2011 and beyond: a synopsis of key regulatory reforms for asset managers
Welcome

This regulatory reform booklet provides a snapshot of key global developments that impact the asset management industry across alternative and traditional investments. Each individual theme will be covered in more detail over the coming months. It complements our series of Regulatory Spotlight newsletters, the first of which addressed the EU AIFMD adopted in November 2010.

The policy initiatives we cover in this booklet include global, US, EU and Asian developments such as G20, Basel III, the US Dodd-Frank Act, Volcker Rule and FATCA; the EU AIFMD, UCITS IV/V, EMIR (OTC derivatives), MiFID II, Short Selling Regulation, Market Abuse Directive II, Solvency II, Insurance Mediation Directive II, PRIIPs, the Investor Compensation Scheme, Credit Rating Agencies, the Securities Law Directive, the ECB’s T2S project, the Single Market Act, which addresses also social responsible investments; and Asian developments such as the Asian Funds Passport, as well as Hong Kong and Chinese regulatory changes.

Our booklet is intended to be a quick reference guide on the pertinent regulatory matters impacting our industry. It also serves to highlight the high levels of interplay between the regulatory initiatives and how they are, or will, affect the investment management industry’s business models and decisions. I hope you find this of use.

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G20
G20 leaders are focusing on greater global coordination of policy measures for financial markets and their actors since the events over the past two years. This approach acknowledges that financial players operate in an interlinked world and that macroeconomic implications can no longer be segregated into individual countries or regions. Some of the key measures that are being globally coordinated include investor protection, capital requirements of financial players, the central clearing of OTC derivatives and remuneration.

Basel III
Basel III measures aim to strengthen the capitalisation and liquidity of financial institutions and to increase the stability of financial markets. In the US, they have been incorporated through the Dodd-Frank Act; in Europe, through the Capital Adequacy/Requirements Directive CAD/CRD III for banks. However, these same concepts are also reflected and implemented at local and regional levels for other industry sectors through various regulatory reforms, e.g. the AIFMD for alternative and non-UCITS fund managers, in SOLVENCY II for insurance companies and in the new European Market Infrastructure Regulation (EMIR) for securities central counterparties (CCPs).

For asset managers and other players (particularly multifunctional ones), the major challenge will be the different speed of adoption, implementation and content nuances of all these interlinked global regulatory reforms across countries and regions, and in particular between the US and Europe.
United States of America

Dodd-Frank Act and Volcker Rule
The US Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law in July 2010. For asset managers, it mandates enhanced registration, reporting and oversight rules. This broad-based framework also addresses market stability, systemic risk, capital and banking restrictions, transparency and disclosure. Implementing legislation, to be adopted in the current year and over the next three years, will provide further details.

By July 2011, asset managers will need to take action on a number of aspects, not least of which include the following.

Registration requirement for investment advisors (including hedge funds and private equity firms)

US advisers will need to:

• Register with the SEC if AUM are greater than USD100 million (or, if only private funds, the threshold raises to USD150 million, eliminating the previous “14 or fewer clients” exemption).

• Register with the respective US state under the “blue sky laws” if AUM are less than USD100/150 million respectively and registered in less than 15 US states.

For non-US advisers:

• They will need to register with the SEC if AUM are above USD25 million and/or if the investments in sponsored funds are attributable to US investors, or more than 15 clients are domiciled in the US.

• “Foreign private advisers” are exempt if they have less than 15 clients domiciled in the US, less than USD25 million in AUM and no place of business in the US.

• A “regulation-lite” approach may be taken by the SEC (as yet unconfirmed), whereby most new provisions may not apply for registered non-US advisers with regards to non-US clients, including non-US funds in which US persons invest.

Stricter recordkeeping and reporting requirements apply in the future: with regards to AUM, capital leverage ratios, counterparty credit risk exposure, trading and investment positions and practices, valuation policies and practices, liquidity and short-selling positions, concentration limits, and books-and-records retention system including for emails and other details.
Increased oversight and periodic inspection once registered, firms can expect further regulation, oversight and periodic inspection by US regulators on the before mentioned aspects, which will increase in particular for firms designated as “systemically important”.

Review of client compensation agreements will be required: as performance fees (including carried interest) can only be charged to “qualified clients” (person with minimum USD750,000 under the adviser's management or USD1.5 million net worth) or a person who is not a US resident, a review of client compensation agreements will be required.

Qualified custodian sending statements directly to clients to keep assets: custody rules mandate that assets must be kept with a qualified custodian that sends account statements directly to clients.

Volcker rule
The Dodd-Frank Act also comprises the Volcker Rule, which mandates segregation of banking and proprietary trading and from sponsoring or investing in alternative investment management functions, such as hedge funds or private equity. US banking organisations are therefore likely to spin-off or at least reduce their participation in these financial activities, as either a sponsor or an investor, resulting in of an increasingly independent asset management sector. The Volcker rule is expected to become effective in July 2012 and there will be an initial two-year “conformance period” probably expiring in July 2014.

OTC derivatives
For OTC derivatives, the Dodd-Frank Act covers the following key aspects:

- It mandates the central clearing of OTC derivatives and trading through a swap execution facility (SEF), unless one of the parties is a non-financial entity opting for the clearing exemption.

