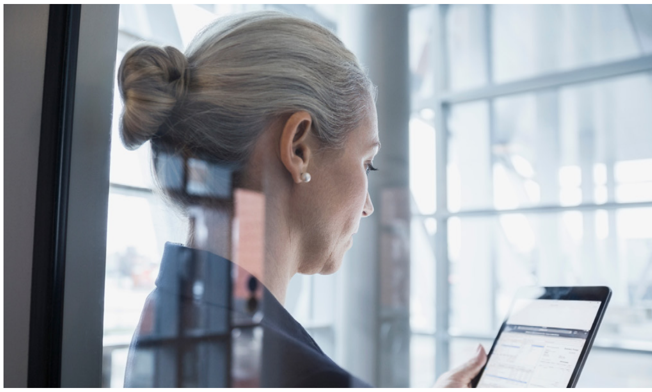
FUND COMMUNICATION SOLUTIONS

Broadridge®

The Evolution of Fund Regulatory Reporting



Ready for Next

REGULATORY BACKDROP

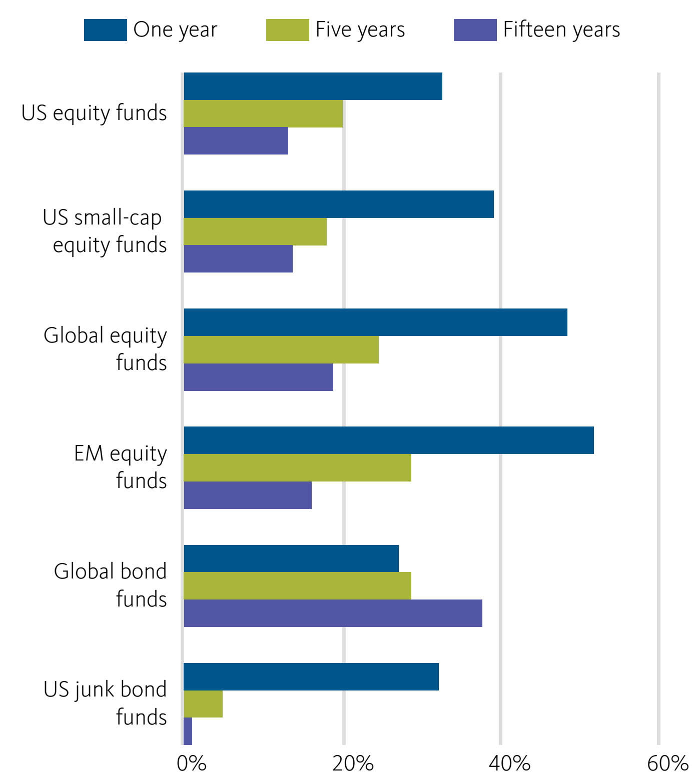
Post-financial crisis, EU regulators hastily introduced a slew of new requirements and reporting obligations for asset management companies. Some of these new rules – including PRIIPs (Packaged Retail and Insurance Based Investment Products); MiFID II (Markets in Financial Instruments Directive II) and Solvency II have created enormous challenges for the industry at a time when it is already facing a number of obstacles. Nonetheless, there are a wide range of innovative solutions available to asset managers, which can help them navigate the current regulatory landscape.

2020: VOLATILITY TAKES ITS TOLL ON ACTIVE MANAGERS

COVID-19 and the volatility that immediately followed took a number of active asset managers by surprise. According to Morningstar research, just half of all active equity funds and one third of active fixed income funds were able to outperform their benchmark equivalents during the first six months of 2020[1].

INVESTMENT FUNDS STRUGGLE TO BEAT THEIR BENCHMARKS

% of funds that outperformed their index over one, five and 15 years[2]



That active asset managers were unable to beat their respective indices is not a new trend however. As a result, clients are starting to reassess their active manager relationships.

Outflows from active asset managers have been ongoing for some time – with Morgan Stanley estimating that $1 trillion has been withdrawn since 2010 alone. A lot of this capital is now being reallocated into much lower cost passive products (i.e. ETFs (Exchange Traded Funds), index trackers, smart beta, multi-factor ETFs etc). According to the Investment Company Institute (ICI), assets controlled by passively managed funds exceeded $12.1 trillion, having looked after just $2.8 trillion a decade ago. In 2017, Moody's predicted that passive providers would overtake active funds by AUM share by as early as 2021. In fact, this is happening ahead of Moody's schedule. For example, the AUM managed by index tracking US equity funds surpassed that of active stock-pickers back in 2019.

