WINTER 2021/2022

# ASSET MANAGEMENT - HOT TOPICS

Focus on Financial Institutions – Part of the Horizon Scanning series

QUICK LINKS



With many of the themes that were considered in our previous Spring 2021 edition remaining relevant, in this edition we undertake a round-up, and take a closer look at some, of the more significant developments arising from those themes. Many regulatory developments are afoot in the UK as it considers the shape of its financial services industry post-Brexit and the extent of regulatory divergence from the EU. Nonetheless, some issues continue to dominate the sector as a whole, whether in the UK or outside – not least continuing attention on ESG and sustainability issues, and the role of the asset management industry in allocating capital to long term assets and infrastructure. Indeed, as we will see, these issues cut across multiple areas where we have seen significant regulatory initiatives: whether in relation to governance, prudential regimes, or proposals relating to new fund vehicles.

## 1 The Investment Firm Prudential Regime

The new Investment Firm Prudential Regime (IFPR) that applies to FCA-regulated MiFID investment firms will come into force in 1 January 2022, with the stated aim of streamlining the prudential requirements for those firms. Firms within scope include current BIPRU firms and Exempt CAD firms, as well as alternative investment fund managers that have MiFID top-up permissions (collective portfolio management investment (CPMI) firms). Having published three consultation papers (CP20/24, CP21/7 and CP21/26), the FCA has finalised the rules for the regime following publication of the final Policy Statement (PS21/17). Policy statements (PS21/6 and PS 21/9) responding to the earlier consultations were published over the summer of 2021.

While the aim is an overall streamlining of the regime by replacing the Capital Requirements Directive and Capital Requirements Regulation (which were designed for credit institutions) with a “fit for purpose” regime specifically tailored to the business models of investment firms, the new prudential rules do introduce more complex and, in many cases, more stringent capital, liquidity, reporting, governance and remuneration requirements for firms within scope.

The regulatory capital requirements are based on a quantitative assessment of the size the firm, and on the activities or services it undertakes or provides. Small and non-interconnected (SNI) firms must hold “own funds” that is the higher of a permanent minimum capital requirement (PMR) (which will usually be £75,000) and a fixed overheads requirement (FOR) (equal to one quarter of its relevant expenditure in the previous year) while Non-SNI firms will be required to hold an “own funds” amount that is the higher of its PMR, FOR, and total “K-factor” requirement (specific to each firm). Furthermore, all investment firms must establish an internal capital adequacy and risk assessment (ICARA) process, which is designed to supplement a firm’s own funds requirements and allow a firm to identify, monitor, and, if relevant, mitigate all material potential harms that could result from the ongoing operation or winding down of its business – this assessment may very well result in potentially higher capital requirements as firms will be required to satisfy an Overall Financial Adequacy Rule through this process.

The FCA may apply consolidated supervision if the firm belongs to an "investment firm group", (broadly where there is a UK parent entity of a group containing at least one FCA investment firm). This will mean imposing prudential consolidation requirements directly to (and at the level of) a UK parent entity unless the use of the group capital test (exempting the UK parent entity from applying the rules on a consolidated basis) is permitted for the group.

### Remuneration requirements

The remuneration requirements under this new regime will no doubt attract considerable interest. The new MIFIDPRU Remuneration Code (see our client briefing for more detail) will apply to all in-scope firms (including CPMI firms in respect of their MiFID business) although requirements will vary, depending on the type of firm. The MiFIDPRU Remuneration Code applies to remuneration paid to a firm's "staff", which is broadly defined. All firms are required to establish and implement remuneration policies, on a proportionate basis. In addition, further requirements apply to "material risk takers" (MRTs) within non-SNI firms, including the need to ensure that malus and/or clawback arrangements are in place for such persons. Non-SNIs (and SNIs on a more limited basis) are required to make remuneration disclosures, including a summary of their approach to remuneration, the objectives of their financial incentives, and governance surrounding their remuneration policies and procedures. It should be noted that carried interest will be treated as variable remuneration.