- It establishes the need for registration as swap dealer and possible designation as “Major Swap Participant” (MSP) if dealing with substantial swap positions (including, for example, pension funds as “users”), and mandates specific business conduct, capital, margining rules, inspection and oversight by US regulators.

- “Push out” rules determine that there will be no discount window for swap dealers, which means dealers will not have access to the discount window or FDIC insurance.
It has a significant impact on asset managers, for example: 1) margining requirements are likely to increase costs and restrain liquidity; 2) credit risk exposure to CCPs and clearing members will need to be fundamentally reconsidered also in the light of potential concentration risk and new CCP governance models; and 3) ensuring confidentiality and disclosure of transactions will become an operational challenge.

**FATCA — The Foreign Account Tax Compliance Act**

In March 2010, US President Obama signed the Hiring Incentives to Restore Employment (HIRE) Act, which includes the provisions of the Foreign Account Tax Compliance Act (FATCA). These provisions have implications for a wide range of foreign financial institution (FFIs), including any non-US asset manager such as hedge funds and private equity firms who own or hold US investments regardless of whether the client is a US or foreign citizen.

As of January 2013, these institutions must implement new company systems to identify and report US account information to the IRS (Internal Revenue Services). Non-compliance will result in a 30% withholding tax imposition not just on the respective US-source income but including all gross enterprise wide US sales proceeds, ie of all its US proprietary and client accounts.

Asset managers who hold or own US investments will need to review their existing reporting capabilities against the new requirements. Further detailed guidance by the US authorities on the exact reporting requirements, definition of foreign financial institution and potential exemptions can be expected in the form of further regulation by the US Treasury in the coming year.
ESMA – European Securities and Markets Authority
The former CESR authority (Committee of European Securities Regulators) has now transformed into ESMA and is equipped with enhanced supervisory powers to ensure greater consistency across all EU 27 member states. It is composed of local market regulators from all EU 27 jurisdictions and its main mandate is to safeguard the stability, the orderly functioning of securities markets and to enhance investor protection. ESMA will work towards greater convergence with the other European supervisory authorities for banking (EBA – the European Banking Authority) and insurance (EIOPA – the European Insurance and Occupational Pensions Authority). The designated first chair of the new ESMA is Steven Maijoor, who previously was managing director at the Dutch regulator and responsible for oversight of financial reporting, auditing and integrity of financial markets.

AIFMD – Alternative Investment Fund Managers Directive
The AIFMD came into force in January 2011 and the directive will now need to be transposed into national law by the EU 27 member states so to become applicable to the asset management industry in January 2013. In parallel to the national implementation of this Level 1 legislation, authorities are conducting consultations and drafting European Level 2 policy measures that scope out the technical details of the framework directive.

The AIFMD widely applies to all funds not regulated under UCITS and particularly to hedge funds, private equity and real-estate funds for any investment activity within Europe. Its aim is to increase investor protection following the events in financial markets over the past two years. It establishes common EU rules regarding the authorisation and supervision of AIFMs and their operating conditions, including capital requirements, business continuity, the management of conflict of interests and remuneration.

Most importantly, the AIFMD determines marketing and passporting provisions and the need to appoint a depositary for any alternative assets under management. EU AIFs will be able to apply for a passport in 2013. However, non-EU AIFs will need to wait at least another two years and until then can continue to distribute their alternative funds in Europe through the existing private placement regime via individual countries at least until 2015.

The depositary will not only need to properly monitor the AIF’s cash flow but also face stricter liability. From 2013, the depositary shall be liable for any loss of financial instruments held in custody and it will need to return – without undue prevention, management and disclosure of conflicts of interest.
Overall, this regulatory change will result in greater compliance and other cost implications for asset managers and particularly private equity firms who shall be required to hold certain assets for 24 months in order to prevent asset stripping.

**UCITS IV/V – Undertakings for Collective Investment in Transferable Securities (mutual funds)**

The UCITS IV rules saw significant progress when, in July 2010, the European Commission adopted further Level 2 technical implementing measures based on the advice of CESR and carried out public consultations. These measures will need to be implemented by EU member states and shall become effective by 1 July 2011. They provide further clarification on four key areas, namely:

- UCITS mergers and master-feeder structures: a common approach regarding asset pooling techniques and the sharing of information between master and feeder UCITS will apply and also cover liquidation rules.
- The notification procedure and supervisory cooperation: standard documents and procedures shall be used for the notification procedure in requests for access to another member state.
- The KIID (key investor information document): a standardised disclosure document (transitionally) replacing the simplified prospectus (SP) will increase transparency for investors and include more investor-friendly presentation of risk information, calculation and charges.
- Conduct rules of UCITS management companies: consistent standards with MiFID will apply to investment firms and cover the prevention, management and disclosure of conflicts of interest.

UCITS IV has not fully gone live and yet UCITS V is already underway. Key changes are envisaged regarding UCITS managers’ compensation and stricter liability rules for UCITS depositaries, aligning the requirements for mutual fund investments with those stricter rules now adopted in the context of the AIFMD depositary for alternative investments. A public consultation has been released requesting industry feedback, and a legislative proposal is expected for 2011.

