Top issues facing asset managers
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Dear clients, colleagues, and friends,

After the financial crisis of 2007-09, a recession and the volatile markets of 2011, the US and global economies have been undergoing a modest, if tentative, upturn, and the asset management industry similarly has been recovering, experiencing improved valuations, increased assets under management and enhanced margins.

Even as it enjoys this mild resurgence, the industry continues to face challenging markets, the implementation of regulatory reform initiatives, competition for clients and talent and new expectations from investors, regulators, industry partners and other stakeholders.

Under such circumstances, asset managers are attempting to generate improved performance results, rebuild profitability, manage risk, compete for talent and achieve the operational excellence that will drive future growth.

This paper identifies nine key challenges that the asset management industry faces, describes at a high level how the relevant issues are evolving and outlines how some managers are responding to these conditions.

In spite of the challenges it faces, the asset management industry is positioned for performance and future growth. However, success is not guaranteed nor will it be universal. The firms that succeed will be those that can take transformational steps to adapt to changes in the industry and take advantage of the opportunities opening up in the global marketplace. Those firms that can successfully adapt and compete will be the winners in this larger arena.

PwC is committed to working with its clients and partners in the asset management industry to help them develop effective solutions for the business issues they encounter. We look forward to hearing your thoughts on these issues. Please feel free to contact any of the practice leaders listed in the back of this report or your local PwC representative with your comments.

Barry Benjamin
US and Global Leader, Asset Management
More than at any time in the past, asset management boards have significant oversight responsibilities and need help executing their roles and responsibilities effectively.

Key considerations for asset managers

Since passage of the Sarbanes-Oxley Act of 2002, asset management companies have seen an increased focus on governance and heightened fiduciary expectations for both executives and directors. Subsequent regulatory initiatives in the US and globally, including the Dodd-Frank Financial Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act), the Basel Accords and the Solvency II Directive, have helped to create what is effectively a new regulatory framework for the asset management industry.

At the same time, the volatile markets of the past dozen years have also had an impact on asset management governance, with risk management programs, controls and conduct of companies subject to increased scrutiny by shareholders, policymakers, regulators, investors and other stakeholders. There is pressure for enhanced transparency and disclosure, increased executive and director accountability and a greater voice for shareholders and other stakeholders in decision-making.

In light of these new regulatory and stakeholder initiatives, the industry is rethinking its traditional organizational and governance models, with greater involvement and oversight by executives and directors, especially board audit committees. In particular, many directors are increasing their level of expertise, and are reconsidering the depth and breadth of their oversight of a range of issues.

Alternative asset managers, too, are re-evaluating their governance models, including considering more formal committee structures, as the pressure for transparency and disclosure is felt just as keenly as it is among managers of traditional funds. Alternative asset managers have also been implementing a range of new controls in response to investor and regulatory expectations, which need to be coupled with strong governance oversight.

Oversight requirements are likely to increase significantly during the next two years, as final rules generated by the Dodd-Frank Act and other new laws are implemented.

The US Securities and Exchange Commission (SEC), in particular, is focused on how asset management firms are assuring effective oversight of their activities. The SEC is especially looking at how fund boards are carrying out their duties, as well as the extent to which boards are partially or fully responsible for problems discovered within fund groups, e.g., the role of boards in analyzing fund expenses. SEC staff members are examining board meeting minutes to identify problems and evaluate whether boards have used good judgment in their oversight function.
Looking ahead

Asset management directors may consider defining and periodically evaluating the appropriate governance committee structure, roles, decision rights and supporting management processes to drive effective decision-making, manage risk and enable improved transparency. Management’s information and reporting practices also could be analyzed to help meet the need for greater transparency and more timely delivery of information.

Directors may need to undertake an active dialogue with executives on emerging industry issues and challenges including, among others, regulatory compliance, valuation and disclosure. Risk management is an ongoing concern, and requires a continuing effort to identify and assess risk. Directors also might want to have greater insight of the compliance program, to gain confidence that it is reasonably designed and operating effectively. In this regard, boards and executives could benefit from an independent assessment and analysis of the compliance program.

Directors will need to continue to closely monitor compliance with existing regulations—and be mindful of new ones— affecting the industry and their funds. Given the increasing complexity of regulatory requirements, asset managers may wish to consider seeking directors with specific types of relevant knowledge and skills and create board sub-committees with expertise in such critical functions as risk management, compliance, valuation and governance. Directors should be comfortable working with the details of such complex matters as the use of derivatives, controls to prevent insider trading, valuation policies and regulatory compliance.

Companies also may want to consider creating a risk management “road map” to identify potential threats, warning signs and lines of defense early on, and promote strong, respectful relationships among directors, internal auditors, chief compliance officers and risk management executives to better advance understanding of issues such as trading strategies, valuation policies and compliance.

Communications between executives and directors could extend beyond quarterly meetings and other regularly scheduled sessions. Given the rapid pace of regulatory change, companies may want to offer continuing education programs, especially given the important changes in regulations and corporate governance.

How PwC can help

- Assist managers in developing and offering continuing education programs that can help directors further understand their roles and acquire the technical and industry knowledge needed to discharge their responsibilities effectively.
- Aid boards and management in improving their functioning by identifying external benchmarking data and key performance indicators to help recognize opportunities for process improvement and cost savings.
- Define, and periodically evaluate, the appropriate governance committee structure, roles, decision rights and supporting management processes to drive effective decision-making, manage risk and enable transparency.
- Assess the existing risk management program or perform an independent risk analysis to compliment the view provided by management. Boards need confidence that their firm and its funds have no unintended or undiscovered key risks, and existing legacy risk management programs may not be adequate to meet these expectations in an evolving environment.
- Periodically assess management’s information and reporting practices to make them more responsive to the need of the board, investors and other stakeholders for more transparency and timely delivery of information.
- Assist boards in their compliance oversight responsibilities by evaluating the fund/adviser’s compliance program, and providing feedback on its design, operation, and effectiveness, as well as conduct analyses of particular compliance-related problems or concerns that may arise.
Navigating Risk Complexity

The financial crisis and its aftermath have raised questions about the effectiveness of risk management. Economic uncertainty, the convergence of risk factors and new regulations add to the complexity of risk management.