> *"Firms within scope should be well-advanced in their preparations for this major change."*

The process any firm must undertake to implement this new regime is very involved, with firms required to undertake various assessments in order to determine their relevant classification, the application of consolidation requirements and whether any group consolidation exemptions and waivers apply, and ultimately their capital position. The new capital requirements may be especially onerous for firms with limited regulatory permissions which were previously only subject to a low fixed capital requirement, and some firms may need to consider a recapitalisation with all its attendant issues. With the date on which the regime applies imminent, the FCA is at this stage asking investment firms to complete a Questionnaire, which includes questions relating to the firm's status, their corporate structures and expected ICARA reporting dates. Firms have also had to begin collecting data on relevant K-factors by no later than 1 December 2021. Those firms within scope should be well-advanced in their preparations for this major change.

## 2 Climate change and greenwashing risks

In the context of the UK having just hosted the COP26 conference, and the general acknowledgement of the urgency of climate change issues, there is little doubt that ESG issues, and climate change in particular, will continue to dominate the headlines. Financial institutions in general and asset managers in particular are seen to be at the forefront of the push to re-orient capital towards sustainable investments. Accordingly, regulatory focus in this area centred on asset management firms has never been higher, with an emphasis not just on "financing green", but (to use the government's terminology in its recently published roadmap on Greening Finance) "greening finance" as well.

As various firms promote their ESG credentials and the number of funds and products marketed as "sustainable" proliferate, regulators are increasingly concerned with "greenwashing" risks. In the FCA's recent strategy paper outlining its ESG priorities, it links ESG considerations with its operational objectives of consumer protection and market integrity, noting that misleading or unsubstantiated claims and misrepresentation of ESG data could give rise to many areas of potential harm. The August 2021 "Dear Chair" letter published by the FCA also highlighted to authorised fund managers the poor quality of the applications relating to funds with an ESG or sustainability focus for which they are seeking authorisation.

### Sustainable investing - just hype?

Scepticism has also been expressed by certain quarters on whether firms' push into sustainable investing amounted to no more than marketing hype. The debate surrounding the evidence on whether ESG-related funds outperform non-ESG funds remains live – there should be better clarity as the data matures over time but it is likely that, in any event, the picture that emerges on performance will be mixed. More fundamentally, some have criticised the concept of ESG investing altogether, indicating that investors are simply paying higher fees for products which have no, or minimal, real-world societal or environmental impact or benefit. One question raised is whether asset managers are required not just to report on ESG matters in respect of their ESG-labelled products, but to take into account such matters in *all* their investment decisions and across their entire product range as part of their normal duty of care. Increasingly, institutional investors are already making ESG considerations part of their criteria in awarding mandates and often impose obligations on asset managers to consider such issues via contractual means. Arguably, integration of ESG or sustainability matters should simply form part of a manager's normal duty to act in the best interests of its client – at the very least it is recognised that such issues should be considered as part of risk management, given the very real possibility of adverse climate or social events having a materially negative impact on the value of investments.

## Sustainability reporting and disclosures

Irrespective of the wider debate, regulators such as the FCA view transparency as a key theme in fostering investor trust in firms' dealing of climate change and sustainability issues. Unsurprisingly, it is in relation to ESG reporting and disclosures where we have seen the most regulatory developments. The EU sustainable finance disclosure regime (SFDR) came into force earlier this year (March 2021) and UK firms with cross-border EU businesses are already having to make disclosures in line with the SFDR. With the UK equally keen to be seen as a global leader in "greening" the financial system, the FCA has proposed a number of regulatory measures applying to asset managers in order to address greenwashing risks and improve transparency to investors.

Under FCA CP21/17 (see our earlier client briefing), the FCA is proposing that asset managers, life insurers and FCA-regulated pension providers make mandatory climate-related disclosures in accordance with the TCFD recommendations at both entity and product level – the FCA will finalise its position by the end of 2021 and for asset managers with assets under management of more than £50 billion and asset owners with assets under management or administration in relation to in-scope business of more than £25 billion, it is proposed that the new rules will come into force immediately from 1 January 2022.

Following publication of the government's roadmap setting out how it will realise its climate change ambitions including through the introduction of Sustainability Disclosure Requirements (SDRs) on real economy companies as well as asset managers and asset owners, the FCA has published DP21/4, seeking initial views on the development of SDR disclosure requirements for asset managers and a sustainable investment labelling system. The overall regime comprises three main tiers: product labelling; consumer-facing disclosures; and more detailed entity and product-level disclosures for institutional investors.

