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# *Creating value for the Asset Management industry*

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# Introduction

Dear Industry players,

After the financial crisis of 2007-09, a recession and the volatile markets of 2011, the South African and global economies have been experiencing volatile equity markets which impacts directly on valuations, assets under management and margins.

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 publication identifies a number of key challenges being faced by the South African asset management industry, 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 South African asset management industry is positioned for performance and future growth. However, success is not guaranteed nor will it be universal. The asset managers 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 asset managers that can successfully adapt and compete will be the winners in this larger arena.

PwC is committed to working with you in the South African asset management industry to help you develop effective solutions for the business issues you encounter. We look forward to hearing your thoughts on these issues. Please feel free to contact any of the contacts listed in the report or your local PwC representative.



**Ilse French**  
Asset Management Leader – Southern Africa

# Governance

## Key considerations for asset managers

Since the financial crisis, asset managers have seen an increased focus on governance and heightened fiduciary expectations for both executives and directors. At the same time, the volatile markets of the past several 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.

The Code for Responsible Investing in South Africa (CRISA) encourages institutional investors to integrate into their investment decisions sustainability issues such as environmental, social and governance (ESG). CRISA aims to provide the investor community with the guidance needed to give effect to the King Report on Corporate Governance South Africa (King III) as well as the United Nations-backed Principles for Responsible Investment (PRI) initiative. Both require institutional investors to take ESG issues seriously. CRISA applies to institutional investors such as pension funds and insurance companies as the owners of assets, and their service providers, including asset managers and consultants. The Code requires institutional investors to fully and publicly disclose to stakeholders at least once a year to what extent the Code has been applied. If an institutional investor has not fully applied one of the Principles of the Code, the reasons should be disclosed. Disclosure as well as policies should be made public.

In light of the new regulatory and stakeholder initiatives, the industry is rethinking its traditional organisational and governance models, with greater involvement and oversight by executives and directors, especially board and 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 are also 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.

## 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 could also be analysed 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 gain 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.

*More than at any time in the past, asset management boards have significant oversight responsibilities and need help executing their roles and responsibilities effectively.*

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 defence 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 we can help you***

- We can 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.
- We help 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.
- We assess the existing risk management program or perform an independent risk analysis to compliment the view provided by management. Boards need confidence that their asset manager 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.
- We periodically assess management's information and reporting practices to make them more responsive to the needs of the board, investors and other stakeholders for more transparency and timely delivery of information.
- We 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.

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# Navigating risk complexity

## 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 recognising need to be a part of their risk management function. No longer is tax simply an adjunct function to an asset manager's day-to-day operations; instead, it is becoming a fully integrated part of the asset managers risk management function. This requires asset managers and their tax departments to approach the tax function differently.

External forces are also 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 asset managers' risk management practices than ever before.

Additionally, regulators have been conducting investigations stemming from problems that emerged during the financial crisis. This may have implications for asset managers' risk management programs: possible weaknesses and fraudulent valuations

*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.*

of portfolio holdings, possible misrepresentations concerning the risk of specific products and investment strategies, and complex structured products.

In addition, recent high-profile cases globally 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 asset managers that fail to manage their operations through rigorous risk and control programs.

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

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

## 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 are increasingly looking to revise their risk management programs to place greater emphasis on newer, emerging risks or those that might be considered improbable in nature. Asset managers 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 requested 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 we can help you*

- We assist with the design and implementation of an enterprise-wide risk management framework and organisation for identification and management of financial, business and operational risks.
- We provide professional services in connection with the development of testing programs around key risk controls and risk management technology solutions (e.g. use of models, content and quality of risk reporting and information).
- We assist with risk management policy development.
- We support asset managers in the development and assessment of risk methodologies for market, credit operational, liquidity and funding risks.
- We assist with the development and assessment of trading supervision programs and controls.
- We help with the design and assessment of valuation-related processes including independent price verification, sources of valuation data and methodologies, and model controls.
- We assist with transaction due diligence on target company portfolios and risk processes and controls.

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# Navigating Regulatory Complexity

## Key considerations for asset managers

In common with other parts of the financial sector, asset managers are being subjected to a raft of new regulations. Some examples of regulatory and compliance challenges being dealt with by South Africa asset managers include:

- reforms of the distribution system
- minimum qualification requirements in terms of the Financial Advisory and Intermediaries Act for intermediaries
- revisions to Regulation 28 of the Pension Fund Act
- impending revisions to reporting requirements in terms of Section 13B of the Pension Funds Act
- regulation of hedge fund products within South Africa, and
- asset managers operating outside of Europe may have to comply with new requirements of foreign jurisdictions, including the Basel Accords and the European Union's AIFM Directive.

In addition to new regulations, regulators have higher expectations of registered investment advisers today – they will demand that asset managers have robust governance processes and current compliance programs with rigorous testing.

