The EY Outlook for Asset Management in 2020

Building sustainable leadership for Ireland's funds industry

February 2020

Building a better working world

Contents

EY in numbers

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EY is the market-leading consultancy to the European funds industry

EY provides...

84%

tax services to 84% of the top 25 global asset managers

72%

advisory services to 72% of the top 25 global asset managers

90%

services to 90% of the top 10 European asset managers

80%

tax services to 80% of the top 10 European asset managers

70%

advisory services to 70% of the top 10 European asset managers

100%

services to 100% of the top 25 global private banks/wealth managers

100%

services to 100% of the top 10 and 96% of the top 25 global asset managers

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As we embrace the challenges and opportunities of a new year it is important to reflect back on our industry's previous successes, and to use that perspective to set a more ambitious vision for the future.

The asset management industry currently stands at 4.8trn euro, a sizeable increase from 4.2trn in the previous year. This is not only good news for our industry, but for our country. With wages and salaries of €1.5bn, direct tax intake of €846m, and 16,000 jobs across the island of Ireland - expected to increase to 33,000 in the next three to five years - there is no doubt that we make a significant positive contribution to the local economy.

We are not only an industry that is important to Ireland – we are also an industry that is important to Europe. In Ireland we administer about 16% of all European assets, a number which continues to grow as we consistently outpace our competitors. For the last five years we have been growing at a faster rate than anywhere else in Europe, which positions us nicely for further growth.

Yet as positive as all of this is, it is imperative that our success to date does not create complacency about our future. What's worked in the past may not be what will work over the next 5, 10, 15 or 20 years. Our industry must respond to the rapidly changing world in which we operate, whether that be low or zero interest rates, worries about the liquidity of some funds or other key drivers that are already reshaping the funds industry. When it comes to these challenges and opportunities, we must ask ourselves: are we doing enough?

It's time to be brave and to set ourselves the goal of creating a stronger, smarter, better industry that will allow Ireland to provide sustainable European and global leadership in the funds sector. That means we need to think critically not only about what we already do well, but about what we need to do better in the future. Most importantly, we need to develop the emerging advantages that we will need to secure our success. At the moment, I see three key areas that we need to prioritise.

1. Enhance transparency and investor outcomes

Ireland has already taken the lead in areas such as ETF regulation and fee transparency. Let's build on the CBI's view that funds must be properly overseen and that Ireland can no longer be a 'pass through' domicile.

Let's put investor outcomes at the heart of the industry, by improving transparency in areas of growing concern, such as liquidity profiles and ESG factors. Let's make sure we always do the right thing and that we're creating a lasting legacy for investors.

2. Mastering sustainability and green investing

There is a real opportunity here for the whole industry to step up. Making Ireland a key centre for sustainable investing is about much more than supporting climate change or ESG funds – although that's a great start.

Other EU member states, including France, the Netherlands and Luxembourg, are already setting high standards for sustainability with legal requirements driving many of these ambitions. If Ireland is to be a leading hub for sustainable and green investing we'll need to: adopt or develop new policies, guidelines and taxonomies, primarily originating from the EU legislation; encourage firms to base value-adding ESG activities in Ireland; integrate sustainability into all aspects of our firms' activities; and make a genuine commitment that goes beyond marketing and puts sustainability at the heart of our investment culture.

3. Amplify our voice post Brexit

Finally, it is incumbent on the Irish funds industry to amplify our voice post-Brexit. We must ensure we are doing enough to defend our industry, to defend the cross-border model and to demonstrate the benefits of that model to the end investor.

Are we doing all we can to strengthen our brand and value proposition, encouraging firms to develop substantial, high-value operations in Ireland?

Neither should we ignore the wider EU geo-political regulatory developments arising from Brexit, from the strengthened role of ESMA, to creeping prudential rules for asset managers and increased transparency on all things related to ESG and climate change.

In my view, these and other drivers of change show a need for Ireland's asset management industry to assume a more visible leadership position on both the European and global stage. This will ensure that we are ready for the challenges ahead and secure the future success of the Irish funds industry for decades to come.

Warmest regards

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Our team

Our Wealth and Asset Management practice in Dublin is led by Lisa Kealy and is home to more than 230 professionals providing assurance, tax and advisory services.

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> The arrival of financial institutions supporting their European business and clients has considerably broadened and deepened the scope and value of the financial services being provided out of Ireland.

Brexit: now, next, beyond

2020 is a milestone year, as Britain leaves the European Union after more than three years of negotiations and much uncertainty, talk and incredulity. While this was not a desired outcome for Ireland and specifically the Irish financial services community, the deed is now done and we have to move on.