The paper goes on to suggest potential approaches to the development of a sustainability product labelling system, as well as the disclosure regime requiring firms to disclose sustainability risks, opportunities and impacts. In relation to the latter, the proposed new regime would build on the TCFD aligned climate-related disclosure requirements as set out in CP 21/7 but with a widened scope that goes beyond climate to cover other sustainability factors. It is expected that firms will also be required to assess their investments against the forthcoming UK Green Taxonomy, which will set out a common framework defining "environmentally sustainable" investments, and report accordingly. In addition, while maintaining the TCFD's framework for detailed entity and product-level disclosures, the intention is for the new regime to incorporate the so-called "double materiality" concept which would cover not just risks and opportunities to the firms, but also the impact of firms and their products on the environment and society.

With many firms operating in different jurisdictions and subject to overlapping but different disclosure requirements, one major practical challenge remains the resources available to firms to put in place systems and processes that will allow reporting against the myriad of requirements. In light of further developments at the EU (the EU having just published its final report on draft Regulatory Technical Standards (RTS) relating to certain taxonomy-related sustainability disclosures under the SFDR) and international level (for example, the IFRS International sustainability standards, which may affect asset managers as a company or a listed issuer), the FCA is mindful of the increasing burden on firms and the potential for confusion among users if firms present slightly different information on the same issue. Nonetheless, despite the FCA's acknowledgement that "*many UK firms…are subject to (EU) SFDR in respect of their cross-border EU business*" and a stated desire to "*remain as consistent as possible with SFDR*", it is already evident that its proposed labelling system does not always map neatly to categories ("Article 8" or "Article 9" products) established under the SFDR. Whatever the practical challenges of disclosure, the recent opening of investigations by German and US regulators into DWS Group arising from allegations that it has misled clients about its sustainable investing credentials is cautionary – firms must be clear that disclosures are not made simply as part of a compliance or marketing exercise but ultimately bear up to substantive scrutiny.

### ESG ratings and data providers

> *"..misrepresentation of ESG data could give rise to many areas of potential harm."*

Given lack of standardised data from many companies, for which (apart from the largest listed companies) ESG reporting remains in its relative infancy, asset management firms place heavy reliance on third party private sector providers of ESG ratings and data. The IOSCO final report on ESG ratings and data providers (published November 2021) identified a number of issues relating to the use of such providers including the lack of clarity on what the ratings or data products are intended to measure; lack of transparency in methodologies underpinning the data and concerns relating to conflicts where the ESG ratings and data products provider (or an associated entity) performs consulting services for companies that are the subject of these ESG ratings or data products.

This is likely to be an area of regulatory focus (as recommended in the IOSCO report) especially given, as noted above, the FCA's acknowledgement of the potential for misrepresentation of data to cause potential harm and the current lack of regulatory oversight over such providers. The FCA has already raised these issues for discussion in CP21/18, noting that asset managers are the largest users of such information. The discussion focuses on ESG ratings with firms increasingly using these on the design and delivery of their sustainable investment products. The multi-dimensional nature of ESG performance (resulting in different providers using different methodologies and metrics to measure performance) as well as data gaps all contribute to the increased likelihood of the higher potential for harm through the provision of ESG ratings. The FCA is considering a number of policy actions, ranging from bringing the provision of ESG ratings within the regulatory perimeter (similar to what EU is proposing) to encouraging a best practice code for providers.

## 3 Effective Stewardship

The UK Stewardship Code 2020 defines stewardship as the "responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society." Alongside the increased focus on ESG issues, expectations on asset managers' stewardship practices have also grown in tandem as both asset owners and governments (as noted in the government's roadmap on Greening Finance when discussing asset managers' stewardship role in facilitating companies' net zero commitments and transition strategies) expect asset managers to exercise good stewardship in order to achieve positive outcomes among investee companies.