In addition to the challenging performance conditions, active managers are seeing the cost of doing business increase. Many firms were forced to invest heavily into their operational and back-end processes after deficiencies were uncovered during the financial crisis. At the same time, investors are demanding more information from their asset managers as part of a wider transparency drive. As the dust settles from COVID-19, it is also likely that asset managers will be required to reappraise their business continuity plans (BCP) and disaster recovery processes, especially if there were teething problems during the onset of the crisis. This will all add further to asset managers' overheads.

REGULATION TRULY BITES

Regulation has come in thick and fast for asset managers since 2008. Alongside the MiFID II, PRIIPs and Solvency II requirements, EU regulators have introduced the AIFMD (Alternative Investment Fund Managers Directive), UCITS V, OTC (Over-The-Counter) derivative clearing and reporting under EMIR (European Market Infrastructure Regulation), and SRD II (Shareholder Rights Directive II). Incoming regulations that will impact asset managers also include a new and detailed disclosure regime for ESG (Environmental, Social and Corporate Governance) investing and provisions around settlement discipline under the CSDR (Central Securities Depositories Regulation). The cost of implementing the rules will not be insignificant while it is increasingly clear that the regulatory reporting components attached to these rules are causing challenges for the industry.

PRIIPS: MIRED WITH DIFFICULTY

Introduced in 2018, PRIIPs was designed to make it easier for retail and insurance-based investors to compare the products they were buying. In order to do this, regulators demanded asset managers become more transparent and instructed them to produce a KID (Key Information Document), which would be made available to prospective and existing investors. The contents of the KID, said Shane Flatman, Regulatory Document Solutions Manager at Broadridge, includes information pertaining to forward-looking fund performance and details on transaction costs, which must be disclosed as a percentage. While these reporting variables sound straightforward, Flatman said the KID has been anything but.

> *"The way in which PRIIPs require asset managers to report forward-looking performance has been controversial."*
>
> SHANE FLATMAN

Under the provisions, managers must make predictions on their future performance based on four separate scenarios – namely favourable market conditions, moderate market conditions, unfavourable market conditions and stressed market conditions. One of the challenges is that the PRIIPs methodology for calculating forward-looking performance adopts a broad-brush approach, which is not ideal for an industry as diverse as asset management. "This has resulted in some funds trading esoteric bond instruments, for example, coming up with very strange forward-looking performance indicators," said Flatman.

In many instances, this is leading to wildly optimistic performance forecasts. According to the Financial Times, one investment fund disclosed in its PRIIPs KID that it was projected to deliver 523,000,000,000% annualised returns based on the regulation's prescriptive methodology.

"One of the principle benefits of the UCITS KIID (Key Investor Information Document) is that it discloses historical performance trends, which are generally better understood than future based performance calculations," continued Flatman. However, UCITS funds will now also be expected to provide their investors with PRIIPs KIDs from 2022, a situation which is likely to lead to widespread confusion, particularly among retail clients. Despite the inherent flaws in the PRIIPs' KID, European regulators have yet to reach a consensus on how to prevent this performance misreporting from happening.

AN END-TO-END PRIIPS KID AND EPT SOLUTION

Broadridge provides a comprehensive PRIIPs KID outsourcing solution that includes proactive management, professional expertise, cost-effective processes and rigorous evidential control systems to support you from pre-production through to compliance monitoring. The solution provides end-to-end support for all aspects in the calculation, creation, translation, maintenance and document distribution of PRIIPs Key Information Documents and European PRIIPs Templates (EPTs).

AN EASY, EFFICIENT AND RELIABLE PROCESS FOR UCITS KIIDS AND EMTS

Broadridge provides a comprehensive, end-to-end KIID outsourcing solution that includes proactive management, professional expertise, cost-effective processes and rigorous evidential control systems to support you from pre-production through to compliance monitoring. The solution provides end-to-end support for all aspects in the calculation, creation, translation, maintenance and document distribution of UCITS Key Investor Information Documents (KIIDs) and European MiFID Templates (EMTs) in all jurisdictions.