**EMIR – European Market Infrastructure Regulation (OTC derivatives)**

The European Commission published its formal proposal on the standardisation of OTC derivatives, central counterparties (CCPs) governance, interoperability for cash equities and trade repositories on 15 September 2010, following an almost two-year consultation on the
objectives, scope and practical feasibility of such policy measures. It is the European implementation of the G20 commitment that the US adopted in the form of the Dodd-Frank Act, and it mandates the central clearing of most OTC derivatives through a CCP and central reporting to a trade repository by the end of 2012. Capital charges will be imposed for those transactions that do not fulfil these requirements.

While the G20 are working towards greater global regulatory convergence, the US and EU versions nevertheless differ significantly in some key aspects. Europe, for example, has no equivalent to the US “push out” rule and less restrictive rules regarding non-financial counterparties. In addition, some provisions in Europe regarding trading and transparency are endorsed in a separate regulatory framework - MiFID, not EMIR. These different approaches will impose operational and compliance challenges, particularly for asset managers operating in both jurisdictions.

The new law generally applies to contracts entered into on or after the implementation of EMIR, which is envisaged to be January 2013, but possibly some outstanding contracts may have to migrate. The legislative text, however, is very advanced but not yet finalised, and European policy makers are still refining some aspects based on industry feedback, including which contracts may be exempt from the scope (such as possible intra-group transactions), how to design equal access for all players to CCPs and if a CCP from outside Europe could be recognised for clearing services of EU firms. To ensure greater implementation consistency across all EU 27 member states, EMIR will be adopted in the form of an EU regulation that becomes directly applicable to the industry and does not require transposition into national law (such as EU directives). Further detailed technical implementing measures and recommendations can be expected in the years to come.

Asset managers will now need to get ready to operationally manage the segregation of centrally versus non-centrally cleared contracts and fundamentally review any implications with regards to counterparty risk exposure to the CCP(s) and whether their collateral is truly ring-fenced from that of other participants. Increased margin requirements, furthermore, will add capital costs. To mitigate these new risks and costs, it is generally expected that some managers may look to diversify their clearing exposure by opting for multiple clearing agents and close out some contracts before the end of 2012.

**MiFID II – Markets in Financial Instruments Directive**

MiFID, which came into force in November 2007, is currently under review, and a formal adoption amending the existing framework is expected mid-May 2011. Its intention is to increase the competitiveness of financial markets across Europe and ensure investor protection. It facilitated the emergence of multilateral trading facilities (MTFs) triggered by
the deconcentration rule of stock exchanges leading to greater competition in trading across Europe. However, new technologies enabled the emergence of new systems and strategies such as high frequency trading or “dark pools” operated by regulated markets, MTFs or banks (ie where there is no pre-trade transparency because price/order volumes are not disclosed on the system in advance) that may not be fully covered yet from a regulatory perspective. Consequently, policy makers are introducing a new category called “organised trading facilities” (OTFs) that capture also so called “(broker) crossing networks” operated within investment firms and are reviewing whether any automated trading activity or the recent high-profile exchange outages mandate any changes to the existing regulatory framework. The former may require prior authorisation and ongoing detailed reporting in future. Also, the events over the past two years have generally mandated a closer examination of capital markets functioning, taking into account any policy commitments made at the G20 level to increase the transparency, safety and soundness of financial systems and investor protection.

To strengthen regulatory oversight, for example, all OTC derivative contracts that are eligible for central clearing and sufficiently liquid will need to be traded on regulated markets, MTFs or OTFs in the future. The commodity derivatives market will also be scrutinised with regards to the efficient functioning of its hedging and price-discovery purpose in particular. The current requirements for the provision of investment advice to clients with regards to more complex instruments will also be reviewed to find out whether it is sufficient or should be enhanced. To encourage social responsible investment (SRI) – i.e. investments that offer not just financial but also sustainable social returns for society and the environment or are generally ethical investments – the MiFID review proposes to make it a requirement to disclose any relevant information when providing investment advice.

UCITS are currently automatically classified as “non-complex products” under MiFID. A major impact for asset managers would be the potential extension of reporting requirements to UCITS funds or their possible classification as “complex products” under MiFID, which would likely lead to increased complexity and compliance costs and restrict the selling of these funds to retail investors. The sales process of PRIPs (packaged retail investment products) may also be regulated within MiFID as it already contains detailed investor protection and transparency requirements setting the benchmark.

The issue whether custody services such as safekeeping, administration, collateral and cash management should change their current classification as “ancillary services” to an “investment advice” status in future has been excluded as part of the current MiFID consultation by the European Commission. Instead, custody aspects will be considered more
widely in the context of the Securities Law Directive (SLD). However, the recent SLD consultation expressively suggests changes should be made to this effect. Consequently, depositaries may need to be authorised and supervised under MiFID in future, which will likely increase compliance costs of the custody industry in general.