The recently published inaugural list of signatories to the Stewardship Code 2020 contained a few surprises as some large firms failed to make the list. For some, their omission from the list appeared to be the result of purely technical shortcomings. However, it was also clear that the FRC's emphasis on outcomes meant that those firms which failed to evidence sufficiently how their stewardship activities have led to tangible outcomes lost out on the initial list. Many firms tout their stewardship credentials by disclosing their policies, but the FRC has made it clear that simply having policies in place is insufficient. Firms must demonstrate how their engagement activities with investee companies have resulted in good stewardship or have supported stated objectives.

### Holding service providers accountable

Another area of weakness identified by the FRC is the monitoring of service providers. The influence of proxy advisors on voting decisions is widely recognised, and firms rely heavily on technology and data supplied by third party service providers. Principle 8 of the Stewardship Code requires signatories to monitor and hold to account service providers. It should therefore come as no surprise that firms need to demonstrate that they have done proper due diligence when choosing their own service providers and ensure that there is proper monitoring of those providers to enable them to address any shortcomings in service delivery. It should also be expected that good stewardship practices would entail asset managers applying some critical judgement in deciding whether or not to follow a proxy adviser's recommendation rather than delegate voting decisions wholesale to proxy advisors.

### Passive investing and stewardship

As expectations grow on asset managers to influence corporate behaviour especially when it relates to ESG matters (with a particular focus on climate change at the moment), some firms have adopted a more aggressive approach involving public activism and divestment rather than just "behind the scenes" private engagement as a stewardship tool. For passive investors and index-trackers however, it is more difficult to pursue such a strategy given their more limited discretion over stock selection. It does raise the question of the extent to which passive funds – which have seen exponential growth in recent years – can be effective stewards.

One challenge, as already noted, stems from the inherent constraints of passive investment and index-tracking, making a divestment strategy in relation to specific companies difficult. This does mean that engagement becomes a more important tool. However, even with firms that are willing to take a more active stance in terms of engaging with investee companies, the limits of individual engagement can be seen: one example is LGIM, the UK's largest asset manager, which recently called time on providing feedback on remuneration policies, noting that this has not resulted in much tangible change among companies. The main challenge however stems from the practical difficulties for such funds to engage meaningfully with the large number of companies contained in the indices they track. With lower costs being one of the attractive features of passive investing, many have relatively fewer stewardship resources and rely extensively on proxy advisers. However, with investors and asset owners stating that they would like passive funds to take an active stewardship role, the onus is on passive funds to show that they are not also passive owners.

> *"...the onus is on passive funds to show that they are not also passive owners."*

## 4 Product Governance

Consumer protection from potential harm is a priority objective of the FCA. It is therefore unsurprising to see product governance high on the FCA's agenda as it seeks to improve best practices to ensure financial products offered satisfy the needs of identified target clients, and deliver appropriate consumer outcomes. The FCA's product governance review in February this indicated various shortcomings by firms in product design (failures to identify negative target market and to address conflicts) as well as product testing (lack of stress testing and quality of cost disclosures) which may result in investor harm. The FCA's recently published perimeter report 2020/21 highlighted other areas of significant vulnerability, notably a misuse of exemptions in the financial promotion regime allowing unauthorised persons to market high-risk investments to so-called "sophisticated" or "high net worth" individuals. The FCA is specifically targeting the self-certification regime, identifying the relevant eligibility criteria as inadequate in the context of changes in the investment environment (such as the ability for retail investors to invest in unlisted securities via crowd-funding platforms and changes in the pensions regime) and the fact that the thresholds at which an individual is classified as "high net worth" is significantly lower than in other jurisdictions.

### "Green" products

With increasing appetite (including among retail investors) for sustainable funds and products and with it, increasing concerns around greenwashing, product governance rules become an ever more significant tool in the regulator's toolbox to ensure appropriate outcomes. As noted above, the FCA has already fired a warning shot in its August "Dear Chair" letter to authorised fund managers noting that the poor design of funds with a purported ESG focus may be in breach of various existing conduct and product governance rules. Where a fund is marketed as having ESG characteristics by using ESG-related terms in its name, the FCA would expect a fund's investment strategy and objective to reflect the fund's name. Any fund with sustainable-linked objectives (for example, the promotion of positive social change) should be clear and specific about what that means, its approach to achieving this, and how it intends to evaluate and measure performance against this objective.