And yet there will be no immediate relief for those of us suffering from Brexit-fatigue, because the reality is: it's not over just yet. Although Brexit day has passed, the transition period extends till the end of the year and there is much work to be done to negotiate and finalise the details around the future relationship of the UK and the EU – including, notably, agreements around financial services. Much remains unclear and it is only now that we will begin to see the intentional, as well as the unintentional, consequences of losing a key member of the European financial ecosystem.

What is clear at this stage of the Brexit process is the emergence of Dublin as a more significant European financial centre. The inflow of international financial services institutions into the Irish market has been significant across every sector of financial services, including banking, capital markets, wealth management and insurance. EY's latest Brexit Tracker (Jan 2020) reports that a total of 30 financial services firms have confirmed they are transitioning business and/or operations to Dublin and many have outlined and executed their recruitment plans for additional staff.

On the ground, we have witnessed the changing landscape of the international financial services landscape, as the first wave of institutions select, establish and transition their business to Ireland and launch their freshly licensed Irish-regulated entities as their new European platform.

As transition-stage negotiations develop, we are sure to gain greater clarity on the details around the future UK-EU financial services relationship. Importantly, we will also gain a better understanding of the EU's stance and strategy for the future of European financial services. A hard negotiation stance by the UK, numerous and complex political agendas and another cliff-edge timeline could still deliver a 'hard or no deal' scenario at the end of the year. Those UK-based institutions who have yet to make or complete the relocation decision may be further pressed into action, and we could very well witness institutions going to even greater lengths to increase their Irish presence and cement their European footprint.

Ireland's Brexit reality involves facing significant change and challenges to our relationship with Britain but as with all disruption, opportunities will emerge. The arrival of financial institutions supporting their European business and clients has considerably broadened and deepened the scope and value of the financial services being provided out of Ireland. Dublin has fully emerged as an important European financial centre and combined with our already vibrant tech scene – with companies like Microsoft, Google, Facebook and LinkedIn all basing their EMEA headquarters here – we have a burgeoning innovative

Brexit: now, next, beyond

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> There is no doubt that Ireland's young and educated workforce is a key part of our value proposition.

ecosystem that is unique to Ireland's capital, with rich potential for both sectors to feed and succeed off each other.

For our new entrants that have transitioned across to the Irish market, 2020 is likely to be the first full year of operation, post-license and authorisation. For most, that means coping with the not so normal day-to-day challenges of managing a new, fragmented business through a new entity, new operating model and new team, while building out and embedding very important structures and processes around governance, risk and regulatory management in an unfamiliar jurisdiction. The level of effort and cost it takes to deliver this change should not be underestimated. As one executive commented, relocation of a business is complex, time consuming and resource intensive so it is not surprising that one can really see Brexit-fatigue on some of the new arrivals' faces.

The extent of the initial regulatory engagement and the license authorisation process may be over, with most firms fully transitioned into their day to day regulatory supervision and engagement activities. But not surprisingly, the focus to deliver on the commitments made during that process have become a top priority for management. Indeed, the regulatory challenge and supervisory aspects have been immediate as new management teams have already been invited by the regulator to engage on topics such as strategy, governance, conduct, outsourcing, the Senior Managers Regime and the InterBank Offered Rate (IBOR). Regulatory engagement with the CBI and or the ECB has been pervasive and has significantly matured, on both sides, over the past three years. Firms have had to evolve and explain the precise details of their business and operating models and have been required to adopt and adapt to the Irish-entity specific and focused attention of the CBI as they exercise their robust regulatory mandate. Achieving and maintaining the balance between 'Group' and 'Local' entity structures and perspective has and remains a real executive focus and challenge. Developing, explaining and managing the interconnectivity, reliance and oversight of group activities will be one of the key management tasks going forward for the new group of Brexit financial services exiles.

Firms have been immersed in other challenges too, most notably around talent and infrastructure. With the creation of several thousand new financial services jobs in Ireland, resourcing these roles has been a particularly hot topic. We have witnessed a healthy repatriating of Irish professionals, inflow and secondment of talent from major overseas financial centres, and a significant movement of capable candidates from financial services players already based in Ireland.

There is no doubt that Ireland's young and educated workforce is a key part of our value proposition. Our education system is amongst the best in the world, and we boast one of the most highly educated workforces. The Organisation for Economic Co-Operation and Development noted that 52% of 25-34 year-olds have a third-level qualification compared to the EU average of 42%. In the financial services sector, more than eight out of ten people employed hold, at minimum, a bachelor's degree.

