities undertaken by many firms continue today.
In this industry outlook, we will explore the current status of investment management firms and their plans for achieving success in 2021 and beyond. This outlook is fueled by a proprietary survey of investment management firms across the globe and by examples of bold action taken by investment management firms (see survey methodology). Talent, financial management, and digital enablement of operations are three organizing areas that investment management firms appear to be prioritizing to emerge into the post-COVID-19 environment stronger than they were at the start of 2020. Over the next 18 months, the future of investment management firms could depend on how they execute these priorities.

Figure 1
Passive funds and private capital continue to outperform and gather assets (USD trillion)



Note: Size of the bubble indicates 2019 AUM of the investment vehicle in USD trillion.
Sources: ICI Factbook 2020; BarclayHedge; Preqin; S&P Global Market Intelligence.

1. Yun Li, "This is now the best bull market ever," CNBC, 14 November 2019.
2. Tyler Cloherty, Ben Phillips, Kevin Quirk, Scott Gockowski, "Righting the ship: Transforming active equity for a competitive world", Casey Quirk a Deloitte business, April 2020.



Managing the return to the workplace, preserving the culture, and creating a diverse workforce

Throughout 2020, investment management firms faced real difficulties keeping their people equipped to meet client demands while simultaneously protecting their well-being in the face of the pandemic. Employee safety is the primary concern as they work to meet or exceed customer expectations. And, for long-term success, it must be done while preserving or strengthening corporate culture.

The first step to bring employees safely back to the workplace should be having a clear vision and plan. Interestingly, 48% of respondents to our survey agreed or strongly agreed that their firm had a vision and a clear action plan to maintain operational and financial resilience through the COVID-19 pandemic. This level appears low, given the importance of a clear action plan and the high percentage (~90%) of respondents who indicated that their firm has already taken steps or has a plan for elements of a safe return to the workplace.

The low reporting of a vision and a clear action plan may be due to the uncertain nature of the pandemic itself, further complicated by government action that continues to be unpredictable. Planning must be agile enough to meet changes on a daily basis in this environment.

In addition to all the internal practices that firms are developing, some large firms like Vanguard are using pandemic spread data to inform the return-to-the-workplace approach across their global footprint[3]. In addition to considering local regulations, they are using case rates and spread statistics to determine when specific geographies have reached threshold virus incidence levels.

Using external data and a geographic approach adds a layer of objectivity and control to back-to-the-workplace plans, which can increase confidence in the return-to-work process. Firms that follow a data-driven approach and communicate that approach well are more likely to enhance enterprise-wide unity and emerge from the pandemic culturally stronger.

The diversity makeup of organizations is also likely to rise in importance as more data becomes available to external stakeholders. Institutional investment data collected by eVestment will soon include diversity data not only about the composition of the firm's leadership, but also at the portfolio manager team level[4]. The questionnaire allows managers the opportunity to demonstrate their commitment to diversity and inclusion, which in turn may better enable the organization to attract and retain top talent[5]. Diversity is expected to be a major topic for discussion as firms develop their talent objectives for 2021.

With these plans in place, the number of investment management firms that externally share high-level roadmaps for increasing diversity is likely to grow. However, firms may be able to differentiate by providing additional transparency about that roadmap. The LEAD (Listen, Engage, Acknowledge,

3. Dervedia Thomas, "Vanguard Constructs Tool to Guide Office Reopening, Sales Mtg Plans", FundFire, 21 August 2020.

4. Aziza Kasumov, "Evestment Will Start Asking Mgrs for Staff Diversity Data in 2021," FundFire, 30 September 2020.

5. Deloitte, "The Deloitte Global Millennial Survey 2020," 2020

Do) framework is one such roadmap that can help investment management leaders take meaningful action today to build an inclusive workplace for all current and prospective employees[6]. The LEAD framework can be used globally to address racism, and firms can apply many of its considerations to create an inclusive and supportive workplace environment within their local communities.

Managing finances through 2021

Leadership at most investment management firms stabilized financing as an early action step in the highly uncertain times at the onset of the pandemic, as one of a broad spectrum of activities. When asked about internal budgeting actions, half of our survey respondents indicate that their firms plan to reduce total costs by 11% to 20%. These cost-reduction targets look ambitious considering that the workplace-related cost per employee is estimated to increase by as much as 50%, straining cost-reduction plans[7]. Let us explore the cost-reduction changes for two large expense categories—workforce and technology.

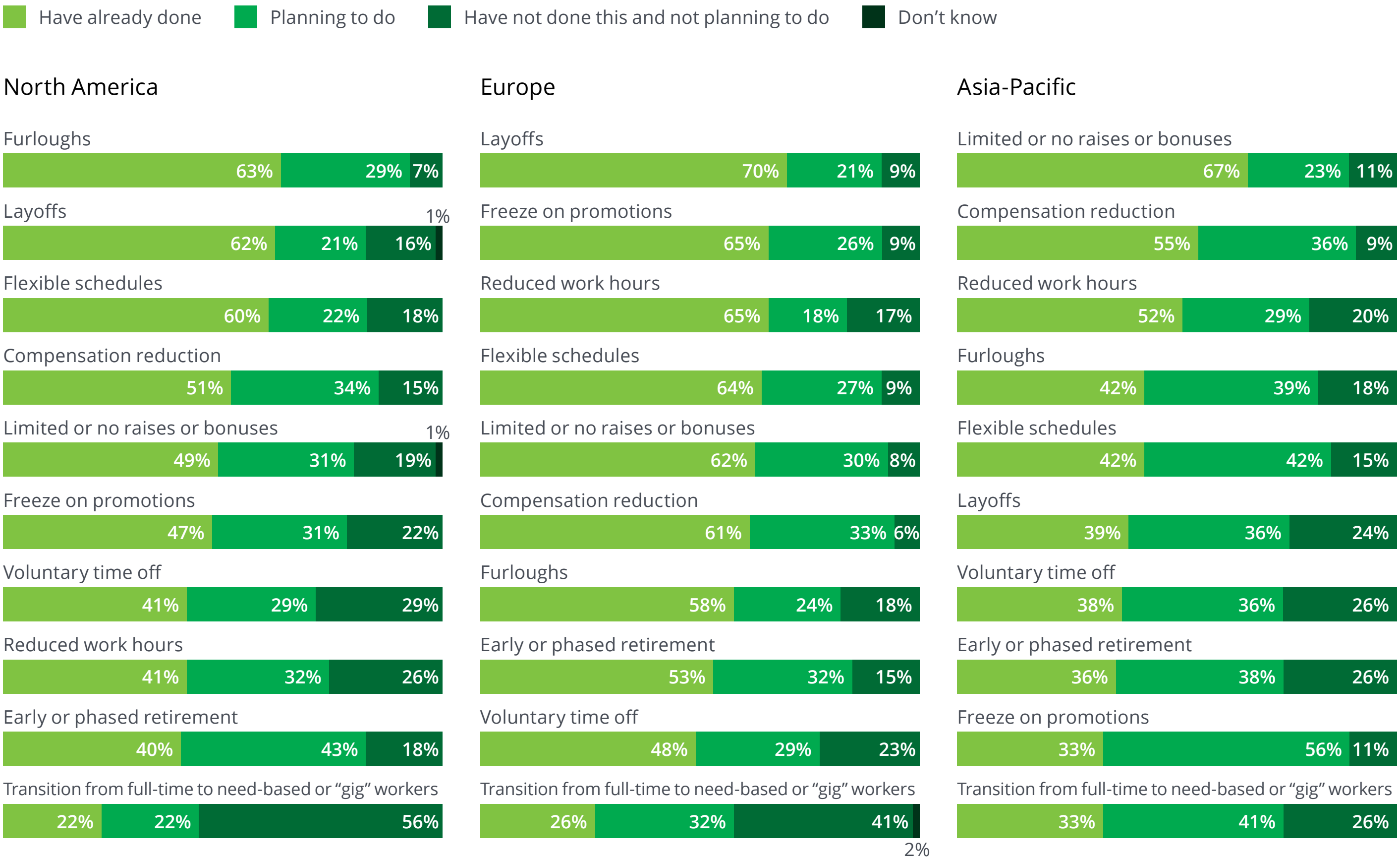
The LEAD (Listen, Engage, Acknowledge, Do) framework is one such roadmap that can help investment management leaders take meaningful action today to build an inclusive workplace for all current and prospective employees.

6. Terri Cooper, Kwasi Mitchell, Christina Brodzik, "Support your Black workforce, now," Deloitte, 2020.

7. Jennifer Surane, "At $18,000 per banker, cost of returning to Wall Street will sting", Bloomberg, 20 June 2020.

Figure 2: What employment actions, if any, has your company taken to reduce workforce-related expenses?

Percentage of respondents from investment management industry



Note: Percentages may not add up to 100% due to rounding

Source: The Deloitte Center for Financial Services Global Outlook Survey 2020

Workforce

Leadership has many options available to manage the cost of the workforce, and many firms are breaking traditional patterns as they address this pandemic. Our survey results indicate that, globally, firms are taking multiple approaches to managing workforce costs, and that most actions were taken by the summer of 2020 even though there were some significant regional differences. At the time of the survey, executed workforce actions outnumbered "planned but unexecuted" actions by a factor of about two to one.

While almost all of these workforce cost management actions have planned and completed utilization rates of about 80%, it is important to note that this is a binary indicator, which does not speak to the depth of cost management of any of the alternative actions. For example, deep layoffs at investment management firms have not been widely reported in the news, and according to the US Bureau of Labor Statistics, employment in the group containing investment management increased in 2020[8]. This group saw employment declines in only two months in 2020—April and June[9].

A similar occurrence is found in the European Union. The number of persons employed in the economic activity classification including fund management dropped by 0.1% between Q1 and Q2 after increasing during the first quarter of 2020[10].

However, in the Asia-Pacific region, some investment management firms preferred to use strategic reductions in bonuses and salaries rather than implementing job eliminations[11]. This course of action is also evident in the survey, as the top two actions already taken by firms in Asia-Pacific are both related to compensation (see Figure 2). These results point to a resilient industry leadership performing well in challenging conditions by preserving at least some of their workforce capabilities—setting themselves up to thrive as the world recovers from COVID-19.

8. U.S. Bureau of Labor Statistics, "Workforce statistics for Securities, Commodity Contracts, and Other Financial Investments and Related Activities: NAICS 523," accessed 2 October 2020.

9. Ibid.

10. Eurostat, "Employment by sex, age and detailed economic activity," accessed 20 October 2020.

11. Echo Huang, "Pressure to take pay cuts likely to rise for Asia's fund execs," Ignites Asia, 13 May 2020.

Digital transformation and underlying technologies
Overall, according to our survey, investment managers are more likely to increase than decrease both outsource and offshore approaches to digital transformation. In contrast, they are decreasing their emphasis on vendor solutions and in-house build projects, while partnering is more balanced.

But Europe and Asia-Pacific each show some interesting deviations from the overall trend. In Asia-Pacific, both build and buy projects are much less likely to be de-emphasized. In Europe, partnering and outsourcing projects are much more likely to be de-emphasized.

When we look at the technologies with spending expected to increase over the next year, an interesting pattern emerges. Respondents report that, in their firms, the top technologies seeing an expected net increase in spending are cybersecurity and data privacy. Not surprisingly, this indicates that firms are spending in part to support remote and distributed working arrangements brought about by the pandemic.

According to 92% of survey respondents, firms are implementing or are planning to implement technologies that enable their people to work from anywhere.

According to 92% of survey respondents, firms are implementing or are planning to implement technologies that enable their people to work from anywhere. This accelerated effort is being achieved with an increased emphasis on outsourcing and offshoring, rather than building or buying new technologies. In addition to the broad modernization benefits that cloud computing offers, it enables firms to perform their tasks in a remote, low-contact work model while meeting the heightened data security requirements.

Controlling operational change and meeting customer demands digitally
Digital transformation enables the adaptation of existing processes in addition to the development of new offerings like targeted environmental, social, and governance portfolios. Digital transformation is accelerating, and 2021 has the potential to be the year that laggards face strategic risk, not from what they offer investors but from how the offerings are supplemented by digital capabilities. Digital transformation will also likely become an element in many investment management firms' brands. Like it or not, investors may judge investment managers on the sophistication and elegance of their customer interactions. Many will likely assume that technological prowess in customer interactions translates to prowess in the investment

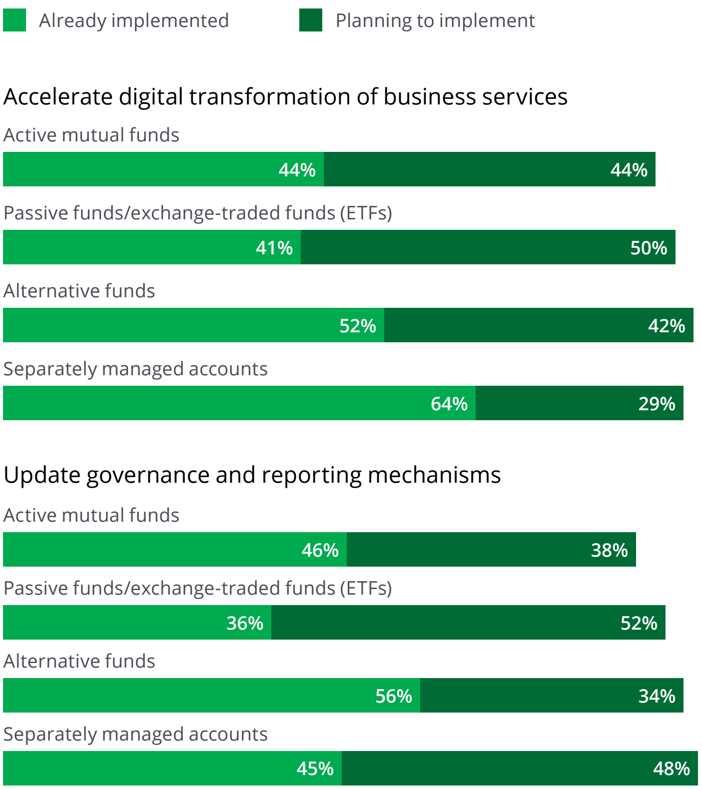
12. Stephanie Graham, "The G2 on the Digital Transformation of Brand Perception," G2, 25 September 2019.

management process[12]. While customer experience will likely be an important face of digital transformation, the heart of an active investment management firm is its investment decision process. Digital transformation has the potential to update how strategies are implemented and portfolios are managed. But moving ahead with new digital capabilities calls for corresponding updates to governance and reporting practices.

Our top line survey results for these activities are very similar (see Figure 3) but these similarities in the top line belie an important detail. Less than half of the firms that are already executing accelerated digital transformation of their business services have also started implementing updated governance and reporting mechanisms. This indicates that these endeavors are not tightly linked and that there is operational risk creeping into the equation as digital transformation is implemented.

This potential operational risk is evenly spread across active mutual fund managers, passive managers, alternative investment managers, and separate account managers. As 2021 unfolds, look for governance and reporting projects to increase at firms as they roll out new or enhanced services enabled by digital transformation.

Figure 3: Firms' approach to maintaining operational resilience in the next six-12 months - Percentage of respondents



Source: The Deloitte Center for Financial Services Global Outlook Survey 2020.

12. Stephanie Graham, "The G2 on the Digital Transformation of Brand Perception," G2, 25 September 2019.

CONCLUSION

PRESSURE CATALYZES PRUDENT TRANSFORMATION

2020 challenged the investment management industry, and the industry responded. The volatility and personal hardship lessons learned and the industry's commitment to both customers and employees will likely lead to a stronger, more digitally capable investment management industry. Investment management firms changed priorities and accelerated many digital enablement projects based on the experiences and necessities brought about by the COVID-19 pandemic. The actions and numbers bear evidence that the commitment to employee health and well-being was palpable across the industry. There was also a commitment to digital transformation on behalf of the customers, supported by a persevering and competitive spirit.

The industry is trading some long-term differentiation for a swift transformation to digitally enabled processes that support operations and customer interactions. Collaboration and relationship building on digital platforms will likely emerge as necessary elements of an effective process. By the end of 2021, the human element is likely to grow and act as an accelerant to digital processes that served adequately while it was squelched. The employee retention levels in the investment management industry suggest that employees were valued by their firms through the pandemic. Now employees can return the investment in them back to their firms with renewed energy, resolve and commitment. 2021 is setting up to be a remarkable year for the investment management industry, which is likely to emerge stronger.

TO THE POINT

- According to the results of our proprietary survey conducted over the summer of 2020, most investment management firms indicate they have more to do to develop agile back-to-the-workplace plans and communicate these plans, to help employees feel more comfortable.
- Investment managers are more likely to increase both outsource and offshore approaches to digital transformation. In contrast, they are decreasing their emphasis on vendor solutions and in-house build projects, while partnering is more balanced.
- Digital transformation could become an element in many investment management firms' brands. Like it or not, investors may judge investment management firms on the sophistication and elegance of their customer interactions.
- The experience gained from weathering the volatility and personal hardship, along with the industry's commitment to both customers and employees, will likely lead to a stronger, more digitally capable investment management industry by the end of 2021.

Figure 1 methodology

1. *US passive domestic equity funds comprise AUMs for 1940 Act domestic equity index ETFs and domestic equity index mutual funds sourced from ICI Factbook 2020. Returns correspond to 10-year returns for S&P Composite 1500 from SPIVA US year-end 2019 scorecard. Domestic equity index ETF AUM was estimated based on the proportion of domestic equity AUM in the total ETF AUM by investment objective.*
2. *US active domestic equity funds comprise AUMs for 1940 Act actively managed ETFs and actively managed domestic equity mutual funds sourced from ICI Factbook 2020. Returns correspond to 10-year returns for all domestic equity funds from SPIVA US year-end 2019 scorecard. Domestic equity active ETF AUM was estimated based on the proportion of domestic equity AUM in the total ETF AUM by investment objective.*
3. *Global private capital: AUM and performance data has been sourced from Preqin. AUM is the sum of unrealized value and dry powder. Performance corresponds to Preqin Private Capital Index returns.*
4. *Global hedge funds: AUM and performance data has been sourced from BarclayHedge. AUM figures exclude fund of funds assets. Hedge fund performance represents Barclay Hedge Fund Index return, which is a simple arithmetic average of the net returns of all the reporting hedge funds (except funds of funds) in the Barclay database.*

Survey methodology

In July-August 2020, the Deloitte US Center for Financial Services fielded a global survey, eliciting responses from 200 senior investment management executives, including a fairly even representation from finance, operations, talent, and technology. Respondents were equally distributed among three regions—North America (the US and Canada), Europe (the UK, France, Germany, and Switzerland), and Asia-Pacific (Australia, China, Hong Kong, and Japan). The survey included investment management companies with revenue of at least US$500 million in 2019. 11.5% had more than US$500 million but less than US$1 billion in revenue, 28.5% had between US$1 billion and US$5 billion, while 60.0% had more than US$5 billion.

The survey focused on how investment management companies are adapting to the pandemic's impact on the market, society, and the economy, as well as their own workforce, operations, and culture. We also asked about their plans for investment priorities and likely structural changes in the year ahead as they continue to adjust and start pivoting from recovery to the future.

PETER JUBBER
MANAGING DIRECTOR
FIDELITY DIGITAL FUNDS

Evolution of Digital Assets, Bitcoin, and Mainstream Investments

A CONVERSATION WITH FIDELITY DIGITAL FUNDS' PETER JUBBER

ROB MASSEY
PARTNER
DELOITTE

PAUL KRAFT
PARTNER
DELOITTE

In the research leading up to Deloitte's 2020 Global Blockchain Survey, we found that 83 percent of executive respondents believed that digital assets will serve as an alternative to, or a replacement for, fiat currency in the next five to 10 years. This is consistent with Deloitte's premise that blockchain—and the commercial activities it enables—are moving from potential to reality, and is particularly evident as we look at the evolution of investment strategies, where digital assets like Bitcoin are increasingly mainstream.

Fidelity has been into Bitcoin since the early days of digital assets. Following the vision of Chairman and CEO Abby Johnson, Fidelity began a small mining operation that kicked off the firm's long experiment with Bitcoin. As the firm's knowledge and understanding of all things Bitcoin evolves, Fidelity has broadened its ability to engage clients in this space—including institutional funds.

Peter Jubber, Managing Director of Fidelity Digital Funds, shares his latest thinking on emerging global trends in digital assets with Deloitte partners Rob Massey and Paul Kraft.