### Assessment of value assessed

Following the commencement of the COLL rules relating to assessment of value in September 2019, most authorised fund managers should have completed at least one round of reporting in relation to their assessment of value (AoV) for their funds. However, the FCA's July 2021 review of a sample of firms' AoVs found significant shortcomings, with the FCA concluding that many fund managers had not implemented assessments meeting the minimum consideration requirements and fell short of expectations in their practices. Criticism included unjustified assumptions, incomplete assessments, and a failure to consider what the fund should deliver given its investment policy, investment strategy and fees. With respect to the latter, it was noted in particular that certain firms have assessed that their (higher cost) actively managed funds (which were therefore expected to outperform markets) provided value on the basis that they generated positive returns (in a generally rising market environment) even though those funds underperformed the relevant markets. The FCA has made clear that the review should galvanise change where appropriate and expects firms to be fully compliant by the next review.

### A new consumer duty?

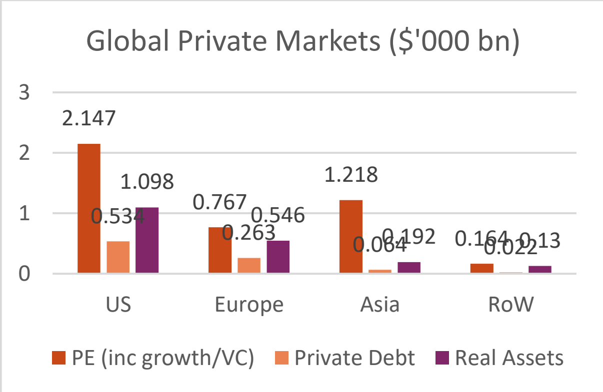
More generally, the FCA is also proposing a new consumer duty that will apply to any firm subject to the principles conducting regulated business where there is an ultimate transaction with a retail consumer, to the extent they are involved in the manufacture or supply of products (such as funds) and can influence material aspects of the design, target market or performance of a product or service that will be used by consumers - potentially bringing even wholesale asset management firms within scope (see our blog piece on implications for regulated firms more generally).

> *"...all firms [should] be putting consumers at the heart of their businesses, offering products and services that are fit for purpose and which they know represent fair value."*

As noted in its proposal, the FCA "*want[s] all firms to be putting consumers at the heart of their businesses, offering products and services that are fit for purpose and which they know represent fair value*". The proposed duty will require all firms involved in the design, manufacture and distribution of products to retail consumers to conduct more detailed and proactive monitoring of consumer outcomes throughout the product life-cycle. These obligations overlap with many of the existing requirements under PROD/RPPD and COLL (regarding assessment of value) sourcebooks but firms conducting non-MiFID business may have to adhere to these obligations for the first time.

## 5 Private Capital and vehicles for long term investment

Private capital (which encompasses a whole range of non-publicly traded assets including private debt, infrastructure, private equity and real estate) as an asset class has grown exponentially as investors seek higher returns away from the public markets in a low interest rate environment. Estimates for the first half of 2020 put assets under management allocated to private capital at more than $7.3 trillion with private equity assets comprising approximately $4.5 trillion of that total (McKinsey Global Private Markets Review, 2021). Many asset management firms have sought to grow or re-focus their private capital business in light of client demand and many have targeted or committed to increased direct investments in infrastructure and real estate.




The government's proposals to finance its "build back better" economic recovery programme in the aftermath of the Covid-19 pandemic mean that it is seeking to harness this demand to encourage further investment in more illiquid assets, particularly in infrastructure. To this end, the government has proposed a number of measures, most notably the introduction of a new open-ended vehicle for so-called "long term" or "patient" investments - the Long Term Asset Fund (LTAF). This is based on the existing Non-UCITS Retail Schemes (NURS) structure but adapted to include certain characteristics. Traditionally, investors have invested in long-term assets via closed-ended vehicles but the view is that having an FCA authorised open-ended fund which invests in long-term assets should broaden choice to investors by widening the options available. This also feeds into initiatives to make the UK a more attractive and competitive regime for funds.

