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Success of the Fittest
A Swift Survey of Shifts in Asset Management

BOB MCDOWALL

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BOB MCDOWALL

July 2012

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About the Author

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Bob is a director and shareholder in Ubicap Group Ltd, a private equity broking and investment company based in Guernsey; and, through UbiCap, an advisor to Alderney Renewable Energy. Bob's previous experience includes a Senior Consulting analyst role at Aite Group, where he focused broadly on trading issues in the European marketplace, as they apply not only to those within the capital markets sector but also within wholesale banking. He covered all asset classes, risk issues and compliance with European regulation, most significantly Basel II, Basel III and MiFID. Before this Bob was a research director at TowerGroup, focusing on the European financial services industry.

Bob has spoken at numerous industry events and conferences, including Worldwide Exchanges Conference, Sibos, GARP and the Long Finance Autumn Conference 2011. He has frequently appeared in the press, including the *BBC, Bloomberg, CNBC* and *CNN* and pens a regular column for *The Economic Times of India*.

Based in the UK's Channel Islands, Bob holds a law degree (LLB Hons) from University College London, University of London. He is fluent in French and he speaks Russian and Spanish.

Foreword

"The superior man seeks what is right; the inferior one, what is profitable." – *Confucius*

The theme of "significant and ongoing uncertainty" runs throughout this short report which presents a snapshot of some of the issues with which the asset management industry is currently grappling.

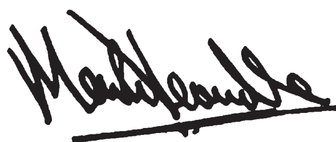
The survey outlines some economic trends; looks at the environment in which asset management exists; examines some of the moral issues in the industry; looks at fitness for purpose; and then makes some predictions for the future. The two sections of the report that particularly grabbed my attention are the 'moral issues' section and Bob's, often bold, predictions.

Moral issues for asset managers include corporate social responsibility (CSR), legal, ethical and discretional factors. One of the big moral hazards of the moment is, of course, the issue of 'too big to fail'. This hazard does not impact independent or boutique asset managers but does impact asset management divisions of major banks. The reputation of the asset management division suffers when the banking brand is damaged. This begs the question – should asset management businesses, like retail banking, be compelled to be independent businesses that cannot cross-sell within a financial services or banking group? The answer is not straightforward, as a significant degree of detachment and independence can inhibit growth.

Ethical investment is another relevant theme in 2012. Ethical investment encompasses a range of investment styles including thematic investing, the selection of companies which offer profitable solutions to problems such as climate change or reduction in poverty. Green and ethical investments extend to investments that practice responsible ownership, where shareholders use their influence to ensure that companies behave responsibly.

So, what of the future? Bob predicts that the Euro-zone may fragment, making location decisions for asset managers more complex. Another prediction is that asset managers that remain part of large banks will see their growth slowed because of the bank brand association. A third prediction is that medium and large asset managers will increasingly use the 'multi-boutique' operating model because asset management is a people business, where size creates remoteness and remoteness creates detachment.

What is certain is that the shifts taking place in asset management make this a sector to watch.



Mark Yeandle
Z/Yen Group Limited

Introduction

This report has been written at a time of uncertain outlook for the global economy and financial sector as a whole. This uncertainly will continue for the foreseeable future. The sovereign debt crisis in Europe has expanded into a Euro-zone crisis, which has impacted financial confidence throughout the world. The sovereign debt crisis and the Euro-zone crisis illustrate how cross-border investment can produce major systemic risk for national and international financial systems, financial market participants and end investors. The crisis highlights the competing political and national interests both inside and outside the Euro-zone. Euro-zone politicians are trying to resolve both crises in a way which will minimise systemic risk and consequent disruption to the financial markets. The routes to long-term resolution of the crises are protracted. The financial and economic uncertainty affects the asset management industry as much as any other segment of the financial services sector. The overriding uncertainties are reflected in this report.

This report is set out in five major sections:

- **Section I** explores the macro-economic climate.
- **Section II** examines the current industry environment.
- **Section III** examines “the moral issues" which the asset management sector is facing. Most of “the moral issues” are common to other sectors of the financial services industry.
- **Section IV** looks at key trends in asset management.
- **Section V** analyses the current fitness of the asset management industry, challenges to its fitness and how to address these challenges. It includes a review on the importance of the fitness of the asset management sector in a geographical and regional context.

The conclusions are followed by some brief predictions for the industry over the next three to five years.

SECTION I

Macro-economic Trends

The financial world is in a period of great uncertainty at present. Amongst this uncertainty are a number of identifiable macro-economic trends. This chapter offers a review of these macro-economic trends together with a brief analysis of their impact on the fitness of asset management businesses and, where relevant, their geographical impact.

Recovery from the global financial crisis is proving to be a long road. Growth of the world economy is now decelerating on a broad front, a prelude to a weaker global growth outlook. The asset management business will reflect the slow recovery in terms of reduction in assets under management and the exit of some investors from the financial markets, followed subsequently by very slow growth.

Weaknesses in major developed economies not only continue to inhibit global recovery but pose risks for world economic stability because there are no quick resolutions for the problems that these economies are still facing following the financial crisis. Asset managers will have to demonstrate clearly their risk management capabilities and adopt defensive investment strategies.

While policy measures taken by governments during the financial crisis of 2007-2009 contributed to stabilising financial markets and stimulating recovery, the excess availability of cheap credit which led to the crisis, and the capital and liquidity problems that ensued, are proving to be much more challenging issues to resolve.

Many of the banks in major developed countries are exposed to multiple risks, including a further deterioration in property markets and in sovereign debt markets. These risks are now accompanied by continued low credit growth associated with overall economic weakness and the continuing debt reduction by businesses and households. Asset managers will find few growth opportunities for asset allocation in the property sector – historically a sector that produced high income and capital growth for both residential and commercial property; or in the finance sector – historically a sector that delivered high dividends. Growth in retail asset management is especially inhibited as households reduce their levels of debt.

High levels of unemployment, especially an increasing number of long-term unemployed, are having a negative impact on private consumption as well as housing foreclosures, and consequently weakening the financial system. These unemployment trends are affecting the growth prospects of retail asset management.

Many countries have seen their fiscal deficits grow. This deficit growth increases country risk when assessing asset allocation across sectors.

In many countries, national public deficits have increased: the financial crisis has contributed to falling government revenues and rising social benefit payments, while the costs of fiscal stimulus measures have increased. Sovereign risk is assuming a more complex form of risk assessment involving the political will of countries and their electorate to honour and repay their debts.

Increasing public debt has engendered political and financial stress in a number of European countries and, more broadly, has undermined support for further fiscal stimuli. However, as governments shift from fiscal stimulus to austerity, the recovery process is being placed in further jeopardy. Slow recovery will continue to affect the growth performance of asset managers and decrease the asset allocation to European jurisdictions.

Governments of developed countries have formulated fiscal consolidation plans that will damage gross domestic product (GDP) growth

in 2012 and 2013. This action constitutes another challenge for the performance of asset managers in the short to medium term. By contrast, many developing countries are experiencing strong GDP growth, which has been contributing to more than half of the expansion of the world economy since the third quarter of 2009.

It is uncertain, however, whether large emerging economies, particularly China, India and Brazil, can sustain the same robust pace of growth beyond 2012. Despite strengthened trade agreements amongst these countries, they are very dependent on demand from the developed countries for their exports. Asset managers should not expect the same level of growth in investment returns from those regions and may temper their growth and resources plans for the region.

Many developing countries have used financial buffers, which they created in the years before the crisis, to adopt strong stimulus packages, which have helped to boost domestic demand and to facilitate a relatively quick recovery from the global economic downturn.

A faltering recovery in advanced economies, resulting from the risk mentioned above, should thus be expected to moderate growth prospects for developing economies as well. In addition, there are important risks associated with the surge in private capital flows to emerging market economies. These flows are causing upward pressure on the currencies of those countries and risk inflating domestic asset bubbles. The return of capital flows is associated, to some degree, with the strong monetary expansion in the major developed countries. These flows have encouraged investors to seek more profitable ventures given continued weakness in financial sectors and the real economy in those developed countries; and caused policymakers in the emerging market economies to worry about the competitiveness of exports and the possibility of sudden capital flow reversals. They are responding by intervening in currency markets and imposing controls on short-term capital inflows. Such steps increase the vigilant assessment of sovereign, legal and regulatory risk by asset managers and can lead to avoidance of asset allocation and premature reduction of asset allocations in emerging economies.

Fear of protectionist measures by developed countries has increased. As base commodities are increasingly seen as alternative financial assets, short-term capital has flowed deeper into commodity markets, producing higher volatility in commodity prices and raising economic insecurity for many developing countries. Volatile commodity prices pose increasing risks to the stability of international trade and finance. The policies will impede a strong but sustainable and balanced recovery of the global economy. Managing these risks poses policy challenges. Within major economies, macroeconomic policy options are limited by political factors that constrain further fiscal stimulus and positive market responses to sovereign debt distress. Policy makers rely increasingly on monetary policy. Authorities in the main developed countries have cut interest rates further and moved deeper into quantitative easing. Quantitative easing is unlikely to boost demand and create new jobs, including jobs in the asset management sector, while financial sector weaknesses remain and fiscal stimulus is ineffectual. In terms of asset management, quantitative easing is a high risk and desperate measure to kick-start economies that destroys the real value of savings as much as inflation does. Any destruction in the value of savings detracts from trust and confidence in the asset management sector.

In summary, the outlook for the global economic environment is very turbulent. This turbulence creates a number of challenges for the asset management industry. Developing country growth remains the main driver of the global recovery, principally in Asia and South America, although growth of those economies is slowing down, affected by the economic malaise in the western hemisphere.

SECTION II

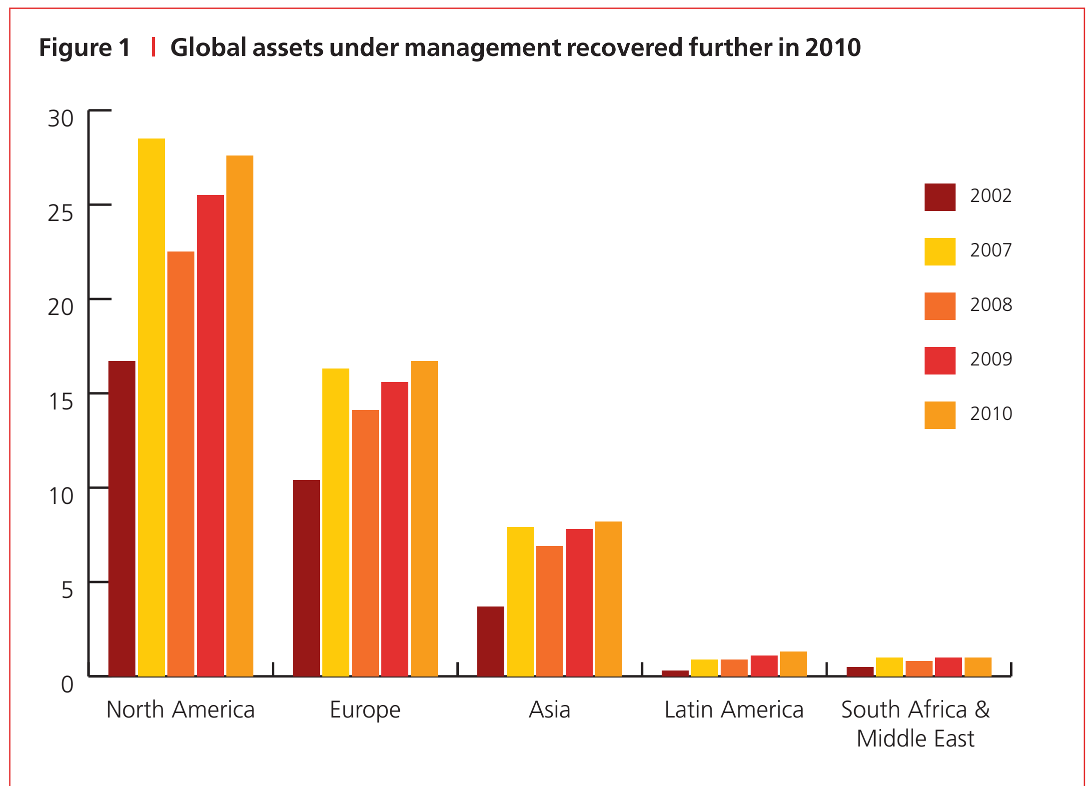
The industry environment

This section of the report focuses on the key issues that are shaping and changing the environment for asset managers globally, with regional reference where relevant.