**Short-Selling Regulation**
Since various emergency measures were adopted by individual EU 27 member states such as Germany and France to temporarily ban or restrict short selling generally or for specific instruments, the European Commission adopted a proposal on 15 September 2010 on the European-wide regulation of short selling and certain aspects of credit default swaps (CDSs). The aim is to ensure the coordinated action of member states, equip them with necessary powers, increase transparency and reduce risks. The political debate will continue throughout 2011, but it is envisaged that these measures will come into force by July 2012 and apply directly to the industry.

Policy makers acknowledge that short-selling techniques are generally key for market liquidity and efficient pricing. However, in distressed markets increased transparency would allow the detection of risks for sovereign debt markets in particular. Increased reporting and transparency shall therefore require the “flagging” of any short sales, allowing regulators to track which securities are sold short, particularly for sovereign bonds and sovereign CDSs. The disclosure notification threshold to regulators (0.2% of company shares) would be lower than to the market (0.5%). National regulators could then temporarily restrict or ban short selling for a day of any instrument if the price fell significantly during a day. Nevertheless, it is debated whether actually conclusive evidence in empirical data exists to corroborate or justify that sovereign CDSs have damaging systemic effects and should be captured at all.

Restricting so-called naked or uncovered short selling to limit potential risk of settlement failure is also envisaged. The proposal suggests that an investor must have borrowed the instruments it plans to short-sell in advance or at least must have entered into an agreement to borrow them or have an agreement with a third party be able to locate or reserve them for lending. This is referred to as the “locate and reserve” approach and would ensure that they are delivered by the settlement date.

Asset managers may benefit from a harmonised framework and consistent, common regime for regulatory intervention across Europe. While increased reporting requirements to the regulators may support greater transparency, however, disclosures regarding positions of individual firms to the market or short selling bans could have an adverse effect on market efficiency. This could be mitigated through allowing an aggregate disclosure.
MAD II – Market Abuse Directive

MAD was also reviewed in 2010 and a revised legislative proposal is expected for the first half of 2011. The framework directive was adopted in 2003 and it addresses insider dealing and market manipulation practices. This review looks to 1) close any gaps in regulation regarding a) financial instruments, b) markets or c) behaviours that are not yet fully covered; 2) enhance the consistency and effectiveness of regulatory enforcement across the EU 27 member states moving towards a single rulebook; and 3) potentially ease some of the provisions for issuers, especially SMEs.

Going forward, the directive may cover instruments traded on alternative venues such as MTFs, which have emerged since the 2007 adoption of MiFID (markets). It shall also capture commodity derivatives and OTC derivatives in particular as these can significantly influence the prices of instruments traded on regulated markets (instruments). It is furthermore envisaged that MAD shall cover attempts to manipulate the markets (behaviour), which would also sanction unsuccessful market abusers. But the latter is also more difficult to evidence and consequently may increase legal uncertainty, particularly under market conditions of high-price volatility. MAD’s review will be closely aligned with other ongoing interlinked policy initiatives including EMIR, MiFID II and short-selling regulation.

Asset managers would generally benefit from a pan-European harmonised approach and the strengthening of investor protection and market confidence, which are essential for the correct functioning of financial markets. However, it is debatable whether definitions (for example, in the commodity markets) are workable (other than electricity and gas), because the underlying commodity market has no equivalent to the disclosure requirements that govern the securities market, for example that of the issuer needing to keep the market informed of any price sensitive information. The European Commission is in parallel working on new public disclosure requirements in the energy sector, which would then enable the definition of insider information for derivatives of that specific sector.

Solvency II – Insurance

Solvency II will be implemented in January 2013 and introduce economic risk-based solvency and prudential requirements for re/insurance companies that will fundamentally overhaul this industry sector. Inspired by Basel III, the revised legislation will be based on three key pillars: 1) capital requirements (building on the insights gained through the fifth quantitative impact study QIS5), 2) governance and supervision; and 3) disclosure rules. The aim is to ensure re/insurance companies are financially sound regarding quantitative capital requirements and qualitative requirements regarding risk management, IT, governance, management accountability and disclosure to regulators and the public.
Citi GTS recently published a detailed paper in December 2010 on industry implications and GTS solutions, particularly with regards to new extensive reporting requirements, securities, cash management and treasury analytics. For asset managers there are three main impact angles for either: 1) those owned by large insurance companies, 2) those investing extensively in the insurance market, and 3) those having insurers on their client books as institutional investors. Solvency II will change the discounting model for insurance liability valuation and the calculation of regulatory capital, both of which will affect asset allocation decisions.

Asset managers should assess whether operationally their current systems can accommodate the future demands of insurance clients.

**IMD II – Insurance Mediation Directive**

The IMD took effect at member state level in January 2005. It regulates the distribution of insurance products by intermediaries with a view to protecting consumers. It also aims to establish a high level of professionalism and competence for insurance intermediaries and to increase greater consistency across all EU 27 member states (for example, through a centralised registration system holding proof of professional requirements).

That said, a high degree of regulatory fragmentation caused by the minimum harmonisation approach mandates a review of the IMD to increase pan-European consistency in how insurance mediation is regulated. The initiative is closely linked with Solvency II (regarding a new risk and transparency regime) and with the newly envisaged PRIIPs requirements that will address retail disclosure and selling practices. A new legislative proposal is expected for late 2011. Asset managers distributing insurance products may look forward to greater regulatory consistency across Europe but will have to prepare for higher compliance requirements for 2012 and beyond.