## Top compliance risk areas for asset managers

Compliance program	Has your company 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?
Safeguarding investor assets	Are investor assets safe from theft, loss, and abuse? Are fee and expense calculations and allocations controlled and monitored to prevent abuse?
Valuation	Is your company able to price and value client securities appropriately, particularly illiquid or difficult-to-price securities, in all market conditions?
Institutional conflicts	Has your company identified and addressed potential conflicts arising from the selection of service providers and the manner in which securities and opportunities are allocated among clients, in brokerage execution and affiliated dealings? Is your disclosure adequate?
Personal conflicts	Does your company have an appropriate code of ethics and adequate controls over employee trading, gifts and entertainment, political contributions and other potential employee conflicts of interest?
Insider trading	Has your company 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?
Investment guidelines and restrictions	Does your company maintain adequate controls to assure that all investments and holdings are consistent with disclosures made to clients and applicable restrictions?
Marketing practices	Are your company's marketing, performance advertising, and sales efforts fully compliant with all requirements? Is there a robust pre-use review process?
Regulatory reporting	Is your company submitting fully accurate regulatory reports on a timely basis?
Trading	How does your company comply with its obligation to seek best execution, and how does it prevent and detect trading violations involving short selling, offerings and manipulation?
Risk disclosures	Are you making full and accurate disclosures to all relevant investors/clients concerning liquidity, counterparty, investment, and other risk areas?



## Looking ahead

Staying current with new regulations as well as continuing higher investor expectations and regulatory oversight and enforcement will be challenging for asset managers. Asset managers 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.

## How we can help you

- We provide a comprehensive regulatory compliance and regulatory risk management service, 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 company employees.
- We assist directors, senior managers and chief compliance officers by conducting an analysis of the design, operation and effectiveness of the compliance program.
- We conduct risk-targeted analyses in areas of concern and provide recommendations concerning robust compliance practices.
- We assist asset managers in developing the reporting metrics and surveillance, monitoring and training features of the compliance program.

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# Delivering cost-effective Technology, Processes and Operational Governance

## Key considerations for asset managers

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 are also experiencing an increase in transaction volumes and complexity; placing stress on their front, middle and back-office systems.

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 asset managers have underinvested in technology, have not consolidated or integrated systems after mergers or continue to use manual processes.

Market volatility and pressure on fees have also 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.

Asset managers are dependent on efficient and effective back, middle and front-office processes and controls to ensure that administrative costs and operational losses are

limited; and that the business can effectively comply with service levels and mandates set by investors. Investors and regulators expect processes and controls to be effective and that such processes would reduce risks associated with outsourcing investment management and custodianship.

*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 specialised services with established service levels.*

Failure of 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 areas that will require attention are:

- constant changes to local and international regulatory requirements
- managing complex investor portfolios in volatile market situations

- limited or no control over outsourced activities
- managing high volumes of transactions and cash, and
- pressures to limit operational losses due to ineffective mandate management and breaches.

## 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 standardise 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 centres 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, asset managers are realising that multi-asset class convergence can generate needed processing efficiencies.

Changes in legislation and regulatory requirements, complexity of service offerings and institutional investor demands will require asset managers to implement more robust processes and systems. Costs associated with the implementation of new systems and processes to comply with investor performance and regulatory compliance requirements may not be all recoverable from investors. Asset managers will be required to implement systems and processes that are agile and flexible which will facilitate the efficient implementation of investment and regulatory changes whilst maintaining internal controls.

The following will be key considerations for asset managers in respect of efficient and effective controls and processes:

- Ensuring compliance with key regulatory requirements when accepting business such as The Financial Intelligence Centre Act and Anti Money Laundering requirements.
- Ensuring complete and accurate record keeping in respect of client, fund, portfolio and security record keeping through adequate systems and robust processing controls.
- Ensuring effective management of outsourced arrangements and outsourced activities including pricing functions, asset administration and custody over assets through selecting reputable business partners, detailed service level monitoring procedures, and enforcing sound contracts.
- Ensuring good investor relations through effective customer interaction and accurate reporting on investment matters.
- Ensuring effective management of asset management and investor cash through efficient and accurate matching processes, and effective bank account management of various entities such as nominee bank accounts.
- Effective management of mandates and regulatory requirement such as Regulation 28 of the Pension Funds Act by enabling systems to perform detailed compliance validations and checking and reporting on breaches.
- Effective and efficient management of client investment and disinvestment activities in accordance with investor mandates and regulatory requirements including effective management of trades and settlements.
- Ensuring effective portfolio and investment fund management through key systems and controls that can manage portfolio liquidity and investment risk.
- Effective modelling of asset management fees and expenses including dealing with rebates received/ allowed in respect of other investment institutions and vehicles to enable optimum fee strategies to remain competitive and limit revenue leakage.
- Effective and accurate reports to regulators and investors by implementing reporting warehouses and reporting templates.

## 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 organisation.
- Assist in implementing operational and technology improvements in areas such as sustainable cost management and control; business process execution; and organisational 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.

We can review the business processes and controls for front, middle and back office for fund of funds, segregated portfolios, Linked Investment Service Providers (LISPs), Collective Investment Schemes:

- Benchmarking systems and processes to identify areas where there could be possible inefficiencies or where possible operational losses may occur due to system or process overrides or failures.
- Assist with the evaluation and selection of systems to perform customer liability management, portfolio management, accounting functions and front-office trading.

- Reviewing where systems and processes may be changed to deal with constant changes to local and international regulatory requirements.
- Assisting with the implementation of controls, systems, policies and processes to deal with volatile markets such as pricing processes, risk and collateral management.
- Assisting with implementing processes to manage outsourced activities.
- Assisting with processes to manage high volumes of transactions and cash.
- Assisting with controls and processes that will limit operational losses due to ineffective mandate management and breaches.