Assets under management 2011 vs. 2008/9

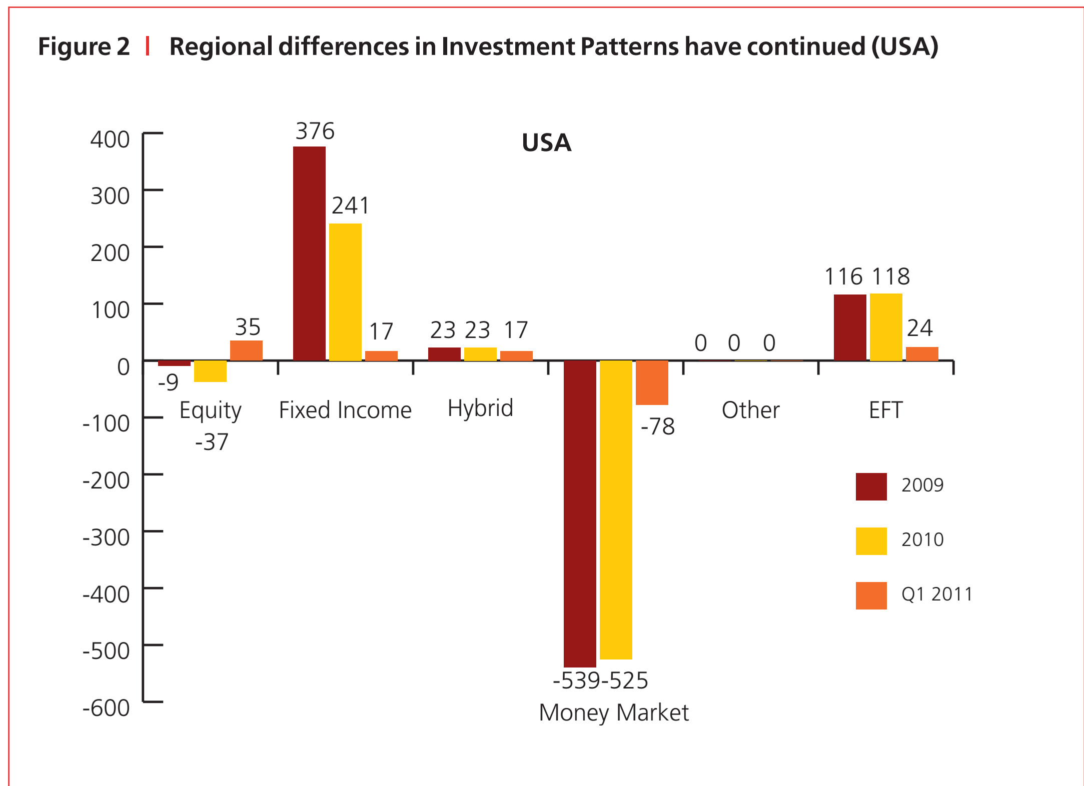
Contagion or collateral damage from direct or indirect exposure to the European sovereign debt crisis affects the rest of the world, not just a Euro-zone headache, as economies are linked through financial markets and trade. Investors run to safe havens, economies shrink, and unemployment rises. The major economies of the USA, China and India are all sensitive to the impact of the Euro-zone crisis on their domestic economies. One rating agency has suggested that it would downgrade sovereign credit ratings even with a debt deal in place. That move would likely encourage more investors to withdraw from the market, as they fear fund managers will have to decide whether to sell off other holdings whose value could be affected by lower ratings.

Figure 1 | Global assets under management recovered further in 2010

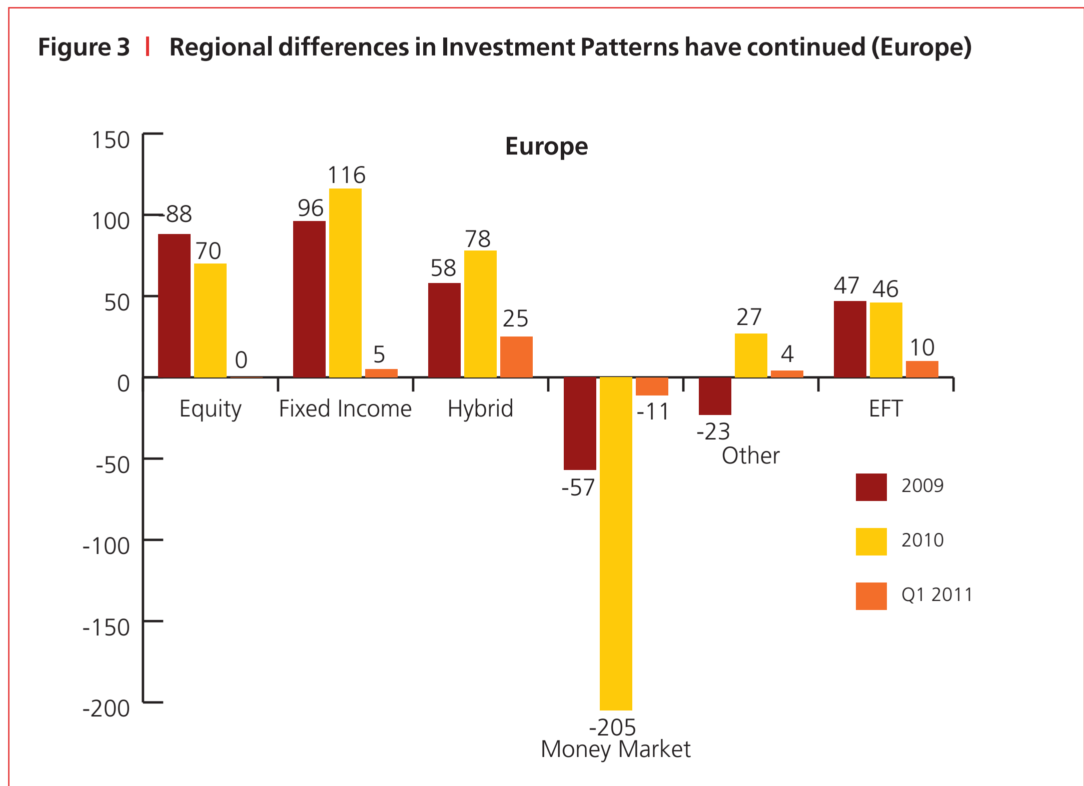


Source: BCG Global Asset Management Sizing database 2011

In 2010 assets under management were increasing throughout the world, principally in response to the equity market's recovery. That growth continued through into 2011. However, during Q2 and Q3 of 2011 there seems to have been a substantial reduction in the assets under management. Funds were withdrawn from the markets because of the volatility and uncertainty created by the European sovereign debt crisis, which has turned into a crisis over the structure and future of the Euro-zone.

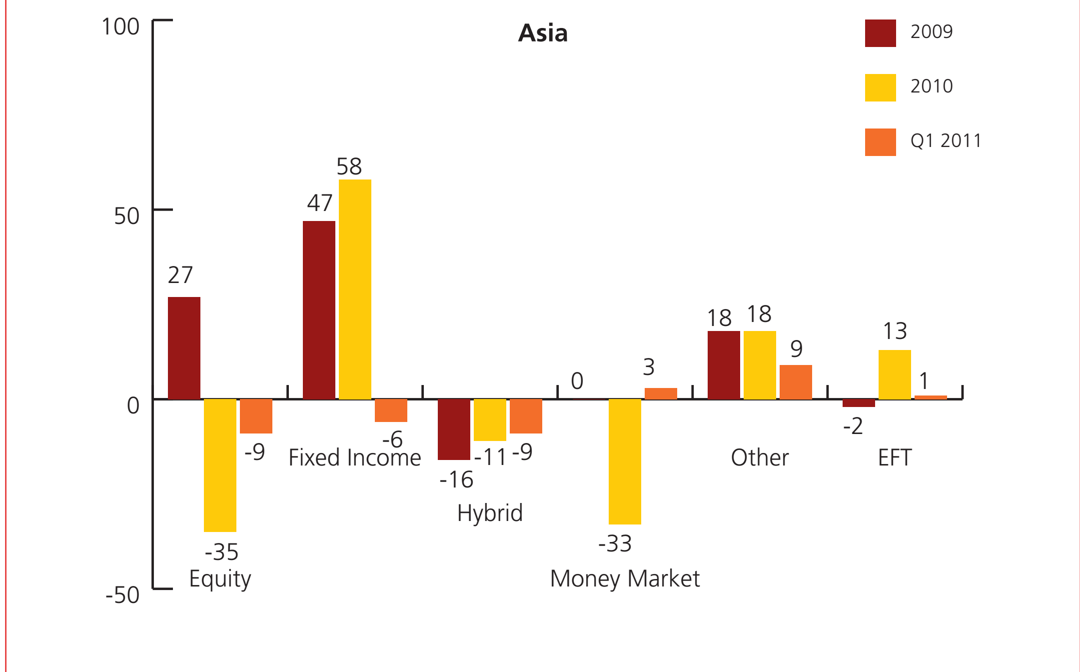


Source: BCG Global Asset Management Sizing database 2011



Source: BCG Global Asset Management Sizing database 2011

Figure 4 | Regional differences in Investment Patterns have continued (Asia)



Source: BCG Global Asset Management Sizing database 2011

Patterns in regional investment have shown considerable contrast and diversity both in asset class and region over the past three years.

This trend can be illustrated by the inflows of funds into all major asset classes in Europe in 2009 and 2010, even though money markets did experience outflows of funds in that period. This trend was attributable to low interest rates and more attractive deposit rates offered by banks during their recovery from the financial crisis. 2011 showed a continuation of inflow of funds into packaged investment products including exchange traded funds and hybrid funds while there has been a substantial decline in flows of funds into fixed income and equity asset classes. This trend has influenced the move away from traditional asset class allocation and brought complexity to asset management, at least in the short term.

The Global Financial Centres Index (GFCI) 11 (published in March 2012) identifies the top ten centres for asset management and wealth management based on almost 3,000 responses to an online questionnaire by senior financial services executives (see Table 1).

Table 1 | Top 10 global financial centres for asset management

Rank	Asset management
1	London (-)
2	New York (-)
3	Hong Kong (-)
4	Singapore (-)
5	Boston (-)
6	San Francisco (+3)
7	Toronto (+1)
8	Chicago (-1)
9	Tokyo (-3)
10	Zurich (-1)

Source: Global Financial Centres Index 11 (2012)

In the USA there were substantial outflows from money market funds in 2009 and 2010. This slowed in the first half of 2011 but increased in the second half as money market funds withdrew placement of funds within European banks – Euro–zone domiciled banks in particular. Net inflows of funds into equity and hybrid mutual funds continued in 2011.

