

12 October 2015

The New City Initiative (“NCI”)

The Next Five Years: Regulatory Challenges That Will Impact Asset Managers

In an opinion paper published today, the New City Initiative outlines some of the regulatory issues expected to confront the asset management industry over the coming years and calls for changes to be made to better structure this regulation. The full paper is available on the NCI’s website at www.newcityinitiative.org/publications/.

Commenting on the future regulation, Dominic Johnson, Chairman of New City Initiative, said: *“Regulation must be sensible and it must be proportionate. Most importantly, it needs to serve the purpose for which it was intended; to protect all investors and guard against systemic risk. As currently proposed, this host of regulatory initiatives will likely prove detrimental to the former, and do nothing to mitigate against the latter.”*

He continued: *“It is all too often the case that regulations within the financial services industry end up doing the opposite of what they are supposed to do – namely destroying competition and making the large firms larger. This not only reduces returns to investors, but also increases risk in the financial system. Despite this, too much of tomorrow’s regulation appears to be heading in the same direction. Risk will be better managed and greater transparency achieved through changing how people ‘think and operate’ rather than through more inefficient regulation.”*

The NCI’s research looks at the impact pending regulations are likely to have on the boutique asset management industry and makes a number of recommendations intended to ease the regulatory burden. The full paper is available on the NCI’s website and a summary is provided below:

SUMMARY OF INCOMING REGULATIONS AND NCI’S RECOMMENDATIONS

- **AIFMD marketing rules**
The NCI advocates the extension of the pan-EU AIFMD passport to more third country managers in a timely fashion. The NCI advocates that member states adopt a consistent approach to the rules surrounding marketing and that regulators clarify what is and what is not permissible under reverse solicitation.
- **AIFMD Management Company “Manco” rules**
The NCI advises its members to conduct rigorous operational due diligence on AIFMD Manco platforms prior to their appointment.
- **AIFMD depositary rules**
The NCI calls for the regulators in the EU to clarify whether they intend to extend the prohibition on depositary banks discharging liability to their sub-custodians as mandated under UCITS V to AIFMD, or at least to certain AIFMs.
- **Common Reporting Standard (CRS) or GATCA**
The NCI advises its members to leverage the expertise they have accrued through FATCA compliance and apply it to the OECD’s CRS.
- **Base Erosion and Profit Shifting (BEPS)**
The NCI would advise managers to analyse the implications BEPS will have on their businesses, and if necessary, make plans on how to attain compliance. The NCI would also urge the OECD to issue guidance as to whether AIFMs will be designated as CIVs or non-CIVs.

- ***Solvency II***

The NCI advocates regulators rethink the capital charges being imposed on insurers' underlying investments. The NCI advocates its members formulate a strategy to deal with the transparency obligations that will be associated with managing capital on behalf of insurers.

- ***Securities Financing Transaction Regulation (SFTR)***

The NCI advocates regulators learn from some of the challenges they faced during EMIR implementation, and apply them when they enact SFTR.

- ***European Long Term Investment Funds (ELTIFs)***

The NCI welcomes the ELTIFs initiative from the EU as an innovative mechanism to help return more money into the real economy.

- ***Basel III***

The NCI advocates that hedge fund managers think very carefully about how Basel III will impact their businesses and formulate a plan to mitigate the challenges.

- ***Financial Transaction Tax (FTT)***

The NCI advises regulators look at past experiences of FTT, most notably in Sweden, before it introduces a pan-EU FTT.

Nearly seven years after the financial crisis, regulators still do not appear to have acknowledged the differences between fund managers and banks, and as such are pursuing a regulatory agenda that many feel is damaging the fund management industry and its competitiveness – particularly for boutique asset managers.

A number of managers who historically ran lean operations have had to ramp up the number of hires in operations and compliance. For some, the cost of doing business today has become excessively high, and this risks stifling the emergence and development of promising managers in what has historically been a highly competitive and innovative industry.

Such an outcome reduces the availability of manager choice for investors at a time when returns are hard to come by. For investors such as public sector pension plans – many of whom are running significant deficits – manager choice and diversity are central to generating returns for underlying shareholders. Furthermore, by preventing the development of smaller to mid-sized managers through excessive regulation, regulators risk forcing institutional investors to concentrate their assets into a handful of large portfolio managers rather than enabling them to diversify. This could expose a number of high-profile institutional investors to increased levels of concentration risk. If one of those managers were to enter into a severe credit event, those investors could be seriously affected.

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About The New City Initiative

The New City Initiative (NCI) is a think tank that offers an independent, expert voice in the debate over the future of financial regulation. Founded in 2010, NCI counts amongst its members some of the leading independent asset management firms in the City and the Continent. The NCI gives a voice to independent, owner-managed firms that are entirely focused on and aligned with the interests of their clients and investors. Over the last decade, an old fashioned "client-centric" approach has enabled entrepreneurial firms in the Square Mile and beyond to emerge as a growing force in a financial industry dominated by global financial giants. Now, more so than ever, these firms play a key role in preserving the stability and long-term focus of the financial sector, which is of benefit to society at large. Today New City Initiative is comprised of 49 leading independent asset management firms from the UK and the Continent, managing approximately £400 billion and employing several thousand people.

Core aims:

- To serve as an independent, expert voice in the debate over financial reform;
- To restore society's trust in the financial sector;
- To promote the values and practices of European owner-managed firms which align their interests with those of their clients; and
- To raise awareness of the positive, stabilising contribution small entrepreneurial firms make to the economy and society as a whole.

MEDIA ENQUIRIES:

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|--|----------------------------|
| Temple Bar Advisory (PR advisor to NCI) | +44 (0)20 7002 1486 |
| Tom Allison | +44 (0)7789 998020 |
| Ed Orlebar | +44 (0)7738 724630 |
| Alycia MacAskill | +44 (0)7776 253482 |