Key considerations for asset managers

The financial crisis and its aftermath have caused deep reflection within the asset management industry on the effectiveness of risk management in its current form. Economic uncertainty and the resulting correlation and convergence of risk factors – such as credit, market, liquidity and valuation risks – during periods of heightened market volatility and stress have underscored the need for a more proactive and adaptive approach to risk management.

In addition to economic risks, there are tax risks which asset managers are recognizing need to be a part of their risk management function. No longer is tax simply an adjunct function to a firm’s day-to-day operations; instead, it is becoming a fully integrated part of the firm’s risk management function. This requires asset managers and their tax departments to approach the tax function differently.

External forces also are driving change, with the bar being raised significantly in terms of expectations around sound risk management and governance practices, for both traditional and alternative asset managers. An increasingly complex regulatory climate has significantly heightened demands for risk oversight, transparency and accountability. Investors also expect institutional-quality governance, processes and controls from their asset managers and are seeking greater transparency and disclosures around the firm’s risk management practices than ever before.

Additionally, the SEC has been conducting aggressive investigations stemming from problems that emerged during the financial crisis. This may have implications for firms’ risk management programs: possible weaknesses and fraudulent valuations of portfolio holdings; possible misrepresentations concerning the risk of specific products and investment strategies; and complex structured products.

In addition, recent high-profile cases have involved operational errors, allegations of fraud, rogue trading, insider trading and improper use of information or disclosure. Headline-making investigations and enforcement actions threaten severe reputational damage to firms that fail to manage their operations through rigorous risk and control programs.

Each of these trends is likely to continue for the foreseeable future, increasing the complexity and interconnectedness of risk. The confluence of these factors is compelling asset managers to formalize and improve their risk management process with enhanced risk oversight, transparency and accountability.

The Internal Revenue Service and its counterparts around the world also have increased their activities, performing audits in the belief that all possible tax revenue is not being collected. In order to be prepared for these audits, which can be intensive, firms need to prepare differently than in the past. Well-organized files, documentation of positions taken and the assistance of experienced dispute resolution resources are part of the tax infrastructure needed for this process.

As transparency around risk management increases, it also will be critical to align descriptions of the risk management policies, procedures and disclosures made to investors, regulators and others with the firm’s risk management controls in practice.

Beyond the requirements of a changing and more complex tax environment, transparency is also being demanded by both investors and governments (e.g., via measures such as FATCA). The requests for information, sometimes within short timeframes, place a toll on the tax function. Failure to obtain the information quickly and accurately can put a firm at tax risk, as well as shake investor confidence in the firm’s risk management processes. More and more, investor due diligence processes inquire into a firm’s operations, tax function and tax positions taken.
Looking ahead

Economic uncertainty, volatile market conditions, tax scrutiny and an evolving regulatory environment are likely to continue for the foreseeable future, and asset managers – both traditional and alternative – are adapting and refining their risk management strategies and controls.

Asset managers increasingly are looking to re-tool their risk management programs to place greater emphasis on newer, emerging risks or those that might be considered improbable in nature. Firms are placing more focus on monitoring both the internal and external environment to spot developing trends, understand the interconnectedness with other risks and plan appropriate risk mitigation strategies. In addition, managers are reassessing their tax functions, which are being asked to address new compliance requirements, more complex processes, smaller tolerances for error and expectations that they be a part of risk management.

Asset managers are likely to continue focusing on strengthening the linkages between risk, regulation and business strategy with increased focus on an enterprise-wide approach to risk management. Expect a heightened focus on operational risk, compliance risk, service provider risk, tax risks, fraud risk and liquidity risks while balancing regulatory demands for increased transparency and due diligence.

While approaches to risk management and the formality of risk management programs continue to vary across the industry, common practices are emerging, including identification of the types of risks that most asset managers are looking to mitigate and processes to identify, assess and report on enterprise risks.

How PwC can help

- Assess and benchmark risk management function, organization and framework.
- Assist with the design and implementation of an enterprise-wide risk management framework and organization for identification and management of financial, business and operational risks.
- Perform analyses to identify tax issues, prepare supporting documentation and reduce the risk of protracted audits or adjustments.
- Provide professional services in connection with the development of testing programs around key risk controls (e.g., use of models, content and quality of risk reporting and information).
- Assist with risk management policy development.
- Document tax policies, conduct analyses and perform training on a variety of tax issues (e.g., permanent establishment) which may have been set out at the beginning of a business or operation but could create issues if not revisited in light of new requirements or evolving circumstances.
- Support asset managers in the development and assessment of risk methodologies for market, credit, operational, liquidity and funding risks.
- Assist with the development and assessment of trading supervision programs and controls.
- Provide professional services in connection with the development and implementation of risk management technology solutions.
- Conduct financial product and withholding tax analyses on a periodic basis to reduce the potential for unexpected tax situations.
- Help with the design and assessment of valuation-related processes including independent price verification, sources of valuation data and methodologies and model controls.
- Assist with transaction due diligence on target company portfolios and risk processes and controls.
- Assist with tax audit processes through experienced dispute resolution teams.
- Conduct state nexus studies to determine whether liabilities exist.
Navigating Regulatory Complexity

New regulations issued under Dodd-Frank and other legislation are changing how asset managers do business. Additional rulemakings and stepped-up oversight and enforcement promise even more pressing challenges.