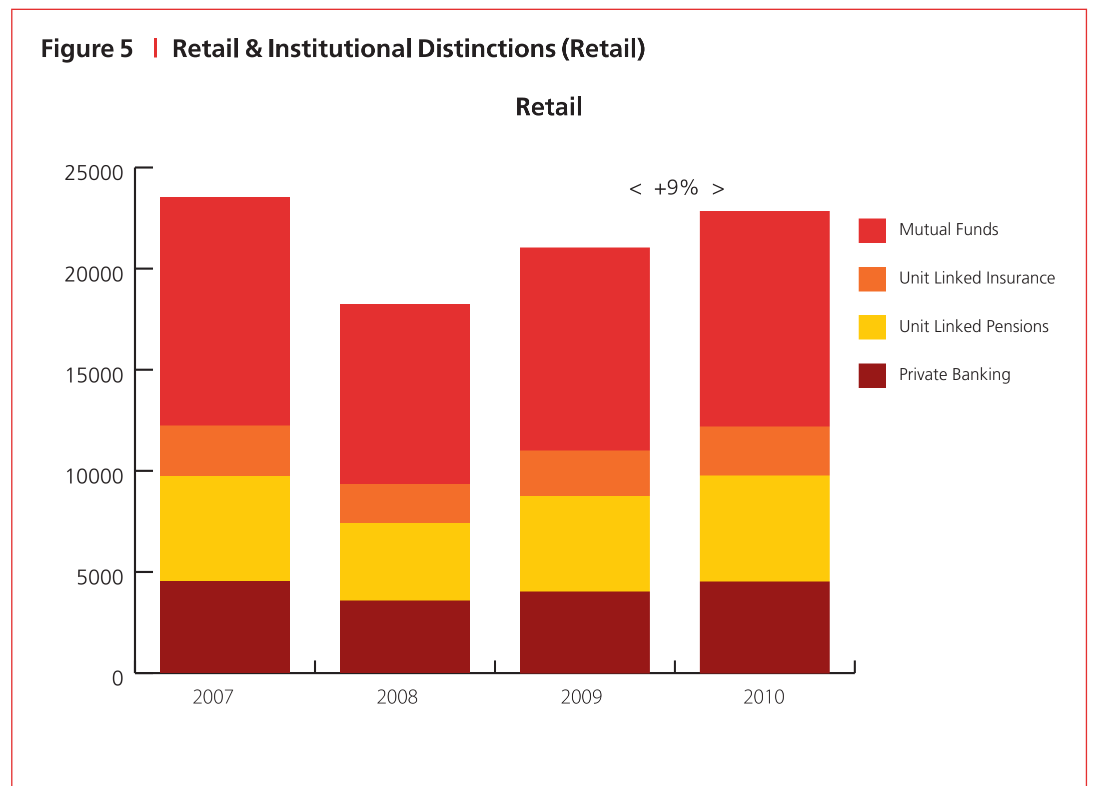
In Asia, fixed income inflows were strong in 2009 and 2010 from Asian investors. Asian investors recorded substantial outflows of funds across all asset classes in 2011. By contrast, there were heavy inflows of funds into Asia and other emerging markets across all asset classes in 2011, albeit at a lower rate, again in response to the uncertainty and volatility in Europe. Western hemisphere asset managers are increasing their coverage of all Asian markets in a bid to retain and grow their existing business. Concurrently, Western hemisphere asset managers are establishing businesses in the major Asian financial centres to enhance their insight into Asian markets as well as developing retail and institutional client bases in Asian markets.

Idle money – cash

Funds withdrawn under management in 2011 Q3 & Q4 have found their way into safe havens, as investors face the prospect of a default or downgrade in sovereign creditworthiness. Safe havens include US Treasury notes, UK Government securities as well as minor safe haven currencies including the Swiss Franc and Norwegian Kroner.

In the search for safer havens, investors have flocked to newer investments such as US federally guaranteed, zero-interest checking accounts and zero or negative interest deposits in safe haven minor currencies. Fund managers, in turn, have increased cash levels and shifted their portfolios to hold even more investments that can be easily sold to meet investor withdrawals.

Figure 5 | Retail & Institutional Distinctions (Retail)



Source: BCG Global Asset Management Sizing database 2011

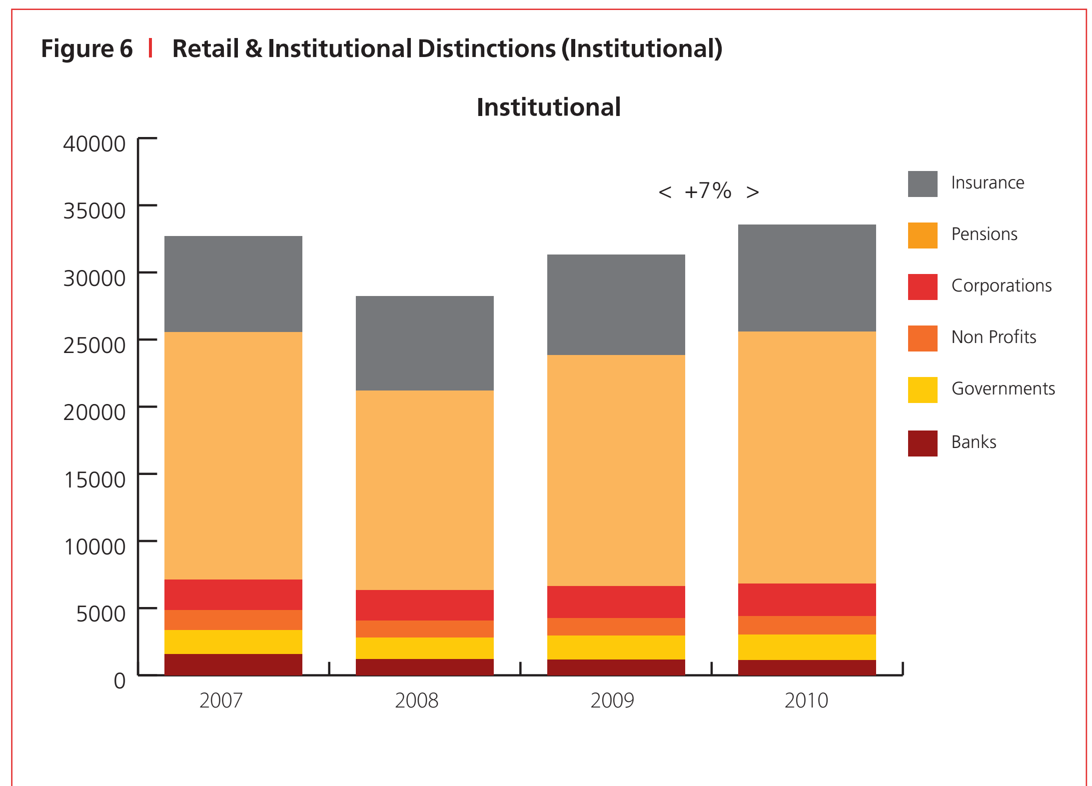
Of course, for asset managers, maintaining a large cash balance is costly because the return on investing in cash is low, negative after inflation has been taken into account. In such a situation, more liquid assets or other assets that can be redeployed and sold at a price closer to their fair value can work as a substitute for cash during low cash flow states to meet forecast cash requirements. Therefore, in considering the costs of hoarding cash, asset managers should choose a lower level of cash balance when their real assets are more liquid.

Financial institutions are strengthening the risk management profile of their mandates for placing cash in order to mitigate the risks arising from bank defaults in weak Euro-zone jurisdictions and prospective losses from the currency risks arising from disintegration or fragmentation of the Euro-zone.

At the end of 2010 and into the end of Q1 of 2011, 60% of global assets under management were institutional and 40% were retail.

Retail assets under management grew during 2011. The growth was supported by the increase in discretionary investment mandates for high net worth individuals and families, many from BRIC countries and those in the Asian Pacific Region. In the USA and Europe the growth was supported by packaged investment products and pensions investment, notably in the UK and Germany. The growth in retail assets under management flattened in the third quarter according to the individual reports of asset managers. The halt in growth of retail assets under management came one quarter later than similar reports from institutional asset managers in response to the European sovereign debt crisis and the Euro-zone crisis. Predicted long-term decreases in living standards and disposable income may also be attributable to the later halt in assets under management in the retail asset management segment of the industry.

Figure 6 | Retail & Institutional Distinctions (Institutional)



Source: BCG Global Asset Management Sizing database 201

The growth in institutional assets under management was supported by insurance, pensions and government investment. Investors are retreating in response to the market volatility arising from the European sovereign debt and Euro-zone crises.

Pension deficits

Public and private sector defined benefit pension schemes throughout the western world continue to announce deficits to their pension schemes. The deficits arise through a combination of factors that affect the Western Hemisphere.

Frequent regulatory changes, which increase the legal burden on company sponsors and are excessively complex, discourage plan sponsors from making long-term pension promises. Accounting changes, which align the pension plans with fair value or market-based accounting principles in order to recognize gains and losses in the year they occur, do not allow smoothing of gains and losses, based on a prudential view of asset values and liabilities over a period of time. It is a simpler method, promoted by the Financial Accounting Standards Board and the International Accounting Standards Board, in a move toward convergence of global accounting standards. However, market valuations do distort the value of pension funds during periods of abrupt decline and volatility.

Declining mortality rates: pensioners of defined benefit schemes are living longer and are causing an unexpected drainage of funds and subsequently influencing investment profiles to fund the short-term cash requirements.

Continuing record low interest rates are increasing the liabilities of pension funds because the funds are unable to obtain the returns within the prescribed investment mandates and because they use the return on long dated government bonds as the benchmark rate for returns to cover long-term liabilities. Quantitative easing, which to date has involved central banks buying back government securities, is another one of those measures which has had the effect of pushing up the value and decreasing the yields of government bonds.

Pension deficits are having a major impact on their corporate providers. They are increasing the cost of financing for the corporate provider while reducing funding availability at a time when bank funding is increasingly scarce. Rating agencies have become more consistent in evaluating pension shortfalls as a form of debt that affects the company's overall risk exposure. Proposals to grant higher priority on insolvency to defined benefit pension deficits in insolvency will affect corporate bond rates.

How are these issues being managed? Since the timing of an economic and market recovery, which would provide some relief to the pension deficit issue, is highly uncertain, companies are developing comprehensive risk assessment and mitigation strategies. Risk assessment includes projections of pension costs on income volatility, cash flow volatility and balance sheet volatility, including potential debt covenant considerations. Companies are assessing the competitive risks such as the impact on the affordability of programs and their relative pension costs compared to competitors. They have to consider the potential impact of demographic changes such as employees deferring retirement due to the decline of retirement investments or the extended life expectancy of retirees. Changes in demographics are exacerbating the current problem. Companies have to examine all the relevant factors, including assumptions about future compensation, which may help to mitigate the issue of future compensation increases being less than past increases and current assumptions.

SECTION III

"Moral issues": How important are they?

How should moral issues be defined in the context of asset management? Moral issues combine corporate social responsibility issues with the economic, legal, ethical and discretionary responsibilities of the asset managers and their business ethics – which usually focus on the moral judgments and behaviour of individuals and groups within organizations. This section examines the importance of key moral issues which challenge the asset managers in the current environment.

The fiduciary role of the asset manager

Fiduciary asset management – a type of asset management where the manager exercises discretion over some, or all, strategic investment decisions that a pension scheme needs to make – has been growing, particularly in the UK, since 2007. Demand for fiduciary management has grown slowly in the UK because only a few providers offer a full service. Pension funds of £3bn plus are more inclined to achieve the same benefits by bringing their fund management in-house, while smaller funds can often achieve a lot by revamping their trustees' governance capability. Trustees are reluctant to relinquish any degree of control as they are not actually able to delegate their responsibility. However, markets volatility and the growing regulatory burden on trustees have driven demand as many trustees put their governance structures under internal review in an attempt to better handle these uncertain markets.