When it comes to digital asset investment products, more than 80 percent said they would be interested in institutional investment products that hold digital assets.

EVOLUTION OF DIGITAL ASSETS

Q. FIDELITY HAS BEEN FRONT AND CENTER IN BLOCKCHAIN AND DIGITAL ASSETS FOR YEARS. HOW DO YOU VIEW THE ECOSYSTEM TODAY, AND HOW HAS IT EVOLVED?

A. Today, we have futures and other non-spot-based products as probably the most popular part of the crypto ecosystem. Exchanges and payments make up another important segment. Custodians play a key role, some of whom offer lending, prime brokerage, and investment management. The other core aspect is mining.

If you went back five years, you would see that the predominant activity in exchanges and payments was mostly retail driven. I would also say that five years ago the discussion was a lot more about how Bitcoin (the protocol and payment network) would reinvent financial services by reducing the need for intermediaries who would not be necessary if you had a blockchain. That's not to say that Bitcoin (the currency) was not important, there was just more of a balance then.

We had a little joke at Fidelity when we had use cases come into pitch. I'd have a little wooden ruler with a stop sign on it. Whenever people came up with great ideas, we'd say "Stop! Tell me why you need a blockchain for that?" This was because, in most cases, a distributed database could handle that use case perfectly well.

We moved on from there to the emergence of tokens as a store of value today. I think what we've been seeing recently is the rise of a different kind of—mostly institutional—investor that is a product of this macroeconomic environment, which has contributed to the development of **Bitcoin's role as an alternative investment.**

According to our **Institutional Investors Digital Asset Survey** from June 2020, more than 80 percent of investors indicated they would be interested in institutional investment products that hold digital assets. Of this group, nearly half indicated they would prefer to hold an investment product that provides them with exposure to multiple digital assets.

TODAY'S ECOSYSTEM

Q. IT'S INTERESTING HOW WE'VE GONE ON FROM ALL THESE ENTERPRISE USE CASES, WHICH STILL EXIST, BUT IT'S REALLY FINANCIAL SERVICES THAT HAVE CARRIED THE DAY. YOU REFERENCE AN INCREASE IN INSTITUTIONAL INVESTORS. WE'VE HAD A HANDFUL OF INSTITUTIONAL INVESTORS FOR A LONG TIME, BUT THEY WERE DOING THEIR OWN THING WITH PROPRIETARY SOLUTIONS AND CUSTODY. THE WAVE OF INSTITUTIONAL INVESTORS COMING IN TODAY IS EXTRAORDINARY. HOW IS THAT NOW INFLUENCING OTHER TRADITIONAL CUSTODIANS AND BROADER TRADITIONAL FINANCIAL SERVICES?

A. Traditional players have fundamental decisions to make: When and how do you engage in blockchain, and do you then engage in the store of value represented in the tokens? Then, if you decide to play in that game, how do you play? Luckily for us (at Fidelity), those decisions were made early on.

For a startup, it's a unique calculus because they're already all in. For the incumbent, it's an entirely different conversation driven around the question, "How do we think about digital assets as a firm?" Does their vision for the customers they're serving—whether by offering or not offering digital assets—alter their fundamental proposition with their customers? That's

one set of questions. Another set of questions might focus on an overall risk calculus. A firm has a persona, and it might view Bitcoin or blockchain as just too risky. In the end, the tide will move toward larger players recognizing that they need to move into this space, driven by demand from their customers and by their infrastructure needs, as spelled out in our **Institutional Digital Asset Survey**.

We found that more than 60 percent of investors believe that digital assets have a place in their portfolios. As I noted, when it comes to digital asset investment products, more than 80 percent said they would be interested in institutional investment products that hold digital assets. However, only 36 percent of institutional investors surveyed currently invest in digital assets. Mind you, this survey was conducted early in 2019 and we've seen the market evolve since then. We see greater maturity of trading venues, greater transparency of pricing and tighter spreads, the emergence of futures and other instruments, and more and bigger players coming into the space with their attendant processes and protections. No one is going to enter the space lightly, so they're bringing the normal processes they use for doing business in traditional assets. That will help accelerate maturation and innovation.

BITCOIN MINING

Q. IS FIDELITY STILL ENGAGED IN BITCOIN MINING? CAN YOU DISCUSS WHY YOU GOT INTO THAT, AND WHY IT'S AN IMPORTANT TOPIC RIGHT NOW GIVEN THE CURRENT ECONOMICS AND PRICING OF BITCOIN?

A. At the beginning of our journey at the firm, we fanned out and looked at all the tendrils of what was emerging with Bitcoin. And mining was obviously one thing we could look at and touch, and feel, and try. And we did. We started out with a tiny operation in one of our regional sites and learned a lot. Mining consumes a ton of electricity, and for all of that electricity, you can maybe mine a Bitcoin every now and again. And when you do, there was no clear set of predictors as to how, when, or why.

We've kept that operation going and have now scaled it beyond the experimental. We want to look at it on more of a commercial scale to better understand all of the ins and outs: How do you source hardware? What types of energy make sense and what types of energy don't? How do the economics behave as volatility hits? And what happens at a halving?

We're able to inspect a lot with mining, but we're still thinking about it in terms of a learning phase. We learn a lot all the time, and with such an unpredictable market, we don't know how it's all going to turn out. But it does present opportunities for us to explore further. We use each lesson to more fully explore a path than we would have been able to had we not run a mining operation.

Mining is the foundation of Bitcoin. Having a deep knowledge of that, we think, is critical for us as a company.

We found that more than 60 percent of investors believe that digital assets have a place in their portfolios.

Q. CAN YOU PROVIDE FURTHER DETAILS ON SOME OF THE LESSONS YOU'VE LEARNED AS THEY RELATE TO MINING? CAN YOU PROVIDE AN EXAMPLE OF HOW IT'S ACTUALLY INFORMED A DECISION YOU'VE MADE OR A DIRECTION YOU HAVE TAKEN?

A. We've learned many interesting lessons.

For example, there are many questions you need to ask and answer regarding energy and expenses. What energy source and what price? At what cost do you need to buy energy to mine profitably? Can you secure a fixed-price contract? Or are prices variable? What kind of operating expense do you need to run? These are the most basic arithmetic parts of the economics. One obvious advantage would be securing the lowest possible cost for energy for the longest possible contract.

The next question is, are those sources scalable, are they available long-term? And, when you look at sources of renewable energy that would be different from non-renewable sources—those have different economics. You need to spend time with each of these latitudinally to learn enough about how they behave over time. So, the experiments we've conducted have been more in the renewable energy space as a source. We are still continuing to expand our thinking in this space.

NEW INVESTOR PERSONA

Q. SWITCHING GEARS A BIT, LET'S TALK ABOUT CORPORATES. IT SEEMS LIKE DIGITAL ASSETS HAVE INSPIRED A DIFFERENT CONVERSATION AMONG CORPORATES, ON THE LINES OF, "SHOULD THERE BE SOME AMOUNT OF OUR TREASURIES HELD IN DIGITAL ASSETS?"—WHETHER OR NOT IT CORRELATES TO THE BUSINESS SIDE. CAN YOU DESCRIBE WHAT YOU'RE SEEING IN RELATION TO CORPORATES, AND HOW THIS INFLUENCES THE ECOSYSTEM?

A. If you believe that corporate treasurers are, in essence, portfolio managers for that treasury asset then, in this environment, they should continue, as a fiduciary, to deliver value to the corporation. Bitcoin, just like gold or other types of alternative investments, might offer sources of return. We would have the conversation around what kinds of goals they are targeting in their portfolio, and then work through the analytics to understand the potential return by having a timed allocation to something like Bitcoin.

Q. DO YOU SEE THIS AS A TREND WHERE MORE CORPORATE TREASURY FUNCTIONS WILL ENGAGE WITH DIGITAL ASSETS?

A. Yes. I would anticipate that we would have more of these conversations with corporations. Fundamentally, in the current macroeconomic environment it makes perfect sense. But in two or three years, things can change. I think we all must keep our eyes open—both in general and as investors.

Any asset considered for inclusion in a portfolio must include diversification through low correlations and also enhance returns. With Bitcoin, the ways these come about is slightly different. So, yes, there's low correlation—we compute an average .11 correlation across a broad range of traditional assets in the last five years. We note four key factors as to why this is the case:

1. There are different risk/return factors that Bitcoin exhibits. It is an asset that is more reflexive to sentiment and momentum effects than you might observe with traditional assets.
2. There are also evolving narratives. So, for every investor in Bitcoin, I would argue that there is separate story of why they are investing in Bitcoin. We think that in time, these stories will reduce in number and as they do, we will probably see the correlation track a little more tightly to traditional asset classes.
3. We are seeing an increasing overlap of market participants—it's a young asset, which until recently was untethered to traditional markets. As it is integrated into traditional portfolios, we are seeing other players available for you to get this exposure.
4. This is a retail-drivem phenomenon. So, unlike just about every other asset that we could observe, retail has driven adoption of this today.

Bitcoin, just like gold or other types of alternative investments, might offer sources of return.

Q. IN THE FIDELITY DIGITAL ASSETS BITCOIN INVESTMENT THESIS RELEASED IN OCTOBER 2020, YOU ALSO TALK ABOUT ENDOWMENTS, PENSION PLANS, AND OTHER TOPICS. COULD YOU DESCRIBE THEM IN A BIT MORE DETAIL?

A. Endowments, defined benefits, and pension plans all have the same problem: they're large portfolios that are mostly invested in traditional assets. The question investors might be asking revolves around, "Is there an opportunity for more opportunistic investments that could move the needle?" In this environment, it's a perfect storm for them to answer such questions.

There is significant upside potential for market appreciation as Bitcoin and other digital assets are adopted by more investors. Today, it's a tiny fraction of the size of the alternative assets markets as well as the size of other competing store-of-value investments. Were the digital assets market to grow its share to a higher proportion of these kinds of assets, billions of dollars more of value would be available to investors.

There are three incremental benefits that we think are present with Bitcoin when you compare it with traditional alternative assets:

1. Liquidity—you can trade 24/7 without the presence of intermediaries, and there are very few restrictions on entering or exiting the market.
2. Accessibility—Bitcoin de-marketizes access, and it does not discriminate based on what kind of investor you are or where you are in the world.
3. Low fees—if you're buying Bitcoin, you don't pay management fees, you don't pay performance fees, you just pay the cost to trade in and out, and what it costs for custody your holdings.

GENERATIONAL WEALTH TRANSFER

Q. I KNOW YOU HAVE THEORIES ABOUT A GENERATIONAL WEALTH TRANSFER. SINCE WE HAVE A GENERATION THAT'S MATURING, WHERE DO YOU SEE AN IMPACT FROM DIGITAL ASSETS AND BITCOIN SPECIFICALLY? CLEARLY, WE'VE SEEN IMPACTS FROM THE INSTITUTIONS AND CORPORATES, BUT WHAT ABOUT FROM PEOPLE GROWING UP WITH BITCOIN?

A. There is a coming avalanche of nearly $70 trillion of wealth that will be transferred to millennials in the next decade. These investors consume investment information and advice in a very different way. They pay a lot more attention to social media and influencers. Among younger investors there is a greater propensity to hold Bitcoin. Why? They're digitally native; they've grown up with the Internet, and, in many cases, they are open to new ideas that are not intermediated by traditional financial institutions. They might have longer timelines and investment horizons, or they've grown up in a digital world. Digital tokens as investments are normal to them. Given the run up in crypto prices in late 2017, and perhaps what's happening today, if you have a little discretionary income, you might start to invest in something like this.

So, I have two perspectives:

- The mindset for the younger investor is perhaps more attuned to considering these kinds of investments to include in a portfolio—especially as they become more practiced in the art of investing.
- The other thinking is within existing customer segments—let's say a family office—we're seeing some evidence that there's a greater interest in having the conversation around Bitcoin with younger investors versus the family patriarch or matriarch.

Q. WE'D IMAGINE THERE ARE SOME PARALLELS WHEN TALKING ABOUT THE REASONS TO INVEST OR NOT INVEST, BUT ALSO CONTROLS AND RISK WHEN YOU'RE TALKING TO AN INSTITUTION VERSUS A FAMILY THAT'S GOT A 20-SOMETHING-YEAR-OLD WHO'S SITTING AT THE TABLE TO MAKE THIS INVESTMENT.

A. Exactly. So as a provider you must be able to have both conversations. I think you need to look at the portfolio and find the client's risk-reward framework, and what returns they are seeking. And then we can examine how Bitcoin fits—or doesn't fit—into the investment strategy. We should be able to respond to our family office clients with a thought-out answer and treat them as sophisticated investors.

RISK AND TRANSPARENCY

Q. WHEN YOU THINK ABOUT SOME OF THE RISKS YOU DESCRIBED AND THE INSTITUTIONS COMING IN, WHAT DO YOU TELL PEOPLE TO BRING DOWN THE ANXIETY LEVEL AND ADDRESS THE RISKS IN AN AREA THAT'S STILL A LITTLE NEW AND UNTESTED?

A. I think in the first instance we would be quite transparent about the risks that are present. The risks around Bitcoin or any of these digital assets that were around three to five years ago are still around today. They are still more volatile than traditional assets, and investors should understand this before committing to any investment.

Using Bitcoin as an example, if you've not done your research around how it is mined, how it was created, where it's deposited, and how its value is exchanged—if you've not done that homework, I would caution an investor about a possible investment.

Fidelity believes that an investment in Bitcoin must be the subject of good research and good forethought. So, we're comfortable preparing an offering that is targeted toward our most sophisticated investor clients. This also gives us the opportunity to have a deep conversation with them about what this represents and what it doesn't represent.

We would not rush into markets that are less sophisticated, such as the retail segment, and that's in keeping with how we think about investing in general. We would have that conversation about what Bitcoin can and cannot do for a traditional portfolio. We need to balance customer needs and demands—which we would represent in any conversation with a regulator. It would also be our duty to behave in a way that meets the requirements of that regulator. I don't believe that customer needs and regulatory requirements are in balance today. I think that comes with time and multiple conversations.

GLOBAL LONGER-TERM VIEWS

Q. EXPANDING THE CONVERSATION GLOBALLY, CAN YOU SHARE SOME OBSERVATIONS? WHERE DO YOU SEE LONGER-TERM VIEWS EMERGING?

A. In my unit we have aspirations to offer investors access to these types of investments globally. It's a global market that operates 24/7, and we would be remiss if we weren't able to at least mirror the way it operates. To do that, we need to think globally and understand investor sentiment globally. Especially in Europe, we see a greater level of acceptance and willingness to invest in Bitcoin.

Our Institutional Investors Digital Asset Survey found that investors in Europe and Asia generally have a more progressive view of investing in digital assets. Looking specifically at the European context, there are certain jurisdictions that are a little further along from a regulatory perspective than their counterparts in Europe and the US.

It gets really interesting in Zurich, for example, because they have a really nice symbiotic relationship: there is demand for digital assets from sophisticated investors, there are innovative providers, and there are progressive regulators. And they just make it happen. I think of Germany, Switzerland, and maybe the Scandinavian countries as specific examples of where we're seeing a lot of innovation. This is especially happening on the listed front, which, to my mind, is the expression of an efficient investment for investors.

So, looking at those clues, how do we now make progress on offerings that would need investment? I would say our scope is global, and we're focused on specific areas that may be of interest, especially in areas that have a kind regulatory environment.

ASIA NOW AND LOOKING TO THE LONGER-TERM

Q. CAN YOU COMMENT ON ASIA—WHERE IT'S AT NOW AND HOW IT PLAYS OUT LONG-TERM? PARTICULARLY WITH RECENT NEWS OF CENTRAL BANK DIGITAL CURRENCIES (CBDCS) COMING INTO PLAY AND EXPRESSIONS OF MONETARY POLICY THROUGH DIGITAL ASSETS, THERE ARE SOME INTERESTING NEW INFLUENCES.

A. First, Asia is not monolithic. It is made up of many different places with many different regimes. You have China with a very complex set of activities. It's the center of mining for Bitcoin, so that creates opportunities and risks. When regulators want to fix or change something, it's instantaneous. But then there are other locales like Singapore, which are more open and much more progressive in the way they approach financial products.

Of course, Singapore is not the same as China or India. These are all very different places with enormous markets. We need a specific strategy for each.

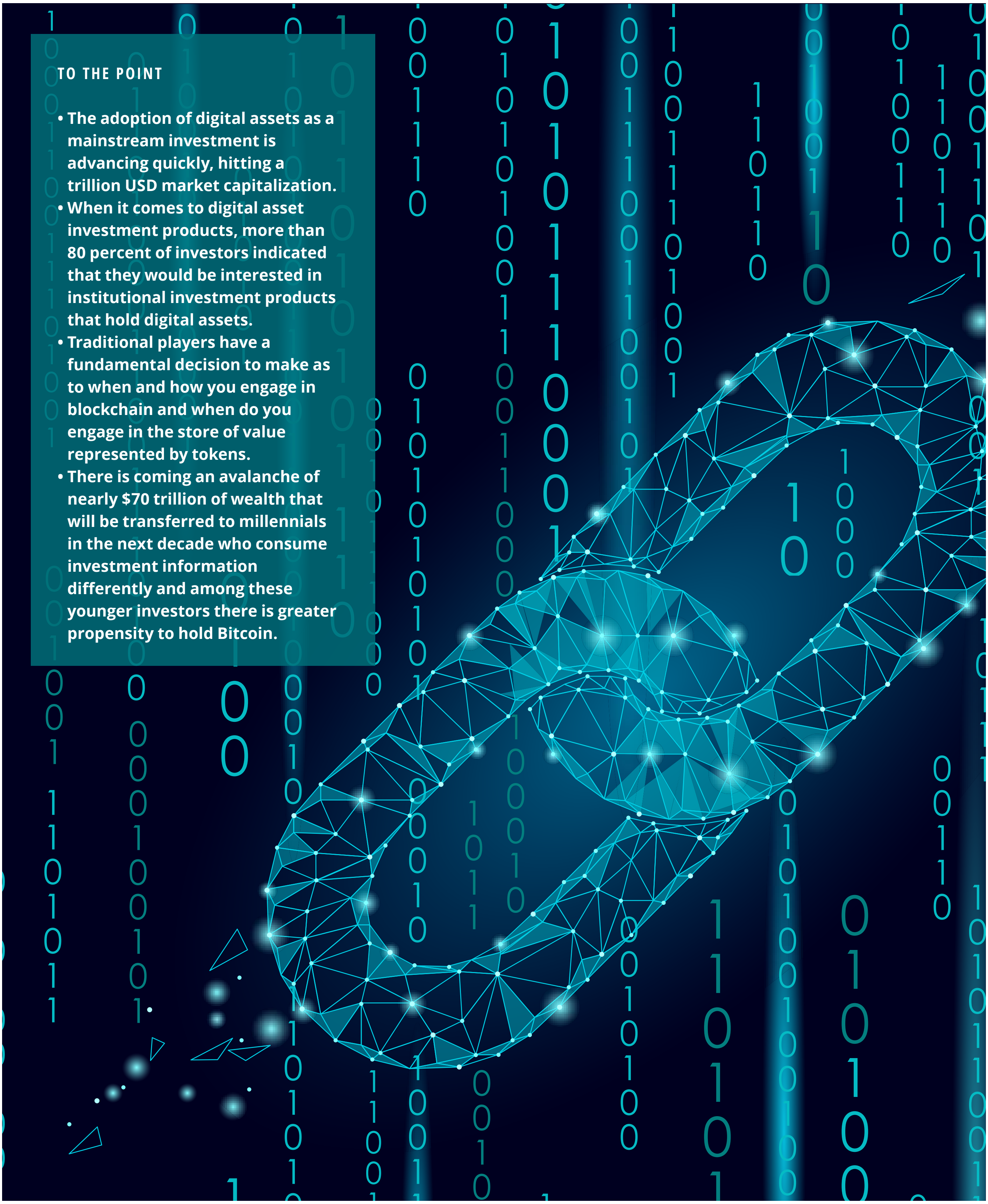
At this point, we're fairly focused on our core practice in the US. We think the US institutional opportunity is enormous. So, we must start to serve the US and think about Europe as a next phase for, perhaps, a different offering.