However, existing fund structures such as European Long-Term Investment Funds (ELTIFs) (which was similarly meant to provide a collective investment framework allowing investors to invest into companies and projects that need long-term capital) have so far met with limited success – with only approximately 30 funds raising around €2 billion since 2015. The limited take-up demonstrates the level of care that is required to design a vehicle that affords a suitable level of investor protection but retains sufficient flexibility in order for it to be a viable and credible vehicle for firms designing products for long term investments. Some aspects of the proposed LTAF structure had already come under challenge during the consultation phase, including the onerous obligations imposed on depositaries and external valuers with respect to the valuation of assets. In addition, the initial proposal on distribution rules relating to the new vehicle restricted distribution by subjecting them to same rules as Qualifying Investment Schemes (QIS) but with tougher governance and other requirements deemed fit for retail investors. This was seen as unduly restrictive making it difficult for investors to sufficiently differentiate it from any other QIS who may therefore perceive it as an unnecessary structure.

The government's view is that the primary distribution market for the LTAF is defined contribution (DC) pension schemes – in this context, the Productive Finance Working Group (comprising asset managers, insurers and trade associations) has, in tandem, made a series of recommendations to encourage a shift in mindset for DC scheme trustees and investment consultants from a sole focus on achieving the lowest costs of investment to generating better and more sustainable returns for investors in order to better facilitate investment in illiquid assets. Suggestions include amendments to increase the DC charge cap (currently capped at 75 basis points) to accommodate asset classes such as private equity or private credit for which managers often charge higher fees and carried interest. The government has since published a consultation paper (November 2021) to consider the proposals of the Working Group.

The FCA has now finalised its rules relating to LTAFs in its Policy Statement (PS21/14). Although an open-ended vehicle, redemptions will be no more often than monthly, with the final rules also requiring the LTAF to have a minimum notice period for redemptions of at least 90 days. In practice it is expected that many LTAFs will have significantly longer notice periods.

Having worked with many stakeholders such as the Investment Association, the FCA has also taken into account some of the initial criticisms levied against the proposals. Welcome changes to the initial proposals include lowering the responsibility placed on the depositary so that it is only required to determine that the manager has the resources and procedures for carrying out a valuation of the assets, as well as extending access from just professional investors to sophisticated retail and high net worth individuals. However, the FCA remains wary of broadening access to the wider retail population at this stage, undoubtedly influenced by the high-profile failure of the Woodford funds following its liquidity crisis. Governance and disclosure requirements remain high – for example, only a full scope AIFM is permitted to manage an LTAF. The appetite for vehicles that can accommodate investment in long-term assets is certainly there, and having consulted extensively on the design of the vehicle, there is a better chance for a more successful take-up of LTAFs. In any case, for asset management firms, the launch represents a new opportunity as it seeks to capitalise on the government's demand for "patient" capital to fund its various long term infrastructure projects.

## 6 Post-Brexit regulatory and funds regime

The UK government has not hidden its desire to position UK as a leading location for funds and the asset management industry post-Brexit as it seeks to ensure that UK retains its influence as a pre-eminent financial centre and to bolster its attractiveness now that it is outside of the EU regulatory ambit. Even as the government continues to consider its overall response to the wide-ranging UK funds regime review launched earlier in 2021, it has already taken a number of concrete steps towards the implementation of a more fund-friendly regime. The introduction of the LTAF structure (discussed above) is one; the proposals relating to asset holding companies (AHCs), which have been the subject of a number of earlier consultations, is another.

## Asset holding companies

Numerous countries have committed to implementing the 15 Actions relating to base erosion and profit shifting (BEPS) practices, one effect of which is to make it more attractive to locate fund management activity and AHCs in the same place. In this context, given the scale of asset management activity currently in the UK, the proposals may help realise UK's potential as the location of choice for new AHCs. Currently, certain European jurisdictions – chiefly Luxembourg – have more favourable AHC regimes which better facilitate fund structures' objective of tax neutrality. The government is seeking to redress this by introducing a new regime for qualifying asset holding companies (QAHC). The regime includes exemptions on gains from disposals of certain shares and overseas property by QAHCs, treatment of premiums paid on share repurchases from individuals as capital rather than income distributions, and certain entry and exit provisions, including the rebasing of certain assets when a company enters and exits the regime. While the costs of moving existing fund structures may mean that few existing funds would move, the hope is that going forward, the announced measures in the UK would increase UK's attraction as base both for funds and the industry servicing those funds. There have also been calls to simplify the UK's archaic limited partnership legislative framework in order to facilitate the establishment of private funds in the UK, particularly given the growth in private equity and other private capital asset classes.

