SLAUGHTER AND MAY/

SPRING 2021

ASSET MANAGEMENT - HOT TOPICS

Focus on Financial Institutions – Part of the Horizon Scanning series

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Welcome to the Spring 2021 edition of our **Asset Management - Hot Topics** series. Against the backdrop of the COVID-19 pandemic and the end of the Brexit transition period, we explore some of the significant themes currently affecting the asset management and funds sector – considering, in particular, post-Brexit developments, the increasing focus on ESG and sustainability matters, as well as the latest on topics such as operational resilience, liquidity management, and product governance.

1 The post-Brexit regulatory framework

The UK government is hoping that moving away from EU's regulatory ambit post-Brexit may provide it with a number of opportunities to consider wider reforms that may enhance the attractiveness of UK as a location for funds over the longer term. The Government recently launched a call for input asking the industry and other stakeholders to consider a whole range of reforms to the UK funds regime, with a view to identifying options which will make UK a more attractive location to set up, manage and administer funds. The review is wide-ranging – considering both regulatory and tax reform and views are being sought on enhancing existing structures and proposals for new structures, including new vehicles to invest in alternative asset classes and long term assets. Separate consultations on asset holding companies and reform to the VAT regime are already underway. It should be incumbent on asset managers to feed into the review in order to shape the proposals since they may have significant impact on the industry in the UK going forward.

The Investment Firm Prudential Regime

In the more immediate future, near the top of the regulatory agenda for asset managers must be the proposed new regime for prudential regulation of investment firms in the UK (the Investment Firm Prudential Regime or IFPR), which will be broadly aligned with the changes proposed in the European Union under the Investment Firm Directive (IFD) and Investment Firm Regulation (IFR). While the new proposals are intended to simplify the existing prudential framework for investment firms (including asset managers), they mark a sea-change which will require firms to devote considerable resources towards ensuring they are ready for when the new regime comes into force, currently expected to be 1 January 2022.

The broad aim of the proposals is to create a new prudential regime that is more appropriately tailored to, and takes into account specific risks faced by, investment firms. The current CRR regime was designed for credit institutions and does not quite address the potential harm posed by FCA investment firms.

Changes include: new liquidity rules for UK investment firms; changes (likely to be increases) to the level of initial capital to be held; a new approach to calculation of capital (under the so-called “K-factor” approach); and new rules on remuneration and disclosures.

For many, this would mean a more stringent regulatory capital regime, in contrast to the lighter-touch regime they may be used to. This includes more prescriptive rules on remuneration practices and associated disclosures. The extent to which obligations would apply would depend very much on the size and complexity of the firm in question. Systematically important firms will still fall under the CRR regime, as would firms with consolidated assets of more than £5 billion and which have permissions to deal on their own account and/or to underwrite on a firm commitment basis.

Firms that are not permitted to deal as principal or hold client money or assets (typically smaller asset managers and advisers) will be classified as "small and not inter-connected" (SNI) firms, and will benefit from a proportionate, reduced implementation of the IFPR in key areas such as the calculation of capital requirements. The non-SNI category comprises all other FCA investment firms, which will be subject to the full regime. Firms will need to assess which class of investment firm they will be categorised as, following which they can start assessing what adjustments need to be made to capital, liquidity risk, reporting, and remuneration requirements.

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Divergence from the EU framework?

With the new-found ability to diverge from EU regulations, the UK has also focused on areas where the industry has made clear that immediate improvements can be made. The UK has already announced that it intends to amend the much criticised PRIIPS regime in its upcoming Financial Services Bill 2019-21. In other areas, the European Commission is currently undertaking an extensive review of the AIFMD and UCITS regime, and has just closed its public consultation on the review. The consultation followed ESMA's letter to the Commission raising various issues around areas in both the AIFMD and the UCITS Directive requiring (in its view) "harmonisation" and/or "clarification". The primary focus of the consultation is on suggested areas of improvement and harmonisation on areas of detail within AIFMD (including the possibility of a single licence for managers of AIFs and UCITS funds) although there are concerns around delegation to third countries given the political backdrop of Brexit (see below). It will be interesting to see UK's approach in relation to any amendments to the AIFMD and UCITS regimes following the EU's review.