Key considerations for asset managers

Asset managers face unprecedented regulatory and compliance challenges. The Dodd-Frank Act imposes new obligations and new regulatory frameworks, with additional rules still to be issued. In addition to the Dodd-Frank Act, regulators are imposing other new rules that will have significant impact on the asset management industry.

The new rules govern many, if not most, aspects of the asset management business – the advice provided, the way securities are traded, how funds are marketed, the disclosures provided and personal trading by employees.

New regulations require that advisers to private funds – hedge funds and private equity funds – register with the SEC as investment advisers, submit new information on Form ADV and come into compliance with the Investment Advisers Act of 1940. This is a significant undertaking since it requires compliance with new disclosure, recordkeeping, custody, compliance program and supervisory requirements.

Private fund managers also are required to submit data on the new Form PF (Private Fund), intended to provide the government with a measure of systemic risk. Form PF will require changes in operational, data and compliance policies and procedures for many private fund managers. Most asset managers have their initial Form PF compliance dates during 2012. To meet this deadline, they are assessing the extent to which they currently collect the needed data, determining whether their technology systems are sufficiently robust to gather all of the required data and testing their ability to collect and submit the data.

Many asset managers are affected by other new US regulations: requiring advisers to commodity funds to register with the Commodity Futures Trading Commission (CFTC); imposing reporting requirements on “large traders”; prohibiting banks from managing or sponsoring the Volcker Rule’s “covered funds”; creating new prohibitions on political contributions (pay-to-play); and providing bounties for “whistleblowers” to bring information about violations to regulators. New regulations for money market funds are expected to gain traction. Outside the US, many asset managers will be affected by a range of new regulations, including the new European Union’s Alternative Investment Fund Managers Directive (AIFM Directive).

In addition to new regulations, regulators have higher expectations of registered investment advisers today – they will demand that firms have robust governance processes and current compliance programs with rigorous testing. The SEC will assess the firm’s compliance program during examinations, and may deem an adviser to be “higher risk” if it has a weak compliance program, or its senior managers do not appear to support a healthy “culture of compliance” within the firm.

The SEC is also taking steps to investigate and bring enforcement cases in the asset management industry. Having created a specialized unit, the SEC’s enforcement staff is investigating practices ranging from having an ineffective compliance program, to abuses involving valuation, sales practices and disclosure, allocations of expenses and securities, performance claims, insider trading, and other types of compliance problems. The consequences of non-compliance can be significant, and a compliance failure can be detrimental, even fatal, to a firm’s business.

Beyond regulatory expectations, investors, clients and prospective clients are demanding greater transparency and confidence that the manager has strong compliance and internal controls. With increased demands for accountability, senior executives and boards also need confidence that their firm has no hidden compliance problems. Existing compliance programs may not be adequate to meet these expectations. The chart below shows some of the key compliance challenges for asset management firms today.
### Top compliance risk areas for asset managers

<table>
<thead>
<tr>
<th>Compliance program</th>
<th>Has your firm recently assessed the particular risks of its business model and operations? Is your compliance program effectively designed and administered to prevent, detect and promptly correct compliance problems? Have you addressed the areas that regulators currently focus on?</th>
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<tr>
<td>Safeguarding investor assets</td>
<td>Are investor assets safe from theft, loss, and abuse? Are fee and expense calculations and allocations controlled and monitored to prevent abuse?</td>
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<tr>
<td>Valuation</td>
<td>Is your firm able to price and value client securities appropriately, particularly illiquid or difficult-to-price securities, in all market conditions?</td>
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<tr>
<td>Institutional conflicts</td>
<td>Has your firm identified and addressed potential conflicts arising from the selection of service providers, the manner in which securities and opportunities are allocated among clients, in brokerage execution and affiliated dealings? Is your disclosure adequate?</td>
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<tr>
<td>Personal conflicts</td>
<td>Does your firm have an appropriate code of ethics and adequate controls over employee trading, gifts and entertainment, political contributions and other potential employee conflicts of interest?</td>
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<tr>
<td>Insider trading</td>
<td>Has your firm identified the sources of material non-public information it receives and/or maintains? Has it instituted adequate controls to prevent and detect possible insider trading at the personal or portfolio level?</td>
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<tr>
<td>Investment guidelines and restrictions</td>
<td>Does your firm maintain adequate controls to assure that all investments and holdings are consistent with disclosures made to clients and applicable restrictions?</td>
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<tr>
<td>Marketing practices</td>
<td>Are your firm’s marketing, performance advertising, and sales efforts fully compliant with all requirements? Is there a robust pre-use review process?</td>
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<tr>
<td>Regulatory reporting</td>
<td>Is your firm filing fully accurate and timely regulatory reports, including newly-required reports?</td>
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<tr>
<td>Trading</td>
<td>How does your firm comply with its obligation to seek best execution, and how does it prevent and detect trading violations involving short selling, offerings and manipulation?</td>
</tr>
<tr>
<td>Risk disclosures</td>
<td>Are you making full and accurate disclosures to all relevant investors/clients concerning liquidity, counterparty, investment, and other risk areas?</td>
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### Looking ahead

Staying current with new regulations and having the means to provide effective implementation will be daunting enough for asset managers, but the year ahead promises even more pressing challenges – accelerated rulemakings as well as continued higher investor expectations and regulatory oversight and enforcement.