COMING TO TERMS WITH MIFID II

MiFID II is a very expansive piece of EU regulation, which is designed to improve transparency and drive best trading execution across the asset management industry. It also introduces strict product governance requirements on fund manufacturers, to mitigate the risk of mis-selling. Pre-financial crisis, there were several cases involving retail investors being sold unsuitable or obscure financial products, some of which resulted in serious unexpected losses. Under MiFID II, manufacturers are forced to identify who their target investor market is and share this information with their distributors via an EMT (European MiFID Template). However, Flatman said EMT reporting was causing logistical challenges and upon receiving target market data, some distributors have been forced to limit who they sell products to.

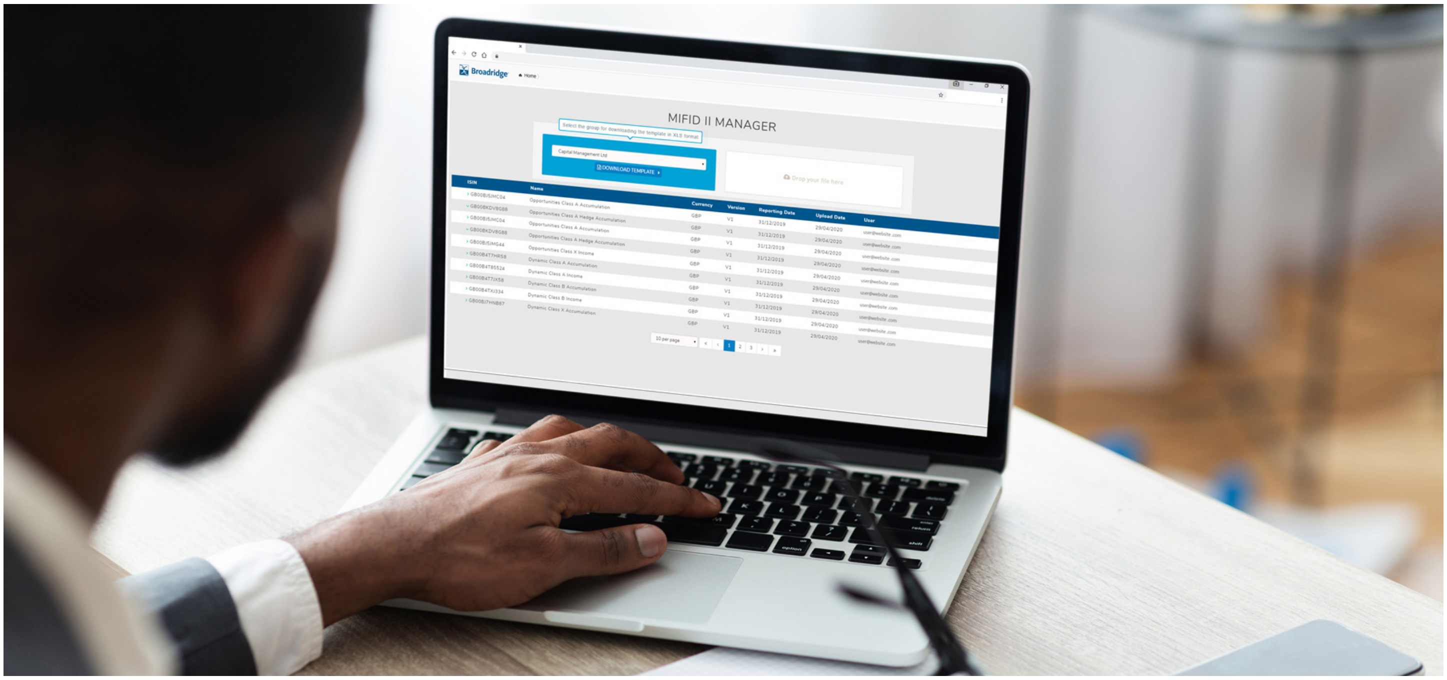
MiFID II also demands manufacturers provide details about their costs and charges. While price transparency is critical in helping investors benchmark their funds on a cost basis, Flatman said the rules have caused confusion, especially for fund of funds. “If an EU fund invests into an underlying fund, then it will need to identify the costs and charges in that fund. This is difficult, especially if the underlying fund is in a non-EU country which is exempt from MiFID II. These funds will not typically produce an EMT or data in the correct MiFID II format,” he added.

AN ABSOLUTE, INTUITIVE MIFID II REPORTING SOLUTION

Broadridges’ MiFID II Manager is an end-to-end service encompassing production, management and distribution of your EMT data. This comprehensive MiFID II costs and charges solution allows clients to calculate ex-ante and ex-post product costs, disseminate target market data and cost information via the EMT and meet their disclosure requirements whilst ensuring distribution remains unaffected. The intuitive interface allows for the automated or manual submission of data, validated upon input and subsequently made available to Europe’s leading platforms.