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# A Changing Tax Landscape

## Key Considerations for Asset Managers

In the wake of the financial crisis, the asset management industry is facing increased scrutiny globally. Mounting pressure for increased tax revenues and greater transparency in tax matters, coupled with an onslaught of tax legislation, regulatory changes, and increasing investor demands, has had a significant impact on the tax landscape.

The most significant reporting demands come from US laws enacted in recent years, notably the Foreign Account Tax Compliance Act of 2009 (FATCA). 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, analysed 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. 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.

Tax is no longer important only to tax directors and tax advisers; it now has profound effects on the performance, reputation, and operations of asset managers. Tax issues should be on the radar of every fund manager, chief financial officer (CFO), financial controllers, tax director, and service provider in the asset management industry today.

## Looking Ahead

### Tax risk management

Asset managers must proactively consider current and potential future tax risk management as a key component of the fund's overall investment strategy. Asset managers should be aware of the changing global tax statutes and enforcement, and they need to gain deeper insight into tax exposures that could have a material impact on the financial statements, which can affect not only a fund's financial performance but also its reputation. With tax being a top 10 risk for the financial services industry and global trends and developments around transparency, risk based enforcement from revenue authorities and

increasing expectation from shareholders and investors, the management of tax risk has become a necessity. Increased regulation and governance requirements do not specify tax and focus on the managing of enterprise risk, governance and internal financial controls. Tax, however, have significant implications on internal financial controls and therefore requires a tax control framework to be in place, supported by tax governance practices. Some of these developments include King 3, the new compliance program of SARS which focus on risk assessment and the Tax Administration Act. Potential consequences for asset managers that are not in control of their tax risk could result in not only a higher level of scrutiny by SARS, but criminal offences under the Tax Administration Act for reasonable care not being taken in managing compliance.

Tax risk originates at various levels in the organisation and reporting is required based on different requirements, for example management reporting and accounts, IFRS reporting and IT14SD reconciliations, etc. These different reporting requirements results in complexity with difficulty to manage tax risk as organisations need to manage tax with a financial, operational, compliance, reputational and management perspective. Tax responsibility can therefore not only be restricted to the tax function but should be managed enterprise-wide across all three lines of defence. Proper controls at a decision making and transactional level is important and tax should be controlled through a strategy, policies and procedures with the necessary monitoring and independent internal assurance to enable the board and audit committee to discharge their responsibilities around risk management, compliance, governance and systems of internal control.

### Investments review

Investment funds would be prudent to review and assess the tax implications of new and existing investments, as well as trading strategies. There should be policies and guidelines for making investments, including pre-clearance of trading that encompasses tax risk and due diligence when reviewing investments and operational structures to evaluate local and foreign tax exposures. Funds should create processes that are integrated into their day-to-day operations to ensure the policies and guidelines are being followed, monitored, and adjusted as the business evolves. With additional scrutiny activity on the rise, it is also more important than ever to have documentation on significant tax positions. Investment funds should establish standardised documentation and reporting processes to ensure they are maintaining audit and investor-ready files.



### ***Heightened investor demands***

Asset managers are also dealing with increased demands from investors. Simplification, transparency, and consistency are vital for investors, since they need to comply with increased domestic and global tax regulations. Not only is this focus on transparency vital for compliance with domestic and global regulations, but it also is important for increasing investor confidence, which in turn will increase the ability to retain and attract investors. Whereas investors used to focus mainly on performance and strategy, they now are increasingly scrutinising operational efficiencies as well. Managers have been inundated with ad hoc requests and demands for information on the tax implications of their investments. Investors are asking more sophisticated questions about how funds manage their tax risk exposures because of the potential material effect on net asset value. Because investors are demanding more frequent and accurate tax reporting, tax functions must be prepared to provide this information on a real-time basis. While investors are looking for simplification and consistency around reporting, they also expect to be provided with options and flexibility to invest in vehicles that are most tax efficient for them.

### ***Organisational review and interim planning***

Funds should do an analysis of their organisational structure. This can assist the funds in planning opportunities such as entity simplification and can reduce the risk that a return or disclosure of a foreign investment is overlooked, which could impose significant penalties. Managers should also be considering interim tax consulting and reviews of business and investment activity, as well as providing or reviewing quarterly or year-end tax estimates. Interim tax planning and consulting provides an opportunity to spot issues and prepare documentation prior to year-end. Vetting issues ahead of year-end tax compliance will calibrate year-end tax results for planning purposes, and avoid surprises in the midst of tax compliance by analysing and documenting issues on a real-time basis.

### ***Technology assessment***

With the increased scope and complexity of the tax rules, as well as investor demands, technology solutions have become a vital component to an effective and efficient tax function. Technology solutions have evolved significantly over the past few years. However, many asset manager tax functions are still relying on outdated tools and tax processes remain primarily a manual process. To provide cutting-edge services, tax functions should be revisiting their use of tax technology solutions to obtain efficiencies. A fresh approach and an increased focus on effective tax technology will enable asset management tax functions to meet increasing demands.

### ***Transfer pricing issues for management companies***

Countries are becoming more vigilant in enforcing transfer pricing rules and policies, particularly for the activities and functions of management companies. In most countries, funds are required to compensate management companies for functions those companies perform on an arm's-length basis. Funds must prepare and keep appropriate documentation supporting the transfer pricing method used in determining compensation for asset managers and showing how that method satisfies the arm's-length standard.