Asset management firms will want to take a hard look at the operation, resources and effectiveness of their compliance programs, particularly in the key risk areas. Senior managers, chief compliance officers and directors will continue to see increased regulatory and investor expectations with respect to compliance programs, and may benefit from having an independent analysis of the compliance program.

Additional forthcoming regulations may include those affecting money market funds, target-date funds, use of derivatives, mutual funds’ distribution expenses, and broker-dealers’ standard of care. Asset managers operating outside of the US may have to comply with new requirements of foreign jurisdictions, including the Basel Accords and the European Union’s AIFM Directive.

### How PwC can help

- Provide regulatory compliance and regulatory risk management services that include everything from an initial risk assessment to a thorough compliance analysis to the development and monitoring of an effective, ongoing compliance program, to assistance in training firm employees.
- Assist directors, senior managers and chief compliance officers by conducting an analysis of the design, operation and effectiveness of the compliance program.
- Conduct risk-targeted analyses in areas of concern and provide recommendations concerning robust compliance practices.
- Assist asset management firms in developing the forensic testing, reporting metrics, surveillance, monitoring and training features of the compliance program.
- Assist asset managers with preparing to file Form PF, through a three-phase, firm-wide assessment of compliance readiness with a thorough evaluation of the firm’s ability to collect the data required for completion of the form.

April 2012
The operations function has always been a highly complex, yet essential, part of the asset management industry. Even while asset managers are responding to a changing regulatory regime and increased oversight, they also are experiencing an increase in transaction volumes and complexity, placing stress on their front, middle and back office systems.

Market volatility and pressure on fees also have concentrated the attention of asset managers on their operational processes as a way to control costs. In order to streamline processing and increase profitability, asset managers are focusing on technology and operations enhancements to drive efficiencies. These have become increasingly important given the continued trend towards profit margin erosion and rising expenses.

The demands on asset manager operations functions are growing because of expanded regulatory oversight, new rules, new and more complex asset classes and investment strategies and growing investor expectations. Asset managers also are seeking to drive operational efficiencies in response to industry-wide drivers such as fee compression and flat or decreasing asset levels and to respond to complex tax requirements, especially when multiple jurisdictions are involved. Some firms also have underinvested in technology, have not consolidated or integrated systems after mergers or continue to use manual processes.

Failure for these functions to perform as expected places asset managers at multiple risks, including higher costs due to inefficiency or errors, losses because of problems with execution, unmet client expectations and regulatory violations that can result in reputational damage or financial loss.

**Key considerations for asset managers**

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### Delivering Cost-Effective Technology & Operations

Asset managers continue to evaluate opportunities to increase operational excellence and efficiency. Third-party servicing relationships allow managers to leverage technology investment, realign operations and eliminate costs while receiving high-quality specialized services with established service levels.

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### Profit margin erosion

![Graph showing profit margin erosion from 2001 to 2011](source-image)


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### Asset manager expenses

- 43% Investment Management
- 38% Sales & Marketing
- 19% Ops, Tech, Admin

![Pie chart showing asset manager expenses](source-image)

Looking ahead

Many asset managers are seeking the capabilities necessary to execute properly at each stage of the operations function, whether by developing the needed expertise and resources in-house or acquiring them through outsourcing.

Some functions lend themselves particularly well to outsourcing, including middle office operations such as corporate actions processing. The scope of outsourcing is also expanding to the front office, where functions such as research are reengineered, with lower-level data management tasks consolidated and transferred to providers, while value-added data analysis remains in-house.

Workflow management tools are increasingly being used to standardize both system and operational processes to improve efficiency, provide greater transparency and create an increased rate of straight-through processing. Workflow tools can also allow processes to become more portable to either on-shore or off-shore centers of excellence.

Asset managers are investing more heavily in data management strategies and platforms to improve efficiency, management reporting, and compliance reporting and oversight, as well as to allow for the ability to switch external service providers more readily, should the need arise. Traditional methods of data warehousing are being supplemented by more virtual data warehousing, where information is retrieved and assembled for reporting upon demand from multiple underlying transactional source systems.

Many asset managers are seeking greater multi-asset class coverage within their support platforms, be they in-house or outsourced. Historically, securities have been processed separately from derivatives, and alternative investment strategies have been processed separately from traditional investment strategies. Rather than simply creating the appearance of integration on client statements, firms are realizing that multi-asset class convergence can generate needed processing efficiencies.

How PwC can help

- Aid asset managers in achieving operational excellence by improving their operating model, defining key process control points and benchmarking to leading practices with peer asset managers.
- Assist asset managers in achieving greater efficiencies through defining and enabling process driven workflow and providing solutions to drive process-centric document management across key aspects of the organization.
- Assist in implementing operational and technology improvements in areas such as sustainable cost management and control, business process execution, and organizational design improvements.
- Perform analyses for operations and technology platform enhancements, conduct due diligence on prospective vendors and provide professional services in connection with implementation of technology, systems and process improvements.
- Assist in the development of an IT strategy which more effectively aligns technology investments and initiatives with business priorities and industry trends, while identifying solutions for gaps in key capabilities and underlying infrastructure.
FATCA and Global Information Reporting

Offshore funds or other foreign financial institutions could be subject to a 30 percent US withholding tax if they fail to comply with new documentation requirements, due diligence procedures and reporting obligations.

Key considerations for asset managers

New tax and regulatory requirements, investor expectations, the globalization of the asset management industry and the increasing scope and complexity of products are combining to increase the global information-gathering and reporting demands facing asset managers. The most significant reporting demands come from US laws enacted in recent years, notably the Foreign Account Tax Compliance Act of 2009 (FATCA), for which regulations providing guidance were proposed on February 8, 2012.