NAVIGATING SOLVENCY II

Solvency II demands insurance companies set aside risk-weighted capital on their underlying investments - known as the Solvency Capital Requirement (SCR). In order for insurers to reduce the amount of risk-weighted capital they hold, the asset managers which they are invested in must provide a full portfolio look-through and share this data with them in a Tripartite Template (TPT). With this information, insurers can calculate their SCR. While gathering the data is pivotal if asset managers want to retain and win mandates from insurers, it is a painstaking



endeavour, not least because the reporting template contains more than 140 data fields. Katie Geleff, Head of Regulatory Services at Broadridge Fund Communication Solutions, said the data gathering process was very challenging, and required managers to obtain information from multiple sources, which often meant there were problems with data consistency.

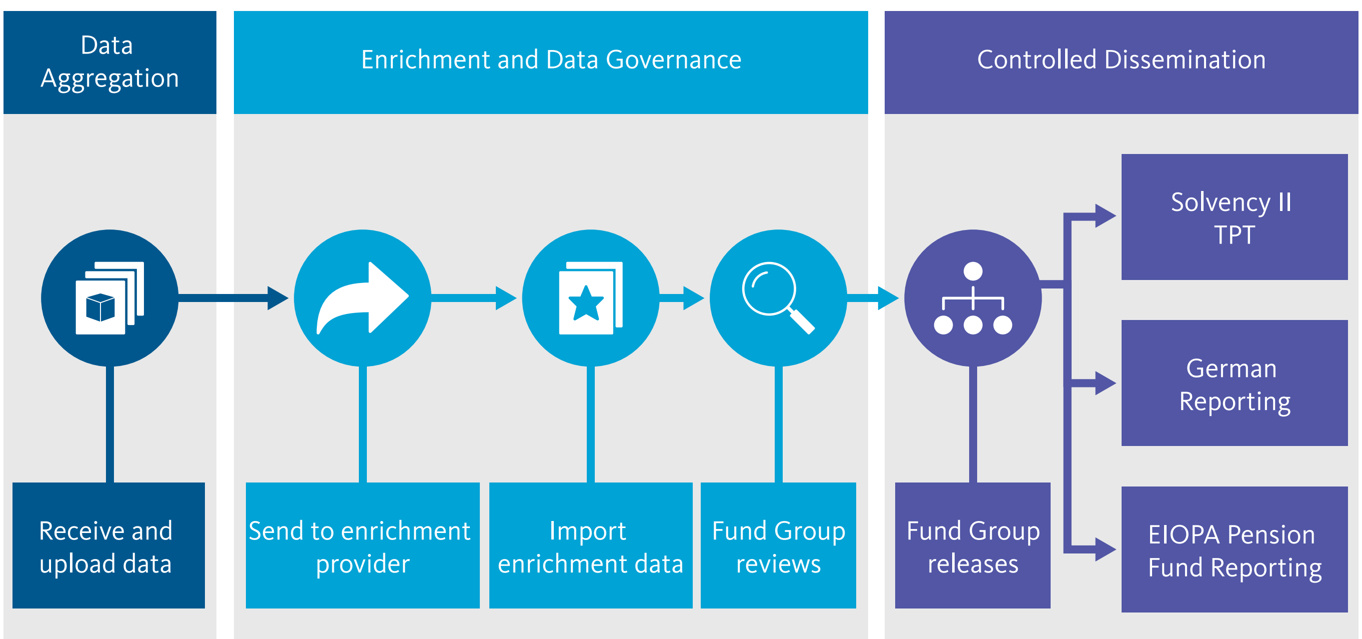
Additional demands are also placed on asset managers through the need to provide additional, specific reporting. Examples include the additional EIPOA PFE.06.02.30 pension fund reporting template which enables an asset manager to fulfil the reporting requirements for their European pension fund clients, whilst VAG and GroMiKV reporting templates support asset managers in the sale of their funds to the German market.

Compounding matters further is that the European Insurance and Occupational Pensions Authority (EIOPA) have stated that "overall the Solvency II framework is working well and no fundamental changes are needed at this point in time, but a number of amendments are required to ensure that the regulatory framework continues as a well-functioning risk-based regime".