FINAL THOUGHTS

The one thing that I've observed in my journey at Fidelity on this topic is that it's a lot more difficult for incumbents to make this stuff happen. Just as it's massively difficult for a startup to just get traction, it's equally difficult for us to get traction in our core business, where the priority is serving the needs of our customers.

And as I said at the top of this discussion, we've had the benefit of the tailwinds of the owner of our firm being very inquisitive about Bitcoin and wanting to deeply understand it. Now we have a broad ecosystem in the firm of passionate people who think about this day in and day out. And it's terrific seeing that growing up now.

It's been a fantastic little journey so far, but we're hoping to make it a lot bigger.

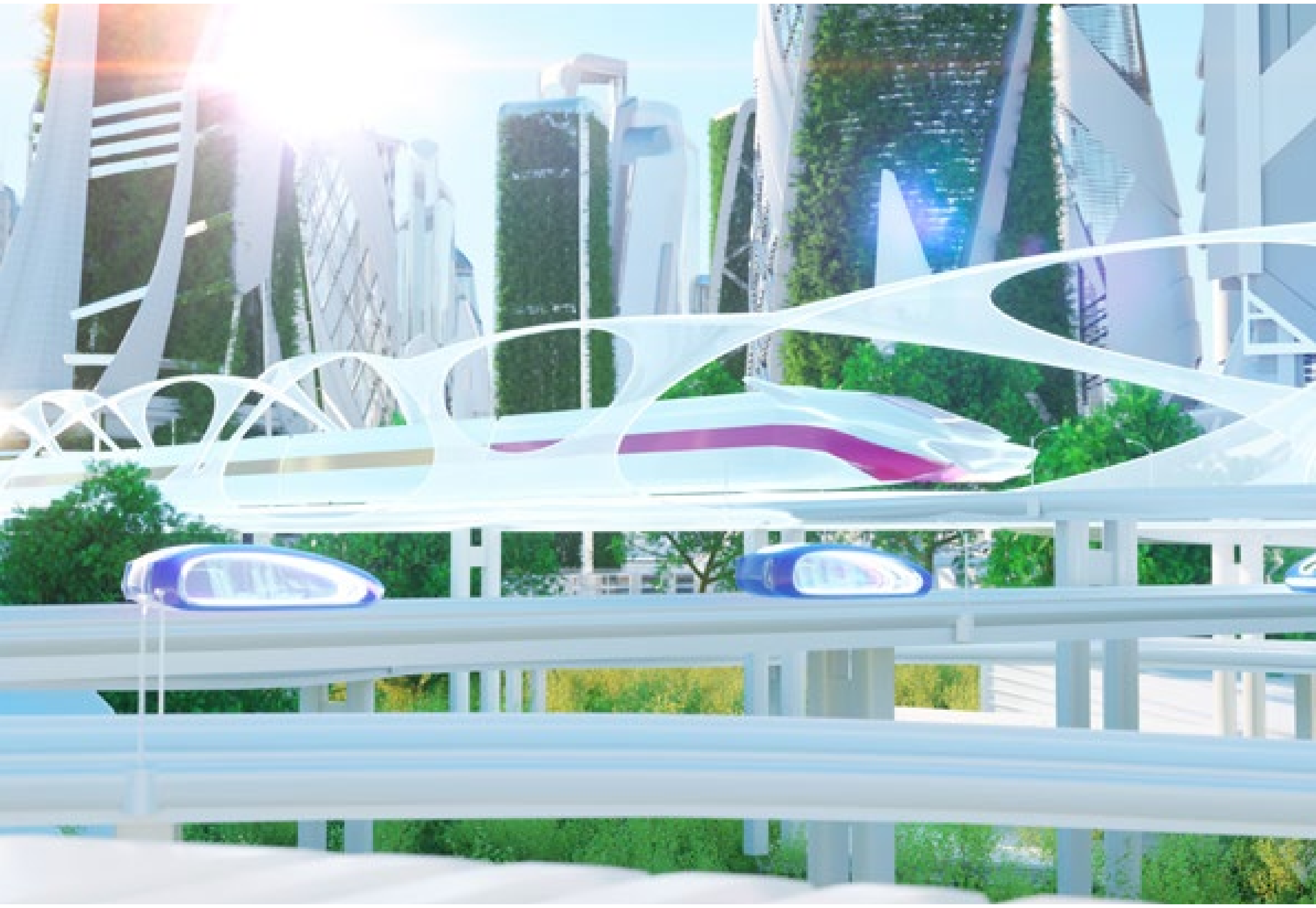


TO THE POINT

- The adoption of digital assets as a mainstream investment is advancing quickly, hitting a trillion USD market capitalization.
- When it comes to digital asset investment products, more than 80 percent of investors indicated that they would be interested in institutional investment products that hold digital assets.
- Traditional players have a fundamental decision to make as to when and how you engage in blockchain and when do you engage in the store of value represented by tokens.
- There is coming an avalanche of nearly $70 trillion of wealth that will be transferred to millennials in the next decade who consume investment information differently and among these younger investors there is greater propensity to hold Bitcoin.

CLIMBING ABOARD THE SUSTAINABILITY TRAIN

HOW THE SFDR AND THE GLOBAL PANDEMIC MAY INFLUENCE SUSTAINABLE AND RESPONSIBLE INVESTMENT



FRANCESCA MESSINI
DIRECTOR
SUSTAINABILITY LEADER
RISK ADVISORY
DELOITTE

ELODIE VAN DE WOESTYNE
MANAGER
CONSULTING
INVESTMENT MANAGEMENT
DELOITTE

KATHARINA LAMPARSKI
ANALYST
CONSULTING
INVESTMENT MANAGEMENT
DELOITTE

All over the world, the investment landscape is experiencing an enduring shift towards sustainable and responsible investment (SRI). Between 2016 and 2018, sustainable investing assets climbed in all regions and countries in scope of the 2018 Global Sustainable Investment Review (Figure 1).

Over the last few years, SRI has evolved from a marginal investment practice to a mainstream one, driven by demand- and supply-side factors. According to a 2019 study by Morgan Stanley[1], millennials are more interested in SRI than the general population, and a strong positive trend was identified for both populations between 2015 and 2019 (Figure 2).

1. Morgan Stanley Sustainable Signals (2019) : Individual Investor Interest Driven by Impact, Conviction and Choice.

These shifts are reflected in end investors' demand for ESG financial products. They emanate, for example, from social movements like "Black Lives Matter" that raise concerns for human rights, or climate change threats like environmental disasters. On the supply side, a considerable number of institutional investors have recognized the industry's responsibility to direct investments towards sustainability by investing in accordance with ESG values. Various international, nongovernmental initiatives also encourage and facilitate the move towards SRI by lowering barriers to entry.

The European Union (EU) recognizes that the public funds allocated to sustainable investments are not enough to reach the climate goals set out in the 2015 Paris Agreement. Neither are the private market's current additional efforts regarding SRI, an estimated US$30.7 trillion (Figure 1) in sustainably invested assets at the beginning of 2018. Luckily, however, the growth potential for SRI is large: a survey[2] conducted by Moody's concludes that the ESG penetration of responsible funds covers, on average, only 6.5% of investors' assets under management.

Therefore, since 2015, it has become the role of regulators to further push private investments towards ESG integration, while leading institutional investors away from greenwashing practices. The EU aims to achieve this, amongst other measures, by clearly defining what can be considered sustainable through a classification system; setting low-carbon benchmarks; establishing a green bond standard; and outlining concrete requirements regarding nonfinancial disclosure.

Weakening arguments against SRI adoption

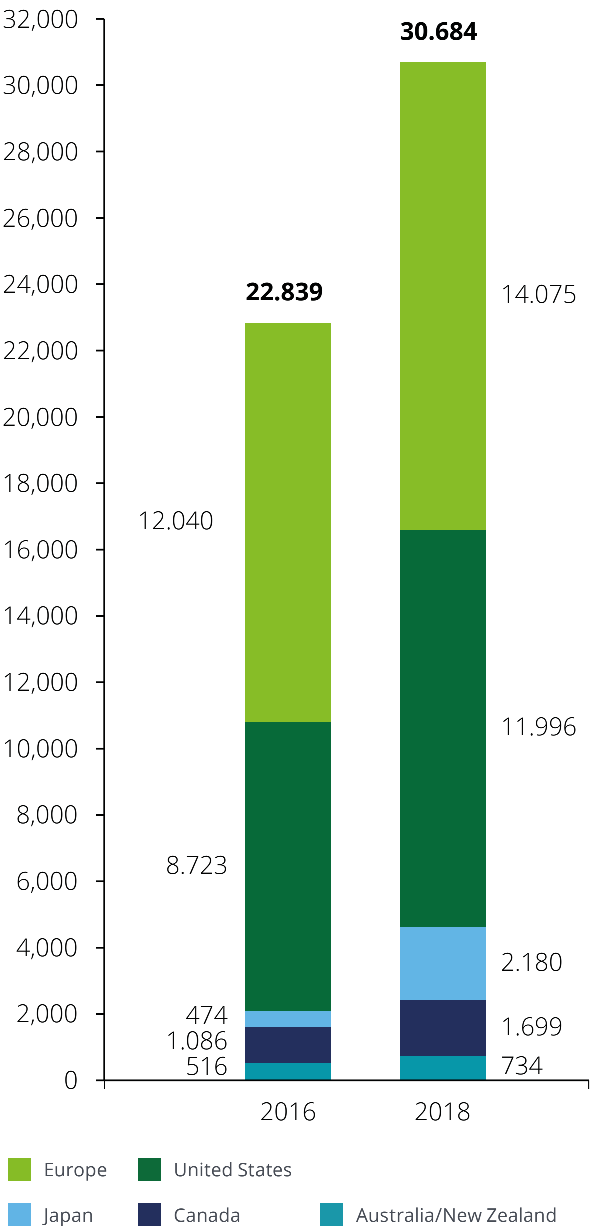
When investment managers are asked why they have not yet taken the strategic decision to join the "green wave", the same answers are repeatedly given. Actors raise their concerns about the financial performance of ESG financial products and state that their clients have not specifically raised concerns regarding ESG. While these statements were somewhat justified in the past due to contradicting research and different investor mindsets, investment managers should reconsider whether these arguments are still valid, given the industry's knowledge of SRI to date.

Researchers Friede, Busch and Bassen (2015) studied 2,200 papers that aimed to identify the nature of the relationship between ESG and financial performance. They concluded that about 90% of these studies report a non-negative relationship between the two variables, with a large majority even describing positive findings. Such conclusions have not only been drawn in the academic world but also in the industry: a recent study by Morningstar[3] conducted for seven investment sectors observed that about 59% of sustainable funds had outperformed traditional funds over 10 years.

2. Moody's Investor Service, Asset Managers – Global (2020): Beyond passive, ESG investing is the next growth frontier for asset managers.
3. Morningstar (2020): How do Sustainable Funds Measure Up?

> The COVID-19 crisis has demonstrated the extent that nonfinancial risks can lead to financial losses. During the pandemic, a major observation has been that ESG funds perform better than traditional funds.

Figure 1
Global sustainable investing assets, 2016-2018, expressed in USD billion



Source: Global Sustainable Investment Alliance (2018)

This same sentiment exists at an individual investor level: some Deloitte clients have stated that, while their ESG products tend to underperform against traditional funds in the short term, they outperformed them in the long term. Therefore, this evidence seems to refute investors' performance concerns regarding ESG financial products, at least within a longer time frame.

Regarding the fact that the investment management industry's clients have only shown limited interest in SRI, there is reason to believe that the demand for ESG financial products will grow stronger and more urgent in the future. The general population's concern for ESG is expected to increase, as ESG threats like climate change continue to become more tangible. On top of this, ESG-minded millennials are the next generation of influential end investors in terms of values and financial firepower. It is likely that millennials will effectively push the industry towards more consideration of sustainability criteria.

ESG takeaways from COVID-19

The COVID-19 crisis has demonstrated the extent that nonfinancial risks can lead to financial losses. During the pandemic, a major observation has been that ESG funds perform better than traditional funds. One reason for this is that many ESG funds exclude highly carbon-intensive industries from the investment universe, which are probably the most threatened by the current crisis because of lasting travel restrictions. On top of this, it can be argued that ESG funds take sustainability risks into account throughout the investment decision-making process, leading to portfolio managers investing in firms and industries that are less threatened by nonfinancial risks, such as a pandemic.

The observation that ESG funds were, whether consciously or not, better prepared for COVID-19 can be generalized. In fact, a Morgan Stanley study found ESG funds' downside risk and volatility in periods of market stress to be lower than those of traditional funds.

Therefore, the current crisis is only one example of a nonfinancial risk that accentuates the rationale for the consideration of such risks. It has clearly pinpointed the winning and losing industries in the event of a health crisis and, at the same time, highlighted the material impact that nonfinancial risks can have on individual firms and entire industries.

The enormous performance gaps between winners and losers should raise ESG concerns for both institutional and end investors. It should also urge investment managers to identify, in the event where nonfinancial risks become material (climate change, social movements for the respect of human rights, etc.), which firms and industries would thrive and which would be threatened, in order to prepare their portfolios accordingly.

SFDR as an imminent regulatory push for a minimum consideration of ESG

The Sustainable Finance Disclosure Regulation (SFDR) will apply to financial market participants—for example, alternative investment fund managers (AIFMs), undertakings for the collective investment in transferable securities (UCITS) and insurance-based investment products (IBIPs)—and financial advisers, and will progressively enter into force as of March 2021. This regulation aims to create harmonized practices regarding nonfinancial disclosure, reduce information asymmetries between institutional investors and end investors, and push all players in scope to, at the very least, start thinking about ESG. The SFDR plans to achieve these objectives by introducing precise and harmonized rules for financial market participants and financial advisers on:

1. How sustainability factors and risks should be integrated into investment decision-making, and respectively the advisory process;
2. How adverse impacts of investment decisions on sustainability factors should be considered; and
3. How these should be disclosed to end investors.

Several articles of the SFDR will be supplemented by regulatory technical standards (RTS), transforming the SFDR into a two-level regulation. Whereas the first-level requirements were published back in November 2019, the final version of the more specific level-two disclosure requirements, determined by the European Supervisory Authorities, should be released in January 2021.

The regulation dictates both entity- and product-level disclosure requirements, which generate considerable operational and organizational challenges, especially for financial market participants.

These actors must revise their processes and policies to integrate sustainability risks and principal adverse sustainability impacts, while also reviewing their IT systems to make all required website disclosures easily available.

Even if ESG data problems persist, financial market participants must establish contracts with external ESG data vendors to collect a maximum of key nonfinancial performance measures, as well as to monitor controversies and their investee firms' ESG scoring. The draft RTS proposed ESG key performance indicators to be assessed, but quantitative metrics can be difficult to obtain—and qualitative metrics can be difficult to compare between firms because assessments are based on the assessor's subjectivity.

The reliability of ESG data is another matter of concern, next to the resource intensity required for nonfinancial disclosure. Whereas the data challenge is already significant for UCITS, it should be noted that it is even larger and more time-intensive for AIFMs, due to the absence of publicly available data for their investments. This requires AIFMs to develop manual processes to collect ESG information from their investee companies and consolidate it at the portfolio level.

An additional challenge regarding SFDR adoption arises from the delay in the final RTS' release and entry into force, coupled with the regulation's imminent entry into force. This will require those actors who prepared early to twice update their documentation

The regulation dictates both entity- and product-level disclosure requirements, which generate considerable operational and organizational challenges, especially for financial market participants.

and potentially engage in repapering processes to fully comply with the SFDR. While on the other hand, actors who decided to wait for the release of the RTS to avoid this two-fold updating process may struggle to be fully compliant with the level-one requirements by March 2021.

The SFDR obliges entities in its scope to embed at least a minimum of ESG considerations at the entity and financial product level. Indeed, the nonfinancial disclosure itself is merely the tip of an immense iceberg that requires actors to take strategic decisions regarding their positioning on the ESG wave, given that the consideration of ESG criteria is becoming increasingly urgent from a regulatory perspective. As such, the SFDR pushes financial market participants to rethink their SRI product strategy; for example, if they made products marketed as being "green" available before the regulation enters into force, these products may not be considered sustainable according to the new SFDR classification.

Will the coming months be greener for investment managers?

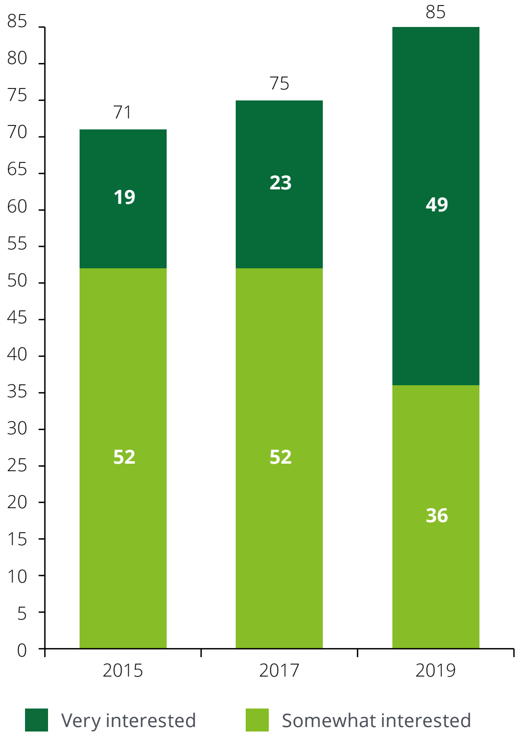
The SFDR urges institutional investors to make informed decisions on how to address its disclosure and underlying sustainability requirements. The regulation obliges players to define and describe sustainability risks regardless of their approach towards SRI. Given the challenges posed by the SFDR, there is reason to believe that it will accentuate the diffusion curve regarding SRI adoption through an inevitable compliance race with the new regulation.

Three major groups of players are likely to crystallize:

1. The leaders, who have been embedding ESG in their core strategy for decades and will have to focus on formalizing processes already in place and disclosing information already monitored, to a certain extent at least;
2. The followers, representing the vast majority of players, who are benefitting from the compliance angle to effectively start integrating ESG into their strategy; and
3. The laggards, who will struggle to meet the SFDR's minimum requirements but will not integrate sustainability into their investment process in the future.

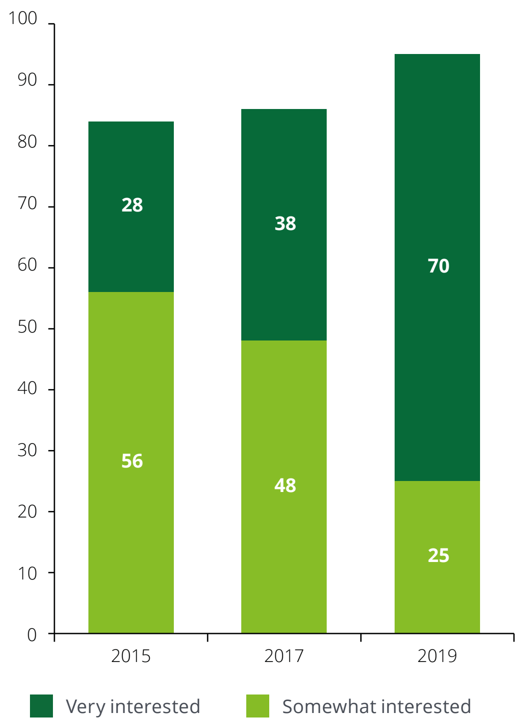
Although this will push laggards towards their first confrontation with SRI, their motivations and beliefs regarding the movement are unlikely to be changed through compliance. Instead, it is the COVID-19 pandemic that could shake up the laggards, as they have witnessed the enormous impact that nonfinancial risks can have, leading them to recognize the importance of

Figure 2
Evolution of general population's interest in sustainable investing



Source: Morgan Stanley Sustainable Signals (2019)

Evolution of millennials' interest in sustainable investing



Source: Morgan Stanley Sustainable Signals (2019) considering these risks during the investment decision-making process. Ultimately, end investors may provide the decisive push, as their demand for consideration of ESG issues is expected to rise.

The followers will probably be the group of actors most strategically affected by the SFDR. To date, greenwashing is still a recurring practice for the majority of investment managers, whether voluntarily or involuntarily. What is evident is that the SFDR will hinder greenwashing, as it will either push greenwashers to effectively consider ESG for financial products, or pull them back from promoting their funds as being sustainable.

For the SRI leaders and followers who decide to approach the SFDR as an opportunity, the regulation provides a clear and long-awaited framework. This may further encourage the development of ESG financial products.