### ***International tax issues***

Foreign governments also face increased revenue pressure, and the globalisation of many asset manager activities and international investments has caused foreign governments to scrutinise the industry. Each country typically has a different set of rules. Therefore, transactions and structures should be considered on a case-by-case basis, having regard to the specific tax regimes of the countries in which the participants are tax resident or in which they operate. The following are a few risk areas to look out for:

#### ***Capital gains tax exposure in foreign countries***

Some foreign countries impose capital gains taxes on the sale of securities or other assets held in the foreign country. In this regard withholding taxes may, or may not apply.

In addition, a number of foreign countries impose self-assessment tax regimes in which tax is not withheld at the source. An analysis should be done for investments in foreign countries that include consideration of interest, penalties, and the statute of limitations applicable in each jurisdiction.

#### ***Permanent establishment risk***

If an entity has a permanent establishment (PE) in a foreign jurisdiction, income derived from that business activity may be subject to taxes in the foreign jurisdiction. A PE can be created when dependent agents act on behalf of an entity in a foreign jurisdiction. If an investment fund sets up an office in a given jurisdiction, it has to monitor the PE risk, as activities of an asset manager may in certain instances give rise to a PE for the investment fund which it manages. As such, the funds should ensure that it has protocols in place to mitigate the aforementioned risk.

## Residency risk

There is a risk that an entity could be regarded as a tax resident outside its jurisdiction of incorporation and accordingly that entity may be subject to tax on its worldwide income in two jurisdictions. Generally, a non-resident corporation is deemed to be resident in a specific jurisdiction if it has its place of management and control in that country. Asset managers should be sensitive to the risk which their activities may pose in relation to the funds which they may manage, with regard to tax residency. Generally, funds mitigate exposure to source-country taxation and reporting by investing through treaty-protected Special Purpose Vehicles (SPV's) or holding companies. Absent sufficient substance, these structures may be attacked and should be considered in assessing tax risks.

## Withholding tax concerns

At present a number of tax authorities worldwide are scrutinising the use of complex structures and resultant strategies designed to reduce withholding taxes. Investment funds should assess any positions that could be open to scrutiny.

## FATCA

Asset managers will need to assess what information gaps exist, determining what systems changes will need to be made and communicate with their service providers and investors to address the rules and make the necessary changes to their business processes and procedures in order to comply with FATCA's requirements.

Compliance officers of asset managers can begin to identify which funds and clients will fall within their FATCA footprint, identify the requirements associated with those investment 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.

## How PwC Can Help

### Tax risk management

- Tax risk management methodology, which entails realising a robust and effective Tax Control Framework through a step by step approach, ultimately ensuring an effective tax function. These steps include a practical analysis of tax risk for key areas of focus; the implementation of formalised internal control procedures to address the identified risks in the various tax processes of each key focus area; and formulating a tax strategy and policies.
- Indicators of risks across the different tax types associated with your operations or business model and integrate, where applicable, the management and monitoring of these risks into existing governance and enterprise risk management structures and processes in your organisation. This can provide you with best practice frameworks and an adequate and effective tax control environment for ultimate tax risk assurance to all relevant committees and stakeholders.
- Assisting with the formulation of tax governance frameworks, including reporting protocols, augmenting your internal audit teams with specialists to support tax-specific reviews and optimising the form and content of internal audit communications.
- Improve the internal operations of your tax function, assess potential risks and enhance the efficiency of your tax processes through the use of tax technology.

### Local corporate tax

- Review and assess the tax implications of investor products as well as the compliance of tax systems (such as CGT, STT, 24J, etc. systems) with the local tax legislation in order to provide accurate and compliant tax information to investors.
- Assisting with the review of finance structures and instruments, including the tax implications of funding and investment transactions and, if applicable, advising on the enhancement of the tax robustness and effectiveness and/or the tax risk.
- Structuring and implementing group re-organisations as well as assisting with mergers and acquisitions including assessment and management of acquisition/merger risk and also ensuring tax efficient deal structuring and post-deal integration.
- Develop and deliver specific training based on your business, industry, operations and tax capabilities, and deliver tailored tax training to your tax team, accountants and financial directors.

### International tax

- Provide practical advice and assistance in establishing offshore operations, including advising on optimal cross-border funding structures, related exchange control issues, profit repatriation and exit charges, setting-up offshore companies, holding company strategies, withholding tax minimisation, foreign tax credit utilisation, etc.
- Assisting with controlled foreign companies' ("CFC") tax compliance and planning.
- Advising on the interpretation of international treaties e.g. permanent establishment analysis and income classification for treaty purposes and advising on effective management and tax residence of companies.

- Determining withholding taxes that may apply to cross border payments and assisting with double tax relief, including claiming treaty relief and/or SA credits for foreign taxes suffered e.g. assistance with calculating foreign tax rebate/credits and evaluating the source of income relevant for purposes of foreign tax credits.
- Assist asset managers in determining how they are affected by FATCA.
- Assist asset managers with initiating a FATCA compliance program to facilitate compliance regarding:
  - Investment fund entities;
  - Investment fund investors, including the due diligence process for new and pre-existing investors;
  - Internal operational impacts arising from these requirements; and
  - Business impacts on relationships with third-party service providers; and distributors.
- Assist asset managers address common technology and operations challenges in respect of FATCA.

