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Asset Management Trends in Germany 2022

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Ralf Brenner
Partner at GSK Stockmann

ralf.brenner@gsk.de

+49 89 288 174 – 26

www.gsk.de

BIO

Ralf Brenner is a banker and lawyer and has worked as Head of Legal and Compliance and as an anti-money laundering officer since 2006.

He has also been a managing director at Société Générale Securities Services GmbH since the beginning of 2018. Ralf Brenner joined GSK Stockmann in 2021 as a Partner and advises asset managers, banks and funds providers on regulatory issues as well as outsourcing. Furthermore, he supports foreign asset managers, particularly in the Master-KVG business.

In his 20 years as an in-house expert, team leader and head of entire departments within legal and tax divisions of asset management firms, he has gathered extensive experience in consulting on and implementing regulatory issues, in particular under the German Investment Code (KAGB), the German Banking Act (KWG) and the German Securities Trading Act (WpHG), including responsibility for the establishment, re-licensing and takeover of asset management firms (M&A).

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The asset management industry in Germany fared well in 2021 despite the pandemic-driven situation throughout the entire world and the market volatility created by the uncertainty. In addition, the government in Germany changed, which created an additional phase of uncertainty. As the uncertainty around potential Covid-19 variants is expected to remain in 2022, the asset management industry will face challenges and the success of players in the industry will be driven by the creation or improvement of strong models, operational improvements, alignment with investors' and other participants' expectations, and employee resilience. The following trends and factors will play a key role in the developments in 2022:

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1. Increasing regulatory pressure on asset managers

Asset managers are confronted with a challenging regulatory landscape, which is driven by general topics such as the CSDR and ESG in addition to specific topics for the industry, namely AIFMD, ELTIFs/LTAFs, the prudential regime for investment firms (IFD/IFR), UCITS as well as PRIIPS effects. In addition, asset managers in Germany are facing local developments.

The Central Securities Depositories Regulation (CSDR) as the latest step in establishing an EU-wide harmonised regulatory framework for financial market infrastructures has an effect on the asset management industry which will have to be addressed in implementation projects. The main objective of this regulation is to increase the safety and efficiency of securities settlement and settlement infrastructures in the EU. The rules shall apply from the date of entry into force of the RTS on Settlement Discipline (1 February 2022). At the trialogue meeting on 24 November 2021, it was agreed to decouple the mandatory buy-in regime from the rest of the settlement discipline regime. As the cash penalty regime is not expected to be delayed, the asset management industry will have to handle the new requirements in this area in cooperation with the custodian banks and brokers. Key questions regarding application, such as the setting off of paid and received penalties and thresholds, will have to be resolved to avoid a fragmented application in Germany and the EU.

On the topic of ESG, the first SFDR product level reports for Article 8 and 9 SFDR products are required according to Article 11 SFDR in 2022; the entity disclosures – except for those regarding principal adverse impact (PAI) indicators – had been required since 10 March 2021. The SFDR RTS have been beset with delays and will come into force in January 2023. The publication of the final RTS draft, which bundles SFDR disclosure and Taxonomy disclosure into one consolidated RTS, is expected for the beginning of 2022. As a result, the industry will have nearly a year to establish the operational framework required by these RTS prior to the rules coming into effect.

In Germany the asset management industry faces an additional challenge, as the German regulator is also setting up local requirements for sustainable funds and in November 2021 started to consult on guidelines for such funds to avoid greenwashing. According to the opening statement of the German regulator, the requirements of the draft directive apply regardless of the SFDR and the Taxonomy Regulation. It will therefore become a specific challenge for German companies in 2022 to comply with local requirements in addition to the EU guidance. Such developments are not surprising, as on a political level the objectives that fall under the definition of "sustainable" vary greatly between the European countries. The change in government in Germany will accelerate such developments, for example in the question of whether the nuclear industry is seen as sustainable.

The EU Commission has adopted proposals to amend the AIFMD, the UCITS Directive and the European Long-term Investment Funds (ELTIFs) Regulation. These proposals include harmonisation and tightening of the requirements around minimum substance of AIFM and UCITS ManCos, new requirements around liquidity management for UCITS and open-ended AIFs, targeted amendments to rationalise the requirements around depositories and new eligibility, conduct and reporting requirements for AIFs that undertake lending. There is no mention of the long-promised AIFMD passport for non-EU AIFMs. Non-EU AIFMs operating under the Article 42 AIFMD regime should be aware that some of the new requirements shall apply to them.

The Commission noted that the advantages of ELTIFs have been diminished by restrictive fund rules and barriers to entry for retail investors. The Commission's proposal aims to make ELTIFs more popular among retail investors by broadening the scope of eligible investments, reducing barriers preventing retail investors from accessing ELTIFs and easing the rules for fund distribution solely to professional clients.

The year 2022 will see firms in Germany finalising and implementing the prudential regime for investment firms (IFD/IFR) which has been in effect since June 2021. There are also several key regulatory publications to come in 2022.

While the core objective of the PRIIPs regime of enabling consumers to make informed investment decisions through increased transparency and comparability of products is undoubtedly well intentioned, the KID has proven to be problematic. The UK and EU have proposed changes to their PRIIPs regimes to address these concerns. In November 2021, the European Parliament voted to extend the transitional rule exempting UCITS managers that provide a UCITS KIID to EU retail investors from also needing to provide a PRIIPs KID.