2 The end of the Brexit transition period

With the expiry of the Brexit transition period and EU law ceasing to apply to the UK, the current EU passporting regime has fallen away for firms. While an eleventh hour trade deal was agreed between the UK and the EU (the EU-UK Trade and Co-operation Agreement (TCA)), financial services remain outside scope of the TCA. Instead, the parties have simply committed to regulatory cooperation on financial services in a non-binding Joint Declaration, and confirmed their intention to establish a Memorandum of Understanding (MoU) framework by March 2021. HM Treasury has since announced that technical discussions on the text of the MoU have concluded, although the MoU has yet to be signed and the text of the final version of the MoU has not yet been published.

In any event, the MoU simply provides what is justifiably described as a "bare bones" framework. All that has been agreed is the establishment of the Joint UK-EU Financial Regulatory Forum, which will serve as a platform to facilitate dialogue on financial services issues. Any decisions on equivalence in relation financial services appear distant, as the EU has stated that no decisions will be taken until it obtains further clarity on how the UK will diverge from EU frameworks going forward.

Many firms have prepared for this eventuality but concerns remain, in particular in relation to the extent to which funds domiciled in the EU may continue to delegate portfolio management to UK-based managers. This remains a critically important business model for many asset management groups which run their substantial portfolio management functions out of the UK. The delegation model has, as expected, come under renewed scrutiny by the EU in the run-up to the end of the transition period. It is notable that in relation to the Commission's review of AIFMD, ESMA had suggested in August 2020 a possible tightening of the delegation rules through the introduction of a proposed list of core functions that must be performed in the EU, and of quantitative criteria alongside qualitative criteria to determine whether there has been "substantial" delegation of functions. ESMA has also expressed its ire at non-EU/ third country investment firms which seek to circumvent market access rules on provision of financial services to EU clients through the use of the "reverse solicitation" regime, issuing a statement reminding firms that the provision of any product or service must be at a client's own exclusive initiative, and that firms cannot simply rely on a tick box approach by contractually providing that the third country firm will be deemed to have responded to the exclusive initiative of the client.

On the UK side, the UK has enacted a 'temporary marketing permissions' regime (TMPR) enabling EEA asset managers to continue, for a limited period (during which they must seek full authorisation), to market funds in the UK which they had marketed prior to UK's withdrawal from the EU. The Government consulted last year on a proposed permanent overseas funds regime to take effect once the TMPR ends. This has now been outlined in the Financial Services Bill 2019-21 and provides for an "outcomes based" equivalence regime in relation to retail funds and money market funds. However, there has been no movement on the part of the EU towards a reciprocal EU-wide regime and the regimes introduced by individual member states have not, so far, focused on asset management. As a result, UK asset managers will need to consider how they will market their funds in the EEA and may be restricted to using national private placement regimes (if available) on a country by country basis.

3 ESG and Sustainability

It has become somewhat of a cliché to note that 2020 has seen the acceleration of the rise of ESG matters and sustainability to the top of issues that concern asset managers. Much to the surprise of some who thought that the COVID-19 pandemic may relegate ESG matters, the pandemic has instead very much placed issues such as treatment of workforce, supply chain resilience, and pay practices under the spotlight. In the meantime, the narrative around the climate change emergency remains unabated. As significant financial participants within the investment ecosystem, it should come as no surprise that regulators have increasingly focused their regulatory efforts on asset managers. Latest published data shows that rising demand for "sustainable" investment prompted managers to change the strategy or investment profile of 253 European funds in 2020. That, coupled with 505 new ESG fund launches over the same period, helped to push regional assets invested in funds with an ESG tilt to a record €1.1 trillion by the end of December 2020. With the amount of investor money being channelled into such funds, and the asset management industry keen to ensure they capture the *zeitgeist*, there are naturally concerns around "greenwashing". As a result, much of the current regulatory focus is on ensuring proper disclosure by firms at both entity and product level.