The emergence of Dublin as a prominent European financial centre in no way guarantees that the city will continue to grow and evolve in the same vein. To succeed as a true and externally perceived financial centre the 'City of Dublin' needs to be nurtured and supported to become, perhaps not a contender to London, but a complimentary European conduit as we emerge in a post-Brexit world. A financial centre must have a sustaining infrastructure and the ecosystem must generate its own gravity to continue to attract world-class businesses and talent.

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> Ongoing work and attention is needed to embed this expanded community and develop our new international financial services ecosystem.

Brexit: now, next, beyond

Technology developments in business are advancing at pace and continue to disrupt our traditional working practices. New skills, new people and alternative ways of working will be required by the sector over the coming years. Ireland, and specifically the Irish financial services community, must ensure that it leads the way in developing the environment and connectivity to attract required skills in technology, finance, customer behaviour, digital innovation, and environmental and organisational change to build and operate this new world. Partnerships with third-level institutions, being a leader in diversity, having an openness to ideas and people from all over the world and communicating a vision that attracts talent and investment will be key to that future.

The financial services sector and community is an essential component to Ireland's future development and prosperity. Alongside talented and innovative people it is critically important that our supporting infrastructure continues to adapt, improve and keep pace with our ambitions. Dublin has a strong international reputation as an attractive place to do business – we were ranked as Europe's second most attractive city for foreign direct investment by the Financial Times in 2018 – but we cannot rest. We are already seeing other cities noticing the change in our status and there is no doubt that they strive to compete strongly.

In conclusion, there is no doubt that the influx of diverse financial services firms in Dublin has dramatically changed our landscape and has created the basis for the next phase of the Irish Financial Services Centre, one with a very European if not global flavour. However, with this opportunity comes new challenges. Ongoing work and attention is needed to embed this expanded community and develop our new international financial services ecosystem, ensuring it has the necessary support to achieve its full potential as a major European hub. The onus on us now is to nurture and develop this community and ensure that we propel the IFSC into its next 30-year phase with the fuel to stay ahead of competition who will be hard on our tails.

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Millennial investors will continue to disrupt the industry due to their sizeable population, inheritable wealth and preference for digital channels of communication.

The rise of ESG in asset management

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Regulators and investors challenge investment managers to develop socially responsible products.

Growth in Sustainable Investment

Thousands of children across the world have been protesting to raise awareness and demand for more governmental action regarding climate change. They have followed fellow teen activist Greta Thunberg who scolded world leaders for not doing enough on the climate crisis. This demonstrates the younger generation's desire to salvage the planet from the irrevocable implications of global warming and environmental destruction.

Investors are not sitting quietly. We note there has been a recent profound shift in investors' sentiment - particularly millennial investors - towards socially responsible investing; the process of incorporating environmental, social and governance (ESG) factors into investment decisions.

Millennial investors will continue to disrupt the industry due to their sizeable population, inheritable wealth and preference for digital channels of communication. They are demanding investment products that are socially responsible, and they are increasingly factoring assessments of ESG into their investment decision making.

Sustainable investments will continue to grow in demand and the wealth and asset managers who supply millennials with values-based investment options will be strongly positioned to attract new assets to the firm as well as retain existing socially responsible clients.

The world's economies are already absorbing the costs of climate change and as the forces of populism gather, there is a strong argument for moving from narrow economic measures to holistic measures. Evolving macro-economic trends also highlight the need to create a sustainable, inclusive and climate-resilient future. Sustainable investments focus on the long-term practices that respect the environment, the well-being of employees and the prospects of future generations whilst displaying a track-record of generating return, improving profitability, funding innovation and achieving an increased market share.

Why Ireland for Sustainable Investments?

Ireland has a globalised economy; its pro-growth policies and environment attracts investments from all over the world. The Irish economic environment is well positioned to create opportunities for ESG investments through its accessibility to the rest of the European market. Ireland is an attractive option for foreign direct investments. Numerous multinational companies have chosen Ireland for their headquarters.

The Irish government has named ESG as one of their priorities and included it in the national strategic growth plan. This creates an environment of stakeholder awareness which is advantageous for ESG investments. This strategy includes

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Ireland is the fastest growing European fund domicile with a growth rate of 129% in 2018 (2017:126%). In addition, it has the largest ETF domicile in Europe. All these factors indicate that Ireland is poised to be at the forefront in ESG investment.

The rise of ESG in asset management

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sustainable financial infrastructure in the form of green bonds, climate finance socially responsible investing investments etc. Ireland issued its first sovereign green bond in 2018 and raised €3bn. It was also the first country to make a commitment to divest fossil fuel companies in accordance with the Fossil Fuel Divestment Act.