Further, after being criticised for its role in the so-called cum ex and Wirecard scandals, the German regulator BaFin will increase its pressure on the industry, including the asset management industry. In spring 2021, the German Federal Ministry of Finance set in motion a comprehensive program to modernise BaFin and to improve the effectiveness of financial supervision, introducing a seven-point plan and drawing up the Act to Strengthen Financial Market Integrity.

In an interview with the BaFin Journal on 15 November 2021, the new BaFin president Mark Branson explained what changes need to be made at BaFin for it to achieve the target announced by the German Finance Minister of providing "financial supervision with bite". Part of the modernisation and new supervision approach involves a consultation on the Regulation Concerning Reports and the Submission of Documentation in accordance with Section 36 of the German Investment Code at the beginning of December 2021. The draft would expand the information obligations of regulated asset management companies in Germany with regard to outsourcing massively and for this reason has been criticised by industry representatives. It is already clear that the form of notification to BaFin will change from a paper-based to a digital one with more information which will have to be sent to BaFin.

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An amendment of the outsourcing rules of the German Investment Code will force outsourcing partners of German asset management companies outside the European Community starting in 2022 to designate domestic authorised delivery agents with a registered office in Germany to whom BaFin can direct announcements and deliveries.

2. The next phase of tokenisation

Blockchain technology is changing the financial services industry. The recent trend of asset tokenisation continues unabated. Tokenisation has the potential to create new opportunities for the core activities of asset management, as it will allow asset managers to use the benefits of blockchain to generate funds and liquidity. It is a way to make illiquid assets and intangible assets tradable and increasingly liquid. With blockchain technology asset managers might be able to raise liquidity without selling the entire asset as with real estate and without going through complex listings as in the case of real estate investment trusts (REITS).

To ensure long-term success, the following challenges will have to be solved:

- Some harmonisation of the taxonomies is needed, as according to research by the Cambridge Centre for Alternative Finance (CCAF) there are at least eight different terminology taxonomies referring to crypto assets as of February 2019.[1]

- Further, the legal protection of crypto assets will have to be increased as the definition of ownership and requirements for the assignment of virtual assets may lack legal clarity.

- In addition, regulation of the crypto business should be expanded to cover all involved parties, something which is still partly unregulated. Without general protocols or legislation, investors may not develop the necessary trust in this highly promising technology.

3. ESG products

The focus in the previous year was on developing and launching ESG products to satisfy the increasing demand for all products labeled as ESG.

It is expected that this trend will change in 2022, as clients will start to recognise that their needs are not being fully met through simply buying products labeled as ESG. Products will have to fulfill customer needs including ESG in the future and ESG will just be one aspect of the product that satisfies greater, overarching needs.

4. Virtualisation of asset management

As in other industries, over the last two years the pandemic has forced asset managers to change their operating models very drastically and at short notice. While most asset managers set up hybrid working models, in which some of the staff stayed in the office and enabled the rest of the staff to work from home, developments in the coming years should enable employees to decide for themselves depending on their position whether they want to leave the office and in-person contact behind. Due to this, digitalisation must continue to increase and even in-person meetings with clients will be reduced in the long term and replaced by digital communication. Whether this trend fully takes hold in the institutional business will be critical.

The experience of the last two years has nevertheless shown that full digitalisation may be closer to reality than expected.

5. Pressure on commission-based models

The process of selling fund shares and asset management products has not changed much over the last decade even while fund platforms and tokenisation have been on the rise. Sales processes remained product-led processes with performance illustrations and explanations, which are driven in the retail business by commission-based models for distributors.

The commission-based model is still seen as suspicious by some of the parties in the new German government and has come under some pressure as a result. In the course of the coalition negotiations for the new government, strict demands such as a general ban on commission or similar did not succeed.

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6. Investments in China

Further growth in asset management products covering the Chinese market is expected. China is still one of the fastest-growing emerging markets in the world. After recording high single-digit growth over the past two decades, the country is expected to surpass the United States and become the world’s largest economy over the next few years. Due to its enormous population, China’s economic growth is not expected to slow down soon.

Throughout the last two years, the Covid-19 pandemic has affected China’s economy in much the same way as the rest of the world, triggering a massive decline. However, in previous years, the general trend was one of increased growth.

[1] Global Cryptoassets Regulatory Landscape Study 2019, https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/cryptoasset-regulation/#.YdQLuGjMJaQ

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There are many different ways to invest in China, ranging from listed exchange-traded funds, tailor-made fund products to securities listed on its two domestic exchanges. The asset management industry is offering more and more products to enable clients to invest in this market and this trend will continue in 2022.

7. Transformation and transitions

Major asset management companies and service providers for this industry are considering transformations including M&A transactions in the post-Covid period as economies of scale become too big.

Due to the further increase in operational burdens for the industry created by regulatory requirements, economy of scale becomes more and more of a competitive advantage. Many of these new regulations require data, data analysis and data use. As a result, the race for spending on advanced technology and quantitative elements is based on investments and therefore on economies of scale for operating models. Improved distribution reach is a further driver for such developments.

In parallel, small boutiques and private equity firms will move into the gap left behind by the big players.

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