EU regulatory developments

The EU has sought to lead in this sphere as part of its Action Plan on sustainable finance and has introduced various legislative initiatives to enhance transparency and disclosures relating to ESG matters, including the Disclosure Regulation (Regulation 2019/2088) (otherwise known as the sustainable finance disclosure regulation or "SFDR") and the Taxonomy Regulation (Regulation 2020/852). The SFDR imposes various disclosure requirements on asset managers in order to facilitate the integration of ESG factors into their risk processes as well as investment decisions and approaches. While laudable, the detailed requirements pose many technical and practical challenges, not least the difficulty in obtaining relevant data and information from investee companies within a fund's portfolio. Acknowledging some of these concerns, the Commission has delayed the application of the detailed regulatory technical standards which set out the form and content of required disclosures (in particular, in relation to indicators relating to "principal adverse impacts") to 2022. However, many of the high-level requirements, including entity-level disclosures, are applicable from 10 March 2021.

Since neither the SFDR nor the operative provisions of the Taxonomy Regulation form part of UK domestic law as part of the automatic on-shoring process, neither of these regulations directly apply to UK asset managers. The UK may take a different approach in terms of the extent and content of disclosures it may require. Nonetheless, the scope of SFDR means that UK asset managers marketing products in the EU or those to whom portfolio management has been delegated by an EU firm would need to take heed of its requirements. In any event, the FCA has stated its intention to consult on requiring UK-based asset managers to make climate-related disclosures based on the TCFD framework in 2021, and there is much to suggest that the UK may follow the EU's lead in requiring more ESG disclosures from asset managers.

"S"ocial matters: Diversity and Inclusion

Although much of the recent regulatory initiatives focus on environmental concerns, there is also increasing recognition of the risks and opportunities presented by social ("S") issues, in light of, among other things, the Black Lives Matter movement and furore surrounding treatment of those working in the GIG economy. In this respect, asset managers are also challenging companies on a wide-range of "S" and governance ("G") issues. At the same time, the industry itself is increasingly aware of its own shortcomings in areas such as diversity and inclusion. The Investment Association's Annual Survey for 2020 notes the increasing importance of the "Diversity and Inclusion agenda", recognising the cultural and operational benefits of a diverse workplace but also that the industry as a whole needs to better reflect their customers and wider society. In particular, the IA highlighted its issues with black representation and has recently (March 2021) published a report on Ethnicity in Investment Management outlining steps to improve ethnic diversity and inclusion in investment management.

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Shifts in investor expectations mean that, quite apart from regulatory developments, asset managers cannot ignore the increasing demand not just for ESG-focused products but also for asset managers to have regard to ESG factors at every step of the investment decision chain. Asset managers would be very aware of reputational and financial risks as well as opportunities and the need for them to be consistent and align with their stewardship responsibilities as they seek to be at the vanguard of the push towards long term sustainable investments.

4 Stewardship and shareholder engagement

The very *raison d'etre* of asset management involves effective stewardship of assets – that is, the responsible allocation, management and oversight of capital to create long term value for clients. The revised Stewardship Code closely links stewardship to the concept of sustainability as it defines the desired outcome of good stewardship not just as the creation of long-term value for clients but how this would lead to sustainable benefits for the economy, the environment and society.

Any good stewardship practice would necessarily involve robust and effective shareholder engagement on the part of asset managers. A more public form of shareholder "activism", which used to be the preserve of more specialist activist funds, is now not uncommon among traditional long-only fund managers as they seek to engage with, and challenge, investee companies, particularly on ESG issues. Indeed, a recent study by Schroders has identified active engagement as the "key tactic" in driving sustainable change. Engagement has become all the more crucial in the wake of the COVID-19 pandemic, as asset managers would be carefully scrutinizing the strategy and operational performance of investee companies dealing with the considerable economic challenges ahead.