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# Trust and Transparency

## Key Considerations for Asset Managers

*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.*

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.



Global Investment Performance Standards (GIPS) standards are a globally accepted methodology for calculating and presenting asset managers' performance history and that are widely relied upon by asset managers, their clients, and prospective clients for ensuring consistency of asset manager results. In recent years, GIPS compliance has gained more attention globally, most recently in emerging markets.

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.

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 analyse 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.

## 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 investment fund, the asset manager and the investment fund administrator or company 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.
- Provide assurance on the:
  - asset managers compliance on a firm wide basis with all the composite construction requirements of GIPS; and
  - design of processes and procedures to calculate and present performance results in terms of GIPS.

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# Valuations and Pricing

## Key Considerations for Asset Managers

Asset managers are facing increasing valuation challenges, due to market volatility, regulatory pressures and investor demands. It is important for asset managers to take a proactive approach to their valuation process in order to protect both themselves and their shareholders.

Asset managers have experienced increasing difficulty valuing investments due to market volatility. Investors are posing tough questions in respect of valuation methods and whether they are impartial and that checks and balances are in place to preserve the integrity of the process. Asset managers are normally compensated based on the total assets under management and investment performance.

Key considerations include:

- The way the valuations process is governed which include independence, accountability and segregation of duties.
- The way that consistency is maintained across portfolios for the same instrument.
- That clear policies and procedures exist that provide clear direction and address various valuation scenarios across various markets.
- The operational effectiveness of valuation methods across portfolios.
- Whether valuation risks have been assessed and have been adequately mitigated.

## Looking Ahead

Asset managers will be required to understand valuation risks, align risks to current methods, policies and operating procedures and ensure that adequate internal controls have been implemented that will ensure

transparency and integrity of the valuations process. This will include:

- Evaluating more frequently the sufficiency of the valuation methods and valuation sources.
- Ensure consistent disclosures about valuation processes across portfolios.
- Applying more scepticism to and require more transparency about model-based valuation techniques provided by internal and external pricing providers.
- Using more back-testing and sensitivity analysis to determine valuation biases that may exist in the process including processes to identify discrepancies and addressing anomalies in a timely manner.
- Ensure that incentives principles are adequately applied and that valuation methods are fair to all stakeholders.

## How PwC Can Help

- Implementation of market risk measurement systems applicable to treasury operations as well as in middle office functions.
- Advise on market risk management (e.g. Value at Risk, Stress testing, Limit setting).
- Draft and review market risk policies.
- Perform model validation for market risk and valuation projects.
- Review valuation controls covering market risk.
- Perform financial instrument and derivatives valuations for financial reporting purposes.
- Perform fair value modelling for debt instruments (e.g. BEE transactions, structure transactions).

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# Portfolio Management

## Key Considerations for Asset Managers

Asset managers are normally compensated based on the total assets under management and investment performance. Revenue growth can therefore be achieved through effective portfolio management. Funds and Institutional investors require asset managers to manage portfolios within mandates set by regulators and through service level agreements.

Portfolio management considerations include managing the portfolio within the regulatory constraints such as Regulation 28 of the Pension Funds Act, mandates, risk appetite and tolerance set by the client and investment return requirements.

Asset managers need to set adequate portfolio objectives and formulate investment strategies including processes to understand and track portfolio risks, evaluate performance, manage portfolio costs and protect portfolio assets appropriately. The portfolio is normally constructed based on portfolio objectives.

Adequate governance controls are normally required such as segregating the setting and review of investment policy from asset management and trading functions.

## Looking Ahead

Institutional investors and fund managers are requiring more information to ensure that investment risks are adequately managed and that the impact of risk on capital requirements such as those required by SAM is properly assessed.

Regulators and investors are requiring Asset managers to track mandates and breaches proactively and report on non-compliance and actions taken.

Asset managers will be under consistent pressure from fund managers and institutional investors to pro-actively manage privacy, compliance to regulatory and mandate compliance, investor risk, safeguarding assets through collateral management and investment performance. Complex portfolio management systems will be required to manage these functions and to limit the level of override on non-discretionary policies. Due to the interdependencies on markets, complex models are required to simulate scenarios in respect of market volatility, liquidity and concentration risk.

Regulators and investors will expect asset managers to implement robust internal control measures to ensure that funds are adequately protected and managed.

Due to the volatility of markets and investors seeking pro-active advice. Asset managers have realised that relationship management is fundamental to ensure the retention of key fund managers and institutional clients even if a passive investment strategy is followed.

## How PwC Can Help

Portfolio management for segregated portfolios and platform business in respect of policies, controls and processes:

- Mandate management including managing Regulation 28 of the Pension Funds Act.
- Service level agreements with clients.
- Investment policies and objectives.
- Assisting with scenario building and liquidity management on a portfolio.
- Managing investor relationship through customer relationship management.

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# Growing and Leveraging Human Capital

## Key Considerations for Asset Managers

Asset management is regarded as an industry in which the most important assets are highly mobile. This has never been truer than today: Regulatory flux, globalisation and significant changes in personnel practices have combined to place talent – attracting it, developing it and retaining it – high on the agenda of asset managers.