**PRIIPs – Packaged Retail Investment Products**

European policy makers are consulting on PRIIPs – packaged retail investment products – designed for the retail market on how to raise standards for the protection of retail customers, as some products are considered to be complicated and non-transparent for consumers. PRIIPs have no clear-cut definition, are inconsistently regulated across EU 27 member states and can take different legal forms (including, for example, UCITS investments, unit-linked insurance contracts or structured banking products). Generally, PRIIPs are considered to offer exposure to underlying financial assets but with a modified exposure compared to direct holdings. Hence, they are engineered or manufactured to combine different assets into a single proposition.

Tackling two key areas in particular is envisaged by adopting rules on: firstly, the form and content of disclosure about the product to address inherent information asymmetries (PRIIPs
KIID); and secondly, the sales process including the conduct of business and conflicts of interest aspects for intermediaries distributing the products (principle/agent issues). These latter sales rules will be benchmarked against and endorsed within existing legislative frameworks, namely MiFID for non-insurance products such as structured bank deposits and the Insurance Mediation Directive (IMD) for insurance products.

Asset managers active in the retail market can prepare for greater and more standardised disclosure to clients similar to the UCITS KIID that will also need to reflect additional risks and costs being introduced through the engineering process (PRIPs KIID). This shall be endorsed through new legislation or existing frameworks such as the Prospectus Directive, Solvency II or UCITS. Furthermore, managers will likely be captured by the envisaged scope extension of MiFID/IMD with regards to the sales process to prevent any conflict of interest in case they engage in both the manufacturing and the distribution processes. Depending on further feedback resourced through the public consultation, this initiative may either result in a new legislative proposal or be factored into existing laws.

**Investor Compensation Scheme Directive**

To better protect retail investors’ cash savings, investments and insurance policies, the European Commission proposed a review package in July 2010 that would boost consumer protection and confidence in financial markets. It includes a review of the Deposit Guarantee Schemes Directive (DGSD) for cash, the Insurance Guarantee Scheme (IGS) for policy holders and the Investor Compensation Scheme for investments. The latter has been in place since 1997 and is of most interest to asset managers. It ensures that investors receive compensation in case investment firms are unable to return assets (for example, due to fraud, negligence or system failures), but it does not cover investment risk.

Most of the review may come into effect by the end 2012, and it proposes that rules become more efficient for investors and are consistently applied across all EU 27 member states, particularly with regards to the type of financial instruments that are protected. It aims to ensure that there is sufficient funding available and the protected investment coverage level shall increase from EUR 20,000 to EUR 50,000 per investor and limit any payout delay to a maximum of 9 months. In addition, it looks to provide wider protection for UCITS unit holders and other investments that would also cover the default or fraud of a third-party custodian, which is currently not the case. The proposed revision is expected to be finalised during 2011.
CRAs — Credit Ratings Agencies

In November 2010 - only one month before the new regulatory framework for CRAs would come into force in December 2010 - the European Commission launched a public consultation on CRAs to assess whether any amendments of the existing policy framework is required in light of recent events during the euro debt crisis. Areas of concern included potential overreliance and insufficient internal credit risk assessment potentially leading to volatile markets and the instability of financial systems. Further debate is sought on how to improve sovereign debt rating, increase competition to the small number of big firms, civil liability aspects and conflicts of interest in the “issuer-pays” model.

Asset managers will benefit from increased standards, competition and scrutiny of CRAs as the research and capabilities of CRAs are naturally extensively used by the investment management industry. While managers’ in-house research capabilities typically depend on the size and business model of each firm, this policy sets a new trend, incentivising players to strengthen internal credit risk assessments from 2011 going forward.

SLD — Securities Law Directive

The European Commission launched a second consultation in November 2010 on the “Legal Certainty on Securities Holdings and Dispositions” with a view to establish a new legal framework for intermediated securities referred to as Securities Law Directive. This law may come into effect in 2012 and the transposition into national law is envisaged to be finalised by the end of 2013. The industry consequently will need to prepare for compliance as of January 2014. The aim of this initiative is to increasing the safety of the cross-border transfer of securities within Europe building on the work done by the European Legal Certainty Group and international initiatives such as UNIDROIT and The Hague conventions.