## Flexibility in divergence

While the longer term consequences arising from loss of equivalence regimes post-Brexit remain to be seen, and the extent of the UK's success in maintaining or increasing its standing as an asset management centre can only be judged in the long run, the UK's new-found ability to move away from EU rules has already given it some flexibility to make improvements – which is welcome in certain targeted areas. For example, the government launched its much-trailed consultation (CP 21/23) on amending the much-criticised PRIIPs regime in July 2021. Uncertainty relating to the scope of PRIIPs – in particular in relation to corporate bonds - has led to issuers producing prescribed Key Information Documents unnecessarily or excluding retail investors from offerings entirely. Under the proposals, the FCA is being granted rule-making powers to determine the scope of products caught by the regime, which it is using to clarify whether certain features of corporate bonds make a product a PRIIP, allowing it to provide legal certainty in areas where the EU has perhaps been unwilling, or slow, to act. In light of widespread industry concerns that the current rules relating to performance scenario requirements often result in misleading or confusing disclosures to end users, the FCA has also mooted, in place of such requirements, a more flexible requirement for "information on performance".

## The future regulatory framework

On a macro-level, the government has recently published a further consultation on the future UK regulatory framework for financial services, which also sets out its response to the previous October 2020 consultation. The proposals involve a wholesale reform of the framework, envisaging much greater responsibility on the FCA and PRA for setting detailed rules across the UK's financial services landscape, and the introduction of a new secondary growth and international competitiveness objective for both the PRA and the FCA. The direction is for UK regulators to be responsible for setting many of the regulatory requirements which were previously set by the EU, and much of retained EU financial services legislation to be repealed. If these proposals are implemented, implementation will take a number of years.

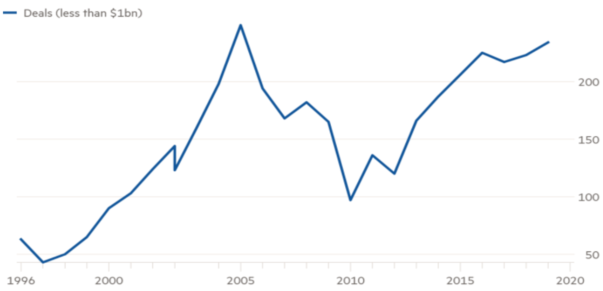
In the meantime, the government has been pragmatic in permitting EU firms to market EU domiciled funds to UK investors - and ensuring UK investors have continued access to a full range of products - initially by putting in place the Temporary Marketing Permission Regime (TMPR), which allows such funds to be marketed in the UK on the same basis as they were prior to UK's exit from the EU. Although the TMPR is due to end at the end of December 2025, the government has already legislated for the introduction of the Overseas Funds Regime, which will allow certain categories of approved non-UK CIS to be marketed in the UK, including to retail investors. The FCA has confirmed that it is working HM Treasury on the design and implementation of the OFR, and will be consulting on amendments to the FCA Handbook in due course.

The EU has been less accommodating. Following the review launched in 2017, the European Commission has finally published its proposed amendments (AIFMD II) to the Alternative Investment Fund Managers Directive. The overall changes are relatively limited, but some proposals may have significant impact on firms' business models – in particular (and as expected), in relation to delegation. The EU's concern surrounding the ("over")use of delegation is well known and the proposals seek to introduce a requirement for EU regulators to scrutinise delegation arrangements and to report to ESMA on an annual basis. ESMA will then be required to report to EU institutions every two years on developing market practice, and to conduct peer reviews of measures taken by national regulators to prevent firms becoming "letter-box" entities. If adopted, delegation arrangements, which the UK asset management industry relies heavily upon, would undoubtedly be subject to intense scrutiny.