CONCLUSION

Overall, it is difficult to predict and generalize the extent to which investment managers will decide to go green in the upcoming months. While there is a compelling argument that events like the COVID-19 crisis will raise investors' concerns for nonfinancial risks, only time will tell how the investment industry will approach these risks and to what extent they will influence their decision-making. The only relatively clear prediction is that the SFDR will hinder greenwashing. Therefore, in the upcoming months, the concept of SRI will be strengthened at its core.

TO THE POINT

- The European Union can only reach the climate goals set out in the 2015 Paris Agreement if it further pushes the private market towards sustainable and responsible investment (SRI) while combatting greenwashing practices.
- The Sustainable Finance Disclosure Regulation (SFDR), which will progressively enter into force as of March 2021, is one of the European Union's tools to achieve these aims.
- Besides setting harmonized rules for nonfinancial disclosure, the SFDR will compel all financial market participants and financial advisers to, at the very least, start thinking about environmental, social and governance (ESG) issues.
- While it is unclear whether the SFDR will actually lead to an increased number of SRI products on the market, it can be expected that the available SRI products will meet higher sustainability standards—and the current COVID-19 crisis may strengthen the SFDR's effect.

The next few years will see a cluster of new rules and a raft of refinements as a consequence of the intense regulatory phase that followed the financial crisis more than 10 years ago.

REGULATIONS
TRENDS AND PERSPECTIVES

SIMON RAMOS
PARTNER
DELOITTE

JEAN-PHILIPPE PETERS
PARTNER
DELOITTE

BENOIT SAUVAGE
DIRECTOR
DELOITTE

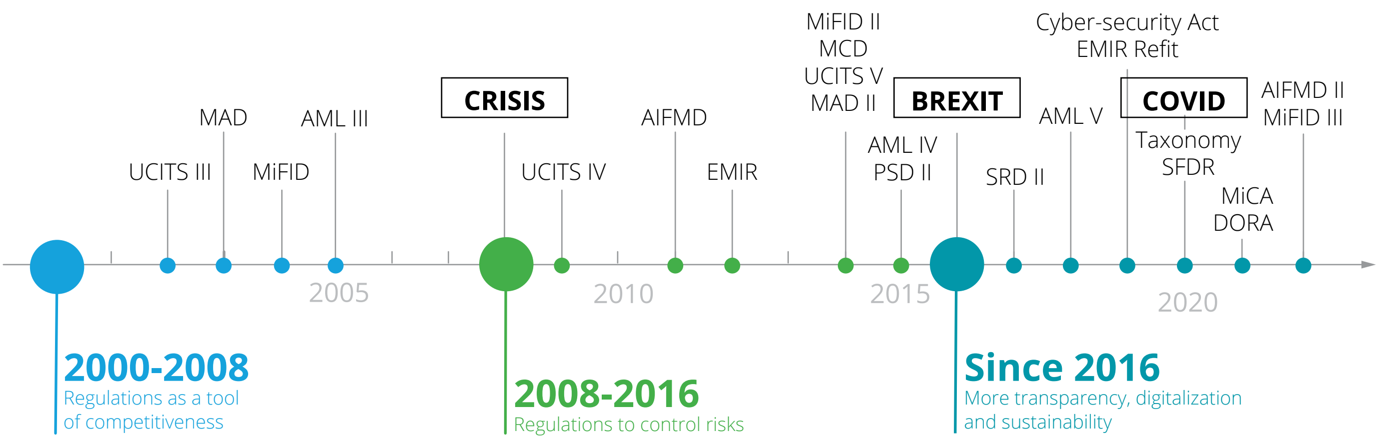
MARIJANA VUKSIC
SENIOR MANAGER
DELOITTE

This article presents an overview of EU regulatory developments impacting investment firms, banks, and asset managers.

Following the 2007/09 financial crisis, the EU authorities launched a far-reaching regulatory agenda, which was often referred to as a tsunami. However, in reality, regulatory change can be more accurately characterized as an ongoing process of reviews and enhancements of existing regulations. In the coming year, a number of regulations are set to be reviewed, while we also expect to see rules proposed in new areas.

Background

The chart below provides an overview of EU regulations from 2000 onwards, indicating the drivers of each regulatory wave.



After the important regulatory reforms due the financial crisis and the move towards more transparency, regulations are moving into new areas (or expanding in existing areas) largely unrelated to the financial crisis of ten years ago, including Fintech, **Cyber security**, Anti-money laundering and counter terrorist financing (**AML/CTF**), **Sustainable finance** and **Digital transformation**.

These developments will be of **critical importance to financial institutions**. Regulation is a key element in the landscape in which they operate and are seeking to develop viable and sustainable medium to long term strategies. Many financial institutions are focusing on business growth and on customer experience, supported to a large extent by data, data analytics and digital transformation. But financial institutions will need to keep a close eye on regulatory developments as regulation and supervision adjust to the data and technology revolution.

The first wave of regulations came in the wake of the last major EU treaty, which introduced, inter alia, the euro. Against a backdrop of dynamic growth for internet companies and innovative ideas, the European Commission launched an economic development program called the Lisbon Strategy. The Financial Services Action Plan that was part of this strategy included creating a common regulatory framework to cover everything from issuance of instruments to their buying and selling by investors, along with all the necessary 'plumbing': The trading and post-trading infrastructure. The aim was to make the EU the world's most competitive financial market, a true common market speaking a single regulatory language. No fixed schedule was set, but we all know what happened in 2007—the very moment when MiFID and the Capital Requirements Directive came into force. The financial crisis marked a clear shift in the EU's strategy, from growth to risk management.

In a second regulatory wave, the watchwords were "leave no one behind" and "risk prevention first". The regulations in these areas built on the previous set of rules and added an impressive amount of detail and a number of stipulations to the existing environment. As some regulators put it, regulations should help create a zero-risk environment. New regulations covered identification systems (for different stakeholders), traceability of transactions (creation of EMIR Trade repositories), and documentation of decisions and client interactions. They also introduced a requirement for product governance, better profiling, and the creation of the LEI as a global identifier for corporates, providing a single number enabling tracing of products and investors, as well as the assessment of product concentration and pockets of emerging risks. This was accompanied by the creation of a banking union, the reinforcement of prudential models, and the introduction of the concepts of recovery and resolution both in laws and in legal entities. It is worth noting that this was also when the ECB took over responsibilities for banking supervision and became the de facto bank licensing authority.

The third wave, however, brought a reverse of this regulatory frenzy in some respects, partly to remedy some of the rigidities introduced. Meanwhile, regulators began to take account of the increasing role of digital, adding further requirements to collect, store and retrieve information. At the same time, the EU started a new initiative in green finance, opening up a new regulatory landscape. These, in a nutshell, have been the regulatory trends since 2015.

The latest European Commission, which assumed office in November 2019, is continuing along this regulatory path. New regulations are in the pipeline, as well as reviews of existing texts to reflect—in addition to digitalization and green finance—its top priorities for the next few years, such as Brexit, increased cohesion across member states, sustainability, and AML/CFT rules.

To create a structure for forthcoming changes, the European Commission has formulated several umbrella strategies called: Capital Markets Union (CMU), Financial digital, Sustainable and AML/CFT. In 2021, it will focus on the initial implementation of ESG (through disclosures) and a review of MiFID II (Q1/Q2) and AIFMD II (Q3). In this article, we will highlight what we consider to be the main regulatory game changers—the CMU, MiFID, AIFMD and digital—since, for now, ESG and sustainability are to be addressed through a single text on transparency for products due to apply from March 10, 2021.

The Financial Services Action Plan that was part of this strategy included creating a common regulatory framework to cover everything from issuance of instruments to their buying and selling by investors, along with all the necessary 'plumbing'.

Regulatory timeline

The chart below presents an overview of regulatory initiatives in the coming year.

Capital Markets Union (CMU)

The CMU is a long-standing project that started back in 2015, but has largely been delayed until the current European Commission due to factors such as Brexit. The CMU strategy involves new and amended regulations aimed at fostering closer relationships between issuers of financial instruments and investors. It also contains "side" projects intended to contribute to digitalizing EU financial markets and support the European Commission green finance strategy. Overall, there are 16 different areas within its scope, such as the MiFID review and digital finance strategy. In addition, the CMU covers a review of the status of investors under MiFID and the AIFMD, as well as prospectus regulation, with a view to creating a new type of 'super' retail investor. Other areas include a review of the CSDR (Central Securities Repositories Regulation), the development of new marketplaces (such as crowdfunding) and SME trading facilities.

This catalogue of measures will take two to three years to work through, followed by a transition phase before the definitive go-live.

Digital strategy

Like the CMU, the digital strategy is not a regulatory project in itself, although it does encompass regulations addressing (i) digital assets (MiCA), (ii) the creation of a pan-European sandbox for testing blockchain ideas, and (iii) an infrastructure framework to ensure efficiencies and IT system resilience. The strategy document complements these proposals by focusing on the longer term creation of regulatory regimes for covering alternative intelligence and other more advanced technologies such as quantum computing and the use of algorithms and data.

MiCA and the sandbox regime are closely related. MiCA creates a MiFID II-inspired framework for entities that enables the issuance of digital assets, client handling, and rights and duties vis-à-vis authorities and other providers, while providing a different status for service providers and the licenses they might have to obtain. MiCA will regulate digital assets that are not regulated by current EU regulations on financial services. However, there are a wide variety of digital assets, which require a case-by-case approach to legally qualify. Some are likely to be qualified as MiFID financial instruments, while others are likely to fall outside of the existing EU financial securities rule. This point has been raised repeatedly via the European Commission and EBA/ESMA over the last year or so. At present, some operators are able to issue digital instruments but under a rather restrictive license. The sandbox regime would help regulated market operators and CSDs among others to create and manage instruments in a protected environment. Unfortunately, these regulations will have to be finalized at EU level and then undergo a transition period, which means that the complete regimen may only go live in 2024 or 2025.

MiFID II review

The MiFID review will cover both the client-oriented and market-focused aspects. The first draft is expected to be issued at the end of Q1 2021. Compared with MiFID I and MiFID II, the scope of MiFID III—which is already extensive—is unlikely to change substantially, but some surprises are on the cards. MiFID review hot topics include: (i) the creation of a new investor class (in addition to the existing categories of retail, professional, and eligible counterparties), which will require the repapering of client profiles; (ii) the "digitalization of MiFID", which saw some progress with the capital market recovery package issued during the summer, and will help investment firms to move from "paper first, digital second" to "digital first, paper second", supporting advance practices such as the use of robo-advisers and artificial intelligence; (iii) the absence of a consolidated tape provider (CTP) providing market prices in a single place at EU level; and (iv) green initiatives vis-à-vis investment firms.

Meanwhile, topics of particular concern are the potential inclusion of spot FX trades, along with issues relating to lost battles from the MiFID II discussions, notably custody and inducements, all of which might be ripe for inclusion and refinement under a new MiFID.

AIFMD II

In a similar vein to MiFID, the European Commission has scheduled a review of the AIFMD regulation a little later in 2021, most likely in Q3, preceded by a consultation that runs until the end of January. Without prejudging the outcome of the consultation and the first draft, there are some areas on which a consensus is likely to be reached. AIFMD II hot topics include some scope-related elements and reporting to authorities, as there is a current perception that this needs to be more efficient. We should also expect new rules on delegation, particularly as regards delegation to third countries entities (in light of Brexit). Lastly, the review may address non-EU-AIFs and AIFMs, and passporting or the servicing of products for EU clients.

After the European Commission releases the draft (scheduled for Q3), there will be discussions at EU institution level, followed by a transposition period or grandfathering if it reaches the regulation stage, which would likely last two years, with the go-live in 2023/24.

The sandbox regime would help regulated market operators and CSDs among others to create and manage instruments in a protected environment.

TO THE POINT

The next few years will see a cluster of new rules and a raft of refinements as a consequence of the intense regulatory phase that followed the financial crisis more than 10 years ago.
Regulatory waves add layers of complexity, creating new requirements that firms must get to grips with, especially in terms of compliance and marketing.

As regulations become more prescriptive, this facilitates digitization and the use of "automatic" rules, increasing the need for data storage and retrieval.

Business organizations and models may need to be rethought so that they can accommodate the new world of big data and digitalization, while operating in a more sustainable environment.

The need for new management processes to deal with the ever-rising bar of regulation will make it essential for firms to keep a tight grip on their costs and adopt an agile approach, especially in a post-Covid world.

THE BANK OF THE FUTURE

UNDERSTANDING THE VALUE OF DIGITAL INNOVATION AND TRANSFORMATION

MARC SNIUKAS
SENIOR ADVISOR
STRATEGY & INNOVATION
DELOITTE

XAVIER TURQUIN
SENIOR MANAGER
BUSINESS TRANSFORMATION
DELOITTE

For centuries, banks have developed their businesses around a limited number of activities, starting with safekeeping valuables and deposits. As deposits grew, money lending became possible. Loan and deposit receipts evolved into paper money—first book money, then electronic money. Later, banks extended their services by providing payment means beyond central bank coins and bills. While banks were extending their offerings and roles in society, their core business did not evolve significantly over the years, except for some adjacent innovations like insurance (savings and products distribution) or providing financial advice. Although the industrial revolutions transformed and modeled the modern economy, they had a limited impact on core banking activities.

However, banks seized opportunities to integrate technologies into their operating models to allow them to deliver services quicker (e.g., SWIFT messages) and extend geographically by using computerization and telecommunication as a business accelerator rather than an innovation enabler. This was a time when technologies were expensive and only accessible by highly capitalized industries.

Today, we are in the digital age, and digital is woven into everything we do. For the first time in history, technology is pervasive and cheap enough that everyone can use it with little or no learning curve, creating business models and opportunities that never existed before. And banking is no exception.

Technology has become ubiquitous and embedded in everyone's lives:

- Society: the explosion of connectivity, data, ease of use, computing power, accessibility, and the rapid pace of innovation has made technology as important as food, water and shelter in society.
- Personal life: family and friends stay connected, scheduled, and entertained. Technology is now necessary for entertainment, health, driving, socializing, shopping, banking, traveling, learning and dozens of other personal activities.
- Business and professional life: digital is transforming every business and touches every employee in a unique way. Some industries are being turned inside out, while others are benefiting from the expanded capabilities. Marketing, customer engagement, employee productivity, sales, and many other business functions are being redefined.

In the last few decades alone, banks have faced more changes than in the past 300 years. Banking in the digital era is undergoing a paradigm shift driven by:

- New technologies, breaking down barriers and allowing new competitors to enter the market;
- Regulation, which among others is driving openness, transparency and the entry of newcomers —e.g., the Second Payments Directive (PSD2) authorizes new players to access consumers' payment accounts (account information service providers, or AISPs), make payments (payment initiation service providers, or PISPs) on their behalf, and provide them an overview of their various accounts, with customers' prior consent; and
- Customers' new expectations, based on an increasingly connected world.

These rapidly evolving customer, technology, and regulatory forces are creating a new operating environment for retail banks. These forces are converging to produce structural shifts to the market dynamics of the financial services industry.

After enduring a regulatory tsunami and resisting business tectonic shifts, banks' resiliency is under stress once more with COVID-19. While it is a type of crisis the market has never experienced before, COVID-19 highlights the urgency of understanding the value of digital innovation and transformation.

But even in a digital era, innovation and transformation is not about tech—it is about becoming more relevant and valuable to customers.

Transforming your organization to become—and remain—truly digital requires more than technology.

A clear strategy determines your organization's ability to reimagine and transform your business for the digital world. The power of digital technologies lies not in their individual use, but how they are being integrated to transform your business and the way you work and operate. As such, your strategy should focus on integrating digital technologies to transform, innovate and achieve strategic goals, instead of using standalone solutions to solve specific challenges.

This strategy should state clear priorities and tell the story of how your organization will develop digital capabilities to align its activities, people, culture, and structure with a set of strategic and organizational goals.

Digitally mature organizations take a "zoom-out/zoom-in" approach to developing a digital strategy. First, they zoom out to consider how their industries and markets will change in 10 years and beyond, and what they need to do to be prepared. Here, scenario thinking is ideal to build long-term perspectives for an industry or organization. Then, they zoom into the next six to 12 months and identify two or three business initiatives that have the most potential to accelerate their progress toward their longer-term destination.

Digital strategies should also tackle how the company will change its leaders' mindsets and evolve its workforce while still supporting its core business. Employees in digitally maturing organizations are confident in their leaders' ability to play the digital game and are motivated to work for digital leaders.

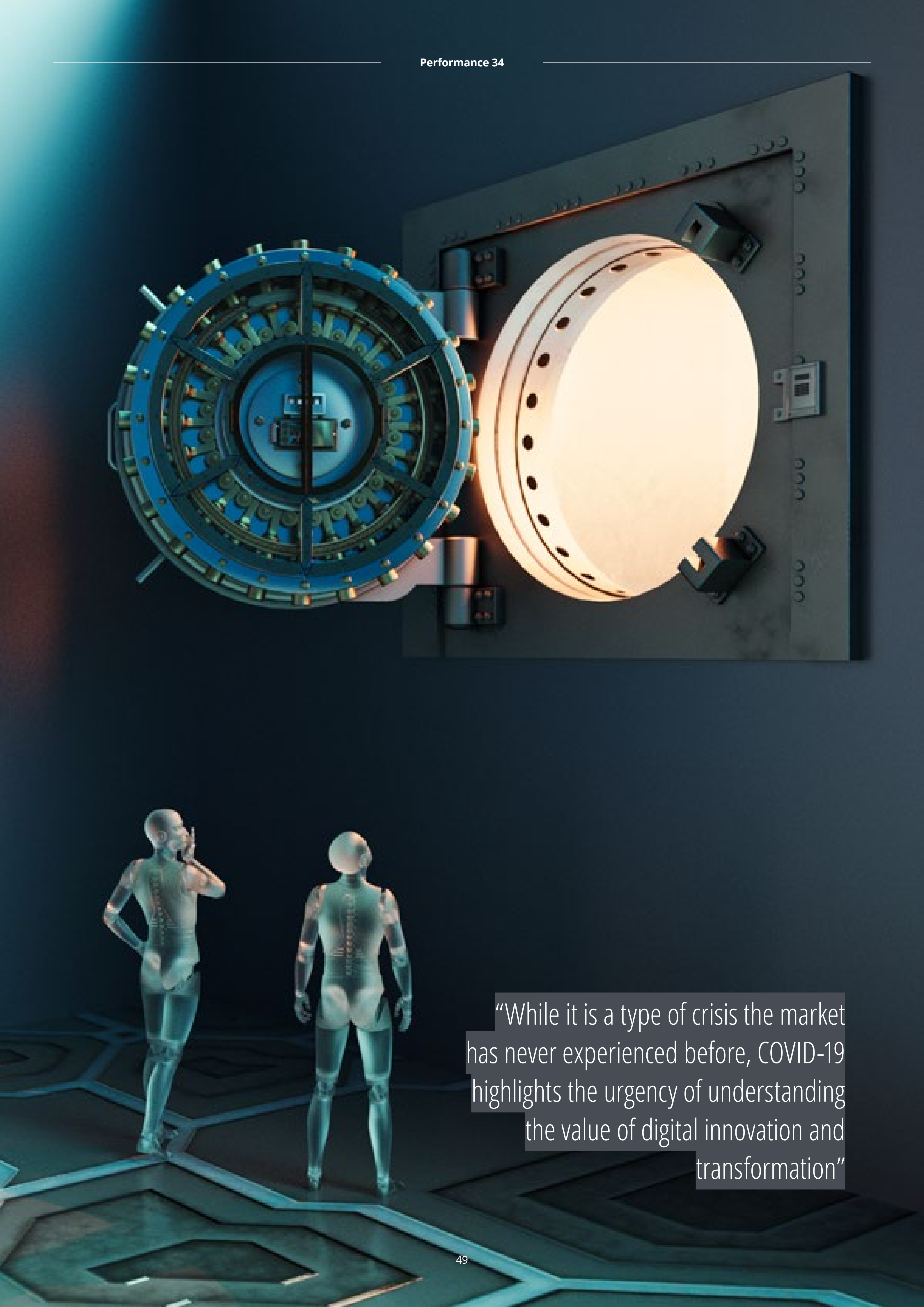
The digital agenda must be led from the top, requiring leaders to possess digital fluency.