> *"At the same time we are still unsure what the impact of Brexit will be on Solvency II reporting for UK insurance companies."*
>
> **KATIE GELEFF**

A COMPREHENSIVE AND FLEXIBLE SOLUTION FOR SOLVENCY II REPORTING

With Broadridges' Solvency II Manager solution you get complete control of your data, with an intuitive online platform developed in collaboration with our clients and validated by a leading global consultancy. As a leader in the field of look-through data for more than 10 years, we have designed a comprehensive and flexible solution that delivers industry standard, high quality reports enabling you to fulfil your client requirements. Reports are enriched with market data, include the population of indicative Solvency Capital Requirement (SCR) calculations and incorporate multi-layered look-through functionality.



FINDING A SOLUTION

Asset managers have been saddled with several regulatory reporting requirements since the 2008 crisis. As operational costs rise and competition increases, managers are looking to outsource as much of their Solvency II, MiFID II and PRIIPs reporting as possible. “By leveraging scalable solutions, outsourcing can help fund managers reduce their internal operational costs,” said Geleff. Flatman concurred, adding that third-party providers will do a lot of the heavy lifting in terms of procuring data and producing regulatory reports thereby freeing up resources at asset managers.

Furthermore, outsourced providers have proven their resiliency during the pandemic, and this too is prompting more fund managers to externalise regulatory reporting.

With the industry looking to rein in its costs, managers are now giving serious consideration to the strategic and obvious benefits of outsourcing, and the consolidation of those service providers is something we have seen a tangible move towards within the industry.

Broadridge Fund Communication Solutions has been at the forefront of these regulatory requirements since their inception and has been delivering regulatory reporting solutions for our clients since UCITS KIIDs, PRIIPs KIDS, Solvency II and MiFID II were first implemented. Our team are actively engaged in industry working groups and forums ensuring that we are always on the front foot with any changes, allowing you to have confidence that you will always be adhering to the latest guidelines.

FOOTNOTES

1 Financial Times
2 Source: S&P Dow Jones Indices. Data from end-June 2020 © FT
3 All figures correct as at 30.09.2020.

If you would like further information about our solutions and services, or have any questions, contact us at +44 207 4181 4556 or FCS_Sales@broadridge.com

BROADRIDGE FUND COMMUNICATION SOLUTIONS

Broadridge Fund Communication Solutions (FCS) combines best-in-breed capabilities in fund data and document distribution, digitised document production and visualisation, and European regulatory expertise.

Driven by deep fund expertise, agile technology and client-focused values

With comprehensive data aggregation and dissemination, digital data visualisation and document production, clients get a scalable, reliable, end-to-end solution to easily meet the ever-evolving fund data and regulatory demands of Europe and other jurisdictions.

- **With over 20 years of fund data, document dissemination and related regulatory reporting, Broadridge Fund Communication Solutions has extensive experience in supporting clients with these challenges.**
- **A trusted partner and leading distributor of fund data, currently working with over 1000 global fund groups[3].**
- **A resilient and secure solution. Our data centre and technology meet the highest industry standards.**
- **Complete access to our accountable and responsive Client Service teams, based in London, Dublin and Bristol.**
- **Solutions delivered by an experienced Implementation team, ensuring timely delivery whilst retaining complete quality.**

OUR THREE PILLARS

Data

Management, validation and distribution of fund data and documents for many of the leading global fund groups. Transforming data aggregation, analysis and distribution from complex to automated simplicity.

Accurate, consistent and timely fund data and documents collected from asset managers and provided to:

- Platforms
- Wealth Managers
- Intermediaries

Regulatory

A comprehensive, data-driven suite of industry-leading regulatory reporting tools serving both the European retail and institutional markets. Leverage our expertise to future-proof your business for ever-evolving regulatory change.

- Solvency II
- Pension Fund Reporting
- MiFID II Costs & Charges Calculations
- UCITS KIIDs
- PRIIPs KIDs
- EMTs
- EPTs
- Financials Reporting
- Translation Services

Digital

A highly configurable and agile suite of digital tools for fund research, comparison and analysis for unrivalled data visualisation and document support. Bring fund data to life for your audiences.

- Fund Pages
- Portfolio X-Ray
- Fund Comparison
- Research Centre
- Factsheets

Broadridge, a global Fintech leader with over $4.5 billion in revenues and part of the S&P 500® Index, provides communications, technology, data and intelligence. We help drive business transformation for our clients with solutions for enriching client engagement, navigating risk, optimising efficiency and generating revenue growth.

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