Currently, the draft principles capture account providers in a wide sense, including custodians, nominees, UCITS and AIF depositaries, and introduce new liability standards that are much stricter. It also suggests that all depositaries shall be authorised and supervised under MiFID by classifying custody services such as safekeeping as an investment advice instead of its current status as an ancillary service. These potential changes for depositaries may likely affect asset managers, who will be obliged going forward to appoint custodians not just for traditional but also for any non-traditional alternative investments according to the new AIFMD, and consequently increase industry compliance costs. The proposed SLD also contains custody pricing and collateral rules that would indirectly affect the investment management industry, as the risk profile of the custody business is undergoing fundamental change driven by new legislation.
ECB T2S - European Central Bank’s Target2-Securities (and UCITS settlement)
In June 2006, the ECB proposed the launch of a central securities settlement system for the settlement of securities in central bank money that would build on the existing TARGET2 payments platform for cash settlement. Following extensive public consultation, a blueprint of the system was adopted in 2010, and the project moved from the specification to the development stage. T2S is envisaged to go live by the end of 2014 through a phased implementation. It aims to reduce settlement costs, ensure greater cross-border systemic safety and act as catalyst for further harmonisation (especially in the more complex area of corporate actions). UCITS for shall also be settled in T2S, which could positively benefit the asset management industry if lower cross-border settlement costs and greater safety are truly achieved.

Single Market Act
2012 will be the 20th anniversary of the EU Single Market and the European Commission has hence launched a new initiative in 2010 referred to as the Single Market Act. It identifies 50 actions that allow European citizens to get greater benefits from participating in the single market. These actions cover a wide range, including strong, sustainable and equitable growth, and are primarily providing tools for Europeans to build an even better cross-border single market in Europe in all aspects. Policy makers are collecting feedback on this proposal and hosting a series of public events throughout 2011.

For asset managers proposal #15 and #16 will be of great interest. Proposal #15 suggests creating “project bonds” that finance innovation and long-term investments and encourage private investors to invest in long-term European economic strategies as well as big European infrastructure projects including transport and energy schemes. These bonds could be issued in close cooperation with the European Investment Bank. Proposal #16, “Promoting Innovative Social Enterprise”, suggests the active mobilisation of (dormant) private savings to invest in (long-term) sustainable and responsible investments, create a better policy environment for venture capital and encourages financial institutions to open up social investment funds, which is overall hoped to stimulate SRI activities.
Asia

Asian Funds Passport
European UCITS funds currently represent the largest cross-border mutual fund product sold across Asia and they have become a true brand for retail and institutional investors globally, but especially in Asia. Therefore, Asian regulators are considering the launch of an Asian Funds Passport equivalent to the European UCITS fund. The idea is driven by various factors such as considerable macro-economic growth in many Asian countries, particularly China, the large and aging population, the increasing middle class and limited availability or use of pension products. However, putting this idea into practice requires the adoption of the concept of mutual regulatory and tax recognition by local market authorities. Once this is in place, the fund passport would then facilitate the regional distribution of funds across borders manufactured and administered within individual Asian countries.

The required removal of various regulatory, tax and other barriers may take some time given the greater regulatory fragmentation of Asian jurisdictions in the absence of an over-arching regional regulatory framework that is in place in the EU and comprises 27 European countries. Each Asian jurisdiction has a different investment fund regulatory and tax regime, culture, language, industry stage and the cross-regional relationship amongst local regulators is complex. However, there seems to be growing support from asset managers and other market participants in the region that could, in addition to the macro-economic dynamic, generate the required momentum for regulators to co-operate more closely on this initiative. The benefits of an Asian fund passport for asset managers include opportunities of greater product innovation and increased sales potential – in Asia and globally.

Hong Kong
The Hong Kong regulatory authority has recently introduced new requirements for retail structured products and reformed existing Securities and Futures Commission (SFC) codes regarding unit trusts and mutual funds, investment-linked assurance schemes and introduced a new code on unlisted structured investment products. Overall, these initiatives coincide with a global trend towards a more stringent regulatory approach to ensure greater investor protection as pursued also in US and European jurisdictions. Consequently, managers must for example provide a Key Facts Statement (KFS) for structured products distributed to retail investors in Hong Kong, similar to the European UCITS KIID, the key investor information document that reflects in short form the investment objectives, strategies, risks, fees, etc. of the fund.
The regulatory changes also open up new opportunities in Hong Kong for asset managers by allowing a broader range of permitted investments for some retail funds. However, the greater focus of these reforms remains on setting out requirements for either unlisted or new products by establishing the eligibility of issuers for example and codifying policies around conflicts of interests between parties involved in the manufacturing, management and distribution of retail products.

**China**

The China Securities Regulatory Commission (CSRC) is preparing a series of regulatory reforms including the simplification of the fund approval process, allowing new products and strategies leading to greater innovation. Employees may be permitted to own stakes in their Chinese fund firms, which would change the shareholding structure of a company.

The envisaged potential introduction of a lower QDII threshold together with these regulatory changes could stimulate even further the Chinese cross-border fund industry business which continues to grow measured by the increase in licenses issued for QDIIs - Qualified Domestic/Foreign Institutional Investor. The QDII scheme, which was implemented in July 2007 to allow local institutions investing into offshore securities markets, has more than doubled since then in terms of the quota of approved institutions and investment funds, despite the challenging events in financial markets over that time period globally. The largest proportion of licensed QDIIs are fund managers that make up about one third of all QDII institutions and more than half measured by invested AUM.