Regulatory developments such as the implementation of Shareholders' Rights Directive II (SRDII) mean that asset managers are already required to develop and disclose their policy on shareholder engagement (on a 'comply or explain' basis), as well as publicly disclose how they have cast their votes at general meetings and provide an explanation relating to the 'most significant votes' in which they have participated. Many asset managers (including some of the largest firms) have also applied to become signatories to the UK Stewardship Code 2020. Prospective signatories must submit their first stewardship reports by 31 March 2021. The FRC has already conducted a review of early reporting under the Code. The focus of the Code on "activities" and "outcomes", rather than simply policies and procedures, requires asset managers to carefully consider whether their stewardship activities and engagement process resulted in concrete outcomes. This is meant to ensure that asset managers cannot “tick the stewardship box” simply by having policies in place but must actually demonstrate that they have acted on those policies and produce tangible results from their stewardship activities.

5 The continuing growth of exchange-traded funds (ETFs)

The meteoric rise of passive investing and exchange-traded funds (ETFs) over a number of years is well documented. Much has also been made of the alleged failure of a number of actively managed funds to consistently outperform passive funds, although the debate around active versus passive remains very much live. Growth in passive investing has driven resultant growth in ETFs which were originally conceived as a structure to provide investors with a single security that would track an index. Data from Morningstar shows that the global volume of assets in index funds has risen from $2.3 trillion in 2010 to $10 trillion in 2020. In Europe alone, assets in ETFs now total more than $1 trillion (with Irish-domiciled ETFs in particular having seen spectacular 50% growth from 2018-2019), and this is seen as a growth area for many asset managers.

While the number of ETF providers among UK firms remain relatively small, various asset managers are launching new ranges of ETF products. However, the competition is fierce and asset managers have had to work hard to differentiate their products, resulting in new ETFs based on thematic strategies or on more diversified benchmarks reflecting wider investment styles. The continued dominance of BlackRock and Vanguard in this area and relentless fee margin pressures mean that scale is required for firms to be able to compete, and consolidation is very much at the forefront of the ETF industry. In the first real test of their resilience, ETFs have also, in the main, managed to navigate their way through the COVID-19 crisis successfully, despite the high levels of trading on secondary markets. Indeed, some have pointed to ETF prices as a much clearer indicator of the value of underlying instruments during time of market stress for certain asset classes than the NAV, which reflected stale valuations at the time.

Changes to UK listing regime for ETFs

With UK-listed ETFs totalling assets of over £330 billion (mostly in Irish and Luxembourg domiciled ETFs) as at 2019, the FCA has, in March 2020, published a consultation (CP 20/5) on creating a more proportionate listing regime for open-ended investment companies (OEICs), which are the vehicles of choice for ETFs. Given investor feedback which suggests that investor protection in relation to ETFs were derived mainly from underlying funds rules (such as the UCITS regime) rather than listing rules, the view was that the existing listing rules were disproportionate, and the rules governing such listed vehicles should be more closely aligned with requirements in the existing standard listing category, rather than a premium listing. The FCA is proposing to streamline the listing applications process for OEICs without requiring the publication of any Listing Particulars or the appointment of FCA approved sponsor to support the application, as well as to dis-apply many shareholder approval requirements.

As part of its wide ranging review of the UK funds regime, the government is also considering measures to increase the attractiveness of UK as a domicile for ETFs, although this is aimed primarily at boosting UK’s reputation as a location for the creation of entirely new funds, rather than encouraging the re-domiciliation of existing EU-domiciled funds, which it recognises is unrealistic.

A move to “active” ETFs?

The growth of passive investing has, however, raised concerns of a different nature. For example, with the outsized growth of certain technology companies in the US resulting in the six largest companies making up a quarter of the S&P500 index, concentration risks become an issue for products which simply replicate the index. Expectations that asset managers will have regard to ESG factors in their investment decisions also lend themselves more naturally to an active strategy, although asset managers are increasingly seeking to innovate by coming up with “passive” products which integrate some ESG screening or thematic ETFs such as “climate change” ETFs which track indices incorporating ESG criteria. State Street recently launched an ESG themed corporate bond ETF which attracted net inflows of some $4.6 billion in February 2021 alone.

