Striking a balance between regulation and innovation

An extract from AM News June 2009

PricewaterhouseCoopers

Striking a balance between regulation and innovation

Dan Waters, Sector Leader for Asset Management at the UK's Financial Services Authority (FSA), provides insight into the regulatory reaction to the financial crisis including the proposed EU Alternative Investment Fund Managers Directive.

Dan Waters
Financial Services Authority (UK)

Q. What areas are you focusing on as you tighten up regulation of asset management?

A. "These are tough times for asset managers and the collapse of equity markets has hit revenues very hard. People are looking to cut costs and in a people-intensive business there are not that many places to do so. We are very sensitive to where resources are being cut and to the depth of resources that are being retained. To the extent that firms view risk management and compliance as cost centres they can be disproportionately targeted for savings, which we think is the wrong thing to do.

"We have had some significant issues globally, within Europe and in the UK on the liquidity of funds. Some asset classes are quite complex, and valuations are becoming quite demanding even in areas where this has not traditionally been the case. There have been issues with open-end real estate investment funds, and we have emerging concerns about corporate bond funds and their liquidity, especially given extreme volatility and anxieties around corporate credit. We are concerned that these funds are popular at a time when conditions are very testing.

"We expect firms to be stress testing funds exposed to this – to have a good view of the impact of redemption requests and liquidity and to be treating customers fairly. This means treating customers who are redeeming, investing and holding funds equally fairly.

"Post Madoff and Lehman, we are also looking closely at the way client assets are held in custodial bodies and the transparency of those arrangements."

Q. What is your view about proposed legislative changes in Europe?

A. "On the legislative front, there are big changes coming down the pipe. We think that the UCITS IV Directive has progressed well, with thorough stakeholder consultation, consumer testing of initiatives and a robust impact assessment. This process has been conducted in a way that we think is exemplary and there will be good outcomes. The management company passport is to be welcomed.

"The other major piece of legislation is the proposed EU Alternative Investment Fund Managers Directive. This has been understandably driven by enormous political pressure when we are living through what has been dubbed the Great Recession. We consider that changes in regulation are warranted. But we are concerned about the rapid pace of this and the lack of consultation with stakeholders. And we are worried about the unintended consequences of legislation that treats such a wide range of asset management businesses in the same way.

"Fortunately, the European Parliament elections have intervened and will give us more time to collect feedback about the proposals in the directive. This is a huge priority for us. We need to create the window for meaningful consultation that the EU process has not allowed. We are running town hall meetings and will devote our annual conference in September to this important issue.

"To the extent that the proposed directive diverges from the work that was done by the G20 in this area, it needs to be questioned. Furthermore, the underlying analysis needs to be produced to justify some of the proposals."

Q. Is the UK changing from a principles-based approach to a rule-based approach?

A. "If you look at what principles-based regulation was about it was delivering outcomes. Instead of focusing on detailed procedures we wanted to focus more on what was happening at the end of the day – in terms of the prudential position of firms and how they were treating their clients. This has not changed, but we are becoming more intrusive and putting ourselves in a stronger position to challenge firms. This is both on the prudential side around business models and on the conduct of business side."

Q. How does this affect the ARROW approach?

A. "We are integrating some of these ideas into the ARROW approach. We did a lot of work on treating customers fairly. That has been embedded in the ARROW training and ARROW visits are looking at things like culture, remuneration and product design. We are modifying and strengthening ARROW to make it more intrusive and to deliver the results we want."

Q. To what extent do you think the regulations likely to be introduced will affect the critical balance between strong regulation and innovation?

A. "This is a difficult balance to strike and whenever we get into a situation like today's there are clarion calls for something to be done. The danger is that something is done but because it was not given sufficient time it makes things worse. The regulator is bound to make a robust and deep analysis of what the problem is, what its drivers are in the marketplace and how to effect change.

"We would certainly not welcome the EU alternatives directive in its current form. Now is the time for the industry and interested stakeholders to give evidence about what the impact of this proposal will be across hedge funds, private equity, real estate and other types of funds."

Global Asset Management contacts

Asset Management News is produced by experts in their particular field to address important issues affecting the Asset Management industry. If you would like to discuss any aspect of this document, please speak to your usual contact at PricewaterhouseCoopers or one of those listed on these pages.

Global Asset Management Leadership Team

Marc Saluzzi
PricewaterhouseCoopers (Luxembourg)
Global Asset Management Leader
+352 49 48 48 2511
marc.saluzzi@lu.pwc.com

Kees Hage
PricewaterhouseCoopers (Luxembourg)
Global Real Estate Leader
+352 49 48 48 2059
kees.hage@lu.pwc.com

Barry Benjamin
PricewaterhouseCoopers (US)
Americas Asset Management Leader
+1 410 783 7623
barry.p.benjamin@us.pwc.com

Pars Purewal
PricewaterhouseCoopers (UK)
UK Asset Management Leader
+44 20 7212 4738
pars.s.purewal@uk.pwc.com

Brendan McMahon
PricewaterhouseCoopers (Channel Islands)
Global Asset Management
Private Equity Leader
+44 1534 838234
brendan.mcmahon@je.pwc.com

Robert Grome
PricewaterhouseCoopers (Hong Kong)
Asia Pacific Asset Management Leader
+852 2289 1133
robert.grome@hk.pwc.com

David Newton
PricewaterhouseCoopers (UK)
Global Asset Management
Tax Leader
+44 20 7804 2069
david.newton@uk.pwc.com

Tony Artabane
PricewaterhouseCoopers (US)
Global Asset Management
Hedge Funds Leader
+1 646 471 7830
anthony.artabane@us.pwc.com

If you would like to receive copies of this newsletter or would like further information about PricewaterhouseCoopers Asset Management publications, please contact Denise Cook at denise.cook@uk.pwc.com

Editor: Rupert Bruce