New regulations being developed globally under laws and regulations such as the Dodd-Frank Act in the US and the EU Capital Requirements Directive (CRD III) are forcing a reorganisation of work and decision-making and have implications for remuneration practices, such as the development of claw-back provisions to manage risk-taking. At the time of writing the EU was in the process of finalising the text of CRD 4 which proposes the introduction of a one-to-one cap of variable to fixed pay. Although the prescriptive elements of these regulations are aimed at large European banks, the impact on the greater European financial services industry is still uncertain.

Regulatory changes are also leading to increased focus on the risk function, which in turn is affecting how performance is measured and analysed. Changes in remuneration practices first seen in Europe may make their way to the rest of the world through legislation, rulemaking and changes in market practices. Although South African remuneration practices are less regulated than in Europe and the US, over time we tend to emulate these markets (especially the UK) in terms of remuneration trends.

The globalisation of asset management is also driving efforts to deliver a truly global organisation strategy which includes an increased need to establish a base-line and manage global workforce data as well as establish flexible and adaptive organisation 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.

Asset managers 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, there is a global trend of asset managers investing heavily in recruiting and retaining talent. They face many challenges in this area, from dealing with regulatory, investor and media scrutiny over remuneration to preserving shareholder returns in the face of increasing payroll expense. From a guaranteed package perspective, our research shows an anticipated increase of between 6% and 7% over the next twelve months in the South African asset management industry.

The unique nature of the asset management business continues to hold many opportunities and challenges for the design of short-term and long-term incentives which drive strategic priorities and are also tax efficient from both the company and employee point of view. There is a growing trend towards the simplification of incentives so that participants can better understand and appreciate the value of such awards.

Leading managers are establishing flexible and adaptive organisation 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

- Help to establish flexible, yet consistent, practices in the areas of incentives and rewards (remuneration philosophy and strategy).
- Performance of job evaluations using the REMeasure® job evaluation system.
- Benchmarking of asset management remuneration (guaranteed packages and short-term incentives). Benchmarking information is available to PwC REMchannel subscribers only. Approximately 95% of South African asset managers are PwC REMchannel subscribers.
- Design of pay scales.
- Design of tax-efficient short- and long-term incentive structures aligned to the organisation's business strategy.
- Assist in establishing common approaches to workforce planning, managing change and organisation design.
- Aid asset managers in enhancing their business partner capabilities.
- 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 organisation's people strategy.

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# Asset Management Data and Solvency Assessment and Management (SAM)

## Key Considerations for Asset Managers

SAM increases the data and governance demands on insurers and will require them to review and possibly rethink their investment strategies. These developments are set to have a powerful knock-on impact on South African asset managers, a large proportion of asset managers business comes from insurers. But this is also a valuable opportunity for asset managers to differentiate themselves by moving early to create SAM-ready operational capabilities and investment strategies for their insurance clients.

SAM is set to shake-up the way insurers calculate their solvency requirements and manage their businesses. The demands of the directive on insurers have significant implications for asset managers, as well as for investment fund administrators, asset servicing companies, custodians and other service providers. As insurers assess their investment strategies and prepare preliminary submissions ahead of the expected implementation in January 2015, they'll be looking to their asset management and asset servicing partners to provide the necessary investment data, advice and systems assurance.

Meeting the demands of increased risk analysis and reporting for insurance clients under SAM will raise costs for asset managers, with insurers likely to gravitate to asset managers and service companies that can provide the quality of information they need, at the lowest cost.

At the same time, there are important openings for asset managers who can provide products that are compatible with SAM and deliver favourable and sustainable returns for their insurance clients, while being able to provide them with greater transparency and control over their risks.

## Looking Ahead

### Revamping investment strategies

Under SAM, the 'standard formula' regulatory capital requirements in respect of market risk / invested assets are based on a specified scenario or shock on the assets of the insurer. The magnitude of the shock drives the resulting capital charges. An analysis of the first Quantitative Impact Study (QIS 1) in South Africa shows that market risk as a percentage of the undiversified basic SCR comprises 70% for life businesses and 30% for non-life. The most significant components of the market risk sub-module are equity and interest rate risks.

The new capital charges will heighten insurers' focus on the balance of risk and reward within their investment

portfolio. Insurers will gravitate to asset managers that can help them to assess their investment risks and risk-adjusted returns more effectively. This includes being able to provide them with more detailed risk information and more extensive scenario analysis. Liquidity is also a key consideration. Insurers will have to demonstrate the liquidity of their investment portfolio, which will influence their choice of assets. They will therefore expect asset managers to provide sufficient information to allow them to analyse liquidity sufficiently.

SAM also introduces a 'look-through' approach to the valuation of funds, under which the underlying investments are treated as direct holdings. Providing the look-through information on the underlying funds may be a particular challenge for managers of funds-of-funds, as the detailed portfolio of underlying funds is often only partially known. To avoid the risk of losing insurance clients' business, fund-of-fund managers will have to make sure that they are able to obtain this information, or at least try to ensure that all the material risks are captured in their reports to their insurance clients. If this information is not available, these funds will be treated as other equities, thereby attracting the highest capital charge.

Insurers will also be looking to match their assets and liabilities more closely, as mismatches will attract a regulatory capital charge. Resulting opportunities for asset managers include working with insurance clients to adjust asset duration or develop more effective hedging strategies to manage financial risks. Many insurers will want to do more than just hedge the financial risk on their accounting statements as they seek to find new and different ways to optimise both their regulatory capital position and the investment returns for policyholders. These solutions will need to take account of the particular nature of the contract, its duration and the timing of cash flows.