Fiduciary management has three factors: adding diversification, tactical asset allocation, and hiring & monitoring fund managers. Smaller schemes stand to gain most from fiduciary management as they benefit from aggregation, saving possibly 10 to 15 per cent on fees related to on-risk investments, achieving diversification despite their scale. Schemes with less than £100m are twice as likely as large schemes to be interested in the service. Different firms cater for different clients, with some providers concentrating on the £50m end of the market and offering portfolios to multiple clients creating economies of scale, others operating a service that is priced not to make commercial sense for funds under £150m.

Appropriate benchmarking is a challenge. Many providers focus on funding ratios but ignore the investment risks taken to get to that position. There is no standard in the market, but the favoured approach is to devise a balanced score card involving a combination of the three key factors.

Fiduciary asset managers focus on adding value in one of two ways. They may take a more active rotational approach to investment. Alternatively, they may act as consultants where they typically add most value in fund manager selection – a process accomplished through their accumulation of data, information and expertise on funds' management and performance.

An asset manager's weakness is that he/she may have a home and timing fund bias. Credible fiduciary managers choose 'best of breed' for funds, while the asset manager-driven services often use some of their own funds where they feel it can be justified. Some build manager-of-manager portfolios with certain risk profiles and split a pension scheme's money across them, while others offer more obviously bespoke services. Most fiduciary managers run substantial assets under management and therefore have good access to a wide range of funds. However, most will shy away from being a disproportionately large investor in a small fund. Indeed small fund managers themselves may be reluctant to take large inflows from a fiduciary manager whose raison d'être, at least in part, is to tactically switch investments around. A sizeable influx of client money, subsequently followed by a large outflow when the fiduciary manager changes strategy, could potentially destabilise smaller fund houses.

Practitioners also stress that it is not only a matter of choosing best in breed fund managers but in knowing how best to blend them.

The weakness of the consultancy-based approach to fiduciary management tends to be operational inexperience. They frequently lack the ability to turn audit reports into operational controls for their own implemented service. Apprehension exists about the potential conflict of interest in consultants offering and implementing advice, and then reporting on it. Some consultants offer an asset management service and are appointed without an open tender process.

It is notoriously difficult for the fiduciary management industry to report their track records in terms of how the assets perform versus the liabilities. Clients should be able to make meaningful comparisons across providers – something that is missing from the industry. There is also a wider interest: many trustees want to see a proof statement, and it is important for the industry to provide one.

The nature of each fiduciary management mandate makes any attempt to make comparisons a daunting prospect, but the initiative is worth working on. Nothing fosters confidence like transparency.

"Too big to fail"

"Too big to fail" is the cancer of moral hazard in the financial system. Moral hazard is used in banking circles to describe the tendency of bankers to make bad loans based on an expectation that the lender of last resort, either through the domestic central bank or the International Monetary Fund globally, will bail out troubled banks. The issue of "too big to fail" does not impact independent or boutique asset managers but does impact asset management divisions of major banks. Theoretically, governance and compliance with financial regulatory, financial accounting and reporting requirements should ensure that even in a bank that is "too big to fail" the debate remains a banking issue. It is the risks of the banking business that would cause a bank ("too big to fail") to be funded by taxpayers or other funders of last resort.

However, asset managers use the brand of banking in their marketing and distribution channels to promote and market their products and services in order to gather and invest client assets. The reputation of the asset management division suffers when the banking brand is damaged. Substantial outflows of funds can delay/cause fund illiquidity and ultimately cause investor losses due to the inability of investors to redeem their investments. This begs the question – should asset management businesses, like retail banking, be compelled to be independent businesses that cannot cross sell within a financial services or banking group? The answer is not straightforward as this degree of detachment and independence may inhibit growth through increased marketing and distribution costs but would add to the transparency of the asset managers' operations.

Taking the moral high ground

Good asset management encompasses a range of processes including requirements analysis, risk analysis, relationship management, execution, continuous review and many others. But how does an asset manager take the moral high ground in discharge of their investment business? Asset managers should seek to reach the moral high ground not as some self-regarding prize but as a prize awarded by investors – a prize that would involve regaining their trust and faith.

The moral high ground is an abstract concept but one that is evident where asset managers can demonstrate certain qualities. Culture and leadership are essential in setting out how an organisation is going to manage its capabilities and its asset management processes. Asset managers, for example, should demonstrate how they measure, define and verify outcomes from the business. Measurements including assets under management, fund performance and asset allocation should be published in a way that can be understood and measured uniformly by all stakeholders.

People and organizational capabilities should be measured by the outcomes over the long term. Long-term consistent outcomes raise the level of confidence and assurance that investors seek. Consistent long-term performance is an

important factor in re-establishing investor trust and confidence. Learning organizations that are open to share and are able to translate what they discover back into their business for the long-term benefit of all stakeholders, reflect the human dimension of the enterprise.

Ethical investing

Ethical investment in 2012 is more of a philosophy towards investment rather than a specific technique or asset allocation. In simple terms, modern green and ethical investments seek to make money and improve the environment in which society operates. Ethical investment encompasses a range of investment styles. They include, for example, thematic investing by selection of companies which offer profitable solutions to problems such as climate change or reduction in poverty. Green and ethical investments extend to investments that practice responsible ownership by increasingly using their influence as shareholders to ensure companies behave responsibly.

Ethical investment has evolved beyond equity investments to include diverse green and ethical financial products including current accounts, mortgages and insurance.

Choosing ethical finances is a growing trend, noticeably in the UK as well as the Germanic and Scandinavian regions of Europe. Non-profit sustainable investment research firms such as UKSIF, report that the amount of money invested in Britain's green and ethical retail funds has just reached a record high of £11.3bn. In the last decade, the number of ethical investors tripled from 250,000 in 2001 to three-quarters of a million today. Such growth is attributable to improved investment returns from picking companies with strong governance, a robust culture, good management of people and progressive environmental strategies. Investors are thinking about the future of their children and grandchildren and any difference it may be possible to make. Finally, some investors want to invest in line with their values and beliefs by avoiding companies that they believe do harm to people and the environment. They support companies that are trying to make a difference to society.

Lack of trust in mainstream banks has led many more people to think about the ethics of their finances. The financial crisis has led to increased awareness of how financial service providers use customer's money. An increasing number of consumers are considering issues such as trust, responsibility and ethics.

According to UKSIF, the sustainable investment and finance association, "International agencies predict that by 2030 the world will need to produce around 50 per cent more food and energy, together with 30 per cent more fresh water, while mitigating and adapting to climate change. Companies that are managing those environmental, social and governance issues well are likely to be the star performers of the future."

Ethical investment is performing better than other sectors in response to the global financial and economic crises. Asset managers who do not profess adherence to ethical investment standards are likely to extend their asset allocation to investments which are deemed ethical, if only to increase performance and returns. Ethical investment remains concentrated within European investors but with increased demand and interest from public sector retirement funds in the USA and Canada. The nuances in the word "ethical" in the U.S. translate into focus on ethical standards of the governance and executive responsibility rather than green investment.

While there are local sensitivities to the environmental impact of industrial exploitation on the environment in the BRIC countries and those in Latin America, this sensitivity to the environmental issues has yet to be translated into ethical and green investment by indigenous asset management companies. European asset managers who have established operations in those regions could exploit sensitivity to environmental issues in order to gain a competitive advantage. However, there is little evidence to date that there is in fact a competitive advantage to be had in doing so. Ethical investment in terms of governance and ethical corporate standards is slowly becoming an issue for asset managers in the Asian Pacific region.

Shareholder engagement

Shareholder engagement, a strategy used to open channels of communication between a shareholder and a company to improve the environmental, social and governance (ESG) performance of the company, is a structured process used in combination with other responsible investment approaches. Companies that improve their practices and better manage certain risks can also benefit from this long-term investment strategy. Many participants in shareholder engagement state that only strong convictions and a well-established process can overcome major practical and political hurdles.

The financial crisis exposed weaknesses in the governance of banking institutions and institutions that invested in them. Public figures focused on company stewardship as a solution to the problems that caused the financial crisis. Are they placing excessive reliance on shareholder engagement as a means of reforming key issues such as the slogan "excessive pay for weak and mediocre performance?"

Market participants often suggest that more active engagement between companies and their shareholders on corporate governance would be beneficial to all, but challenges exist that limit such engagement:

- **Investors have differing views on the importance of corporate governance**

  Long-term investors, such as pension fund managers, insurance companies and mutual fund groups, express their dissatisfaction by selling their shares. However, as institutional investment holdings have grown and diversified, they have found it difficult to sell. By contrast, others view corporate governance as more important because they view the quality of corporate governance as a key indicator of future performance. A few investors have a more passionate and evangelical view that corporate governance is fundamentally an ethical issue.

  Companies have to live with their investor base. Some devote internal resources to analyzing corporate governance, while others do not. Active pension or charitable foundations will take special care in developing their own views and policies on corporate governance and vote accordingly. They may have teams of up to a dozen employees focused on governance, voting and company engagement. Others, such as some institutional fund managers, may have determined there is no benefit in devoting internal resources to do so.

  Corporate governance analysts may not have significant influence on their portfolio managers' buy and sell decisions. Absence of communication within institutional investor groups may also mean those discussions with the governance professionals are at odds with the thinking behind investment decisions. However, the trend is certainly that governance specialists are collaborating more directly with their investment colleagues – leading to more influence within their organizations. They tend to have the most significant influence when there are special issues such as mergers and acquisitions, proxy fights and other governance issues.

- **Proxy advisory firms are seen to have an unfair influence on shareholders**

  Proxy advisory firms provide their investor clients with research services and voting recommendations with the goal of allowing their clients to make informed voting decisions more quickly and easily.

  The heads of corporate governance at large institutional investors are often the heads of sustainable development, or environment, sustainability and governance. Some have set up proxy advisory committees to involve the portfolio managers and to ensure robust processes are in place.

Some shareholders voice concern about the increasing influence of proxy advisory firms in the United States and Europe. They see no connection between the real owners of the shares, who should care about the governance of the companies they own, and the intermediaries – to whom responsibility for voting has shifted.

- Control of proxy votes

Among market participants there is concern that many investors, especially long-term institutional investors, follow proxy advisory firms' recommendations without sufficient analysis. In some cases, investors leave their decision making to the proxy advisory firm in terms of deciding how to vote. In other instances, proxy advisory firms actually make decisions on behalf of clients.

- Lack of engagement between companies and proxy advisory firms

Frequently there is little engagement with (proxy advisory) analysts because both investors and companies are constrained by tight deadlines in the height of the AGM season. During this time, it is difficult to enter a dialogue on particular issues because of the short turnaround the proxy advisory firms may request.

- Undue influence accorded to short-term activist investors

Some companies that have been subject to proxy fights have found the involvement of the proxy advisory firms to be counter-productive. Proxy firms have focused on addressing short-term activists and single issue publicists. These groups have the ability to attract publicity. They can damage the reputation of listed companies through their antics in the eyes of unsophisticated or impressionable investors. Success of the short-term activists can increase the expense of the voting power of longer-term investors. Companies and their proxy advisers need to weigh the damage they may do to their relationships with long-term investors before they cede to the demands of short-term investors.

Business culture and values

Asset managers have embarked on the long road to regain the trust and confidence of investors. That trust was lost in the financial crisis beginning in 2007/2008. Asset managers are re-assessing their business culture and values as one of their responses to loss of trust and confidence by investors. Reputation is hard won and quickly lost. Asset managers recognise that without demonstrable standards in business culture and values, they will not regain the trust and confidence of investors.