FATCA is intended to prevent US citizens and residents from evading federal income tax on US-sourced income generated from investments in or through non-US entities, offshore funds and other foreign financial institutions (FFIs). The new documentation and reporting requirements are meant to increase the transparency of the income of US citizens and residents.

The requirements include greater transparency about investors, such as additional data to be collected, analyzed and reported. In order to comply with the regulations, data may have to be combined from internal sources and from third-party service providers. Systems may need to be enhanced to store, calculate and report the data.

There is a large operational and business component to FATCA for asset managers to consider, since compliance affects numerous functions throughout an organization. These include existing investor relations, investor communications, tax withholding and reporting, compliance, legal and regulatory, including know-your-customer (KYC) and anti-money laundering (AML) compliance.

Many asset managers currently rely on third-party service providers (administrators, custodians, etc.) to have a role in these functions and expect that these service providers would also have a role in FATCA compliance. However, many providers have not yet offered FATCA compliance services to the asset management industry.

In many cases, asset managers will need to work with their service providers to put in place systems to comply with a wide range of data computation and reporting requirements.

FATCA's key compliance dates remain in place. Offshore funds, foreign financial institutions and non-financial foreign entities which fail to meet FATCA's reporting requirements will be subject to a new 30 percent withholding tax on a wide range of US-sourced income, including dividends, interest and gross proceeds.

If applied, the 30 percent withholding tax could make most US investments uneconomical: For example, if a fund has any material turnover, the tax could exceed the fund’s net asset value. Consequently, most offshore funds that have meaningful direct or indirect US investments will have to enter into foreign financial institution agreements; many also will need to make substantial changes to customer information and reporting systems.

Additionally, the US, France, Germany, Italy, Spain and the United Kingdom announced they will explore a common approach to FATCA implementation through domestic reporting and reciprocal automatic information exchange based on existing bilateral tax treaties. This multilateral effort will allow FFIs to report information to their local tax authorities instead of directly to the IRS. The Treasury Department has made it clear that the information required to be reported to local tax authorities will not be materially different from the requirements enumerated in the proposed regulations.

FATCA is only one of several information reporting measures intended to give the IRS more information on offshore US investment activities in order to enhance its enforcement abilities. Other mandates, such as the Report of Foreign Bank and Financial Accounts (“FBAR”), potential compliance with the Financial Transactions Tax (“FTT”) and managing global withholding tax on capital gains each offer their own information-gathering and reporting compliance challenges. For example, new regulations published in 2011 compel many who previously had no FBAR reporting obligation to file reports.

The European Union's Alternative Investment Fund Managers Directive (AIFM Directive), adopted by the Council of the European Union in 2011, will affect US alternative investment managers selling to or raising funds from European investors; compliance will require stronger controls, recordkeeping and reporting. The directive’s provisions are to be translated into national law by each of the EU’s members by 2013 and asset managers will be watching closely as this legislation advances.

Beyond regulatory-driven demands for increased reporting, investors have heightened expectations for increased fund transparency, more accurate reporting and greater accountability and governance on the part of asset managers.
Looking ahead

With regulatory reporting requirements changing quickly and severe penalties for non-compliance, asset managers are closely monitoring developments in the drafting of new rules, standards and guidelines for information reporting.

Among the concerns addressed by the proposed FATCA regulations were the treatment of local distributors, the treatment of funds that prohibit sale to US persons and the application to foreign partnerships. In some cases, they reduce the overall burden imposed on foreign funds. However, they have also added complexity in areas specific to asset management. FATCA, as a whole, will still significantly affect business practices, policies and procedures for many in the asset management industry.

FATCA’s main deadline to enter into an FFI Agreement is set for July 1, 2013. Some have suggested that the proposed regulations have either delayed FATCA compliance or that the efforts around compliance for the asset management industry have been substantially mitigated, but this is not correct. There is still a substantial amount of work to be done.

Although these regulations are only proposed, and not final, they provide sufficient guidance for fund managers to begin assessing what information gaps exist, determining what systems changes will need to be made and communicating with their service providers and investors to address the looming effective dates of these rules and make the necessary changes to their business processes and procedures in order to comply with FATCA’s requirements.

Asset managers can begin by getting up to speed on FATCA and staying abreast of developments such as the issuance of updated Forms W-8, a draft FFI Agreement and the release of the final regulations. Although the proposed regulations provide a great deal more guidance compared to that which had been released previously, there is still a good deal of guidance to come. The proposed regulations also still leave some open questions on a number of topics.

Compliance officers and counsel, who are the most likely to be charged with signing responsibility, can identify which funds and clients will fall within their FATCA footprint, identify the requirements associated with those funds and clients and develop a plan for moving forward.

FATCA implementation agreements may need to be put in place with service providers, intermediaries or distributors for the functions performed by these third parties, with the relevant roles and responsibilities defined. Asset managers will need to begin communicating with these parties.

Many asset managers are trying to coordinate FATCA compliance with ongoing measures to more efficiently comply with the requirements of FBAR, the AIFM Directive and other new regulations. Evolving investor expectations may become even more of a minefield for the unwary. The combination of market declines and losses due to managerial negligence or criminal action has caused both retail and institutional investors to demand greater transparency and accuracy in performance reporting and disclosures.

Asset managers that proactively provide a higher level of reporting, including third-party assurance reporting, and adopt policies and procedures to increase clarity will be able to gain a competitive advantage.