This would allow asset managers to extend their product offering to include structuring and execution of appropriate hedging strategies.

Regulatory capital considerations may encourage some insurers to increase investment in assets with relatively low capital requirements, such as high-rated government bonds, at the expense of corporate bonds, equities, property, hedge fund and other potentially volatile asset classes. But insurers clearly won't want to turn their back on these riskier asset classes altogether, as they need the potentially higher returns to make their portfolios competitive. As insurers seek to balance risk and reward



under the new regime, asset managers will need to adjust their fund offering to reflect potential changes in the risk appetite of their insurance clients. This includes helping them to balance risk, reward and capital considerations in the most effective way by providing clearer, more detailed and more comprehensive evaluations on the instruments.

There are therefore valuable opportunities for asset managers that lead the way in developing products, fund structures, investment strategies and other financial risk mitigation techniques which allow insurers to curb their capital requirements while still delivering favourable returns. These include making appropriate use of derivatives, hedging, diversification and other ways to reduce capital demands and align portfolios with risk appetites. Possible developments include an increase in absolute return products. As long as there is sufficient transparency over the underlying investments, it may also be possible to alter hedge funds such that the lower global equity charge is applied. In relation to property, it may in turn be possible to switch from direct investment to indirect investment structures (e.g. debt instruments or property funds) to reduce the shock or charge applied, though it will be important to take account of the leverage of such structures. Some insurers may also want to take on riskier assets with potentially higher returns to make up for the higher capital requirements.

Certain insurers will utilise internal models as they seek to develop a more finely tuned risk-reward strategy, price their products more competitively and move into product areas from which less sophisticated asset managers may have to scale back or exit. One of the potential opportunities for asset managers would be providing the same level of risk analysis and insight to help insurers which are using the standard formula to review and redesign their investment strategies.

Insurers will expect documented assurances from their asset managers that the quality, consistency and reliability of the risk information they supply, and the governance and control procedures that underpin this, are up to scratch.

### **Demonstrating data quality / getting the data out quicker**

#### **Assurance**

Under SAM, insurers will have to demonstrate to their supervisors that the data they use is sufficiently complete, accurate and appropriate for their specific needs. External data, including information from asset managers, will need to meet the same standards of quality, detail and verification as internally sourced information.

The key word is 'demonstrate'. Insurers will expect documented assurances from their asset managers that the quality, consistency and reliability of the risk information they supply, and the governance and control

procedures that underpin this, are up to scratch. This is likely to require a more formal and systematic approach to data management within many asset management organisations.

Insurers are going to favour asset management organisations that can demonstrate the most effective governance and control. The pressure from insurance boards to ensure that the information they use in decision making and certify for disclosure is reliable means that, far from being a tick-box exercise, the questions and required proof are going to be far reaching. As asset managers look at how to stand out, they may want independent validation. An example would be the International Standard on Assurance Engagements (ISAE) 3402 (previously known as SAS 70), the scope of which can be extended to provide a useful endorsement for their systems and processes under SAM.

In the UK, the Financial Services Authority (FSA) is currently reviewing insurers' progress in meeting the Solvency II directive requirements on data and will agree dates for completion of the Solvency II data work stream. This is likely to have a knock-on impact on the level of assurance that insurers will require from their asset managers and fund administrators. It is highly likely that the Financial Services Board (FSB) in South Africa will adopt a similar approach.

#### **Reporting**

Insurance returns that took a significant time to produce are going to have to be collated, analysed and signed off in a matter of weeks. Asset data will be a key component of SAM's quarterly and annual reports. Asset managers will need to provide a range of information which isn't disclosed in the current returns. Examples include the portfolio of each asset by type e.g. life and, where applicable, the external rating, duration, SAM price and whether it is participating or not. Insurers will also need to produce annual publicly available solvency financial condition reports, which will heighten the market scrutiny on investment strategies, asset-liability management and the underlying risks.

The required aggregations, sensitivity analysis, cash flow projections and other evaluation criteria are going to place considerable strain on the reporting systems of even the largest and best resourced asset managers. It isn't just the scale of the required work, but the transparency and validation that will need to underpin it that will create huge challenges, in particular, funds-of-funds. Both insurers and asset managers may look to investment fund administrators to provide the industrialised approach needed to produce these returns in an efficient and cost-effective way.

Tighter turnaround times are going to put further pressure on asset management organisations that are already

dealing with other regulatory compliance demands, including the revised provisions of Regulation 28 of the Pension Funds Act. There are clear competitive advantages for asset management organisations with the most efficient and up-to-date reporting capabilities. SAM also opens up opportunities to provide market and credit risk analysis, allocation and hedging services for smaller and less well-resourced insurance clients.

Some asset managers may have to raise fees to make up for the cost of these extra demands.