Such reassessment focuses on its approach to risk and risk management. That assessment begins at the board level, where board leadership demonstrates that the enterprise is committed to governance, risk and control. One of many major issues under review is ensuring that remuneration policies are aligned with business strategy and business realities of lower financial expectation in asset management in 2012. Executive performance objectives have to balance financial and non-financial goals. Successful delivery of such policies includes setting the right tone at board level. The right tone for communication of governance risk and control of delivery at board level mitigates some of the risks at an operational level.

At an operating level, asset managers are ensuring that their employees are aware of their personal responsibilities. They have to ensure that they understand the important risks that the company faces and who is managing those risks within the company. Some companies deploy behaviour risk reviews as they provide a demonstration of how employees address risk issues and how their behaviour leaves the company exposed. Formality of policies and procedures through documentation, reporting, and review are all important demonstrations that a company is aware of its responsibilities. Equally important is day-to-day demonstration that employees have espoused the values of governance, risk and control in the way they discharge their roles.

Scrutiny of moral issues within the context of asset management has assumed an important role for asset managers. Asset managers understand that moral issues will continue to be

key factors in re-engendering trust and confidence of investors. The moral issues are varied and diffuse. The moral issues may vary in emphasis over time because they are influenced by business drivers.

A more interesting issue is whether the sector is equipped to manage the moral issues without external intervention. Law in the guise of regulation is not synonymous with morality as Lord Devlin pointed out 50 years ago in his essay "Law and Morality". Regulation will not impose or direct morality but follow it and reinforce it where there is populist demand for legislation to enforce morality.

SECTION IV

Trends in Asset Management

Currently, the trends in asset management are reasonably short-term. This reflects the uncertainty across the globe in response to the highly uncertain and volatile global economic and financial outlook.

Asset allocation

This section sets out some of the current key drivers for asset allocation. The analysis sets out the key drivers for each major asset sector with relevant comments on regional variations.

- **Equities**

  Negative real interest rates are providing support to equities. Equity markets are not expensive relative to history or other asset classes, nor do they deserve to be. Corporate profitability remains surprisingly high, yet this has been driven largely through cost cutting and we are likely to see profit margins start to fall later in 2012. The main risk remains that policymakers raise rates too quickly or push austerity programmes too aggressively, which in turn derails the fragile recovery. Since the start of the year, small and medium-sized companies have outperformed larger blue chips. Given that they are better placed to benefit from the pick up in M&A activity, this trend may well continue.

  The US and China have both reached significant points for reassessment, albeit for very different reasons.

  The US continues to demonstrate an inability to tackle its ballooning deficit. In election year 2012 there is little impetus to take the radical action needed. The US housing market remains in a critically poor financial state. Job creation remains sluggish. The second quantitative easing initiative has continued into a third episode. US equities appear over-priced. China faces quite the opposite problem; raising interest rates consistently since October 2011 in an attempt to moderate growth and inflationary pressures and achieve a soft landing for its overheated economy.

  In 2012 and beyond, austerity programmes will be fully shaped in the developed world. Emerging economies will be forced to take measures to prevent inflation spiralling out of control. However, despite inflationary pressures, the better demographic distributions of the emerging economies would encourage continued investment from the Western hemisphere into these markets.

- **Fixed interest**

  Corporate bonds look expensive and until recently the banking sector was the only area that offered any sort of compelling value. However, the deteriorating sovereign debt crisis has made the banking sector unattractive . Persistent inflation remains the greatest threat to the bond market. Inflation is likely to moderate as raw material prices reduce. There is now almost no chance of wage inflation against a backdrop of high unemployment and public sector pay freezes. This low inflation low growth forecast will create a good environment for continued allocation of assets to bond markets.

  In a low growth environment, strong demand has made high-yield bonds one of the best performing asset classes of 2011. Relative to cash, the yields are still very attractive but continued capital appreciation is unlikely. The ability to refinance debt cheaply has been an important factor in ensuring that default rates are low in the aftermath of the credit crunch. Much high-yield debt, including hybrid debt issued by banks, is due to mature over the next two years – the latter in response to regulatory capital changes. Though it is unlikely, rises in interest rates could push default rates sharply higher. Allocation of funds to short dated bonds will mitigate some of these risks.

- **Property**

  It is difficult to generalise about asset allocation in terms of property returns. Europe has seen a particularly uneven recovery. Southern Europe continues to experience crippling austerity measures. Ireland's austerity measures are blocking recovery of the Irish property market. Meanwhile, the UK, boosted by a weak currency and demand for prime London property, has led the revival. By contrast, banks are seeking to dispose of commercial property debt worth £225 billion in the UK. Pressures on banks in the UK to reduce their property debts may well create a glut of supply. This excess of supply may in turn, suppress rents. Although exposure to the narrow prime London property sector may be attractive, funds are unlikely to increase their exposure to the property sector until the economy experiences recovery. This is unlikely for five to six years, even according to UK Government forecasts set out in the November 2011 budget statement.

- **Hedge funds**

  Hedge fund managers have attributed the wrong type of volatility for poor returns during the last six months. Markets have swung sharply on a daily basis in their response to the sovereign debt and Euro-zone crisis. Few funds have predicted this sharp daily volatility. Weak performance has not, however, reduced investor demand. Massive inflow of funds into the sector continues, though fund managers have been unable to respond with sustained returns in their combat with sharp daily market volatility. Like investors in other asset classes, many are retiring to the sidelines with their idle cash. Yet diverse opportunities continue to exist for good managers to attract investor funds.

- **Natural resources**

  Global energy consumption has risen 45% in the last two decades, far outpacing the gains in energy efficiency. The balance between supply and demand for commodities makes for an attractive asset allocation. The recent volatility in equity markets means that natural resource companies can now be bought at attractive discounts in contrast to buying the physical commodities.

  In volatile times, investors desire certainty in market direction. Invariably, this sentiment leads investors to an oversimplification in their market and economic analysis. They favour developing economies over developed. They fear inflation or deflation which in turn creates a high degree of correlation between markets. The reality is, of course, more complicated. While in recent times diversification has proved difficult, bar a second credit crunch, we are likely to see greater divergence.

Sources of wealth/emerging sources of wealth

Much wealth in the Western Hemisphere is sitting on the touchline. New sources of wealth are not emerging in the Western Hemisphere – entirely expected given the very slow growth. New sources of wealth are emerging from the BRIC countries and the rest of the Asian Pacific Region.

The so-called BRIC countries (Brazil, Russia, India and China) are the major sources of emerging wealth, particularly Ultra High Net Worth Individuals (UHNWI). BRIC nations produced more than half of the new billionaires to join the ranking. China has 115 and Russia 101 billionaires, according to a Forbes survey of 2011.

The Ultra High net Worth Individuals (UHNWI) have some key characteristics:

- **Emerging market UHNWIs are generally younger**

  The average age of the UHNW individual in Russia is 49 and 50 in China. Compare that to more established economies such as the U.S., where the average age of a UHNWI is 66, or France, where it is 74. Since their wealthy status has just begun, the long-term impact is likely to be substantial.

- Emerging market UHNWIs are self-made

  They are self made individuals. Their wealth is almost entirely created through entrepreneurship, not through inheritance, but they remain involved in the conduct of the businesses that provided them with their wealth. As a result of high growth in their businesses and due to the fact that they are younger, they are unlikely to take a passive role in their businesses.

Active versus passive management

Following the 2007/2008 global financial crisis, active asset management strategies were criticized for failing to provide investors with protection against falling markets. Investors have questioned the ability of active managers to outperform the market. Institutions perceived that their ability to match the level of risk to the environment, post the 2007 financial crisis, was more quickly and effectively achieved through passive investment. In consequence, passive products, including index funds, have grown steadily in popularity as passive equity exposure is the easiest way to manage growth or equity risk in response to the investment environment. Equally as important, the traditional fee structure of hedge funds, where investors are charged a 2 per cent annual management fee and 20 per cent on profits, is also coming under pressure. However, because of the highly volatile market of the second half of 2011, investors need to make active decisions in order to achieve superior performance. Passive investment does not work in such conditions.

Passive investments may be riskier than they initially appear. For example, investors who are increasingly unwilling to pay for mediocre performance in a low interest environment and who purchase a government bond index fund to gain exposure across a broad selection of countries, have found that such funds are tilted towards Japan, the US, Italy, Spain, Greece and Portugal. Countries that have issued the most government debt also have the largest representations in the index.

In response to the demand for cost effective measures to develop diversified portfolios, the Exchange Traded Funds (ETF) market has grown rapidly in recent years. ETFs offer the benefits of index-linked products and the liquidity of individual stocks. The value of assets invested in ETFs grew by 26 per cent in 2010 and has nearly trebled since 2005, according to the Boston Consulting Group. This is helped by the fact that providers of ETFs have succeeded in creating niche products that allow investors to get exposure to certain asset classes in a very cost-effective way. ETFs are radically changing the securities markets. ETFs themselves, not the trading of underlying securities, are setting the prices of the underlying securities in smaller listed companies. Innovation in ETFs has seen more complex products, leading to a lack of transparency. The complex products shift the burden of risk management to investors to ensure that they are not exposed to risks that they had not anticipated, a judgment they are ill-equipped to make. Allocation towards passive investments may be increasing, but it certainly does not mean that investors have given up chasing alpha entirely. Often, investors are allocating a slightly larger proportion of their portfolio to passive products, but are also increasing their allocation to alternative asset classes.

Scaling up the bond markets – for all sizes of listed issuers and investors

Capital constraints in the form of new additional capital requirements and lack of private shareholder confidence will constrain the capability and capacity of banks to support the regeneration of Western economies during the next three to five years. More companies will have to raise capital in domestic and international debt markets, both for short and

longer term requirements. In order to raise capital, small companies will seek listings on relevant recognised investment exchanges. This will provide some transparent measure of value of the companies and create a new trend of smaller companies trying to raise debt through bonds and other direct debt obligations from investors.

Exchanges, for example the London Stock Exchange, have introduced technology platforms to enable corporate bonds to be bought in smaller quantities, transparently and on a level playing field with larger institutional investors. These facilities can be extended to institutional investors who, for example, may enter the market to invest in smaller bond issues of smaller listed companies.

Role of the investment advisor

Developments in the field of information technology have led to efficiencies, which enable investment advisors to access investment specialists in every area of the business – from small cap stocks and government bonds to blue chip stocks and hedge funds. They can also access firms that specialize in investment research, the construction of asset allocation models, the creation and evaluation of portfolio management to meet specific objectives such as long-term growth, and current income. These services are provided on a fee-basis. Historically, the fee was a percentage of the amount invested. If the assets grew, the advisor was rewarded for the success as the fee percentage was now calculated on a larger asset base. If difficult markets reduced the value of assets, the advisor's fee fell because the fee percentage was now calculated on a smaller asset base. Now, regulation is reversing the traditional model. Advisors are paid to give advice and, in many cases, earn nothing from the sale of a specific investment product.

The role of the advisor is transforming. With access to all of these specialists, some investors are unclear on the role their advisor plays. Advisors' core functions are best described as those functions which are necessary to demonstrate that the advisor meets the legal duties of care and responsibility to their clients. Investment advisors would show they have discharged their duties of care to their clients by documenting what they have done under the following sequential headings:

- works to discover personal financial objectives;
- assesses entire financial situation (all major holdings including home, art, stock options, etc.);
- designs a customized investment plan that offers a realistic opportunity to achieve goals;
- screens the industry's best service providers to identify those that offer services that complement your goals;
- works with those providers to implement a customized investment plan;
- monitors the providers and replaces them if they fail to meet objectives;
- tracks the providers to be sure they don't stray from the investment style they were hired to implement;
- monitors portfolio and recommends adjustments to strategy based on conditions in the capital markets, changes in life and progress toward investment goals;
- provides education and guidance to help understand investments and to keep investment goals in sight and portfolio on track, regardless of current market conditions.