While the requirement for ETFs to be fully transparent hampers active strategies, there may be some movement in modifying the ETF structure to better accommodate active strategies (with the US having allowed "non-transparent" or "semi-transparent" ETFs for some time), as evidence indicates growing investor demand for "actively managed" ETFs which do not track a pre-determined basket of securities or aim to replicate the performance of their chosen index.

6 Operational resilience and cyber risks

Operational resilience of financial institutions has been high on the UK financial regulators' list of priorities for some time. This goes beyond traditional considerations of operational risk and recovery capabilities to consideration of firms' ability to prevent, adapt, respond to, recover and learn from whatever operational disruption, or 'shock', they experience (including technology failures or external cyber-attacks). The FCA has recently published Policy Statement (PS 21/3) finalising the proposals set out in its December 2019 consultation paper on operational resilience which would require firms and operators of financial market infrastructures (FMIs) (including enhanced solo-regulated firms) to identify their important business services; set impact tolerances for, and identify and document the people, processes, technology, facilities and information that support, those services. Firms must take action to be able to remain within their impact tolerances through a range of severe, but plausible, disruption scenarios.

Following publication of the Policy Statement, there is a one year implementation period for firms to operationalise the policy framework. Firms must be able to remain within their impact tolerances as soon as reasonably practicable, but no later than three years after the rules come into effect on 31 March 2022. Many in the asset management sphere are critically dependent on third parties for the delivery of core services, and oversight of outsourcing arrangements is of utmost priority. The Policy Statement provides some helpful illustrative examples of how the new rules may apply to asset management firms in this context

Resilience in the COVID-19 environment

It is an obvious point that the need for firms to have robust operational resilience across all areas of business is particularly critical in the current COVID-19 environment. As acknowledged in the Investment Association's Annual Survey for 2020, technology has, and will continue to, play a pivotal role in the industry's overall operational resilience, particularly amidst the wholesale transition to remote working as a result of global lockdowns during the pandemic.

Cyber security is a particular concern in this environment, given the type of data (including customers' personal data) that asset managers may hold and their roles as key market participants and counterparties. The increasing use of third party cloud providers to hold information poses further challenges, requiring asset managers to consider carefully how they manage the associated security and operational risks and deal effectively with security incidents as they occur. The FCA's Policy Statement highlighted particular risks arising from the dependency on offshore third party providers during the pandemic, especially where providers were under lockdown in another geographical location, affecting continuity of services.

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The FCA has indicated that it expects firms to have tested contingency plans in place, which include operational risks assessments and for the plans to set out firms' ability to continue operating effectively and the steps they are taking to serve and support their customers and clients. It also expects firms to take all reasonable steps to meet existing regulatory obligations to protect both consumers and market integrity, which should include, if necessary, the implementation of further systems and controls in response to increased home-working. Undoubtedly, the regulator will continue to review and discuss with firms, and trade associations, the operational resilience issues they are facing.

7 Liquidity and appropriate fund structures

Market volatility during the early stages of the COVID-19 pandemic brought liquidity risks to the forefront once again as concerns surrounded the threat of the "dash for cash" to the stability of global markets. While markets held up – although not without some intervention by central banks - regulators' concerns about liquidity issues in the non-banking sector remain, particularly in relation to funds which are invested in relatively illiquid assets but which allow "daily dealing". These concerns precede the pandemic – the structure of open-ended property funds was similarly questioned given the relatively illiquid nature of the underlying assets when a number of such funds were forced to suspend redemptions following the result of the UK's referendum on EU membership in 2016.

At that time, those concerns resulted in the introduction of new rules in PS 19/24 (September 2019) which subject non-UCITS retail schemes (NURS) that fall into a new category of 'funds investing in inherently illiquid assets' (FIIA) to additional requirements, including enhanced depositary oversight, standard risk warnings on financial promotions, increased disclosure of liquidity management tools and liquidity risk contingency plans. The new rules only apply to NURS, but the FCA indicated that, in light of the high profile failure of the Woodford funds in summer 2019, it was considering whether the rules should apply more widely to other types of funds and whether it should explore a wider range of potential remedies more generally. Further regulatory action was proposed in the FCA's CP 20/15 (published August 2020), in which the FCA proposed to require investors in authorised property funds to give notice before their investment is redeemed.