This does not mean leaders need to be technology experts; however, they need to be able to:

- Articulate the value of digital technologies to the organization's future;
- Conceptualize how digital technologies can impact the business; and
- Understand how to use digital technologies to achieve strategic goals.

To become talent magnets, digitally maturing organizations do not only invest in strengthening their senior management's digital thinking. They also commit to delivering digital skills to the entire organization, including a customer-first mindset, collaboration, and design thinking. And they do this increasingly online and on a just-in-time, on-the-job basis, rather than through formal classroom training.

Therefore, the ability to communicate the company's strategy by telling a compelling story is an essential leadership capability. Leaders need to



"While it is a type of crisis the market has never experienced before, COVID-19 highlights the urgency of understanding the value of digital innovation and transformation" create narratives about digital and have a clear agenda to equip the company, its people, structure and culture with the capabilities and strategies necessary to traverse the digital age.

Leaders can set the stage for their employees to excel, creating conditions that foster agility, collaboration, and innovation through new ways of working.

If digital transformation is what you want, reinventing your ways of working is what you need
Despite the importance of leaders showing the way, digital transformation cannot just be a top-down mandate for change. Instead, it involves creating conditions where existing employees can start thinking and working differently, driving change from the bottom up as well. Digital cultures, ways of working and behaving—which lead to the adoption of new technologies—are characterized by innovation through experimentation and learning, risk-taking, agility, and cross-functional collaboration.

Creating such a digital culture and building the capabilities for new ways of working is an intentional effort: 80% of respondents from digitally maturing companies say they are actively engaged in bolstering risk-taking, agility and collaboration.

From a hierarchy to a network of teams
A vital part of transforming your culture and ways of working is focusing on peak-performance teams. Digital organizations recognize and reward collaboration, regard cross-functional teams as a cornerstone of how they operate, and are less likely to rely on hierarchical management structures to make decisions.

To foster speed, agility and cross-functional cooperation, digital organizations:

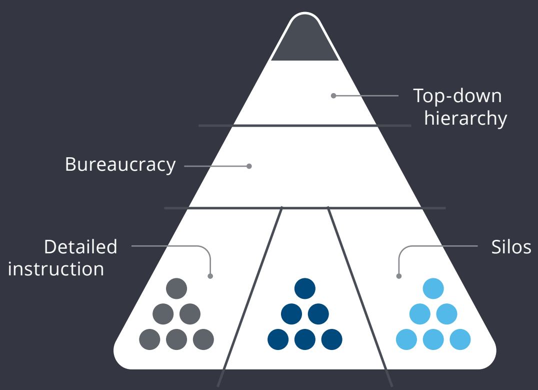
- Simplify and delayer their organizational structure by shifting from a vertical departmental structure to a horizontal end-to-end approach;
- Shift from a process focus to a customer experience focus, which drives cross-functional collaboration;
- Rethink how work is done and by whom, allowing people to fluidly move from project to project;
- Push decision making to autonomous teams; and
- Evaluate teams as a unit.

Agility is a shift in the mental model of what an organization is and how it operates

From traditional organization...

Organizations as "machines"

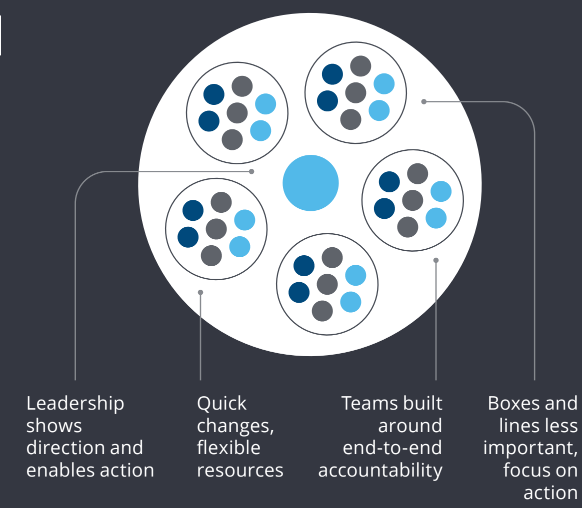
- **Leaders as masterminds** who delegate tasks and instructions
- **Separating** most people in the organizations **from stressors and complexity**
- **Optimizing for set outcomes** and plans
- **People as cogs in a machine**
- **Limited transparency**



... to agile organization

Organizations as organic systems

- **Leaders who show direction and set upthe system for people** to do their jobs effectively
- People **collaborate across boundaries**
- Employees understand their roleand how it **influences customers**
- Exposing all employees to some **uncertainty and ownership**



Digital organizations do not only rely on their internal innovation capacities but are also more likely to collaborate with external partners.

The myth of the lone innovator: Digital ecosystems accelerate innovation
Digitally maturing companies innovate at far higher rates than their less mature counterparts, and they innovate differently.

These companies invest more in innovation and continuously drive digital improvement, spreading the responsibility for innovation throughout the entire organization instead of confining it to labs. This means that the cross-functional teams described earlier have more freedom to innovate in their daily jobs and are provided with the necessary resources. This greater autonomy requires higher governance, which is achieved by giving clear priorities as outlined in the organization's strategy.

Moreover, digital organizations do not only rely on their internal innovation capacities but are also more likely to collaborate with external partners. And, as with many things outlined in this article, they take a different approach to these collaborations; relying less on formal contracts and more on building trusting relationships.

Start your digital transformation by defining your ambitions
Defining your ambitions before you start on your digital journey is crucial. Companies often skip this step and just jump straight into a multitude of small digital projects here and there, which often fail to create any significant impact.

Properly defining and designing your ambition will allow you to avoid random digital acts. Create an aligned portfolio of ideas informed by current trends, disruptors and customer needs, and look to the intersection of technology, market and user insights to help you see and think about the future of digital differently.

Ultimately, this will empower you to go beyond prototypes by building and testing offerings in market with real customers, while pushing your organization to change its DNA by using fast cycle sprints that de-risk and accelerate the path to a successful digital transformation.

What does it mean to define your ambitions?
We define ambition as "A strong desire to do or to achieve something beyond

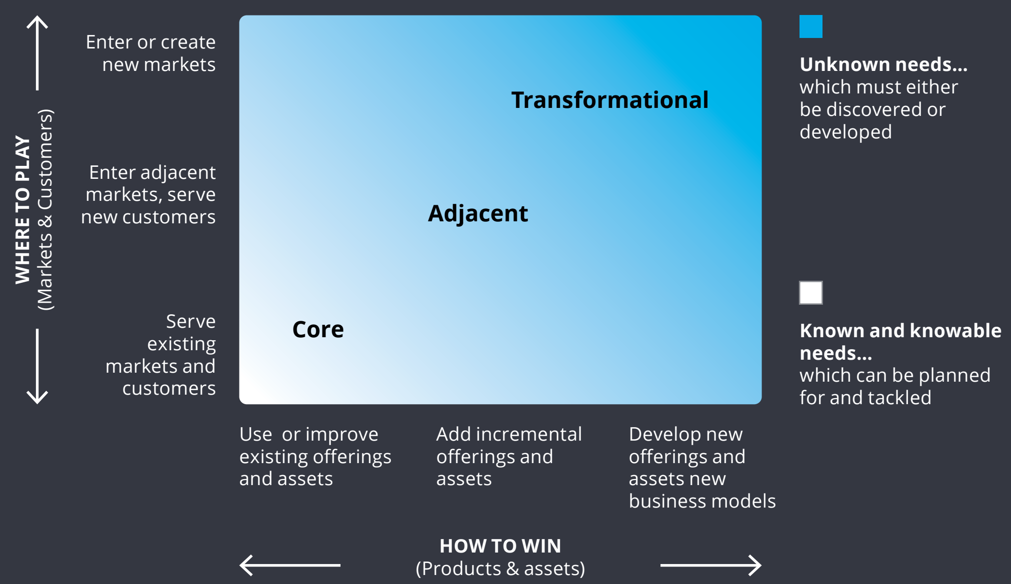
what is typically considered reachable. The achievement of the ambition delivers lasting value to people and organizations. It is measured by its ability to deliver delightful experiences, drive economic value, and create a lasting competitive advantage."

How can you define and design your ambition?
Ambitions can start from three points: core, adjacent, and transformational. They can start in the core and grow into adjacent offerings; however, transformation ambitions can drive core change as well— so, do not limit your starting point.

Key considerations for developing ambitions

- Focus on humans first: human behavior is the fundamental economic gear of every business. If you can identify which behaviors to drive (internally and externally) to create the greatest return and marshal your digital resources to achieve that behavioral change, you will win.
- Find opportunities at the intersections: do not try to produce new ideas alone. To find the future of your business, look to unexpected intersections: between disciplines and domains of expertise, across departments and organizational silos, between industries, and through partnerships that span markets and geographies.
- "Get it out" beats "get it perfect": in a world dominated by uncertainty, the only way to get effective market feedback is to give the market something to react to. Succeed faster via a cadence of rapidly delivering minimally viable offerings (MVOs) into the market and learning from the feedback you obtain for each subsequent iteration.
- Harness the power of enabling technology: the ability of applied technology to further the capabilities of humans, increase the velocity of business and unlock value and new possibilities is a crucial element in achieving competitive advantages. Looking for ways to leverage technology to drive your speed to market or provide access to new ways of doing business is key.

Scope of ambitions



Three steps to help you define your ambition:

1. Sense: understand trends, disruptors and opportunities
- Conduct research to understand digital strengths, development areas, and market perceptions including industry, customer, and emerging technology trends.
- Conduct stakeholder and customer interviews.

2. Aspire: framing your understanding puts opportunities in context
- Develop provocations to paint the future, at distinct levels of ambition for core, adjacent, and transformational.
- Articulate the implications to brand, organization, and potential economic impact.
- Develop evaluation criteria.

3. Decide: define ambition and map the path ahead
- Review, discuss and prioritize developed provocations to align stakeholders on a common future vision.
- Define the steps to bringing the ambition to reality, including impacts on the organization and expected customer experiences.

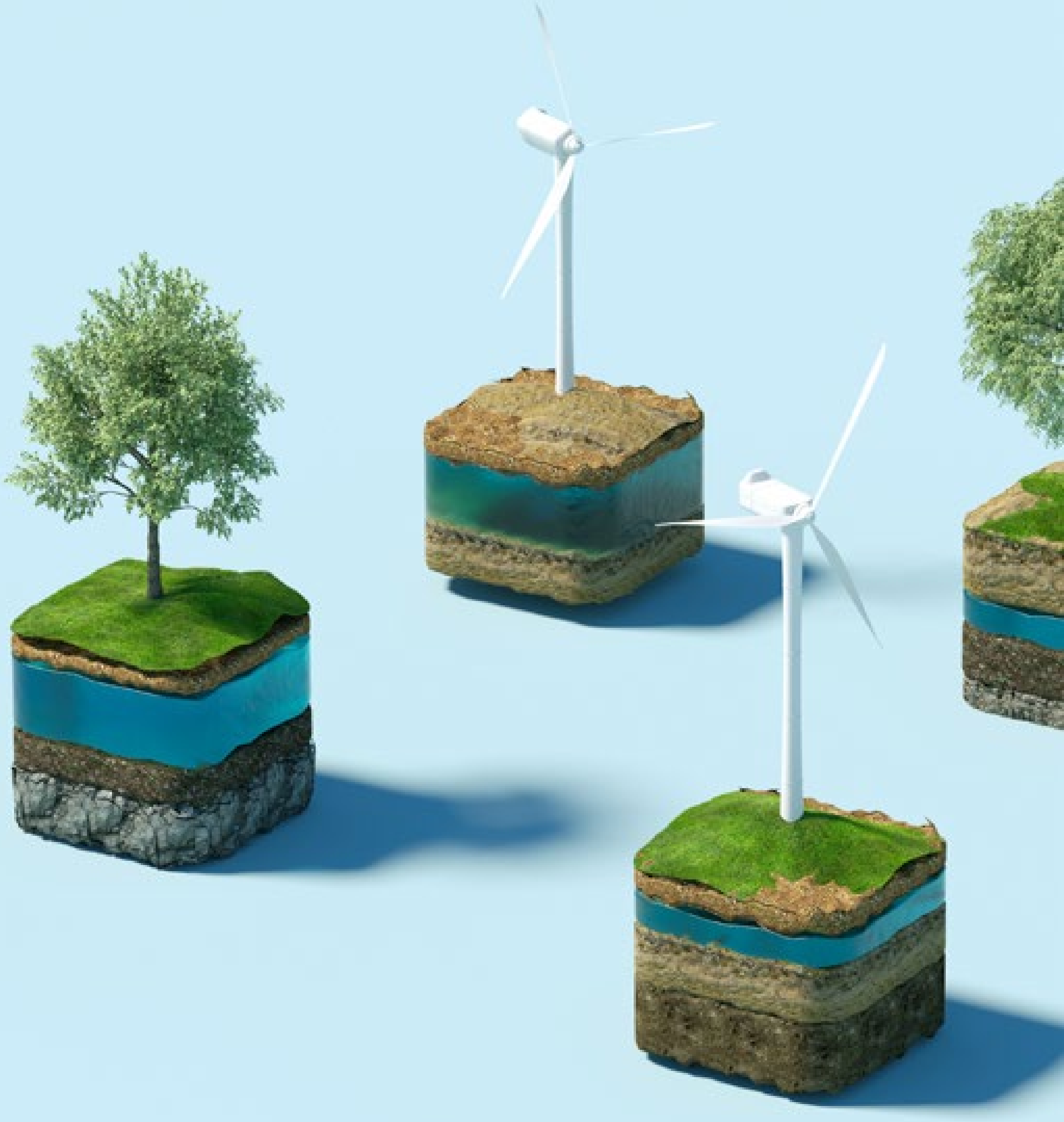
TO THE POINT

Digital transformation and innovation are much more than just about technology and require you to:

- Transform the business by revisiting business models, focusing on customer experiences, rethinking your brand, and uncovering new opportunities through rapid innovation.
- Transform the organization by changing your culture, introducing new ways of working, and building capabilities that are suited for this new reality.

UNLOCKING VALUE WITH SUSTAINABILITY

THE ROLE OF DOUBLE MATERIALITY



FRANÇOIS DE VARENNE
CEO
SCOR GLOBAL INVESTMENTS

As sustainability gains momentum and changes the perceptions of many investors, we are entering a new paradigm where non-financial criteria are increasingly being used to make investment decisions. However, it may seem difficult to navigate this additional dimension if investors do not proceed with a clear idea of what they intend to achieve.

For decades, investors have relied on risk-return models to optimize their portfolio allocation. For a given financial risk budget, the objective was to maximize the financial performance of a portfolio that combines risky assets with different levels of risk, liquidity and yield.

Let's go back to basics: building a resilient portfolio is the objective of many investors. They want to optimize performance, while limiting the downside of adverse developments. Achieving this depends on factors that may positively or negatively impact the price of assets. Identifying these factors is essential, and traditional investors are used to analyzing multiple financial indicators when assessing the risk-return profile of an investment opportunity. Over the last few years, environmental, social and governance (ESG) criteria have gained traction among the financial community. This trend goes far beyond Socially Responsible Investment (SRI), which mainly focuses on ethics and governance.

The two facets of sustainability
Sustainability has two facets. The first is resilience, which relates to the impact of externalities on the value of assets. Resilience reflects the outside-in effect of non-financial factors on the value or the financial performance of an asset or a portfolio. Climate change may hit the value of an asset or the income expected from it, for example, or weak governance may have a disastrous impact on the valuation of a company. The second facet is the inside-out effect, which measures the consequences of an investment decision on ecosystems.

Non-financial criteria, despite their non-financial essence, can provide valuable

Applying materiality to both financial and nonfinancial risks enhances the resilience of a portfolio. Combining outside-in and inside-out lenses delivers superior long-term value creation.

information to increase the resilience of the portfolio, limiting its downside risk and increasing value creation over the long term.

When optimizing investment decisions, the concept of materiality is key to enhancing value creation over time. Including a non-financial, but material risk (e.g. reputational risk for a company strongly involved in deforestation in Brazil) is likely to be more efficient than including a financial, but non-material risk (e.g. interest rate risk when investing in very short-dated securities). Applying materiality to both financial and non-financial risks enhances the resilience of a portfolio. Combining outside-in and inside-out lenses delivers superior long-term value creation.

Adding a long-term view to value creation

More and more studies show a positive correlation between outperformance and strong ESG ratings. For skeptics doubting the value of environmental, social and governance considerations in investment decisions, this outperformance is due purely to more and more investors chasing after the same types of investments because of their ESG risk profile, thereby creating an ESG bubble.

But reality actually goes far beyond this. In fact, by integrating more information – especially relating to material non-financial risks - investors can select the companies that present a high-performance potential and avoid others that bear too high a risk. This may prove useful when dealing with a limited financial risk budget.

Resilience is one aspect of sustainability, and probably the easiest to comprehend for investors who are used to seeking financial performance. However, it is only one side of the coin; sustainability embeds a much broader concept. Outside-in and inside-out effects are strongly

Taking climate change as an example, resilience should lead to protecting the value of assets against both transition and physical risks.

interconnected, and dealing with one while neglecting the other keeps investors locked into their usual short-term view of value creation.

Taking climate change as an example, resilience should lead to protecting the value of assets against both transition and physical risks. These two risks move in opposite directions, as the faster the transition, the higher the possibility of containing global warming. However, this only works to the extent that the transition is sufficiently early and orderly. Otherwise, transition damage – mainly stranded assets – and a significant increase in the severity and/or frequency of climate-related extreme events, may hit investors' portfolios.

Therefore, when addressing the inside-out effects of their investment decisions, investors may decide to exit some sectors that are not compatible with the Paris Agreement. They may also decide to put a best-in-class strategy in place aimed at limiting the adverse impacts of their investment decisions on the environment. By doing so, they actively contribute to a faster transition, which in turn protects their portfolio against physical damage - over a much longer time horizon. This loopback effect reintroduces the long-term horizon into short-term decisions.

Impacting the real economy: Combining best-in-class and engagement

In an ideal world, investees should be actively and directly involved in transitioning their business models to address environmental, social and governance challenges in a frictionless way. To support this transformational behavior, responsible investors can play an active role by engaging with investees.

Returning to the climate change example, a strategy combining engagement and decarbonization targets is best positioned to impact the real economy. Portfolio decarbonization should be carried out in an orderly manner, remaining exposed to all sectors needed to build a more sustainable world. It's not a question of exiting the energy sector to decrease the carbon footprint or the implicit temperature rise of a portfolio. Rather, investors should select the best companies within each sector committed to reaching carbon neutrality as soon as possible, supporting them in their pathway to decarbonization and engaging with them to speed up their process.

CONCLUSION

Sustainability should be considered holistically. It highlights the responsibility of investors in terms of building a sustainable world. Investors are becoming mindful of what they invest in when using the double materiality lens. Sustainability raises the question of how to generate returns not only on financial capital but also on nature and society. It opens the door to "multi-capital" thinking, which complements traditional investment and creates new opportunities.

IN A NUTSHELL

- Sustainability encompasses the double materiality principle
- The loopback effect of investment decisions reconciles short-term resilience with long-term impact and benefits value creation
- Responsible investors should seek to impact the real economy beyond building a resilient portfolio

NEW LIMITED PARTNERSHIP FUND REGIME INTRODUCED IN HONG KONG

A GAME CHANGER FOR THE FUND MANAGEMENT INDUSTRY

WILSON CHEUNG
DIRECTOR
CONDUCT & REGULATIONS - DELOITTE

The Hong Kong's Legislative Council passed the Limited Partnership Fund Bill ("the bill") on 9 July 2020, allowing the long-awaited limited partnership regime for funds (the "LPF regime") designed for private funds to come into operation on 31 August 2020.
The aim of the LPF regime is to attract investment funds (including private equity and venture capital funds) to set up and operate in Hong Kong. Together with the unified Hong Kong tax exemption regime for funds (which provides Hong Kong tax exemption to all funds, provided certain conditions are satisfied), the LPF regime is not only attracting more funds to Hong Kong and accelerating the development of these private funds, but also driving up the demand for capital, talent and expertise from different sectors, including technology and professional services that can take advantage of the tremendous business opportunities inherent to the Greater Bay Area.


誠興蔴雀公司
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中西藥行
麗德
生活百貨

What were the options available to establish funds in Hong Kong and why is the LPF regime so appealing?