## How PwC Can Help

Our extensive involvement in the SAM / Solvency II programmes of our insurer clients and our representation on the FSB's SAM task groups ideally positions PwC to assist asset managers in understanding the impact of SAM on their businesses. At a high level, PwC can assist in the following areas:

- As an initial step, conducting a 'gap analysis' in respect of the asset manager's readiness in terms of the impact of SAM in the following areas:
  - Business strategy: Ensure that an appropriate strategy is in place to effectively deal with SAM requirements and create a competitive advantage.
  - Risk management: Identify, assess and evaluate risk to enable the execution of the enterprise risk management strategy
  - Business process and controls: Ensure business processes produce timely data, at a granular enough level and in a manner which enables easy identification of trends and variations in the original data
  - Applications and technology: Ensure systems availability, backing up of original data sets and possess the capability to trend and monitor data processes.
  - Data: Ensure the completeness, accuracy and appropriateness of data for SAM pillars I, II and III.
- Assessing the current operating model and help to define a target operating model, in the context of SAM, as well as the roadmap to achieve the practical implementation of the operating model.
- Assist with the evaluation and re-engineering of business processes to ensure efficiency and effectiveness in terms of the process as well as adequate process controls.
- Design and implementation of a data quality management system (including the evidencing requirements) to ensure that data is complete, accurate and appropriate.
- Reviewing the current reporting calendar, identification of any current bottle-necks in the close process and

designing and implementation of appropriate changes particularly in respect of SAM reporting requirements and timelines.

- Assist with the gathering of the granular SAM data requirements required by the insurer.
- Analyse how data is processed, stored, and utilised in a given system or suite of systems. Identify gaps or areas for improvement in the context of SAM data requirements.
- Understand the internal and external system interfaces and perform an impact analysis based on the practical implications of SAM.
- Assist with the sourcing of data i.e. evaluate required data entities, source to target mapping, data transformations, look-through granularity for IFRS, SAM and Regulation 28.
- ISAE 3402 reviews to evidence data quality in terms of the defined controls.

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# Treating Customers Fairly

## Key Considerations for Asset Managers

The Treating Customers Fairly (TCF) initiative seeks to help customers better understand the features, benefits, costs and risk of financial service providers. Under “twin peaks” the Financial Services Board (FSB) will fulfil the role of market conduct regulator and therefore monitor how well asset managers service their customers. All asset managers with a retail client base need to carefully consider the implications of TCF on their businesses, specifically with regards to the following areas:

- Business strategy and senior management commitment to customer centricity;
- The impact of strategic business change on the end customer;
- New product design, including pricing;
- Marketing of products, including assessment of the target market for a specific product;
- Sales and advice given during the sales process;
- After-sales service to the customer;
- Complaints handling;
- Organisational culture (is fairness to the customer central to business decisions and communication);
- Employee performance and reward;
- Relationships with other parties involved in the product or customer lifecycle; and
- Availability of metrics, measures and sufficient management information to aid in the evidencing of compliance to TCF.

## Looking Ahead

The embedding of the TCF framework is expected to involve significant resource, time and operational change for asset managers in South Africa. A review of current practices throughout the product life cycle should be performed to identify gaps in the entity’s customer strategy and to embed the culture of TCF within the entity. As TCF is principles-based regulation, asset managers need to define what TCF means for their businesses and be able to evidence compliance based thereon. A pragmatic approach to TCF implementation needs to be followed and should include the following high-level phases:

- Assess fairness in the asset manager’s business context: This phase will be at a strategic level and will look at the strategic objectives in formulating an overarching mission statement in terms of what fairness means for the asset manager.

- Define expected TCF outcomes at process level: This phase involves the identification of all the processes which are impacted by TCF, identification of all the key customer touch points throughout the customer lifecycle, and defining an overarching statement of what it practically means to treat customers fairly at that specific point.
- Define anticipated behaviours to meet outcomes: In order to achieve fairness at a process level, this phase will define the behaviours or behaviour changes that will be required to achieve the overarching statement.
- Revise procedures and communication: Where needed, procedures and client / employee communication needs to be revised to ensure that the required behaviours will be achieved and properly evidenced.
- Define measures and metrics: This is an important phase as it defines which measures and metrics are required in order to be able to measure fairness. Only if these measures and metrics are adequately defined will evidencing be possible.

## How PwC Can Help

- We can assist you at a strategic level in formulating an overarching mission statement in terms of what fairness means for the asset manager.
- Using our Value Driven Compliance tool we can assist you with the identification of all the processes which are impacted by TCF, identification of all the key customer touch points throughout the customer lifecycle, and defining an overarching statement of what it practically means to treat customers fairly at that specific point.
- As part of our people and change value proposition we are equipped to assist you in defining the behaviours or behaviour changes that will be required to achieve the overarching statement.
- We can assist you with the identification of all the processes which are impacted by TCF, identification of all the key customer touch points throughout the customer lifecycle, and defining an overarching statement of what it practically means to treat customers fairly at that specific point.
- Subsequently we can assist in process gap analysis and help setting up a project plan and timeline to address the gaps and required process redesign.
- We have example templates of management information frameworks, matrixes and measures to assist you in developing and designing appropriate evidencing.



- We can also assist with designing and developing the appropriate dashboards and reports required for TCF.
- TCF specifically requires asset managers to prove that they have taken remedial action. We can assist you in the remediation process design and implementation.

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# Conclusion

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.

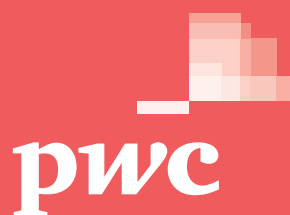
The one certainty is that the asset management industry is in a period of transition that likely will take years. At the end of it, there will be winners: Those asset managers and individuals that are quickest to grasp the potential emerging from the changes the industry is going through and act upon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

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