Systemic risks

Although there is a broader debate as to whether the high profile failures of certain funds as a result of liquidity issues were largely idiosyncratic, the Bank of England Financial Policy Committee (FPC) has highlighted the continuing regulatory concern in relation to potential systemic financial stability risks arising from liquidity issues. The FPC's December 2019 review judged that the mismatch between redemption terms and the liquidity of some funds' assets may grant an advantage to investors who redeem ahead of others, particularly in times of market stress. This may result in forced asset sales and amplify price moves, which has the potential to become a systemic risk.

Against the backdrop of a recent joint Bank of England and FCA survey suggesting that managers of corporate bond funds continue to overestimate the liquidity of their holdings and the ever-present threat of possible market stress at a time when many economies remain in the grip of an ongoing pandemic, it is clear that this is a priority issue for many regulators. ESMA, for example, has separately launched an exercise assessing firms' compliance with UCITS liquidity risk management obligations, the results of which were recently published in March 2021.

As noted in the BoE/FCA survey, asset managers already have various tools at their disposal to manage liquidity, including the use of swing pricing and dilution levies. Asset management firms are certainly expected to have in place, and to operate, effective and robust liquidity management practices. These tools themselves are the subject of much review to ensure they are effective and sufficient. In a speech given to the Investment Association in March 2020, the FCA pointed to some of the existing liquidity management tools available and invited the industry to comment on the best mix of regulatory measures to ensure open-ended funds can manage liquidity risks effectively in the current environment. More recently, IOSCO has launched a thematic review of its 2018 Recommendations for Liquidity Risk Management for Collective Investment Schemes, aimed at assessing the extent to which the Recommendations have been implemented through members' regulatory frameworks and how they have been implemented in practice.

Appropriate structures for illiquid assets

Balanced against the need for investor protection is the demand among investors to be able to take full advantage, in a low-yield environment, of investment opportunities available, including in illiquid assets. Global assets under management in private markets (including private equity, debt, infrastructure and real estate) have grown to approximately $7.3 trillion in 2019 from $2.4 trillion in 2009. Although many institutional investors have had the ability to invest in alternative asset classes for some time, others, notably retail investors, have had less access to private markets.

Proposals to provide a wider investor pool access to such markets have been suggested. The Investment Association, for example, has proposed a new vehicle in the form of the Long Term Asset Fund with wider investment powers than UCITS funds designed to move away from the conventional model of daily redemptions in order to facilitate greater access to illiquid investments, which may also be used as a means to provide capital as the economy seeks to rebuild in the aftermath of COVID-19.

8 Product governance and assessment of value

MiFID II introduced a new regime for investment firms that design and distribute financial instruments, requiring firms to consider the interests of end clients throughout each stage of a product's life cycle. The FCA has recently (February 2021) completed a review of firms' compliance with such rules (implemented in the UK through rules in the PROD Sourcebook) which found scope for significant improvement. PROD rules only apply as guidance, but the FCA has stated its expectations for firms to carefully consider them when meeting their obligations under the FCA Principles of Business and other relevant rules.

Despite the presence of product governance committees in all asset managers reviewed, some fell short of regulatory expectations. Key findings in relation to product design and testing focus on the firms' failure to identify negative target markets (that is, those potential investors for whom a product is determined not to be suitable) and ineffective management of conflict. The FCA also noted the variable quality of contributions from firms' independent non-executive directors, poor record keeping, and the lack of a formal process in relation to product design and oversight. One further finding is the lack of effective information and communication between asset managers and product distributors (which managers often rely on to obtain relevant information on the end consumer), hindering firms' ability to effectively meet best practice on product governance or to address harm to consumers resulting from poor product design or distribution processes.