Role of technology: value added services

Value added services focus on enabling asset managers to track and compare performance on a continuous basis in response to client demand for regular and/or continuous oversight of performance of their portfolios. As an indication of less trust and faith in their advisers, clients want closer and more frequent oversight of asset managers' investment performance to ensure that mangers adhere strictly to investment mandates. Clients want to compare their asset

manager's performance with other asset managers, to some of whom they may also assign concurrent investment mandates.

- **Quantifying performance and comparing it to benchmarks**

  Performance measurement statements are used to visualise and compare net asset value (NAV) to benchmark curves over a given lapse of time, as well as to calculate basic risk indicators (volatility, Sharpe ratio, tracking error, etc.). They are based on NAV history, benchmark price history and the risk-free interest rate.

- **Understanding performance on the basis of one or more objective criteria**

  Performance analysis statements offer access to the respective positions of the portfolio and its benchmark, on the basis of one or more selected criteria. They are based on detailed knowledge on the composition of the portfolio and the benchmark. In some cases, comparisons make reference to non-accounting information, such as the economic sector, rating, sensitivity and other factors.

- **Presenting and commenting on performance**

  Performance analysis statements break down the observed results on the basis of one or several criteria, depending on the asset class and the investment management process. They are based on the identification of individual factors that contribute to performance and result from initial positions and the transactions completed over the period under consideration. These statements are particularly useful for presenting and commenting on investment results for investors. Information that is collected and centralized provides performance measurement, analysis and attribution for equity, fixed income and balanced portfolios.

  These technology capabilities are available globally and may enable asset managers to compare performance by financial centre from which the investment mandate is managed. However, the investment performance of financial centres is likely to reflect the state of economic and financial growth in the region as opposed to the skills of the investment manager.

Risk management strategies

In general, investors remain risk averse. Aversion to risk is likely to remain a permanent feature of investment for the next three years. Regulators and investors are seeking greater transparency in the pricing of products. Both institutional and retail investors are seeking assurance regulated products, which offer specific rights, obligations and liabilities.

Ironically, in light of the fact that G20 regulatory reforms are supposed to bring greater harmony to financial regulation and contribute to financial stability, G20 capital risk and regulatory reforms will not be implemented in the same way or at the same time in each jurisdiction. Practical politics' response to economic and financial events, including the Euro-zone crisis, will delay and even obstruct reform. Lack of regulatory convergence will encourage regulatory arbitrage, including legal entity tourism. A further challenge for the G20 reforms, as distilled and interpreted by the USA and

European Union, is that legislators and regulators have to consult and implement with an increasing number of stakeholders outside their own jurisdictions. Asset managers will have to align their participation and application of governance and risk with investors in a complex jurisdictional web of rules and regulations. Asset managers have to address an increasing number of regulatory measures. They have to anticipate, understand and manage revisions to the measures. Reputational damage of failing to introduce and manage the regulatory processes could be significant. The "Principles-based" or "market-led" approach to regulation is giving way to a return to an "outcomes-based" approach.

Transparency and simplification are required for the execution of transactions. Recent regulatory measures, such as short-selling restrictions, UCITS IV, the AIFM Directive, European Market Infrastructure Regulation (EMIR) on OTC derivatives and the MiFID II measures, require imaginative but intelligent approaches toward mitigating the cost impact of developing commercial opportunities.

Newer regulatory approaches, including those categorizing clients, products and processes, or those that demand extraterritorial accountability, will strain compliance and risk functions alike as well as the conduct of investment business. Closer coordination between the risk and compliance functions will be necessary to satisfy management of the regulatory risks that arise in re-categorising clients, products and services under extra-territorial regulatory regime criteria.

SECTION V

Fitness criteria

Fitness is a moral issue

All businesses, from football to financial services, have developed their own criteria for determining what constitutes a fit and proper person. Industry professional qualifications, skills, knowledge and experience all contribute to assessing whether an individual is a fit and proper person. The objective of each industry is to ensure that the individuals in positions of responsibility possess honesty, integrity and reputation. In services businesses, the collective honesty, integrity, and reputation of its director and employees are critical attributes of their institution. They constitute the trust and confidence that all depositors, lenders and investors, as well as others who seek financial advice, place in the institution.

The industry has recognised that it has lost the trust and confidence of investors as a result of the financial crisis. Client behaviour indicates a loss of trust and confidence. Yet, with few exceptions to date, institutions, directors and employees have not violated the extensive rules and regulations through which financial regulators oversee financial service businesses. Financial regulators are strengthening regulation and oversight of financial services institutions around issues such as capital, liquidity and risk management. Such measures may reduce the opportunity and ability of institutions to take risks that endanger their financial stability and creation of systemic risk but they are unlikely in themselves to re-engender trust and confidence in the financial system. Investors will regain trust and confidence only over time and in response to demonstrations of honesty and integrity in the behaviour of institutions, their employees and directors. Fitness in terms of honesty and integrity is a moral issue in the sense that honesty and integrity define how individuals should behave and react to situations in the course of the day of an asset manager.

How can moral fitness be demonstrated in the asset management industry?

Research by SimCorp, the technology providers of asset management services and applications, has identified two steps where the industry can demonstrate its morality:

Identification and recognition of risks and (shared) responsibilities in the post-crisis world

Addressing retail consumer requirements is essential through closer scrutiny of product and service (“product”) life cycle by looking at all parts of the product value chain, including product development, design and marketing, distribution and post-sale handling. Institutions should have the right incentives at each step in the value chain to deliver products that add value and address real consumer needs.

Customers should be treated fairly through real consideration of consumer needs. Consumer research for product development should focus on the gaps in consumer needs that could usefully be filled by a particular product by contrast with benchmarking against competitor products.

It should ensure, through better internal oversight, that business strategies, models and product development do not create or encourage conduct that poses a risk to consumers. This can be done by testing in a systematic and objective way the consumer experience of the products firms sell, with a view to building oversight and risk supervision into internal governance procedures.

Stress and scenario testing products to ensure they are designed to meet the needs of customers is essential. Firms should identify the type of customer for which a product or service is likely to be appropriate by articulating what the product does, who it is for and key characteristics, including the nature and scale of risks presented.

Products should be stress tested to see how each might perform under a range of different market conditions based on knowledge and experience of past and anticipated market behaviour and the key characteristics of the particular product.

Over the next three to five years, firms will move to managing greater complexity in terms of clients, products and the jurisdictions in which they operate. Their risk functions will need to be even more anticipatory, rather than policing and reporting after the fact. Firms should invest in individuals who can exercise experience and judgment, not only on risk matters but also on compliance, legal, internal audit, business, operations or finance matters as well as communication with clients and non-executive directors.

Transparency

Demonstration of transparency in the investment process is a cornerstone of establishing investor trust and confidence. The processes set out below represent key demonstrations of transparency in the investment processes:

- **Identification of investment processes**

  There needs to be an establishment of systematic processes to evaluate investments through an investment committee that meets regularly to review and discuss the investment process as well as to evaluate the investment vehicles the firm is using. The process should include a screening process used to do due diligence on investment vehicles and/or their managers. A systematic process should extend to compliance with investment guidelines and restrictions, trade execution and transaction processing supported by portfolio accounting and valuation and client administration.

- **Document the process**

  The whole process should be documented for clear communication internally and externally.

- **Communicate the process**

  It is necessary to ensure that the investment process is communicated through the appropriate medium to clients and is available for prospects to view so they can certify that the institution is using a proper methodology for conducting research and due diligence.

Key challenges for asset managers' fitness:

Risk challenges

The asset management sector is experiencing substantial risk challenges best classified under the headings of Regulatory, Market, Legal and Operational.

Regulatory risk

Regulatory environment in Europe, USA & Asia is clouded with uncertainty. Uncertainty about the detailed substance of future regulation is a risk for investors and investment fund flows and has consequences for competitiveness. Industry associations have to demonstrate more effectiveness and respect in their intermediation role between the financial regulator and the industry.

Market risk

Market risk from the asset manager perspective extends over and beyond market volatility to capture "tail-end events". Responses include stress test analysis beyond VAR, improving transparency at all levels of the enterprise and reviewing short-term incentives to include stress testing under scenarios that include:

- significant drawdown / withdrawals from Assets Under Management (AUM) through revaluations and investor withdrawals;
- liquidity pressures meeting current and anticipated investor withdrawals;
- impact of revenue decline from the decline in fees for AUM;
- loss and liquidity demands and their impact on the on-going viability of an Asset Management Firm;

- impact of short-term incentives on asset allocation with short-term profits and (sometimes) tail end risk;

- understanding the risks of complex products.

Legal risk

Basel II describes legal risks as: "Risks that occur when liabilities arise from the relationship between asset management firms and their investors..." Asset managers have to strengthen the regulatory and compliance function in firms, especially oversight of new products and services with particular focus on extensive review of product offering's terms and conditions to improve transparency.

Operational risk

Operational risks are "the risk of direct or indirect losses resulting from inadequate or failed internal processes, people or systems, or from external events excluding market or reputational risk."

Operational due diligence is fundamental to the business models of asset managers. Operational due diligence has to encompass a number of key process. These include external, independent asset valuation and well-resourced external auditors. Asset managers have to move due diligence away from a mechanical tick box approach, requiring experienced resources. Operational risks management should be developed to meet specific regulatory mandates and not generic minimal regulatory requirements.

Cost challenges

Costs are rising while the revenue base is not keeping pace – even when those costs are adjusted for inflationary costs. New regulatory costs have increased as a result of increased business complexity. Costs are fixed and do not scale in harmony with AUM – the key revenue drivers. Key cost challenges are structural, operating model, regulatory and compliance costs.

Structural costs

Asset Managers are challenged by their current business models. The growth of cost base is outstripping the revenue base. Asset managers now have to address the difficulties of allocating costs across different product and services line by:

- applying cost & management accounting to the cost and pricing of products and services;

- examining costs by product/client/ market data, especially where the cost of products exceeds revenues;

- examining client servicing distribution costs by client and product;

- initiating /reviewing transfer pricing, especially in research and technology;

- extracting and reporting hidden embedded costs such as maintenance of information systems – magnitude of costs versus replacement.

Operating model costs

The asset management business has a highly variable revenue base accompanied by high fixed costs. In an industry sector where the business market downturn has resulted in substantial reduction of AUM through revaluations and client withdrawals, the AUM model is highly vulnerable. Providing a solution requires an in depth analysis of the dependency of revenues on the scale of operation, an examination of the extent of fixed costs, and the impact ability to transform them into variable costs:

- develop accurate measures of the economies of scale and their cost advantages;

- accurate assessment of the cost structures per product and scalability of investments;

- consideration of outsourcing services and implications;

- AUM increase and their servicing costs versus other more profitable offerings;

- impact of new products and services on costs/skills/ resources and training;

- new products that do not have fixed costs but vary with AUM;

- operating of managed accounts for institutional business;
- sever the relationship between fees and costs that are locked into AUM.

Regulatory and compliance costs

Much of the increase in regulatory costs is unavoidable – the cost of doing business. Some elements of regulation can be framed in a way to demonstrate transparency and engender growth in confidence to clients and other stakeholders.

Asset managers should directly, and through their national industry associations, seek harmonisation of regulation across national boundaries to reduce regulatory arbitrage, increase investor confidence and enable greater efficiency in delivery of regulation and compliance.

Trading costs

Trading costs have risen in response to the financial crisis due to a reduction in the volume levels and liquidity. Information technology costs are rising. A new trading environment appears to be emerging to which the trading arms of asset managers must adapt. Asset managers should address the following issues:

- reduce their reliance on legacy systems rather than adapting technology to new trading environments;
- assess the role of alternative trading strategies. For example, algorithmic trading and strategies that reduce commissions/charges on market impact and extend Straight Through Processing (STP), deployment of dark pools and similar trading technology;
- unbundle transaction and research services to control trading costs and create transparent allocation of costs to products and services;
- accelerate integration of trading functions across markets and regions.