How PwC can help

• Aid asset managers in determining how they are affected by FATCA, FBAR and other new regulatory requirements.
• Assist asset managers with initiating a FATCA compliance program to facilitate compliance regarding:
  – Fund entities, including Fund Investment Vehicles, SPVs, Disregarded Entities and Blocker, etc.;
  – Fund investors, including the due diligence process for new and preexisting investors;
  – Internal operational impacts arising from these requirements; and
  – Business impacts on relationships with third-party service providers and distributors.
• Address common technology and operations challenges facing asset managers, including:
  – Technology and operations governance with regard to consistency, aligning initiatives and building flexibility;
  – Reliance on KYC/AML systems where information may be insufficient, changes in circumstances may make information unreliable or there are variations in data quality;
  – Expansive number of entity classifications for FATCA makes the classification exercise onerous, data storage difficult and tracking the impacts complicated;
• Aggregation of account holder balances with data quality issues, data privacy laws, defining “relationship manager” and special aggregation requirements based on a relationship manager’s knowledge; and
• Analysis and remediation of pre-existing accounts can be difficult with diverse data housing environments, the need for third-party analysis and the need to coordinate manual work.

Build the necessary global account opening process and standards, as well as systems and infrastructure needed to for compliance.
Trust & Transparency

Awareness and sophistication have increased among investors, regulators and other stakeholders. Increasingly, they demand higher levels of transparency around performance, holdings, investment strategies and other matters.

Key considerations for asset managers

The demands of a global marketplace, increasingly complex products and a decade of market volatility and financial scandals have generated a new awareness and sophistication among asset management stakeholders including investors, consultants and regulators.

The resulting stakeholder scrutiny, together with new regulation, drives demand for greater transparency in all aspects of the industry, including compliance, operations and controls, performance reporting and tax. Senior executives and directors concerned about fulfilling their fiduciary responsibilities also are demanding enhanced reporting from subordinates. As a result, greater transparency in fund management, confidence in reporting accuracy and better accountability and governance have become top priorities.

Asset managers increasingly are finding that, after concerns about the accuracy of asset manager data and statements, enhanced transparency can build trust with investors and consultants alike. Managers who provide information in a timely, accurate and useful manner can gain a competitive advantage in attracting assets.

Demands for enhanced, more frequent due diligence have been reinforced by recent market volatility, with investors seeking greater knowledge of manager policies, procedures and investment holdings and independent verification of manager-provided information as part of enhanced due diligence processes. Compliance with stated investment objectives and requirements increasingly is a concern, especially among institutional investors.

Regulators are a second source of pressure for manager transparency. Regulators throughout the world are seeking increased access to relevant information and expanding oversight and enforcement, especially in the US and Europe.

New and more complex regulations, including more closely aligned accounting standards, are placing competing and sometimes conflicting pressures on asset managers. There is a need to report on new data points that historically have not been required, such as investment data in Form PF, as well as investor data required by FATCA. Some firms also lack the internal regulatory awareness, knowledge and procedures to respond to the new requests in a complete and sustainable manner.

These reporting requirements require sophisticated systems to support requests, especially when real-time data are required (as opposed to the period-end data typically requested in the past). More effort is required to develop accurate reports and information and then analyze the results. The task is complicated by the increasing tendency to use multiple back-office service providers, administrators and prime brokers, many of which may not be using compatible systems.
Looking ahead

The increased demands for investor- and regulatory-driven operations, performance, compliance and tax information reporting are challenging existing reporting systems and burdening staff. The fact that many requests are in real time rather than historical in nature adds an additional level of complexity.

One problem many managers are encountering is that they have multiple legacy systems, often with different technology platforms, to collect and disseminate information. Gathering the data needed out of such legacy systems can be inefficient and typically is not subject to scalable enhancements. Some data systems, especially those that record transactions related to complex derivative products, entail manual entries or work-around calculations.

Requirements in this area are likely to continue to increase. The finalization of a number of new regulations in the 2012-13 timeframe, with their own required data streams, will only add to the reporting burden, especially if the data are generated through overlaid systems.

How PwC can help

• Assist asset managers by helping them to establish the governance and controls expected by investors, regulators and other stakeholders, particularly to provide greater transparency into all aspects of the fund, the fund manager and the fund administrator or firm performing valuations.

• Help managers respond to the challenges they face by assisting them in building their infrastructure and enhancing their processes and controls across a number of areas, including compliance, performance, operations and tax reporting.

• Identify scalable solutions including data warehouses that, combined with a strong internal control framework, can enable the efficient delivery of transparent data to meet stakeholder requests.

• Assess the existing infrastructure and supporting control environment and conduct ongoing, independent verification of management-provided information, including the effectiveness of the control environment and a manager’s performance track record.
In recent years, many asset managers have found both organic and inorganic growth very difficult to achieve. As they strive to grow revenues and earnings, they are examining their portfolio of products, distribution relationships and the globalization and localization needs of their businesses.

Some are attempting to strengthen their market position, growth potential and earnings through the use of mergers and acquisitions. Pure-play asset managers hope to use acquisitions to expand their product offerings, distribution channels and geographical footprint. Smaller players seek consolidation in order to attract investors and spread their operating costs over a larger base.

Yet, despite optimism that M&A activity would strengthen, activity has been much slower than expected, and deal valuations remain lower than they have been historically.

High levels of uncertainty created by the slow economic recovery, volatile markets and regulatory changes slowed down M&A activity, making 2011 the worst year in global asset management M&A in the last five years.

The North American asset management market is mature; therefore, sustainable organic growth is hard to achieve. Although there are many sophisticated asset management firms, the sector is highly fragmented and some firms lack efficiency. If executed well, M&A can create competitive advantage and provide scale, which, in turn, could bring efficiencies.