## 7 Transactional activity in the sector

While the market continues to see large deals such as Goldman Sachs Asset Management's €1.6 billion purchase of NN Investment Partners, M&A activity involving smaller asset managers is on the rise, with latest data showing more sub-$1 billion deals between asset managers in over a decade. Although scale continues to be a driver, the trend of smaller targeted M&A appears to be a product of larger asset managers looking to acquire product lines and add to distribution channels as opposed to simply growing scale. This is exemplified by the number of "bolt-on" acquisitions by various asset managers.

Smaller M&A deals among asset managers runs at fastest pace since 2007




Data are yearly: Jan 1 to Sept 8
Source: Refinitiv, an LSEG business
© FT

### Growth areas and diversification

More traditional asset managers are also seeking to diversify business lines and make acquisitions in growth areas, notably in wealth management and Fintech businesses. The highly fragmented nature of the wealth management industry lends itself to consolidation and this has been buoyed by active interest from both established asset management firms and private equity firms considering a "buy and build" strategy in this sector. The US alone has seen 153 announced deals involving wealth managers. Examples across the US and UK include Vanguard's first ever acquisition - its acquisition of Just Invest, a small wealth manager that focuses on direct indexing which provides customised portfolios – as well as Titan Wealth Holdings' acquisition of Tavistock Wealth, and Mattioli Woods' acquisition of Ludlow Wealth Management. JPMorgan's June 2021 acquisition of Nutmeg, the digital investment adviser, is one of the more high profile transactions announced in the Fintech space.

### Investment trusts - proving active

One interesting trend of 2021 is a notable increase in mergers among investment trusts, driven by the need for size and liquidity. With five mergers completed or announced so far comprising assets totalling £708 million, this is the most number of deals for a decade. The merger of Scottish Investment Trust and JPMorgan Global Growth and Income Trust - two of the oldest investment trusts - was announced in October 2021, the latest in 2021 in a line of mergers that included City Merchant High Yield Trust's merger with Invesco Enhanced Income and Invesco Income Growth's merger with Invesco Select UK Equity. Capital raising using the investment trust structure also reached new highs in 2021, with nearly £12 billion raised through IPOs or secondary fundraisings. The ability of investment trusts as a close-ended vehicle to access specialised asset classes and private assets such as infrastructure has been touted as one reason for the structure's recent resurgence to raise capital to provide financing for a wide range of sectors ranging from renewable energy, hydrogen technology to space travel.

## Contacts

If you would like to discuss any of the issues highlighted in this publication or any other legal or regulatory matter, please do contact us or speak to your usual Slaughter and May contact.

### Paul Dickson

Partner
T +44 (0)20 7090 3424
E paul.dickson@slaughterandmay.com

### Jan Putnis

Partner
T +44 (0)20 7090 3211
E jan.putnis@slaughterandmay.com

### Jonathan Marks

Partner
T +44 (0)20 7090 3056
E jonathan.marks@slaughterandmay.com

### Nick Bonsall

Partner
T +44 (0)20 7090 4276
E nick.bonsall@slaughterandmay.com

### Nicholas Pacheco

Partner
T +44 (0)20 7090 3143
E nicholas.pacheco@slaughterandmay.com

### Alfred King

Senior PSL
T +44 (0)20 7090 3519
E alfred.king@slaughterandmay.com

**This briefing is part of the Slaughter and May Horizon Scanning series**

Click here for more details or to receive updates as part of this series. Themes include Beyond Borders, Governance, Sustainability & Society, Digital, Navigating the Storm and Focus on Financial Institutions. Focus on Financial Institutions explores the financial services sector which continues to be affected by digital/technology disruption and regulatory reform. COVID has added to the burden as financial institutions adapted to a new operating model overnight. This focus brings together our thinking on these points and aims to promote discussion and debate in relation to financial institutions’ responses.

**London**
T +44 (0)20 7600 1200
F +44 (0)20 7090 5000

**Brussels**
T +32 (0)2 737 94 00
F +32 (0)2 737 94 01

**Hong Kong**
T +852 2521 0551
F +852 2845 2125

**Beijing**
T +86 10 5965 0600
F +86 10 5965 0650