Growth challenges

The crisis and economic environment have seen the emergence of low-cost providers who have better economy of scale models and a product mix that suits the current business environment.

Increased competition

Low cost funds such as index and ETFs, which can be structured for different types of investors, are significant challenges to traditional asset managers' revenue base. Asset managers have to consider the significance of cost containment and product consolidation.

Key growth challenges & opportunities

The global financial crisis has challenged the environment of asset managers. The following are considerations when asset managers assess the challenges and opportunities for growth in their businesses in the highly uncertain environment:

- addressing client concerns arising from the global financial crisis such as risk management for retail clients;
- setting client expectations for current markets, education in rebuilding customer confidence, and improvement of operational transparency;
- assessing the impact and adaptation of regulatory changes on distribution channels and product mix ;
- assessing the demographic changes in mature and developing markets;
- assessing new markets and opportunities to construct funds e.g. foreign exchange/commodity/deposit funds as well as opportunities from sovereign wealth funds.

How significant is size?

Increased scale in itself does not reduce costs of AUM and/or increase revenues. Asset managers have to reassess their own perspectives on the importance of size in regards to profitability of their business. The low fee section of the market has the highest economies of scale. Those economies of scale are most impactful in distribution, compliance and administration.

Some key questions they have to ask themselves through analysis of their business models are:

- what drives the scalability of the investment function?

- what are the highest degrees of market penetration or investment platform that can scale well?

- what investment approach (active/passive), research coverage and range of asset type's influence suit the growth aspirations of the business with reference to the skills and client base?

- what is the availability of suitable human capital (since increasing scale can lead to critical staff and business disruption impacting the scale of AUM)?

- what roles in the growth of the business will mergers and acquisitions play because, despite operational efficiencies, cultural and management conflicts can result in disruption?

Positioning & repositioning

Following their assessment and re-assessment of the importance of size to their businesses and business models, asset managers have to determine how to position or in some instances reposition their businesses. Key qualitative steps in repositioning the business in line with re-engendering trust and confidence are:

- maintaining transparency, which is not just a matter of the relationship between asset management companies and their clients but internally in the enterprise between the functions, sales, execution, operations, finance, risk and compliance;

- ensuring focus on "client satisfaction" which extends to all parties in the value chain including all intermediaries. It is partly educational and management of expectations, some of which are unreasonable or fanciful;

- standardising product descriptions and their risks is best achieved through industry associations, as well as efforts amongst its membership and counterparts in other jurisdictions.

Asset management fitness in a geographical and regional context

This section assesses some of the issues that impact the fitness of the asset manager from a regional context. It would be a fanciful and vain notion to examine these on a centre-by-centre basis within regions, especially at a time of uncertain long-term outlook in the industry.

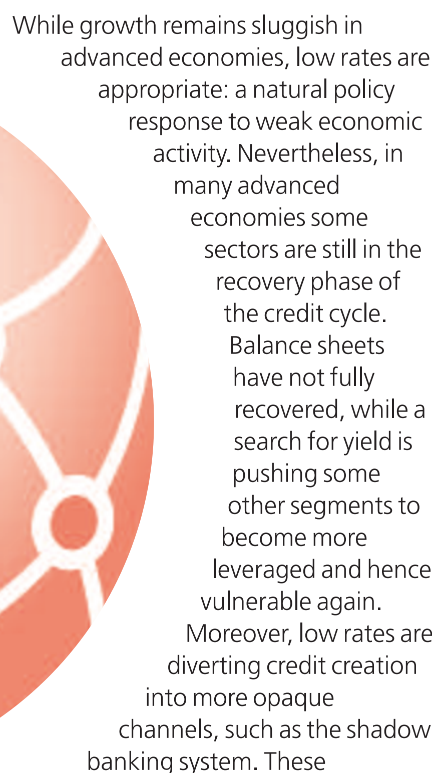
Political & financial stability

Financial stability risks have increased substantially over the past few months. Weak growth prospects adversely affect both public and private balance sheets and challenge the coping of heavy debt burdens. Public balance sheets in many advanced economies are susceptible to rising financing costs, in part owing to the transfer of private risk to the public sector.

Strained public finances force policymakers to exercise care in use of fiscal policy to support economic activity. Monetary policy has only limited room to provide additional stimulus. Against this backdrop, the financial crisis has moved to a political phase. In the Euro area, important steps have been taken to address current problems. Political differences within economies undergoing adjustment and among economies providing support have impeded achievement of any long-term solution.

The United States is faced with doubts over the ability of the political process to reach a consensus on medium-term fiscal adjustment, something that is critically important for global stability. Political leaders in advanced economies have not yet commanded broad political support for sufficiently strengthening macro-financial stability and for implementing growth-enhancing reforms. Markets directly question their ability to take needed actions. Financial and political weakness elevates concerns about default risk and demands a coherent strategy to address contagion and strengthen financial systems.

In the Euro-zone, sovereign pressures threaten the ability of the banking system to support financing of the real economy. The sovereign credit strain in the Euro-zone area is estimated to have had a direct impact of about €200 billion on banks in the European Union since the outbreak of the sovereign debt crisis in 2010. This estimate does not measure the capital needs of banks, which would require a full assessment of bank balance sheets and income positions. Rather, it seeks to approximate the increase in sovereign credit risk experienced by banks over the past two years. These effects are amplified through the network of highly interconnected and leveraged financial institutions; when including interbank exposures to the same countries, the size of spillovers increases by about one half. Banks in some economies have already lost access to private funding markets. This raises the risk of more severe deleveraging, credit contraction and economic drag unless adequate actions are taken to deal with the sources of sovereign risk – through credible fiscal consolidation strategies – and to address the potential consequences for the financial system – through enhancing the robustness of banks.



While growth remains sluggish in advanced economies, low rates are appropriate: a natural policy response to weak economic activity. Nevertheless, in many advanced economies some sectors are still in the recovery phase of the credit cycle. Balance sheets have not fully recovered, while a search for yield is pushing some other segments to become more leveraged and hence vulnerable again. Moreover, low rates are diverting credit creation into more opaque channels, such as the shadow banking system. These conditions increase the potential for a sharper and more powerful turn in the credit cycle, risking greater deterioration in asset quality in the event of new shocks. Stepped-up balance sheet repair and appropriate macro prudential policies can help contain these risks.

Emerging market economies are at a more advanced phase in the credit cycle. Brighter growth prospects and stronger fundamentals, combined with low interest rates in advanced economies, have been attracting capital inflows. These flows have helped to fuel expansions in domestic liquidity and credit, boosting balance sheet leverage and asset prices. Especially where domestic policies are loose, the result could be overheating pressures, a gradual build-up of financial imbalances and deterioration in credit quality, as nonperforming loans are projected to increase significantly in some regions. At the same time, emerging markets face the risk of sharp reversals prompted by weaker global growth, sudden capital outflows, or a rise in funding costs that could weaken domestic banks. This report finds that the capital adequacy of banks in emerging markets could be reduced by up to six percentage points in a severe scenario combining several shocks. Banks in Latin America are more vulnerable to terms-of-trade shocks, while banks in Asia and emerging Europe are more sensitive to increases in funding costs.

Regulation

The financial crisis of 2007 revealed fundamental weaknesses in the structure of financial regulation. In response, policymakers and regulators have embarked on an ambitious regulatory reform agenda that aims to achieve as much global co-ordination and consistency between regional reform efforts as possible.

How successful attempts at international co-ordination and consistency have been deserves further examination. Despite most of the regulatory changes taking place under the auspices of the G20, variations in the approaches taken on both sides of the Atlantic and in Asia can be observed and are increasingly significant. The general objectives might be consistent, but the different regulatory

paradigms in the US, Europe and Asia have become increasingly visible and the resulting changes are, many fear, becoming less coordinated.

In the US, the Dodd-Frank Wall Street Reform and Consumer Protection Act reflect the USA's ambition to strengthen its originally principles-based regulatory framework with a greater role for rules. The debate has centred on how to repair and strengthen an agreed system.

In the European Union however, the debate rests on the fundamental questions of what kind of regulation to adopt and who should oversee it. It appears that those who favour a rules-based regulatory system, orchestrated and overseen by EU-wide authorities, are gaining the initiative. Also, Brussels follows a sector based approach to legislative initiatives instead of one all-encompassing bill. All of this has the effect of reducing the common ground between EU and US approaches.

The EU is working on a large number of initiatives, including the alternative investment fund managers' directive, MiFID, and UCITS, which directly or indirectly regulates or affects markets that are global in nature. Yet, differences in the way these are regulated between different jurisdictions need to be carefully considered. For example, in the context of derivatives regulation, while Dodd-Frank suggests the US Treasury can exempt FX forwards and swaps from the scope, the EU's proposal (at least currently) pursues an all-inclusive scope for the regulation. In all of this, the EU is acting against a backdrop of banking system and sovereign fragility and so faces the twin task of solving its present crises and building a system that will prevent future crises.

A completely different picture presents itself when looking at the state of regulatory reform in Asia. The region is economically booming and its focus is automatically on the continual development of the financial infrastructure rather than on crisis response. There is great debate about the benefits of a global approach to regulatory reform versus the ability to retain local flexibility. Indeed, it is widely expected that the regional financial centres of Hong Kong and Shanghai will seize the opportunity to develop their own banking, brokerage and asset management sectors in view of heavy-handed regulation in the west.

After decades of a world with one superpower and one dominant economic and political model, we are moving towards a multi-polar world, with not only competing powers but also competing ideologies and governance systems.

It is now possible to envision permanently different regulatory responses with regional differences, allowing opportunities for regulatory arbitrage. The standard response to this is to express concern that such moves might risk fragmentation and a distortion of global financial markets.

However, for investors to be able to operate on a global scale, such as sovereign wealth funds and large institutional funds, increasingly divergent economies offer investment opportunities and greater scope for diversification and risk control. Whereas in the past global stock markets tended to show high degrees of correlation in crises, a less connected and less homogenous world may be more resilient to shocks.

Rather than viewing this fragmentation as something to regret or to fear, it is perhaps better to see it more as a natural consequence of the increasing diversity of the world economy. While fragmentation entails assessment of economic inefficiencies and limiting the most optimal allocation of capital, it is not without its advantages for those areas of the global economy which demonstrate growth and resilience. Growth and focus of investment in the Asian Pacific Region and the so-called BRIC countries is a demonstration of the benefits of fragmentation.

Taxation

To attract capital, countries must offer positive risk-adjusted returns, i.e. returns that, at a minimum, cover an investor's cost of capital associated with a particular investment. Since investors are concerned with the loss of value of their assets, especially the risk associated with the loss of control over their asset, they require

property rights and the mechanisms to enforce them. If investors have to secure property rights themselves, then it increases their cost of capital. If states provide this assurance through clearly-defined laws, regulations, and enforcement procedures and are stable enough to apply them, investors will see their cost of capital decrease. In such a case, investor's risk-adjusted returns will increase, even if they have to pay fees or taxes to cover the costs incurred by states to provide this environment. The more expected returns increase in a given state, the more it should attract capital, which in turn should lead to greater economic development.

Increase in the mobility of capital in the last 30 years and the growth of Offshore Centres (OFCs) has not seriously undermined the stability of the international financial system nor greatly affected the tax bases of countries. Stability is unlikely to be undermined as capital maintains greater mobility. It seems that investors require that the bottom be high enough to commit their capital, which in turn limits the potential for instability in the system. The success of those OFCs that have sought to provide high-quality institutional environments for their investors tends to confirm this viewpoint, though bank failures and financial crises will continue to occur. They need not necessarily be caused by activities occurring within OFCs' jurisdictions. If such failures and their attendant crises should arise in OFCs, it is more than likely that their impact on the world's financial system will be limited. OFCs, which are affected will work hard at improving their reputations in order to continue attracting business, as history has shown so far. Otherwise, OFCs will see limited business activity, often of the illegitimate form, and their economic development will suffer as a result.