Similarly, the QFII scheme, which enables qualified foreign financial institutions to invest in Yuan-denominated “A” shares and bonds in China, continues to be in such high demand that the backlog of license applications is building up causing regulatory approvals to take several years. The launch of Renminbi-denominated securities listed on the Honk Kong stock exchange - so called “Mini-QFIIs” or “QFIIs-lite” - are expected to further promote the Yuan outside China in addition to the recent establishment of Hong Kong as the first offshore centre for the Renminbi. This new regulatory change will allow HK based asset managers to manufacture Renminbi products locally offering their investors exposure to mainland Chinese growth opportunities.
<table>
<thead>
<tr>
<th>Origin</th>
<th>Key terms</th>
<th>Status</th>
<th>Hedge Fund Managers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global</td>
<td>New capital definition, levels, countercyclical buffers</td>
<td>European Capital Requirements Directive:</td>
<td></td>
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<td></td>
<td>New SIFI rules: Significantly Important Financial Institutions</td>
<td>• CRD3: 1 Jan 2011 in effect regarding remuneration rules</td>
<td></td>
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<tr>
<td></td>
<td>New Liquidity Coverage Ratio (LCR)</td>
<td>• CRD3: other rules effective from 1 Jan 2012</td>
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<td></td>
<td>New Net Stable Funding Ratio (NSFR)</td>
<td>• CRD4: 2011/12 proposal; 2013 envisaged in force</td>
<td></td>
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<tr>
<td>United States</td>
<td>Mandates central clearing of OTC derivatives</td>
<td>• Signed in July 2010; further rulemaking 2011-2013</td>
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<td></td>
<td>New registration rules with SEC for US/non-US advisers</td>
<td>• Dodd-Frank Act effective as of July 2011</td>
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<td></td>
<td>Segregation of banking / proprietary trading / asset mgmt</td>
<td>• Volcker rule probably effective as of July 2012</td>
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<tr>
<td>US FATCA</td>
<td>Tax reporting for foreign financial institutions (FFIs)</td>
<td>• Signed in March 2010</td>
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<td></td>
<td>(non-compliance: 30% withholding tax on enterprise/US sales)</td>
<td>• FATCA effective as of January 2013</td>
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<tr>
<td>European Union</td>
<td>Mandates central clearing of OTC derivatives</td>
<td>• Legislative proposal envisaged entry into force Jan 2013</td>
<td></td>
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<td></td>
<td>Alternative Investment Fund Managers Directive</td>
<td>• Since 2008 official consultation with industry / regulators</td>
<td></td>
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<tr>
<td>EU EMIR</td>
<td>European Market Infrastructure Regulation</td>
<td>• Effective since Jan 2011 (for industry Jan 2013)</td>
<td></td>
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<td></td>
<td>Mandates central clearing of OTC derivatives</td>
<td>• Level 2 legislation to be designed during 2011/12</td>
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<tr>
<td>EU AIFMD</td>
<td>UCITS are European mutual funds and now a global brand</td>
<td>• UCITS IV adopted in July 2010, but Level 2 in progress</td>
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<td></td>
<td>New eg KiID: Key Investor Information Document</td>
<td>• UCITS V (depositaries) proposal expected by end 2011</td>
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<tr>
<td>EU UCITS IV/V</td>
<td>Regulates securities markets, financial instruments, players</td>
<td>• In force since Nov 2007</td>
<td></td>
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<tr>
<td></td>
<td>New technologies, strategies, “dark pools” etc under review</td>
<td>• Adoption of amending legislation scheduled for May 2011</td>
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<tr>
<td>EU MiFID II</td>
<td>New Europe-wide rules to harmonise member state action</td>
<td>• National laws in force; but no existing EU framework</td>
<td></td>
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<td></td>
<td>Increased reporting, “locate and reserve”, sovereign CDSs</td>
<td>• Effective likely as of July 2012 directly for industry</td>
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<tr>
<td>EU Short Selling</td>
<td>New alternative venues, new instruments, behaviours</td>
<td>• Directive in force since 2003, but reviewed in 2010</td>
<td></td>
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<tr>
<td>EU MAD II</td>
<td>Market Abuse rules: insider dealing / market manipulation</td>
<td>• New legislative proposal expected for 1H 2011</td>
<td></td>
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<tr>
<td>EU Solvency II</td>
<td>Directly regulates capital for re/insurance firms</td>
<td>• Solvency II Directive to be implemented in January 2013</td>
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<tr>
<td></td>
<td>Expected to fundamentally overhaul the insurance sector</td>
<td>• IMD in force since Jan 2005</td>
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<tr>
<td>EU IMD II</td>
<td>Insurance Mediation Directive regulates product distribution</td>
<td>• Level 2 measures for new rules to be designed 2011/12</td>
<td></td>
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<tr>
<td></td>
<td>European harmonisation of rules, “Insurance PRIPs KiIDs”</td>
<td>• Legislative proposal expected for late 2011</td>
<td></td>
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<tr>
<td>EU PRIPs</td>
<td>Packed retail investor products; enhance investor protection</td>
<td>• No new stand-alone legislation expected</td>
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<td></td>
<td>No clear legal definition yet, engineered products</td>
<td>• Integration into MiFID II, IMD II, Solvency II and other laws</td>
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<td>EU ICSD</td>
<td>Investor Compensation Scheme Directive</td>
<td>• Expected to become effective by end 2012</td>
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<td></td>
<td>Raise minimum retail protection to €50K/person</td>
<td>• Regulatory review includes also cash, insurance policies</td>
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<tr>
<td>EU CRAs</td>
<td>Credit Rating Agencies to improve rating and independency</td>
<td>• New regulatory regime came into force in December 2010</td>
<td></td>
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<td></td>
<td>Review on over-reliance on CRAs, lack of competition</td>
<td>• Review launched in Nov 2010 (I), effective as of 2011</td>
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<tr>
<td>EU SLD</td>
<td>Securities Law Directive for intermediated securities</td>
<td>• New law may come into force in 2012 (2014 for industry)</td>
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<td></td>
<td>Harmonise and legal safety of EU cross-border transactions</td>
<td>• Builds on International UNIDROIT/Hague conventions</td>
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<td>ECB T2S</td>
<td>New settlement system for securities (and UCITS) settled in central bank</td>
<td>• Envisaged live date 4Q 2014</td>
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<td></td>
<td>money; public sector owned, run, developed</td>
<td>• CSDs refining strategic / technology response</td>
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<td>EU Single Market Act</td>
<td>2012 will be the 20th anniversary of the EU Single Market Act</td>
<td>• Aims to simulate a wider debate among all stakeholder</td>
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<td>#15 / #16 “project bonds”, SME venture capital investments</td>
<td>• Encourages Social Responsible Investment (SRI)</td>
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<td>Asia</td>
<td>Asia Fund Passport would allow the regional cross-border</td>
<td>• Currently being discussed at industry / regulatory level</td>
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<td></td>
<td>distribution of locally domiciled funds</td>
<td>• Requires regulatory/tax mutual recognition in practice</td>
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<tr>
<td>China QDII/QFII</td>
<td>Continued raised demand for QFII/QDII regulatory approval</td>
<td>• QFII/QDII application backlog due to high demand</td>
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<td>Chinese envisaged regulatory reforms to open up industry</td>
<td>• Reforms take time, but trend is key; industry get ready now</td>
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<td>HK</td>
<td>Internationalisation of RMB with HK as first off-shore centre</td>
<td>• HK is the pilot, and if successful wider expansion expected</td>
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<td></td>
<td>“Mini-QFII” listed on HK of RMB-denominated securities</td>
<td>• Chinese regulator CSRC controls approvals through quotas</td>
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<tr>
<td>Private Equity Firms</td>
<td>Mutual Fund Managers</td>
<td>Insurance Firms/ Pension Funds</td>
<td>Investment Banks Broker/Dealers</td>
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- **Heat Map**
  - **Asia**
  - **Europe**
  - **Global**
  - **USA**