Accordingly, North American asset management firms are likely to return to the market when the conditions improve and they find strategic acquisition targets that will be accretive to their businesses.

Some of the slowness is attributable to the continued volatility in the market, which results in uncertainty about growth prospects in the near- and mid-term and is suppressing valuations. Although the desire for M&A remains strong among buyers, particularly firms based in Canada and Asia, lower valuations are making prospective sellers wary of putting their businesses up for sale. Unless they are forced to sell, these companies are waiting for an improvement in pricing before returning to the M&A market.

Other issues – regulatory approvals, integration of operations and the large number of new regulations coming online whose impacts and costs are uncertain – pose additional challenges to firms seeking to successfully combine operations.

Finally, private equity firms, which had been concentrating on improving the performance of their portfolio companies, are playing a growing role in new deal-making. Their participation is likely to continue to increase, given that many firms have significant amounts of funds awaiting investment.
Looking ahead

As indicated earlier, M&A volume has dropped significantly since the financial crisis. Many prospective sellers are holding back in the hope that valuations as well as earnings will improve in the near future.

Investors continue to worry about risk and de-leverage their portfolios, economic growth for developed countries has been disappointing and factors such as significant competition and increased operating costs are further depressing growth and profitability.

On the other hand, there are many positive factors that could result in improving M&A activity. There are interested buyers in the market, including local and foreign corporate buyers and private equity firms. Both the level of interest from potential buyers as well as an improving economic outlook potentially could push valuations up and bring sellers back into the market.

A large contribution to the expected improvement in M&A activity is expected to come from European bank divestitures. Certain European banks are already well on their way with divestiture of their asset management arms. If they are successful, it will increase deal values.

Business factors also play a role. Both the traditional and alternative asset management sectors are fragmented. With pressure on revenues and the increased cost of compliance, the profits of many companies are hurting, which may increase consolidation in the industry as companies seek scale and efficiencies.

In this environment, asset management firms are evaluating their business, assessing the key markets and product types they want to play in and exploring M&A as a means to achieve strategic goals. This is likely to lead to the sales of non-performing or non-scale businesses; similarly, the proposed Volcker Rule may force institutions to sell off proprietary trading desks or investments in alternative managers.

Deal activity may increase as the market outlook clears and banks execute carve-outs. The situation with European banks, and more broadly the increasing capital requirements for regulated entities, may create opportunities for pure-play asset managers and private equity firms to acquire asset management businesses.

How PwC can help

• Aid managers in implementing merger and acquisition transactions by using a deep knowledge of the industry to identify possible partners and perform financial, tax and operations due diligence in advance of negotiations.

• Assist with strategy development and market research, including development of market insights relating to countries around the world using PwC’s global network.

• Provide due diligence assistance including:
  - Business and financial due diligence;
  - Analysis of third-party audit work papers of the target company;
  - Tax due diligence;
  - Human resources due diligence;
  - Regulatory compliance due diligence;
  - Information technology due diligence;
  - Operational due diligence;
  - Risk management due diligence;
  - Complex accounting support; and
  - Control environment assessment.

• Assist with tax and accounting structuring and integration planning and synergy analysis to promote the most advantageous financial positioning in advance of transactions.

• Assist with support drafting sale and purchase agreements (e.g., earn-out and closing balance sheet and working capital adjustment mechanism, reps and warranties, etc.).

• Assist with capital markets-related needs (e.g., debt offerings, financial reporting).

• Assist with M&A process development and improvement.

• Provide closing balance sheet diligence and purchase price adjustment support.

• Assist with post-merger integration planning, management and execution including operational, human resources and synergy analysis; provide support with product and market deployment, development of appropriate compensation structures and upgrading technology and operations infrastructure.
Economic uncertainty, low interest rates and continued market volatility are affecting investor attitudes, the search for opportunities by asset managers and managers’ relationships with advisers, brokers and other intermediaries. Investors are seeking not only higher returns in a low-yield environment but also more customized solutions to their investment needs. They also are insisting on greater transparency in all of their interactions with managers and intermediaries, including such matters as performance, expenses and risk. Responding to each of these needs complicates operations and adds to management costs.

As the provisions of the Dodd-Frank Act and other new legislation are implemented, more demanding regulation is continuing to affect managers and their business models.

Finally, intermediaries and distributors, operating between managers and their end customers, are increasingly important gate keepers.

With this backdrop, the pressure to achieve growth goals and remain competitive can be a challenge for asset managers.

Asset management companies are closely scrutinizing their business and trying to determine how to restructure in order to strengthen their market position, revenue and earnings. They need to have the infrastructure and processes in place to support growth initiatives, including robust information technology networks, current operations models and platforms and accurate and timely management reporting systems.
Looking ahead

Organic growth, in the absence of market appreciation, may be difficult to achieve and remain elusive for many managers. Nevertheless, organic growth opportunities can be seen in several areas. They all will require sustained focus and investment. This is far easier said than done because operating margins also can be expected to come under pressure as cost structures generally remain inflated and structural changes to the industry decrease revenue yields.

Asset managers may wish to carefully review their current go-to-market strategies and related functions to differentiate themselves and become better aligned with customers, distributors and the global opportunities available to them.

A renewed focus on branding can be expected. Those firms with strong brands and clear alignment across firm strategy, brand and product offerings will attract a disproportionately large share of asset flows. Marketers have an opportunity to engage financial advisers more deeply to better understand end customer investment needs and inform the product development process. New channels provide another opportunity to improve engagement with both advisers and end customers. Mobile technologies, social media and related community-based channels can help to provide a differentiated experience in terms of both offerings and service.