Assessment of value

As part of regulatory initiatives to improve product governance, one specific remedy that came out of the Asset Management Market Study in 2017 was a requirement for asset managers to assess whether "value" is being delivered to investors and explain the assessment annually in a public report (an "assessment of value" report). The requirement came into force in September 2019, and the first assessment of value reports have been produced despite the FCA granting temporary relief allowing for the delayed publication of assessment of value reports as a result of the COVID-19 pandemic. Critics have called the initial reports underwhelming. Although firms have reported on underperformance, some have maintained that underperforming products still represented "value"; others have simply stated that they will "continue to monitor" performance of underperforming products without any detail on how they intend to address the issues. Indeed, of the 135 reports published as at the end of August 2020, it was reported that only 4 per cent made a clear effort to identify remedial action to improve their funds.

> *"Industry reports indicate that the FCA has already been holding discussions with a cross-section of firms to scrutinise the process and governance behind the assessments"*

Asset managers are required to take corrective action if their funds are found not to have delivered "value", and firms will want to consider what action it will take and how it will approach the re-assessment of those funds over the next reporting period, having taken corrective action. Industry reports indicate that the FCA has already been holding discussions with a cross-section of firms to scrutinise the process and governance behind the assessments and to check effective remedial steps are being taken in respect of funds that provide poor value. The FCA is likely to provide market feedback on what it expects in terms of good practice in relation to such assessments in due course.

9 Transactional activity in the sector

In the midst of the global COVID-19 pandemic, deal activity in the investment industry has remained robust, particularly in the US, highlighting the intense competitive pressures on firms, which are driven towards consolidation as they seek to increase revenues and cost savings. While volumes have dropped, the value of announced M&A deals involving asset and wealth managers rose from $13.6 billion in 2019 to $38.9 billion in 2020. Large transactions during this period include Franklin Templeton's $4.5 billion acquisition of Legg Mason and 2021 has already seen the acquisition of Wells Fargo Asset Management for $2.1bn by private equity funds, Reverence Capital and GTCR.

Building scale and 'consolidating' wealth

Building scale is a perennial theme even among existing large firms - recent reports have suggested a possible tie-up between UBS and State Street's asset management businesses. Having pulled back from asset management for a number of years, there is now some indication that banks are again interested in growing their asset management businesses in an attempt to improve yields as interest rates remain at historic lows. 2020 saw Morgan Stanley acquiring Eaton Vance for $7 billion and JP Morgan is reportedly on the acquisition hunt.

UK continues to see both domestic consolidation and acquisitions by overseas financial institutions involving mid-sized and smaller asset managers, as the market seems to coalesce around larger players and boutique specialist firms. In 2020, we have seen Jupiter Asset Management's acquisition of Merian Global Investors, Sumitomo Mitsui's acquisition of TT International, and Liontrust's acquisition of Architas.

> *"Building scale is a perennial theme even among existing large firms..."*

As noted above (see "The continuing growth of ETFs"), M&A activity involving ETF providers is likely to be a feature of the market. Amundi has recently announced that it is in exclusive talks to acquire Lyxor, in large part driven by Lyxor's €77 billion ETF business. Consolidation among wealth managers has also been particularly strong. Although seen as distinct businesses, most asset managers see this as part of their offering and many have prioritised growth in this area as they see better margins servicing high net worth individuals with more specialised products. Private equity has been behind much of this recent consolidation, acquiring wealth managers which are used as consolidation vehicles to acquire other businesses in a relatively fragmented industry. In the UK, Tilney (owned by private equity funds) completed its merger with Smith & Williamson in September 2020, and Standard Life Aberdeen recently announced the sale of its Parmenion wealth adviser platform to private equity funds managed by Preservation Capital.

Specialist growth

Activity is also being driven by firms seeking growth in more niche or specialist areas which, again, may command higher fee margins – examples include Schroders's acquisition of a majority stake in Pamfleet, an Asian focussed real estate specialist, Australia's Perpetual's acquisition of ESG specialist Trillium Asset Management, as well as Temasek's $500 million investment in Leapfrog Investments, a specialist impact investment manager.

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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.

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