A limited partnership is a common constitution form for private funds, such as private equity (PE) funds. In a limited partnership, the general partner (i.e., the operating person) has unlimited liability in respect of the debts and liabilities of the fund, and the limited partner(s), who are essentially investors with limited liability, will have freedom of contract in respect of the operation of the partnership.

Prior to the introduction of the LPF regime, funds were mainly established in Hong Kong in the form of unit trusts or open-ended fund companies (OFC)[1]. However, not all overseas fund managers are familiar with Hong Kong's trust law or OFC regime. Instead, it was more common for fund managers to establish their funds, especially PE funds, through general partner/limited partner structures based in offshore jurisdictions, such as the Cayman Islands, which had the relevant exempted limited partnership laws tailored for funds.

Hong Kong's own Limited Partnerships Ordinance (Cap. 37), which was enacted a century ago, is typically used to establish professional practices such as accountancy, law, etc., rather than meeting the needs of the fund industry. This ordinance offers less flexibility in governing matters pertaining to capital contributions and the distribution of profits. It is unable to meet the operational needs that fund managers require, such as variable share capital arrangements to meet investors' ad hoc subscription and redemption requests, or streamlined procedures for termination.

Against the backdrop of the global regulatory landscape for the fund industry, the Organisation for Economic Co-operation and Development (OECD) introduced Base Erosion and Profit Shifting (BEPS) for over 135 countries, including the Cayman Islands, to combat tax avoidance with the concept of the "economic substance" test. Accordingly, fund managers who are used to establishing funds in offshore jurisdictions without "economic substance" are now potentially subject to regulatory challenges.

These fund managers may eventually need to demonstrate economic substance, perhaps by maintaining a physical presence (e.g., an office) or hiring full-time employees in the offshore jurisdictions where they are situated. These requirements may be further tightened in the future. Taken together, these

1. The new opened-end fund company (OFC) regime was introduced to Hong Kong in July 2018. The FAQs of OFC provided by Financial Services and the Treasury Bureau can be found here: https://www.fstb.gov.hk/fsb/ppr/consult/doc/ofc_faq_e.pdf

push factors may lead fund managers around the world to revisit their fund structures and consider moving their funds and business activities back onshore.

Meanwhile, in February 2020, the Cayman Islands was added to the European Union's (EU) blacklist of non-cooperative jurisdictions, meaning that the Cayman Islands may be subject to additional administrative or defensive measures imposed by EU member states.

On 7 February 2020, the Cayman Islands' government enacted the Private Funds Law 2020, which required any Cayman Islands closed-ended fund that falls within the definition of a "private fund" to register with the Cayman Islands Monetary Authority (CIMA). The requirements include a list of ongoing compliance obligations, including audited annual financial statements to be signed off by a CIMA-approved Cayman Islands auditor and the payment of an annual fee of US$4,268.29, increasing the operation cost of all Cayman funds managers. This could be another push factor for industry players to consider re-domiciling their funds to a jurisdiction in which the fund managers are physically residing or located nearby.

Operating from the center of Asia, Hong Kong enables Asia-based fund managers to maintain the strategic management of all fund matters in Hong Kong more easily, as well as to avoid the legal fees and efforts of engaging offshore lawyers to handle legal and compliance matters. Asia-based fund managers should feel more comfortable with the Hong Kong legal system and may already have the internal legal counsel and resources to handle such legal and compliance matters.

With the incorporation of funds in Hong Kong, these fund managers can keep certain operations such as research teams and deal sourcing teams in other countries if applicable. Also, with the huge potential of investment opportunities in China, incorporating in Hong Kong and leveraging the advantages of its robust legal system, international capital market, and closeness to China make sound business sense.

According to AVCJ data[2] that was cited by Hong Kong's Legislative Council in its brief on the bill, there were 560 private equity and venture capital firms with US$160 billion of assets under management in Hong Kong in 2019. This figure does not even include the assets that are managed in China.

With the huge potential of investment opportunities in China, incorporating in Hong Kong and leveraging the advantages of its robust legal system, international capital market, and closeness to China make sound business sense.

2. Legislative Council's brief on the Bill dated 18 March 2020, which is accessible at: https://www.legco.gov.hk/yr19-20/english/bills/brief/b202003201_brf.pdf

What are the key features of the LPF regime?

1. Constitution of an LPF
At least two partners (one general and one limited), under a written agreement such as a limited partnership agreement.

- General partner: either an individual, a limited Hong Kong private company, a non-Hong Kong company registered with Hong Kong's Company Registry, or a domestic/offshore limited partnership.
- Limited partner: either an individual, a corporation, a partnership, a trustee, an unincorporated body, or any other entity or body.

2. Legal liability
In line with prevailing overseas practices, an LPF is not a legal person. The general partner of an LPF has unlimited liability with respect to the debts and liabilities of the fund, as well as ultimate responsibility for the management and control of the fund. On the other hand, the liability of the limited partner(s) of an LPF will generally be limited to the commitment they make to the fund, and will not have day-to-day management rights or control over the underlying assets held by the LPF.

3. Registration
The LPF shall maintain a registered office in Hong Kong. The application must be submitted by a "presentor", which is either a registered Hong Kong law firm or a solicitor admitted to practice law in Hong Kong. The application shall be submitted to Hong Kong's Registrar of Companies.

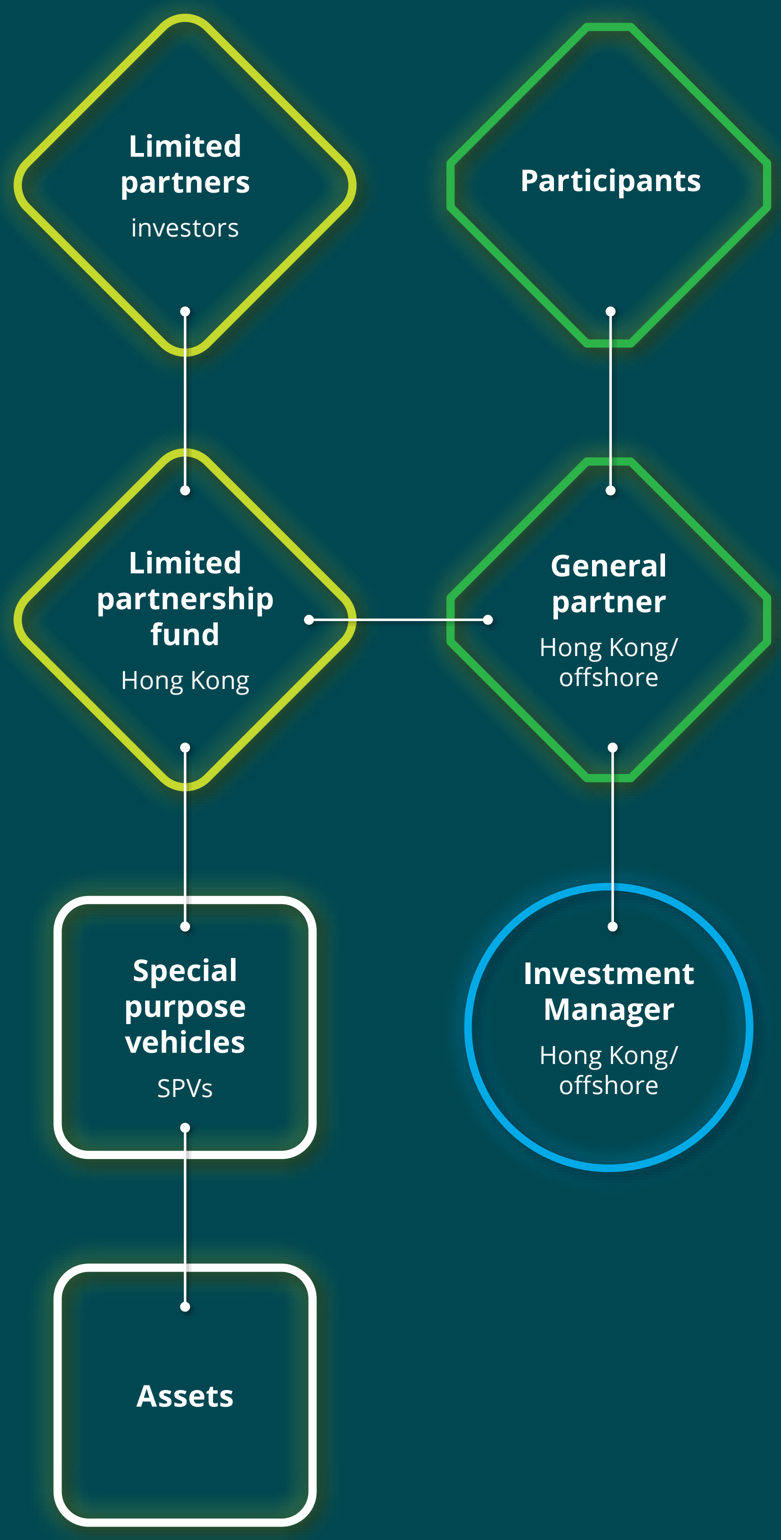
4. Appointment of an investment manager, auditor, and responsible person
The LPF must appoint either a Hong Kong resident over 18 years of age or a corporation registered in Hong Kong as its investment manager, as well as a local auditor to perform annual audits of financial statements, and a responsible person (e.g., an authorized institution, licensed corporation, accounting professional, or legal professional) to carry out the LPF's anti-money laundering/ counter-terrorism financing (AML/CTF) function.

5. Migration of funds
A streamlined channel is provided for existing funds registered under the Hong Kong's Limited Partnership Ordinance (Cap. 37) to migrate to the LPF regime.

6. Confidentiality of limited partners
The identity of the limited partnership should NOT be accessible on public registers for the sake of confidentiality. The relevant records should still be kept at the registered office or any other place in Hong Kong known to Hong Kong's Registrar of Companies and accessible by law enforcement officers when necessary.

7. Tax and stamp duty treatment
The LPF can enjoy profit tax exemption provided it meets certain exemption conditions set out under the unified fund exemption regime. As for stamp duty, an interest in an LPF is not a "stock" and is not subject to stamp duty when the interest is contributed, transferred or withdrawn.

An illustrated example of an LPF structure



TO THE POINT

The LPF regime is playing a key role in attracting fund managers, especially those based in Asia, to consider establishing new funds in or re-domiciling their existing funds to Hong Kong. Recently, we have received a lot of inquiries from our clients, especially China-based fund managers, who are planning to establish new funds under the regime.

The introduction of the LPF regime serves as one of the key steps to making Hong Kong an appealing location for global fund establishment. Another key step relates to tax concessions. In the latest Hong Kong budget speech, the government also stated that it is planning to provide tax concessions for carried interest issued by PE funds operating in Hong Kong, subject to the fulfillment of certain conditions.

These tax concessions, once enacted, should hopefully help address the long-contentious issue of the taxation of carried interest in Hong Kong. It could be a game-changer for the future fund industry landscape.

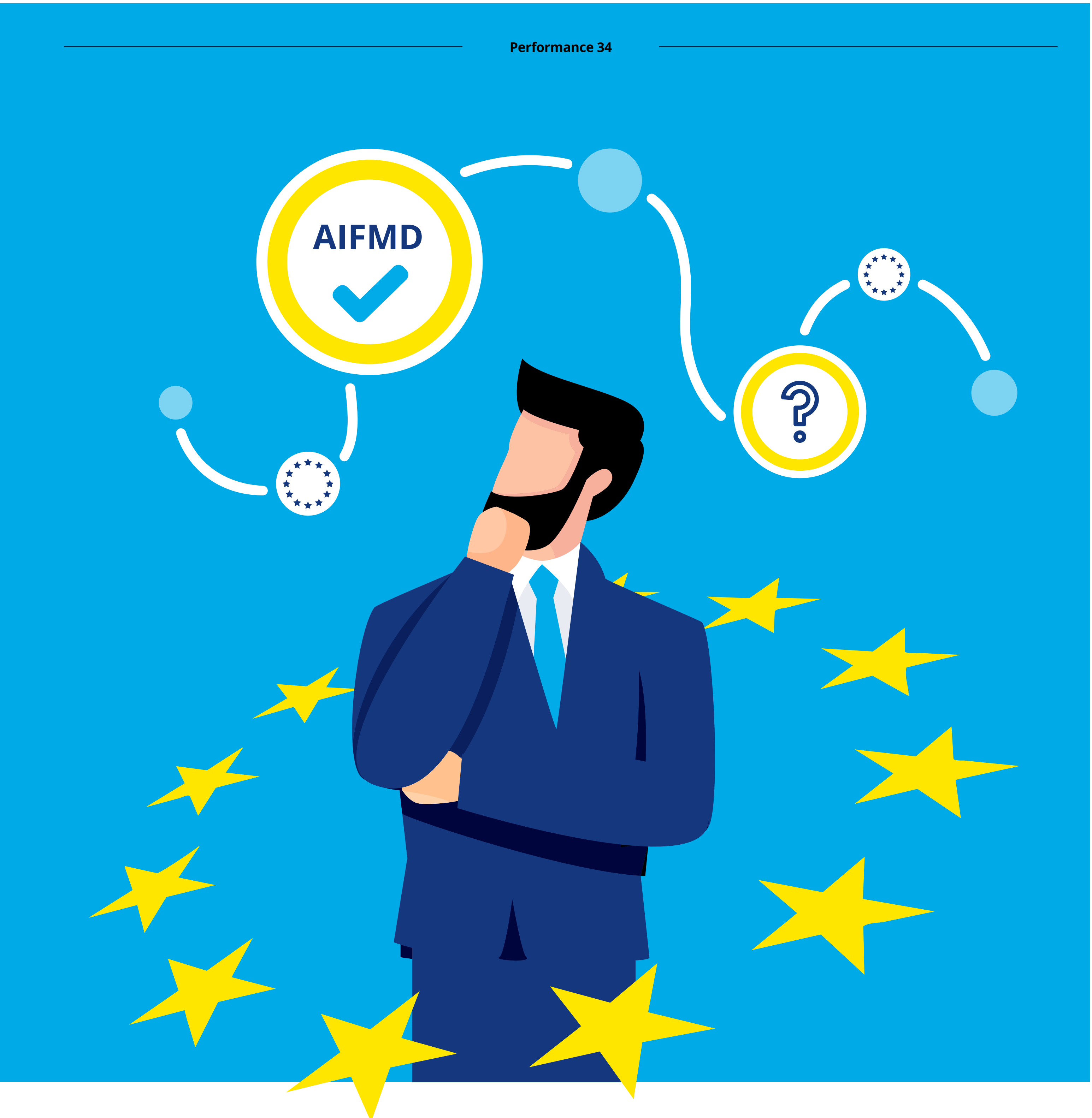
TAKING STOCK OF THE ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE NINE YEARS LATER: WILL THE MARKETING OF AIFS IMPROVE?

FRANCOIS KIM HUGE
PARTNER - CONSULTING
FINANCIAL INDUSTRY SOLUTIONS
DELOITTE

GUILLAUME SCAFFE
DIRECTOR - CONSULTING
FINANCIAL INDUSTRY SOLUTIONS
DELOITTE

MARIE-ANNE MANDROUX
SENIOR MANAGER - CONSULTING
FINANCIAL INDUSTRY SOLUTIONS
DELOITTE

The European Alternative Investment Fund Managers Directive (AIFMD) introduced the alternative investment fund (AIF) marketing passport and is now recognized as a great success. However, this achievement is somewhat tainted by the passport being unavailable to all industry players. This article aims to examine the current state of affairs, explain the limits of the marketing possibilities, and to provide a view as to whether the regulation will evolve in the right direction.



The AIFMD marketing passport is now widely recognized as a success story
The AIFMD was the first step in harmonizing the marketing of EU AIFs within the EU. At present, the Directive grants a marketing passport to EU AIFMs that manage EU AIFs. This allows these AIFs to easily obtain a marketing authorization in each Member State (MS), thanks to a homogeneous and simplified notification process. Raising money from professional investors within the EU can be done relatively simply and quickly. The time-to-market is much faster (a maximum of 20 business days) and less costly (the abrogation of some local gold-plating requirements).

But is AIFMD a total success?
In fact, nine years later, many hurdles remain when marketing AIFs that are non-EU or target retail investors. In these cases, the regulatory framework is not harmonized and different rules still exist across MS, despite the efforts of the European Commission and the European Securities and Markets Authority (ESMA) to overcome discrepancies in the EU regulatory framework.

The European cacophony when marketing non-EU AIFs via the so-called NPPR: technically possible, but in reality...
Even though every MS can market non-EU AIFs via the National Private Placement

Regime (NPPR) from a legal perspective, the reality and market practice is very different, due to many MS setting up technical barriers that make this process overly complex and tedious.

For example, if an MS allows NPPR, then a set of EU obligations defined by the AIFMD applies to the AIFM (e.g., a specific cooperation agreement between the host and home regulators, depositary requirements, and some transparency requirements). And, in addition, each MS may impose certain local gold-plating requirements. This creates an uneven playing field between EU and non-EU AIFMs.

Member States		NPR (art. 42 AIFMD) complexity level/high-level analysis
France	**(Nearly) impossible**	The non-EU AIFM must certify and provide evidence of compliance with all AIFMD requirements. According to the French regulator, this is very complicated to prove.
Italy		Currently, the marketing of non-EU AIFs or EU AIFs managed by non-EU AIFMs in accordance with Article 42 AIFMD to professional investors is not permitted in Italy.
Austria, Spain and Germany	**Highly complex**	Equivalence to requirements that apply to the same category of local funds is required.
Portugal		Specific certificate/confirmation issued by the home state regulator of the non-EU AIFM and AIF is required.
Belgium, Sweden and The Netherlands	**Mildly complex**	A few relatively simple local gold-plating requirements must be met. Numerous non-EU AIFs managed by non-EU AIFMs are registered in these countries for marketing to professional investors.

There is not much confidence around the marketing of third-country AIFs.
It was expected that the AIFMD would evolve to extend the marketing passport to non-EU AIFMs and AIFs, as long as ESMA felt there were no significant obstacles regarding investor protection, market disruption, competition, or the monitoring of systemic risk.

However, for the time being, this project is on hold. So far, ESMA has only assessed 12 jurisdictions (Australia, Bermuda, Canada, the Cayman Islands, Guernsey, Hong Kong, Isle of Man, Japan, Jersey, Singapore, Switzerland and the United States of America). To date, ESMA is unable to provide a definitive assessment; therefore, the third-country passport is not in effect.

And what about Brexit?
The United Kingdom (UK) has now left the EU and Brexit impacts the marketing passports of AIFs and AIFMs, either from the UK to the EU or vice-versa.

Since 1 January 2021, despite the UK-EU bilateral agreement, the UK is, from now on, treated as a third country and UK-based AIFMs and AIFs will fall under the scope of the NPPR (in some countries, marketing of UK AIFs is no longer possible, cf. graph above). The abandon of the passport will then inevitably cause inefficiencies, marketing disruption and red tape.

The UK will treat EU players the same way; luckily, the UK NPPR is simple to implement and should not deter the marketing of EU AIFs in the UK.

The AIFMD did not facilitate the marketing of AIFs to non-professional investors and curbed fund promoters' enthusiasm for the retail market.
The AIFM passport and the NPPR are avenues for targeting professional investors only. In other words, the possibility of targeting retail investors depends on each MS. These requirements are normally extremely complex and restrictive; and, in some MS, it is not even possible to target retail investors.

Back in 2011, fund promoters were enthusiastic about the possibility of marketing their AIFs to retail investors within the EU, but as the AIFMD maintained the status quo on this matter, these issues remained.

In fact, before the AIFMD was implemented, only a few MS allowed the marketing of non-UCITS funds to retail investors locally. Even if the AIFMD's main objective was to homogenize marketing rules across the EU, the AIFMD provisions for marketing to retail investors did not have much impact and this possibility was left to the discretion of each MS.

Nine years later, the position of each MS has not really evolved. Only a few jurisdictions allow the marketing of AIFs to retail investors in their territory (mainly the same ones as before).