Investor preferences continue to evolve along lines similar to those in 2011 with certain product classes representing growth opportunities for product designers who can support differentiated strategies. Pending innovation in liquid investment products (e.g., actively managed exchange traded funds currently awaiting SEC approval), global and emerging market-focused products and customized solutions such as liability-driven investing are all promising areas for asset managers seeking new markets.

Distributors have an opportunity to develop sophisticated analytics using data about their financial advisers, sales teams and customers. These analytics can help asset managers to identify superior performers, provide information on their best-selling or best-performing products and cultivate their distribution network by further understanding investor needs.

Finally, the expansion and enhancement of client-facing services can improve the customer experience and provide greater transparency through sophisticated reporting delivered through multiple channels.

How PwC can help

• Assist asset managers to improve alignment between their strategy, market brand and internal operating model (people, process and technology).
• Exploit new channels such as mobile technologies and social media to differentiate brand identity, better engage partners and clients and provide improved access to products, services and information that can improve investor outcomes.
• Assist asset managers in working closely with their distributors and intermediary partners to use sophisticated analytics to better understand their clients’ investment goals and develop products that are more closely aligned with those goals and more responsive to identified needs.
• Work with designers to identify products and strategies that better meet evolving client needs and also have economics that are attractive to intermediaries, distributors and other stakeholders.
• Assist firms in enhancing the customer experience by helping to develop sophisticated reporting, improved transparency and better insights into metrics for performance, risk levels and other important measures.
• Assist fund managers in implementing the infrastructure necessary to support growth, including a governance and risk control framework, information technology systems, financial reporting controls and an operational model that permits firms to quickly take advantage of new opportunities.
Growing and Leveraging Human Capital

For many asset managers, the most significant workforce-related challenge is not in formulating a people strategy but in aligning it with the business strategy and executing it consistently against that strategy.

Key considerations for asset managers

Asset management historically has been regarded as an industry in which the most important assets walk out the door each evening. This has never been truer than it is today: Regulatory flux, globalization and significant changes in personnel practices have combined to place talent – attracting it, developing it and retaining it – high on the agendas of asset management firms.

New regulations being developed under laws such as the Dodd-Frank Act are forcing a reorganization of work and decision-making and have implications for compensation practices, such as the development of claw-back provisions to manage risk-taking.

Regulatory changes also are causing an increased focus on the risk function, which in turn is affecting how performance is measured and analyzed. Changes in compensation practices first seen in Europe may make their way onto US shores through legislation, rulemaking and changes in market practices. As firms respond to these varied demands, it is crucial that they manage regulatory fatigue and avoid a “tick-the-box” mentality.

The globalization of asset management also is driving efforts to deliver a truly global organization strategy which includes an increased need to establish a base-line and manage global workforce data as well as establish flexible and adaptive organization structures that drive collaboration across traditional business unit, product and geographic silos.

Significant changes in hiring, on-boarding, development and succession planning practices – the latter in response to pressure from regulators to provide continuity in critical functions at both the executive and sub-management level – pose challenges to existing practices.

Firms are once again investing heavily in attracting and retaining talent. In concert with today’s business issues, this is driving an unprecedented effort to align people strategy with business strategy.

While a majority of companies have a defined people strategy, environmental pressures create challenges in executing the strategy and there often is an inconsistency in application. Effective execution of a people strategy requires a balanced focus on building and sourcing capability, including the use of alternative talent pools models to manage supply and demand peaks and troughs and creative approaches to sourcing both entry-level and experienced talent.

It also requires increased rigor in conducting functional and enterprise-wide talent assessments; and targeted investments in talent development. Many asset management leaders are committed to addressing the challenges they face by developing an integrated business and people strategy.
Looking ahead

As signs of market recovery continue, asset managers are once again investing heavily in recruiting and retaining talent. They face many challenges in this area, from dealing with regulatory, investor and media scrutiny over compensation to preserving shareholder returns in the face of increasing payroll expense.

Changes in personnel practices are driven partly by new regulatory demands and partly by an increased need to design for improved productivity and capacity management.

Leading managers are establishing flexible and adaptive organization structures that drive collaboration across traditional business unit, product and geographic silos. They also are realigning how they work, seeking to operate globally with effective decision-making and speed of execution.

How PwC can help

- Aid asset managers in defining, leading and sustaining the enterprise culture changes that can help them to become more competitive.
- Assist in establishing common approaches to workforce planning, managing change and organization design.
- Aid asset managers in enhancing their business partner capabilities.
- Help to establish flexible, yet consistent, practices in the areas of incentives and rewards.
- Enhance the business partnership capabilities, business acumen and product, functional and regulatory insights of human resource functions to enable them to demonstrate relevance.
- Assist human resource offices in developing the capacities that can drive successful innovation and serve as role models for the implementation of their organization’s people strategy.
The asset management industry has seen greater changes in the past several years than at any comparable period in its history:

• Volatile and unpredictable markets with assets that seem increasingly correlated in times of stress;
• Regulatory changes that, while they have the potential to produce more stable markets, also could impose significant costs and limit returns; and
• Investors, regulators and other stakeholders are demanding greater transparency.

Each of these factors poses its own challenges to asset managers. An even greater challenge is the possibility of complexity risk, when the very intricacy of these factors and the uncertainty of their interrelationships can add significant, and as yet undetermined, risks. It is difficult to understand the impact among the hundreds of new securities industry regulations being adopted around the world, or how their interplay may yield unexpected results.

The one certainty is that the asset management industry is in a period of transition that likely will take years. At the end of it, there will be winners: those firms and individuals that are quickest to grasp the potential emerging from the changes the industry is going through and act upon their knowledge. They will be the asset management leaders of tomorrow.
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