An artificially high level playing field should not be imposed across the world. Investors would then face higher taxes and reduced opportunities to invest their assets. The residents of those areas incapable of upgrading their institutions in time because of financial or other structural constraints would see their country's and their own economic development halted or decline. Increased transparency and information in the international financial system are required so that investors could lower the costs of making decisions.

Demographics

Loss of growth arises from reduction in labour supply but labour market developments doesn't mean that equity values are going to decline absolutely, though it does suggest that the rate of return on equity will drop compared with the last couple of decades. Capitalism rewards scarcity. As labour supply fades relative to the availability of capital, returns will shift towards the labour.

We actually have no template about what to expect because 21st century population aging is unique. But it seems reasonable to expect lower rates of return in those countries where labour supply tightens significantly, while conceding that the directional change in equity markets will continue to reside in macroeconomic management, profits, innovation, governance, financial stability and so on. According to the IMF research into demographics, the net present value of pensions, healthcare and long-term care out to 2050 dwarfs the costs of the banking crisis everywhere. It is over 600 per cent of GDP in Spain and Greece, 500 per cent GDP in the U.S., 335 per cent in the UK and between 200 and 300 per cent in other major EU countries. The precise numbers are less important than the orders of magnitude and the implications for public policy. Budgetary pressures have forced governments to implement or consider a variety of demographically driven policies. They include an increase in the retirement age, a temporary freeze on pensions, higher public employee contributions to pension schemes, and schemes to get citizens to pay more towards healthcare, or to specific conditions.

The financial task of supporting an aging population is going to become more intense, raising crucial questions about the adequacy of individual savings, and the affordability of public pensions and healthcare schemes. Individuals generally don't save enough for their retirement. In a recent UK survey by the consumer association, a quarter of those who could save didn't, and half of men and more

than half of women who did, didn't save enough. It's not dissimilar in most other countries, and in the United States, the Fed's latest Survey of Consumer Finances revealed that current or close retirees have roughly $50,000 of retirement savings, excluding the now questionable equity in their homes. However, what is good for the individual is not good for the nation. If citizens save more, they deliver a strong deflationary environment to the economy which unsettles equity and property markets, unless governments balance policy between economic growth and budgetary austerity.

Property cycles are protracted in both directions. Both government and central bank policies have supported housing markets and values, and continue to do so. It would be imprudent to declare that the downswing in prices is over. Banks have not yet written off or restructured many mortgages , too many banks whose main aim is to shrink assets, too many properties for sale (or hidden in bank ownership), and it's far too early for households to come back from their balance sheet repairs. The UK's chronic under building of housing may offer some protection, but not in the event that the economy should slip back in to recession – now a reality despite concerted fiscal retrenchment in 2011 to 2012. In the longer-term, the weaker age structure, especially of younger, first time home buying citizens, will most likely dampen the housing cycle, certainly in real terms.

Soft issues including business culture and values

The soft issues including attitudes, values, norms, beliefs, behaviours and demographic trends of the host countries frequently require a good deal of self-awareness in order to recognize and control culturally specific behaviours.

As wealth from the BRIC countries and elsewhere in the APAC region becomes a significant element of financial assets under management, asset managers must deploy the skills of many international managers. Asset managers must know how to relate to and motivate foreign workers, since motivational techniques differ among countries. They must also understand how work roles and attitudes differ. For instance, the boundaries and responsibilities of occupations sometimes have subtle differences across cultures, even if they have equivalent names and educational requirements. Managers must be attuned to such cultural nuances in order to function effectively. Moreover, managers must keep perspective on cultural differences once they are identified and not subscribe to the fallacy that all people in a foreign culture think and act alike. All of these dimensions can have a significant impact on a manager's success in an international business environment.

Sharia territorial investment

Financial institutions have established *Sharia* funds in financial centres, where there are strong concentrations of affluent Muslim populations such as London, Malaysia and Indonesia. Due to the rapid growth in Islamic finance over recent years, the available range of *Sharia*-compliant funds has expanded as financial services providers seek to tap into the increasing demand for investment products that respect the principles of Islam. *Sharia*-compliant investment funds provide a means of investing while still honouring the high morals and principles of Islam. *Sharia*-compliant funds promote large-scale investment along lines similar to the niche ethical funds available to Western consumers. The funds can be more expensive to develop and administer than mainstream funds due to the need for greater verification of compliance with *Sharia* principles.

Sharia-compliant funds are investment vehicles which are fully compliant with the principles of Islam. The funds are prohibited from making investments in industries categorized as morally deficient, such as those related to gambling or alcohol. They have avoided some of the excesses of financial crises because Islam does not permit any form of exploitation, therefore, ensuring that any kind of investment in conventional banking is outlawed. The concept of debt is also contrary to the principles of Islam. Investment in highly leveraged companies is also not permitted for *Sharia*-compliant funds. The exclusions extend to potential investments in other funds which offer guaranteed returns.

Any use of futures and options, either by the fund managers or by companies in which the funds invest, is also likely to attract close scrutiny by the funds' supervisory *Sharia* boards.

The investment criteria for *Sharia* based funds has not only enabled them to avoid the excesses of the global financial crisis but has drawn the attention of more conventional investors if only because they present a set of investment mandates or criteria that meet some of the investment challenges of the current environment.

Anti-competitive issue with the USA

The USA has always been a notoriously difficult state for foreign institutions to conduct investment business. Its highly prescriptive, rules-based approach to regulation permits little or no reciprocity with jurisdictions that permit entry to U.S. financial institutions. It is the official position of the U.S. Government that foreign investment is strongly encouraged and that U.S. markets remain open and virtually free of investment barriers. However, this statement of principle is tempered by the reality of the post 9/11 world. Regulations make clear that scrutiny will continue to be a substantial hurdle for foreign investors in those aspects of the U.S. economy deemed sensitive to national security, though the conception of what aspects are sensitive remains elusive.

More recently, legislation pertinent to asset management creates further barriers to the conduct of asset management businesses by foreign asset management companies. The Dodd-Franks Act amends several provisions of the Investment Advisers Act of 1940, most significantly through eliminating the private adviser exemption from registration. It does, however, provide certain limited new exemptions from registration, including exemptions for foreign private advisors, advisors to private funds, and advisors to venture capital funds. The precise way in which these exemptions will be implemented awaits guidance from the SEC.

The U.S. Foreign Account Tax Compliance Act (FATCA) challenges Foreign Financial Institutions (FFI) with increased information demands in the Know Your Customer (KYC) process, additional reporting requirements and other duties. FATCA will challenge asset managers in their cross border activities. FATCA introduces a 30 per cent withholding tax on all "withholdable payments" of an FFI. This tax is not deducted from FFIs if they comply with certain reporting requirements to the Internal Revenue Service (IRS).

Conclusions

There are a number of key conclusions that can be drawn from the analysis in this report. Perhaps the greatest challenge faced by the industry is the European sovereign debt and Euro-zone currency crisis. It is a source of crisis because it may give rise to global systemic financial crisis. This could potentially destroy the financial and banking system. The possible destruction of the banking and financial system is the key source of the crisis in confidence. This crisis will not be addressed by a set of immediate short-term palliative measures. The cure will take time; perhaps it will be a generation before certainty returns to the asset management sector that enables the industry to take a longer term and considered view of its growth. Until that uncertainty is resolved, long-term trends in asset management growth and allocation await a firm and sustained political and financial resolution to these crises. The effectiveness of resolution will only emerge over the period of years rather than months.

Asia Pacific and the BRIC countries remain the key areas for sustained growth of asset management, though most of that growth has to come as much from within the region as reliance on growth and inward investment from the Western Hemisphere. Financial centres in those regions should benefit from growing wealth in the APAC region.

Rebuilding trust and confidence is critical. Regulators are as much reputationally damaged by the crisis as financial institutions are. There is a surge in prospective financial regulation as a cure to respond to the loss of trust and confidence. However, the industry has to develop capabilities to deal with the loss of confidence. The measures by which the industry rebuilds trust and confidence with investors must become industry standards. To rebuild trust and confidence, asset managers should ensure that their investment management systems encompass transparency at all levels, including cost structures and competitive comparisons of cost structures, business processes and products.

Specific regional trends in fitness of asset managers are evident only to the extent that they illustrate the economic and financial confidence of the region. The discernable difference in the attention to application measures to improve the fitness of asset managers in the Western Hemisphere is a reaction to the financial crisis, driven by regulatory risk and reputational factors. The beneficial influence of the measures is spreading to other regions by way of good practice as much as regulatory and reputational pressures.

Predictions

Based on the analysis in this report, we can make a number of predictions as to how the industry might develop over the next few years. These are just predictions, not all will come to pass but a bit of speculation is probably more interesting than a rather bland 'we'll have to wait and see' conclusion!

The Euro-zone will fragment as states within the Euro-zone respond to collective Euro-zone political resolution of the European sovereign debt and Euro-zone crisis.

The impact of the fragmentation of the Euro-zone will take the asset management sector up to 18 months to fully absorb, against a continuing and highly uncertain financial and economic environment not only in Europe but globally.

The emerging wealth will continue to derive from the BRIC countries. These countries will be highly selective in their investment in Europe during the continued period of uncertainty as European states respond to political resolution of the European sovereign debt and Euro-zone crisis.

Asset managers will look to Asia for new clients and investment opportunities. However, this shift will happen in small steps, not one giant leap. This will partly be attributed to legal, cultural and economic barriers, as well as the global economic rebalancing that has begun, which has the East saving less (although Asia's saving rates are still very high compared to U.S. and Western Europe) and consuming more. The West is saving more and spending less. Investment culture will take root in Asia, but not so fast as to create a honey pot any time soon.

Asset managers will focus on their base competencies. Increased focus from institutional clients and fund distributors on due diligence and understanding operational risk means asset managers now have to combine a rigorous risk management approach with a flexible business model that enables them to cope with upturns and downturns. In particular, they need to identify and focus on their core business, identifying what they are good at – from asset classes to aspects of client service – and what they can outsource. Where the aim was once cost control, the focus now is on operational excellence and business resilience.

Asset managers that remain part of a banking institution will be hampered in their growth because of the bank brand association.

Multi-boutiques are likely to be the dominant operating model for medium and large asset managers due to the fact that asset management is a people business, where size creates remoteness, remoteness creates detachment, which in turn, can undermine alignment of interests.

Asset managers will simplify their business models. In the boom years, business models became more complex as asset managers ventured into new client segments, geographies and sales channels. With the proliferation of job titles, rules and procedures, diseconomies of scale emerged and in response, asset managers will complete their journey to a destination of multi-boutiques and virtual managers.

The industry will work assiduously on addressing the issues that address its perceived moral failings spurred by regulatory and political pressures.

The measures that asset managers take to address the moral failings will have less resonance with investors than was anticipated until financial markets recover and asset managers deliver consistent and improved performance.

Fitness criteria will become industry standards but political and regulatory pressures will accelerate the progress of the fitness regime.

About this report

For the purpose of this report two questions were included in a survey issued to the Global Financial Centres Index (GFCI) community in February 2012. The questions focused on asset managers' views about the impact of the Euro-zone problems on the location of asset management firms and how the collapse of the Euro could impact on the location of the largest asset management companies.

Along with the responses to these two questions, this survey draws on the Global Financial Centres Index more widely as well as interviews carried out by the author with senior leaders in the asset management industry.

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