Member States		Marketing to retail investors complexity level/high-level analysis
Germany, Italy and Spain	(Nearly) impossible	Equivalence to domestic AIFs suitable for marketing to retail investors must be demonstrated. In reality, however, it is nearly impossible for these AIFs to meet this requirement and local regulators rarely consider that it is the case (discretionary condition).
France	(Nearly) impossible	Specific recognition agreement between the French regulator and the competent authority of the AIFM and AIF must be signed. So far, none of these agreements are in place.
Belgium	Highly complex	Investment policy provisions applicable to Belgian AIFs for the public apply to foreign AIFs.
Austria	Highly complex	Equivalence to requirements that apply to domestic AIFs suitable for marketing to retail investors must be demonstrated.
Sweden	Highly complex	Foreign AIFs must fulfill the conditions for being a "Special Fund" (UCITS-like fund) or admitted to trading on a regulated market.
Portugal	Mildly complex	Foreign AIFs must be subject in their home state to a similar level of protection and security as the one that applies to Portuguese-domiciled AIFs.
The Netherlands	Mildly complex	Although marketing to retail investors is subject to several top-up requirements, we have not observed any blocking point.

But the EU intends to improve the current status and address the lack of efficacy.
The European Commission is aware that it must review the Directive's application and scope. In this respect, the European Commission issued an AIFMD assessment report to the European Parliament and the Council on 10 June 2020. In this report, the European Commission identified various inefficiencies, notably regarding the cross-border distribution of AIFs. It recognized that this inefficacy is caused by local gold-plating requirements (for example, regarding the NPPR), divergences in the national marketing rules (the definition of marketing activities) and nonharmonized interpretations of the AIFMD.

Regarding the latter, the lack of agreement on the definition of a professional investor impairs the marketing passport's efficacy. In some countries, it is possible to use the marketing passport to target sophisticated retail investors with a high net-worth and experience in financial markets. The definition and the level of wealth required to qualify as a sophisticated retail investor differs significantly from one MS to another.

The need for greater convergence regarding the definition of a professional investor was also identified by ESMA in its letter to the European Commission on 18 August 2020 highlighting areas of the AIFMD where improvements should be considered by the European Commission during its AIFMD review. For example, if any new investor category is

Even if we still face a long journey ahead, we believe that the standardization of distribution matters accomplished so far is already a great achievement. The figures speak for themselves: the total net assets of AIFs increased by more than 250 percent from 2011 to 2019. Indeed, the marketing passport has successfully streamlined the distribution of EU AIFs managed by EU AIFMs, following the example of UCITS.

introduced under the AIFMD (such as "semi-professional" investors), ESMA recommends that the appropriate investor protection rules are also put in place. Moreover, the AIFMD passport should be restricted to marketing to professional investors only, and not extended to semi-professional investors, that is currently the case in some MS . And, ESMA also stressed the importance of clarifying the reverse solicitation definition. A harmonized interpretation by each MS should be considered to protect investors.

On 22 October 2021, the European Commission launched a public consultation on the review of the AIFMD. Its objective is to get the views of industry stakeholders on how to achieve a more effective and efficient functioning of the EU AIF market as part of the overall financial system.

CONCLUSION

IN THE END, ARE PERFECTLY HOMOGENIZED RULES ACROSS THE EU A UTOPIA?

The AIFMD's objective was to create a solid legislative framework. Nine years later, there are still many local practices, interpretations and even gold-plating requirements regarding the marketing of AIFs within the EU.

But let us not conclude on a negative note:

- Even if we still face a long journey ahead, we believe that the standardization of distribution matters accomplished so far is already a great achievement. The figures speak for themselves: the total net assets of AIFs increased by more than 250 percent from 2011 to 2019. Indeed, the marketing passport has successfully streamlined the distribution of EU AIFs managed by EU AIFMs, following the example of UCITS.

- Some other improvements are already on their way: a "new" Directive (2019/1160/EU) was put in place in July last year, going one step further in the harmonization of practices at the EU level. While it has addressed some issues, such as the question of premarketing, many others have remained unanswered; for example, the passport extension to third countries, the possibility of marketing to retail, investor classification, reverse solicitation, etc. However, the European institutions are aware of these weaknesses and consultations are being held to reach a more level playing field across all MS.

- Regarding the initial enthusiasm in 2011, we believe that there was a gap in expectations between the investment management industry and the AIFMD's goals. European bodies wanted to impose more governance; their intention was not to revolutionize the industry by providing marketing passport options to retail or non-EU markets at first.

TO THE POINT

The European Alternative Investment Fund Managers Directive (AIFMD) entered into force on 21 July 2011. Its objective was to create a solid and harmonized legislative framework for the alternative investment fund (AIF) industry. Has AIFMD been a total success? Well, nine years later, we can observe some great achievements but also many weaknesses regarding the marketing of AIFs within the EU.

A particular success of the AIMFD is the introduction of the marketing passport for EU alternative investment fund managers (AIFMs) marketing EU AIFs to professional investors, thanks to a homogeneous and simplified notification process.

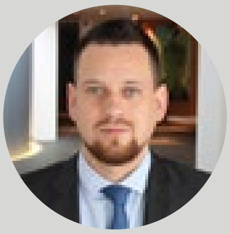
However, this success is tainted by the lack of convergence in other marketing routes: (i) marketing of non-EU AIFs via the so-called National Private Placement Regime (NPPR) and (ii) marketing to retail investors. In fact, there is a European cacophony due to local practices, interpretations and even gold-plating requirements.

Currently, it may be very complicated (or nearly impossible) for non-EU AIFs to enter some EU countries. Moreover, the AIFMD does not facilitate the marketing of AIFs to nonprofessional investors and has curbed the enthusiasm of fund promoters for the retail market.

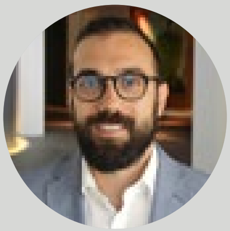
THE DAWN OF MANCOTECH

In the last few years, the pace of change has increased dramatically across all industries, especially for management companies in the asset management industry. Management companies (ManCos) in Europe, faced with growing competition and ever-changing regulations, are being forced to rethink their business models.

FRANCOIS KIM HUGE
PARTNER
DELOITTE



ARNAUD BOUCHAIN
SENIOR MANAGER
DELOITTE



ALESSIO SCUDERI
MANAGER
DELOITTE

Through more frequent onsite visits, regulators are intensifying their scrutiny to ensure ManCos have enough substance in terms of staff and expertise to run their business. Therefore, one of the key challenges faced by ManCos today is to demonstrate they have adequate governance and internal control frameworks in place.

Another challenge is the constantly evolving scope of regulatory rules and reporting obligations, such as the Packaged Retail and Insurance-based Investment Products (PRIIP) Regulation and the European Market Infrastructure Regulation (EMIR). These inflate the volume of data that ManCos need to collect, check, reprocess and publish, intensifying their day-to-day workload.

This scenario is exacerbated by the relative technological immaturity of ManCos, which have lower rates of digitalization compared to other industries. For the vast majority of ManCos in the market today, most tasks are carried out manually or by using standard office tools.

Current regulatory and market trends are demonstrating that the difficulties faced by ManCos today will only increase if they keep using traditional organizational and operating models. Other industries have proven that digital transformation is a key enabler of business growth and sustainability in ever-changing environments. Technology solutions, such as FinTech, RegTech or InsurTech, are widely used across different markets to accelerate business activities, support quality, automate processes and help with decision-making.

Increasing numbers of industry players are starting to grasp that investments in technology are necessary, and a better technology-driven future is beginning to take shape.

The rise of ManCoTech

Let us fast-forward 10 years and imagine the technology-enabled future of ManCos. It is 2030, and ManCos are being supported by proper technology, i.e., a so-called “ManCo system” (aka ManCoTech). No one can imagine or remember how they did their work without it.

At the core of ManCoTech is its workflow management and analytics capability. It enables the ingestion of massive amounts of data and documents sourced internally and externally from business partners, such as distributors, fund administrators, transfer agents and other outsourcing partners or delegates. These are linked together through application programming interfaces (APIs) that aid the exchange of data. Then, the information is routed through workflow tools to manage the product lifecycle, similar to an air traffic control system that controls vast amounts of external data while continuously coordinating actions to be taken.

As such, ManCoTech will be the core enabler of day-to-day operations. Based on the analyzed data, ManCos employees will be primarily making decisions and defining the way forward. For example, employees will have a holistic view of all operational and regulatory risks in real-time, with indications of the next best course of action. Through a powerful customer relationship management (CRM) tool, employees can also seamlessly ensure optimal interactions with their clients and distributor base. And, regarding reporting, a universal reporting factory will satisfy the individual and customized information needs of clients and regulators.

A "one-size-fits-all" solution cannot exist. The integration of customized solutions is the key to success

Currently, there is no fully integrated and all-encompassing ManCoTech solution available on the market that can cope with ManCos' abundant functional needs across their business units. This is unsurprising, as a one-size-fits-all solution cannot meet the needs of a heterogeneous industry that currently lacks organization model standards.

Overall, the factors that explain the variety of ManCos in the market include corporate structure, total headcount, authorizations to conduct regulated business activities, fund types under management, and range of services offered to clients. Every ManCo has a specific operating model, business workflow, and strategic roadmap with different business priorities.

Therefore, ManCoTech needs to offer a high level of customization to adapt to the specific business requirements of each ManCo. Every ManCoTech module must be configurable and able to adapt its functionalities to how each ManCo's business unit is composed and business workflow is coordinated; the granularity of information it requires to perform its activities; and the reporting format to support management meetings. Finally, and most importantly, all these components will only deliver their full value when they are interconnected. As such, ManCoTech will require multiple integration means, from the most advanced data flows (e.g., APIs) to the use of robotic processes to not only read or generate raw data files but also less structured documents such as key performance indicator, exception and management reports.

Combining business customization and technical flexibility will be the key to a successful ManCoTech solution, providing ManCos with the ease to adapt and the scalability they need. If a new set of business requirements arises, whether due to internal factors (e.g., a new policy) or external factors (e.g., a new regulation), ManCos will be able to easily implement new processes, tools or applications, leveraging the technological and organizational infrastructure of the ManCoTech that is already in place.

This also means that ManCoTech providers will be able to propose modular offerings that allow the new technology to be gradually onboarded, mitigating the risk of impacting recurring operations.

No pain, no gain. Get ready to change

The often rigid organizational structures of ManCos can prevent them from carrying out lengthy and costly transformation programs. If ManCos wish to adapt to upcoming challenges, they must increase their organizational agility.

In parallel, ManCoTech providers will need to accompany ManCos through their step-by-step transformation journey. They will need to listen to ManCos' specific requirements and business priorities, support them in identifying their current pain points and determining sources of improvements, and offer them the most suitable ManCoTech modules.

In this context, agile transformations will especially suit ManCos to tackle the cultural changes faced by their organization and staff when adopting new ways of working and using unfamiliar tools and technologies. It will be easier for organizations to measure the benefits of ManCoTech by rolling it out over time to an increasing number of service lines and functions. In addition, as quick wins and success stories will echo the results brought by the digital transformation, ManCos will gain further experience with managing their digital strategy and become more willing to invest in supplementary business cases, exploiting the potential of ManCoTech further.

Every ManCo has a specific operating model, business workflow, and strategic roadmap with different business priorities.

CONCLUSION

ManCoTech is the key enabler for ManCos to remain successful in the asset management industry and offers clear benefits.

Less compliance risk: better governance and oversight reduces the reputational and financial risks of incurring regulator fines. Audit trail and document repositories allow ManCos to promptly retrieve proof required by regulators to demonstrate proper substance.

Clear cut business case: as with most solutions that offer automation, ManCoTech increases operational efficiency, allowing employees to focus their time and skills on value-added activities. ManCos benefit from better operational cost control and an improvement in their financial resilience.

Future proof: the agility that the implementation of a flexible service model and scalable infrastructure delivers makes it easy for ManCos to respond to change.

The evolution of ManCos is unavoidable. To reap the benefits of technological breakthroughs, there is no doubt that significant development and change management efforts will be essential. Clearly, the first movers to embrace ManCoTech will gain an edge over their competition, by generating increased business volumes that will largely justify the initial investment.

TO THE POINT

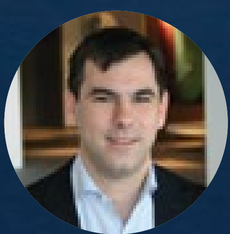
- Management companies (ManCos) are being challenged to evolve their business model to remain competitive, while also ensuring proper governance under regulators' watchful eyes.
- While several solutions already exist on the market to tackle specific problems (e.g., due diligence, net-asset-value checks, etc.), there is no holistic integration model that can fully assist ManCos.
- To plug this gap, ManCoTech is emerging, an overarching technology solution that intelligently combines solutions and technologies to support ManCos.
- There are many measurable benefits of implementing a ManCoTech solution, including:
  - Increased transparency that leads to a reduced risk of regulatory fines and reputation loss;
  - Increased operational efficiency that generates added business value;
  - A future-proof and agile organizational structure that can quickly adapt to changes; and
  - A competitive edge that helps attract new clients and, just as importantly, retain existing ones.

REPORTING REQUIREMENTS IN ASIA

GUIDING YOU THROUGH THE CHALLENGES OF CROSS-BORDER FUND DISTRIBUTION

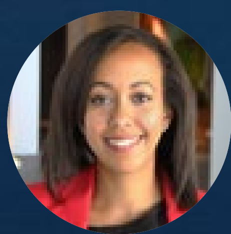
MARC NOIRHOMME
DIRECTOR
REGULATORY AND DISTRIBUTION
DELOITTE

MARIE-ANNE MANDROUX
SENIOR MANAGER
REGULATORY AND DISTRIBUTION
DELOITTE



ANTHONY COLLADO
SENIOR MANAGER
CAPITAL MARKET
DELOITTE

MARIE VON GAISBERG
MANAGER
INTERNATIONAL FUND
TAX SOLUTIONS
DELOITTE



DORIANE HARDY
CONSULTANT
REGULATORY AND DISTRIBUTION
DELOITTE

In our quest to provide our clients with detailed support on how to access Asian markets, we drafted the first edition of our Navigating Asia report, which provided insights into the business cultures, markets, and distribution trends in several countries, while also covering their local regulatory and tax frameworks.

On the right is an overview of our assessment of the level of complexity of the regulatory and tax reporting discussed in the second edition.

For the second edition of the report, we sought to address another major challenge for our industry: the reporting requirements for foreign domiciled funds distributed in Asia. In today's world, reporting is the cornerstone of ever-expanding regulatory regimes and transparency requirements, which in turn create additional barriers to market access coupled with greater demand for expertise in compiling and submitting the necessary reports.
By ongoing reporting, we mean reporting in the broad sense, which encompasses the requirements that foreign asset managers must meet when marketing their funds in Asian countries, i.e., tax reporting at fund level, ongoing regulatory reporting obligations to maintain registrations (e.g. specific disclosures to investors, filing of financial statements), and statistical reporting. In this second edition, we examine the various tax implications for local investors when investing in such foreign domiciled funds, as well as the tax requirements applying to foreign domiciled funds that invest in local securities.

It is considered the responsibility of the asset managers themselves to work out (or to ensure that their local agent works out) which reports they need to submit, together with the flows and type of data needed to compile such reports. In this second edition of Navigating Asia, we have identified the key reporting requirements and assessed the overall complexity level of the regulatory and tax reports that must be submitted when marketing a foreign domiciled fund in Asia, or when such funds invest in local securities.

How complex is the required reporting?
Based on our reporting experience and expertise, we have assessed the complexity of the various reports based on the following indicators:

- Frequency: the level of complexity generally increases with the reporting frequency.
- Type of data: the need for multiple data sources and the use of narratives add elements of complexity.
- Specific forms: the use of a specific form/template creates an additional burden.
- Language: reporting in the local language is a further constraint.
- Filing protocols: in some cases, the report has to be filed by a local agent, generating additional costs and impacting time management.
- Filing method: specific software may be needed to complete or submit the report.

ONGOING REGULATORY REPORTING							TAX REPORTING		
HONG KONG									
Key Fact Statement	Offering Document	Financial Report	Liquidity position of an Authorized Institution Report	Foreign Currency Position Report	Capital Adequacy Ratio Report	Asset & Liabilities Report	Fund level	Investor level	Portfolio level
JAPAN									
Securities Registration Statement	Semi-Annual Securities and Annual Securities Report	Extraordinary Report	Investment Management Report	**Notification of material change to trust deed**	Form 21 FX Form 53 FX	Insurance Company Report	Fund level	Investor level	Portfolio level
SINGAPORE									
Product Highlights Sheet	Form 2A	Form A4	Annual Declaration	Annual update of SRS/Korean prospectus	–	–	Fund level	Investor level	Portfolio level
SOUTH KOREA									
Asset Management Report	Report of Sales	Securities Registration Statement		Securities Issuance Report	Risk Rating Report	–	Fund level	Investor level	Portfolio level
TAIWAN									
Specific Event Reporting	Marketing Event Reporting	(Semi-)Annual Financial Report	Statistical Reporting	Investment Brochure	–	–	Fund level	Investor level	Portfolio level
AUSTRALIA									
No reporting in case of limited connection exemption	Significant Changes Reporting	Breach Reporting	Reporting of Changes to the Australian agent	CAAR Charge Report (Level 1)	CAAR Charge Report (Level 2)	CAAR Charge Report (Life Insurance)	Fund level	Investor level	Portfolio level
THAILAND									
No reporting in case of marketing through local intermediaries	Prospectus & Fact Sheet	–	–	–	–	–	Fund level	Investor level	Portfolio level
PHILIPPINES									
No Reporting	–	–	–	–	–	–	Fund level	Investor level	Portfolio level
MACAO									
Key Fact Statement	–	–	–	–	–	–	Fund level	Investor level	Portfolio level

Complexity level | Low Medium High

Institutional Investors Reporting

Ongoing regulatory reporting—complexity and investor disclosure

By just glancing at the tables, you will see that in a number of Asian countries, such as Hong Kong, South Korea and Thailand, foreign domiciled funds must comply with a local requirement to use a particular type of document for **disclosures to investors**.

Taking Hong Kong for example, based on our knowledge and expertise, we have rated the Key Fact Statement (KFS) as highly complex due to the nature of the data that needs to be provided, including the significant amount of specific narrative reporting. The local regulator, the Hong Kong Securities and Futures Commission (SFC), not only prescribes a specific template for each type of investment fund vehicle, thereby creating an additional constraint for foreign asset managers, but also imposes mandatory filing when changes are made to the foreign investment fund that affect the information contained in the KFS. Furthermore, data relating to past performance must be updated on an annual basis. Finally, and perhaps most importantly, the KFS must be produced in both English and Traditional Chinese.

For South Korea, the Securities Registration Statement Amendment Report (SRS), which we have also rated as highly complex, requires significant amounts of narrative data, including general information concerning the public offering or sale, details of investor rights to the units being publicly offered or sold, plus information on sales commission or remuneration. The SRS must be produced in Korean and submitted to the local regulator via a specific electronic platform to which asset managers must request access.

In Thailand, where a foreign domiciled fund is marketed through a master-feeder fund structure (i.e., a Thai feeder fund investing in a foreign domiciled master fund), interestingly, the asset manager of the foreign master fund is not required to submit any information to the Thai Securities and Exchange Commission. However, the asset manager of the Thai feeder fund is required to file a prospectus and fact sheet, both of which we have both rated as highly complex to produce. The main reasons for the complexity of these documents are the specific template that has to be used, and the requirement to complete them in Thai. In addition, to issue and maintain the prospectus—which must include information about the master fund's structure—the asset manager of the Thai feeder fund has to work closely with the asset manager of the foreign domiciled master fund.

Not all ongoing regulatory reporting is highly complex

The accompanying tables show that although some Asian countries have numerous and highly complex reporting requirements, in other cases—such as Singapore's Form A4 and annual declaration, and Australia's breach notifications—complexity is low, and we have also identified a medium complexity level, which we would apply to the reporting of a 'marketing event' in Taiwan.

Ad hoc institutional investor reporting is mandatory for access to some market segments

Depending on the type of investor (e.g., insurance companies or banks) investing in a foreign domiciled fund, the foreign domiciled asset manager may need to complete additional reporting to enable investors to meet their own reporting obligations ("institutional investor reporting"). For example, to complete an annual report—and in particular, to assess the risks that a foreign domiciled fund is exposed to—a Japanese insurance company may need to ask the foreign domiciled fund in which it invests for additional information relating to the fund's structure, asset composition, and risk profile, etc.