Ireland is the fastest growing European fund domicile with a growth rate of 129% in 2018 (2017:126%). In addition, it has the largest ETF domicile in Europe. All these factors indicate that Ireland is poised to be at the forefront in ESG investment.

ESG Regulatory Development

As investors internationally become more aware of ESG factors, regulators are also introducing new rules that could have a profound impact on companies' ability to raise capital, within the EU and beyond.

The European Commission issued an action plan on sustainable finance as part of a strategy to integrate environmental, social and governance considerations into its financial policy framework. The action plan's first legislative package covered the areas of disclosure, low carbon benchmark and taxonomy. Its main objectives are to increase transparency, manage financial risk from environmental and social issues and to finance more sustainable growth.

In January 2019, the EU Commission published draft rules on how investment firms and insurance distributors should take sustainability issues into account when providing advice to their clients. Later, an agreement was reached between the EU Member States and Parliament regarding carbon benchmarks which is favourable for sustainable investments.

The agreement covers the inclusion of ESG risks and opportunities in the decision-making processes of asset managers and financial advisors as well as their communication to investors.

EU diplomats and the European Parliament have recently agreed a deal relating to green investment rules. These new rules will help define 'sustainable investment' and this serves as another step towards a more uniformed ESG disclosure framework.

The disclosure requirements aim to cover a variety of financial products in the market including insurance-based investment products, individual portfolio management, investment funds, private and occupational pensions, insurance and investment advisors etc.

The regulatory amendments that are being made will improve compliance and disclosure of ESG factors resulting in investors making more informed investment decisions and long-term value creation for all stakeholders. It is therefore essential for financial market participants and financial advisors to start incorporating ESG factors in their decision-making process going forward.

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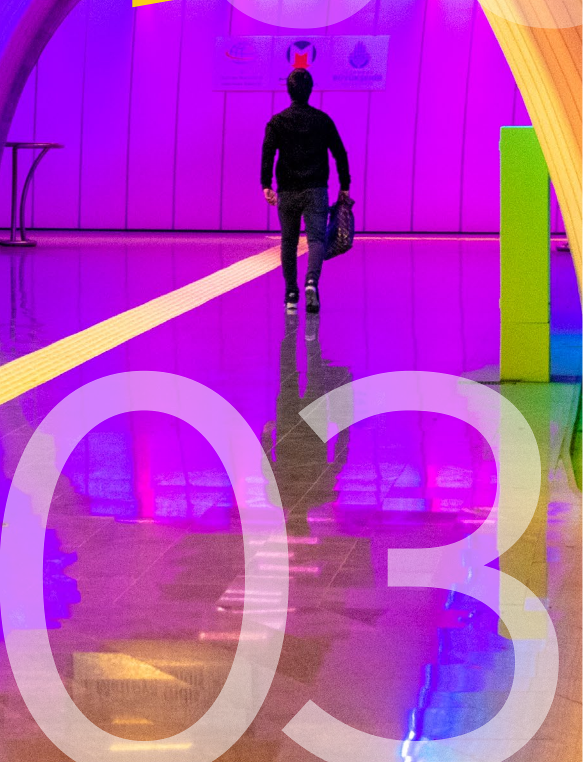
To understand the challenges firms face we must first acknowledge the barriers to greater diversity and inclusivity.



Addressing the diversity and inclusion imbalance

As an industry, asset management has historically been dominated by men and to a large extent this unfortunately remains as the status quo. However, it is encouraging to see that there is an appreciation that companies do better when there is diversity of thought.

Stakeholders in the industry from investment managers to investors alike increasingly recognise the role that diversity can play in combatting groupthink – creating better decisions and thus better investment outcomes. Some of the key players such as Vanguard Group, Inc., State Street Global Advisors and BlackRock Inc. have taken bold moves to bring greater attention to the lack of diversity on boards and in senior management positions. And more recently, Goldman Sachs has announced that starting from 1 July in the US and Europe it will not take a company public unless there is at least one diverse board candidate with a focus on women.

While a lot is being done to increase awareness of the importance of diversity of perspective in the wider business arena, investment managers themselves face challenges when it comes to attracting and retaining a diverse workforce. To understand the challenges firms face we must first acknowledge the barriers to greater diversity and inclusivity. These start with the talent pool from which asset managers recruit: largely investment banks or graduates with STEM degrees. Investment banks too struggle with trying to attain diversity, so recruiting from them is unlikely to lead to better results and as for STEM degrees the take up of these by female students still remains low.