- **Welcome**
  - Pension Funds
  - Insurance Firms/Broker/Dealers
  - Investment Banks
  - Prime Brokers
  - Fund Administrators/Depository Banks

- **Regulatory Heatmap for Asset Managers — January 2011**
  - **HK Internationalisation of RMB with HK as first off-shore centre**
  - China QDII/QFII Continued raised demand for QFII/QDII regulatory approval
  - Asia Fund Passport
  - Asia Market Act
  - EU Single
  - ECB T2S
  - New settlement system for securities (and UCITS) settled in
  - EU CRAs
  - Credit Rating Agencies
  - to improve rating and independency
  - EU ICSD
  - Investor Compensation Scheme Directive
  - EU PRIPs
  - Packed retail investor products; enhance investor protection
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  - EU EMIR
  - European Market Infrastructure Regulation
  - European Union
  - US FATCA
  - Tax reporting for foreign financial institutions (FFIs)
  - US Volcker Rule
  - Segregation of banking / proprietary trading / asset mgmt
  - Basel III
  - New capital definition, levels, countercyclical buffers
  - Global
  - Origin
  - Key terms
  - Status
  - Hedge Fund Managers
  - “Mini-QFII” listed on HK of RMB–denominated securities
  - Chinese envisaged regulatory reforms to open up industry
  - distribution of locally domiciled funds
  - #15 / #16 “project bonds”, SME venture capital investments
  - 2012 will be the 20th anniversary of the EU Single Market
  - central bank money; public sector owned, run, developed
  - Harmonise and legal safety of EU cross-border transactions
  - Review on over-reliance on CRAs, lack of competition
  - Raise minimum retail protection to ¤50K/person
  - No clear legal definition yet, engineered products
  - European harmonisation of rules, “Insurance PRIPs KIIDs”
  - Expected to fundamentally overhaul the insurance sector
  - Increased reporting, “locate and reserve”, sovereign CDSs
  - New technologies, strategies, “dark pools” etc under review
  - New eg KIID: Key Investor Information Document
  - Authorisation, marketing, depositary rules for alternatives
  - Mandates central clearing of OTC derivatives
  - New Net Stable Funding Ratio (NSFR)
  - New Liquidity Coverage Ratio (LCR)
  - New SIFI rules: Significantly Important Financial Institutions
  - (non-compliance: 30% withholding tax on enterprise/US sales)
  - Segregation of banking / proprietary trading / asset mgmt
  - New registration rules with SEC for US/non-US advisers
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