It is worth noting that institutional investor reporting is not necessarily considered a "local regulatory obligation" per se, but it is a condition that must be fulfilled by foreign domiciled asset managers for them to gain access to the universe of institutional investors in those territories and to be able to implement their marketing and distribution strategies effectively.

Tax complexities

Concerning tax, the second edition of Navigating Asia will guide asset managers through the relevant tax filing and reporting requirements at fund, investor, and portfolio level. At fund and investor level, the focus is on requirements for the foreign domiciled fund when distributed in the respective country, leading to the presence of local investor. However, for the portfolio level, we describe the requirements that might arise for a foreign domiciled fund when investing in local securities. As such, the portfolio level is considered as being independent from the actual distribution of the foreign domiciled fund in the respective country. The complexity of the requirements at each level differ from country to country.

At fund and investor level, the focus is on requirements for the foreign domiciled fund when distributed in the respective country, leading to the presence of local investor.

At fund level

Overall, we rated tax complexity as low at the fund level. One exception is Macao, which has a specific tax registration regime requiring foreign domiciled funds to obtain approval from the Monetary Authority of Macao.

In addition, the local fund distributor (agent) is required to register with Macao Tax Authority.

At investor level

At investor level, tax complexity was medium overall (with outliers at both ends). Investor tax reporting is required in South Korea, for example. Also, resident investors who invested in a "qualifying fund" between 1 Jan 2016 and 31 Dec 2017 can benefit from a tax exemption, whereby a Korean Taxable NAV can be calculated and reported to determine the taxable portion of the investment.

In other countries, local investors are taxed on specific income types. In Hong Kong, for example, local investors have to report income received from investing in a foreign domiciled fund in their annual Hong Kong Profits Tax Return (i.e., realized/unrealized gains) but only if it is regarded as Hong Kong-sourced income. In the case of Singapore, local investors are required to self-assess and report taxable income arising from operations or investments carried out in Singapore in their annual tax returns.

Local investors can also be subject to stamp duties on subscription of fund units, as is the case in the Philippines. Other countries, such as Australia, may impose capital gains tax on fund unit redemptions or tax exit gains on a revenue account basis.

At portfolio level

Formalities linked to investment in local securities exist in several Asian countries and can be extremely complex compared to other regions. It is therefore recommended that foreign asset managers gather relevant information prior to investing in local securities.

Stamp duty may apply on the purchase of securities by a foreign domiciled fund where the target entity holds "dutiable assets" (i.e., assets linked to Australian real estate). As for capital gains tax, this is payable on the trade of specific local securities in Japan, the Philippines, and Taiwan, for example.

For instance, we observe a high degree of complexity when foreign domiciled funds invest in Taiwanese securities. In this case, an initial registration as a Foreign Institutional Investor with the Taiwan Securities Exchange Corporation is required. In addition, a local tax agent has to be appointed. A foreign domiciled fund could be required to file a tax return if it conducts stock borrowing and lending, bond, and rollover of FX forward transactions.
Arrangements are also highly complex in Australia, where a tax representative is required to manage the Australian tax affairs of the foreign domiciled fund if it is subject to Australian tax. Furthermore, stamp duty may apply on the purchase of securities by a foreign domiciled fund where the target entity holds "dutiable assets" (i.e., assets linked to Australian real estate). As for capital gains tax, this is payable on the trade of specific local securities in Japan, the Philippines, and Taiwan, for example.

The operational view

Reporting requirements present operational and commercial challenges for foreign domiciled asset managers distributing their funds in Asia.
The examples we have given illustrate the complexity of local regulatory and tax reporting regimes for foreign domiciled asset managers when accessing certain Asian markets. Whereas in Europe, regulation is harmonized, with relatively streamlined market access procedures, the opposite is true for Asian countries. Each country has its own requirements, resulting in a fragmented market. Aspects such as reporting frequency, required data, and submission methods, to name a few, can

vary significantly from one Asian country to another.

In general, where the distribution of foreign domiciled funds in Asia leads to the presence of local investors, asset managers need to be aware of the registration requirements for tax purposes, as well as the tax treatment of their local investors. Even though investor tax reporting is not as widespread as in the EMEA region, being able to provide dedicated tax information can be seen as a competitive advantage when marketing a foreign domiciled fund in Asia. Furthermore, when it comes to investment in local securities, tax filing and reporting requirements are more common than in other regions—and might easily be overlooked.

Foreign asset managers will require additional expertise to comply with reporting requirements in Asia, which is challenging from an operational perspective. There are two possible options: taking care of the reporting requirements in-house, or choosing an outsourcing set-up.

Service providers in Luxembourg and Ireland can cover and support the entire reporting chain for cross-border distribution reporting, while others offer a third way in the form of a hybrid outsourcing option, whereby reporting is carried out in-house and local entities coordinate the overall reporting activity. As long-standing hubs for the cross-border distribution of funds, Luxembourg and Ireland have built up strong cross-border expertise that could be leveraged by foreign asset managers seeking an outsourcing solution.

Creating local substance can be an option for asset managers with sufficient critical mass. Indeed, some Asia-domiciled funds already have access to the cross-border Asia Region Funds Passport. However, having this passport does not obviate the need to support the cost burden created by Asia's un-harmonized regulatory and tax reporting landscape. Fund domiciles with proven cross-border expertise will have a strong card to play.

The preparation of the second edition of Navigating Asia is a global Deloitte initiative aimed at guiding foreign asset managers on their journey throughout Asia. It is a 'living instrument' covering the largest Asian markets, with the exception of China, which will evolve over time to include additional countries and types of reporting. To find out more about reporting requirements in Asia, read the report available on https://www2.deloitte.com/lu/en/pages/investment-management/articles/asian-report.html

TO THE POINT

- Foreign asset managers have to meet ongoing reporting requirements when marketing their funds in Asia, including complex tax reporting at fund and investor level, ongoing regulatory reporting obligations to maintain registrations, and statistical reporting.
- Tax implications must be considered when foreign funds invest in Asian securities.
- The complexity of reporting requirements results in operational and commercial challenges.
- There are two possible models for overcoming these challenges: in-house reporting or outsourcing, where a fund domicile with proven cross-border expertise a "must-have".
- Alternatively, creating local substance can be an option for asset managers with sufficient critical mass.

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- **31 March 2021**
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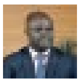
Dates and detailed agendas available here: **http://www.deloitte.com/lu/lunch-n-learn**

Contacts

Africa - East, West, Central and South


Dinesh Munu
Partner - Audit
+27 011 806 5767
dmunu@deloitte.co.za


David Nchimbi
Partner - Audit
+255 222 169 000
dnchimbi@deloitte.co.tz


Joshua Ojo
Partner - Audit
+234 190 421 30
jojo@deloitte.com.ng

Australia

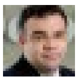

Neil Brown
Partner - Assurance & Advisory
Wealth Management
+61 3 967 171 54
nbrown@deloitte.com.au


Siew-Kee Chen
Partner - Tax
+61 2 9322 3823
skchen@deloitte.com.au


Declan O'Callaghan
Partner - Assurance & Advisory
+61 2 932 273 66
deocallaghan@deloitte.com.au


James Oliver
Partner - Assurance & Advisory
+61 3 9671 7969
joliver@deloitte.com.au

Austria


Dominik Damm
Partner - Advisory
+431 537 005 400
dodamm@deloitte.at


Nora Engel-Kazemi
Partner – Tax
+431537005420
nengel@deloitte.at


Robert Pejhovsky
Partner - Tax & Audit
+431 537 004 700
rpejhovsky@deloitte.at

Bahamas


Lawrence Lewis
Partner - ERS
+1 242 302 4898
llewis@deloitte.com

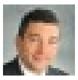
Belgium


Maurice Vrolix
Partner - Audit
+32 2 800 2145
mvrolix@deloitte.com


Tom Renders
Director, Audit
+ 32 474 62 43 78
trenders@deloitte.com

Bermuda


Mark Baumgartner
Partner - Audit
+1 441 299 1322
mark.baumgartner@deloitte.com

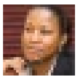

James Dockeray
Partner - Tax
+1 441 299 1399
james.dockeray@deloitte.com


Muhammad Khan
Partner - Audit
+1 441 299 1357
muhammad.khan@deloitte.com

Brazil


Cristina Yong Hae Soh
Partner - Consulting
+55 11 5186 1305
csoh@deloitte.com

British Virgin Islands

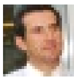

Carlene A. Romney
Partner - Audit
+1 284 494 2868
cromney@deloitte.com

Central Europe


Grzegorz Cimochowski
Partner - Consulting
+48 22 511 0018
gcimochowski@deloittece.com

Chile


Ricardo Briggs
Partner - Consulting
+56 2 2729 7152
rbriggs@deloitte.com


Pablo Herrera
Partner - Financial Advisory
+56 2 2729 8150
paherrera@deloitte.com


Alberto Kulenkampff
Partner - Audit
+ 56 22729 7368
akulenkampff@deloitte.com

China (Southern)


Sharon Lam
Partner - International Tax Services
+852 28 52 65 36
shalam@deloitte.com.hk


Anthony Lau
Partner - International Tax Services
+852 2852 1082
antlau@deloitte.com.hk

China (Easter and Northern)


Natalie Na Yu
Partner - Tax Services
+86 10 85207567
natyu@deloitte.com.cn


Lily Fang Wang
Partner - Audit
+86 2161412431
lilyfwang@deloitte.com.cn

Colombia


Ricardo Rubio
Partner - Financial Advisory Services
+57 1 546 1818
rrubio@deloitte.com

Denmark


John Ladekarl
Partner - Audit
+45 36 10 20 78
jladekarl@deloitte.dk


Anders Oldau Gjelstrup
Partner - Audit
+45 20 41 68 02
agjelstrup@deloitte.dk

Finland


Ilkka Huikko
Partner - Consulting
+358 40 740 3529
ilkka.huikko@deloitte.fi


Sami Toivoniemi
Director - Regulatory Risk
+358 207 555 808
sami.toivoniemi@deloitte.fi


Juha Hyttinen
Senior Manager - Strategy and Operations
+358 207 555 653
juha.hyttinen@deloitte.fi

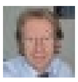
France


Hélène Alston
Partner - Tax
+33 1 55 61 60 32
healston@taj.fr


Yoan Chazal
Partner - Risk Advisory
+33 1 40 88 72 19
ychazal@deloitte.fr


Stéphane Collas
Partner - Audit
+33 1 55 61 61 36
scollas@deloitte.fr


Bruno de Saint Florent
Partner - Consulting
+33 1 58 37 04 46
bdesaintflorent@deloitte.fr


Jean-Marc Lecat
Partner - Audit
+33 1 55 61 66 68
jlecat@deloitte.fr


Sebastien Manelfe
Partner - Financial Advisory
smanelfe@deloitte.fr
+33 1 40 88 85 54

Germany

Andreas Koch
Partner - Audit
+49 892 903 687 39
akoch@deloitte.de

Dorothea Schmidt
Partner - Consulting
+49 699 713 734 6
dschmidt@deloitte.de

Nina Schrader
Director - Consulting
+49 173 258 5554
nschrader@deloitte.de

Christof Stadter
Partner - Audit
+49 89 29036 8269
cstadter@deloitte.de

Alexander Wenzel
Partner - Tax & Legal
+49 69 75695 6111
alwenzel@deloitte.de

Greece

Alexandra Kostara
Partner - Audit
+30 210 67 81 152
akostara@deloitte.gr

Despina Xenaki
Partner - Audit
+30 210 67 81 100
dxenaki@deloitte.gr

Guernsey

John Clacy
Partner - Audit
+44 1 481 703 210
jclacy@deloitte.co.uk

Hong Kong

Anthony Ming Young
Partner - International Tax Services
+852 285 210 82
antlau@deloitte.com.hk

Wilson Cheung
Director, Financial Services Industry Assurance
+852 285 266 09
wilcheung@deloitte.com.hk

Iceland

Gunnar Thorvardarson
Partner - Audit
+354 580 3031
gthorvardarson@deloitte.is

India

Rajesh Gandhi
Partner - Tax Leader
+91 22 6185 4380
rajegandhi@deloitte.com

Bimal Modi
Partner - IM Leader
+91 22 6185 5080
bimalmodi@deloitte.com

Indonesia

Rosita Sinaga
Partner - Audit
+62 21 2992 3100
rsinaga@deloitte.com

Ireland

David Dalton
Partner - Consulting
+353 140 748 01
ddalton@deloitte.ie

Brian Forrester
Partner - Audit
+353 141 726 14
bforrester@deloitte.ie

Mike Hartwell
Partner - Audit
+353 141 723 03
mhartwell@deloitte.ie

Brian Jackson
Partner - Audit
+ 353 141 729 75
brijackson@deloitte.ie

Christian MacManus
Partner - Audit
+353 141 785 67
chmacmanus@deloitte.ie

Deirdre Power
Partner - Tax
+353 141 724 48
depower@deloitte.ie

Israel

Ran Feldboy
Partner - Audit
+972 3 6085478
rfeldboy@deloitte.co.il

Italy

Marco De Ponti
Partner - Audit
+390 283 322 149
mdeponti@deloitte.it

Maurizio Ferrero
Partner - Audit
+390 283 322 182
mferrero@deloitte.it

Paolo Gibello-Ribatto
Partner - Audit
+390 283 322 226
pgibello@deloitte.it

Marco Miccoli
Partner - Audit
+390 283 322 308
mmiccoli@deloitte.it

Riccardo Motta
Partner - Audit
+390 283 322 323
rmotta@deloitte.it

Japan

Yang Ho Kim
Partner - Tax
+81 3 621 338 41
yangho.kim@tohmatsu.co.jp

Nobuyuki Yamada
Partner - Audit
+81 90 650 345 34
nobuyuki.yamada@tohmatsu.co.jp

Kazakhstan

Roman Sattarov
Partner - Audit
+7 7272 581340
rsattarov@Deloitte.kz

Luxembourg

Eric Centi
Partner - Cross-Border Tax
+352 451 452 162
ecenti@deloitte.lu

Laurent Fedrigo
Partner - Audit
+352 451 452 023
lafedrigo@deloitte.lu

Nicolas Hennebert
Partner - Audit
+352 451 454 911
nhennebert@deloitte.lu

Lou Kiesch
Partner - Regulatory Consulting
+352 451 452 456
lkiesch@deloitte.lu

Benjamin Lam
Partner - Audit
+352 451 452 429
blam@deloitte.lu

Xavier Zaegel
Partner - Financial Services
+352 451 452 748
xzaegel@deloitte.lu

Malaysia

Anthony Tai
Executive Director - Enterprise Risk Services
+60 3 7610 8853
yktai@deloitte.com

Malta

Michael Bianchi
Partner - Audit
+356 2343 2879
mibianchi@deloitte.com.mt

Mexico

Ernesto Pineda
Partner - Financial Services
+52 55 5080 6098
epineda@deloittemx.com

Monaco

Julien Le Marrec
Director – Risk Advisory
+377 97 77 27 41
jlemarrec@deloitte.mc

Pascal Noël
Director – Risk Advisory
+377 97 77 47 37
pasnoel@deloitte.mc

Netherlands

Jan-Wouter Bloos
Partner - Consulting
+31 88 288 2768
JBloos@deloitte.nl

Bas Castelijn
Partner - Tax
+38 288 6770
BCastelijn@deloitte.nl

Marieke van Eenennaam
Partner - Risk Advisory
mvaneenennaam@deloitte.nl
+31 88 288 2500


Remy Maarschalk
Partner - Audit
+31 88 288 1962
RMaarschalk@deloitte.nl


Evert van der Steen
Partner - Enterprise Risk Services
+31 62 078 9545
evandersteen@deloitte.nl

Norway


Sverre Danielsen
Partner - Enterprise Risk Services
+47 99 517 686
sdanielsen@deloitte.no


Henrik Woxholt
Partner - Audit & Advisory
+47 23 27 90 00
hwoxholt@deloitte.no

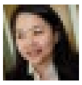
Philippines


Bonifacio Lumacang
Partner - Audit
+63 2 581 9000
blumacang@deloitte.com

Portugal


Maria Augusta Francisco
Partner - Audit
+351 21 042 7508
mafrancisco@deloitte.pt

Singapore


Ei Leen Giam
Partner - Global Financial Services Industry
+ 65 62 163 296
eilgiam@deloitte.com


Ho Kok Yong
Partner - Global Financial Services Industry
+65 621 632 60
kho@deloitte.com

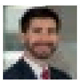

Michael Velten
Partner – Tax
+65 6531 5039
mvelten@deloitte.com

Slovakia


Peter Longauer
Partner - Audit
+421 2 582 49 411
plongauer@deloitte.com

Spain


Rodrigo Diaz
Partner - Audit
+349 144 320 21
rodiaz@deloitte.es


Francisco Rámirez Arbues
Partner - Tax
+34 606289571
framirezarbues@deloitte.es

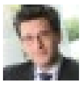

Antonio Rios Cid
Partner - Audit
+349 915 141 492
arioscid@deloitte.es


Alberto Torija
Partner - Audit
+349 143 814 91
atorija@deloitte.es


José María Grande Esturo
Partner - M&A Consulting
+34 944 447 000
jgrande@deloitte.es


Ignacio García Alonso
Partner - Tax
+34 67 952 180
igarciaalonso@deloitte.es

Switzerland


Marcel Meyer
Partner - Audit
+41 58 279 7356
marcelmeyer@deloitte.ch


Simona Terranova
Partner - Audit
+41 58 279 8454
sterranova@deloitte.ch


Andreas Timpert
Partner - Consulting
+41 58 279 6858
antimpert@deloitte.ch


André Kuhn
Director - Tax
+41 58 279 6328
akuhn@deloitte.ch


Markus Weber
Partner - Tax
+41 58 279 7527
markweber@deloitte.ch

Taiwan


Vincent Hsu
Partner - Audit
+886 2 545 9988 1436
vhsu@deloitte.com.tw


Olivia Kuo
Partner - Audit
+886 2 25459988
oliviakuo@deloitte.com.tw


Jimmy S. Wu
Partner - Audit
+886 2 2545 9988 7198
jimmyswu@deloitte.com.tw

Thailand


Somkrit Krishnamra
Partner - Risk Advisory
+66 2 676 5700
somkrishnamra@deloitte.com

Turkey


Hasan Kiliç
Partner - Audit
+90 212 366 60 49
hkilic@deloitte.com

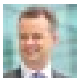
United Kingdom


Allee Bonnard
Partner - Audit
+44 20 7303 0472
abonnard@deloitte.co.uk


Gavin J Bullock
Partner - Tax
+44 20 7007 0663
gbullock@deloitte.co.uk


Jonathan Burdett
Partner - Risk Advisory
+44 20 7303 2580
jburdett@deloitte.co.uk


Baber Din
Partner - Financial Services
+44 20 7303 2878
bdin@deloitte.co.uk


Andrew McNeill
Partner - Consulting
+44 20 7007 6151
amcneill@deloitte.co.uk

United States


Patrick Henry
Vice Chairman
National Sector Leader
+1 212 436 4853
phenry@deloitte.com


Kristina Davis
Investment Management Leader
Risk & Financial Advisory
+1 617 437 2648
kbdavis@deloitte.com


Dave Earley
Partner - Tax
Investment Management Leader
+1 617 319 2048
dearley@deloitte.com


Paul Kraft
Partner - Audit
+1 617 437 2175
pkraft@deloitte.com

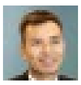

Jagat Patel
Partner - Consulting
Investment Management Leader
+1 203 708 4028
jagpatel@deloitte.com


Tania Taylor
Partner - Audit
Investment Management Leader
+1 212 436 2910
tlynn@deloitte.com

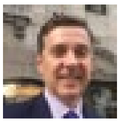
Venezuela


Fatima De Andrade
Partner - Audit
+58 212 206 8548
fdeandrade@deloitte.com

Vietnam


Thinh Pham
Managing Partner
+84 839100751
thpham@deloitte.com

Contacts



Cary Stier
Partner - Global Investment Management Leader
+1 212 436 7371
cstier@deloitte.com

Vincent Gouverneur
Partner - EMEA Investment Management Co-Leader
+352 451 452 451
vgouverneur@deloitte.lu

Tony Gaughan
Partner - EMEA Investment Management Co-Leader
+44 20 7303 2790
tgaughan@deloitte.co.uk

Jennifer Qin
Partner - Asia Pacific Investment Management Leader
+86 21 61 411 998
jqin@deloitte.com

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