The challenges and barriers can be overcome, and much is being done in the industry to achieve this. In November 2019, the Alternative Investment Management Association (AIMA), supported by EY, published a paper outlining 45 practical steps that can be taken by asset managers to improve their diversity and inclusion.

These include:

- the creation of neutral job descriptions;
- training interviewers on how to avoid unconscious bias;
- holding meetings between leaders and staff on inclusion;
- conducting regular, anonymous surveys on the issue;
- adopting formal diversity and inclusion policies, securing internal buy-in for these, and examining the diversity practices of the companies in which they invest.

Akin to the bold moves made by institutional investors in recent years to put pressure on boards to increase their diversity, we are now seeing managers look to tackle the lack

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Achieving greater levels of diversity is a critical part of the equation as asset managers look to successfully navigate the disruptive trends and challenges that are transforming the way they do business.

Addressing the diversity and inclusion imbalance

of diversity within their own industry head on. Man Group has become the second fund manager after Schroders to come to an agreement with its banks that it will pay lower borrowing costs if it meets certain social and charitable targets which include increasing the number of women in senior positions and pay more if it does not.

In Ireland, there are several initiatives with a specific focus of increasing female leadership in the financial services industry. These include 100 Women in Finance which launched its Irish chapter in 2017, Triple FS - Females Fast Forward in Financial Services which offers a unique cross-organisation mentorship programme and Women in ETFs. These initiatives and active involvement of asset managers with such initiatives can help to attract, develop and retain female talent.

Achieving greater levels of diversity is a critical part of the equation as asset managers look to successfully navigate the disruptive trends and challenges that are transforming the way they do business. Diversity is no longer "a nice to have" and has now become a business imperative as investors, regulators and other stakeholders expect this of asset managers. And this is a good thing as it pushes the industry to do more and at a faster pace. What is key to turning this around and making it a success is for all participants in the industry to embrace this change and openly commit to moving it from an ambition to a reality.

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A successful transition from old to new tech will satisfy client desires for increased transparency, real-time updates and better ways of working.

Can't we innovate faster?

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> "Alexa, what's the value of my portfolio?" "Alexa, can you buy me 200 shares of Apple Inc. at the lowest possible commission?"

The future is here and it's everywhere, from wearable technologies to the smartphones we're constantly attached to. Were Maslow to re-write his famous hierarchy of needs for the 21st Century, there's no doubt that access to WIFI would now be one of our most basic needs!

If the future is here, why then is it not as widespread across financial services, what's holding our industry back?

Witnessing interns and trainees kick off bright careers in financial services is like watching two worlds collide. They can't understand why we've made everything so complex, neglecting any consideration of the end-user in the design of the technology they're using.

Firms right across financial services are signalling that their businesses are morphing into technology companies. A successful transition from old to new tech will satisfy client desires for increased transparency, real-time updates and better ways of working, however, the reality of checks and balances will act to slow this progress down. Rightly so, when vast amounts of assets and wealth are in question. But what if, these checks and balances could be quicker, more secure and more intuitive.

I set up my Revolut account, on a Saturday, in a field at a festival in Waterford where facial recognition and a picture of my drivers' license allowed for the execution of their KYC processes. My current account details were added to Apple Pay in minutes, I can now transact using my phone and my thumb-print anywhere that accepts contactless. Both technologies are so simple and intuitive, yielding such a positive consumer experience.

Buy into a fund or an equity on the other hand, not so much. Maybe it's demographics; where more than 90% of global wealth is controlled by those over 40, perhaps the simple, intuitive and cost-effective solutions don't matter quite so much. But what of the next generation? Wealth will, after all, pass on. In addition, widespread acknowledgement of pension deficits, and the fact that populations are living longer, mean that people need to save from a much earlier age than ever before. So, it does matter.

If it matters, why is it taking so long? It's possible that initial take-up will be slow, which means there's time. Or maybe it's the fact that the current regulatory environment is so strict and so complex that it acts to stymy change. Possibly, but this isn't deterring challenger businesses and FinTechs from entering the market with slick, smart and intuitive offerings to compete with traditional players. And while it might seem that it's been around a while, it's sobering to think that Apple Pay was only launched in Ireland in 2017!

So, what do consumers want? Let's start with lower costs, control and transparency. With small amounts of investment, individuals and firms are beginning to place small bets and take little risks on emerging FinTechs and the smaller innovative players that may pave our way into the future.

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Can't we innovate faster?

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> Across the asset servicing space, firms are exploring whether blockchain can replace traditional transfer agency models with digital ledgers.

From here, we'll move into the Silicon Valley stage where start-ups and unicorns with good technology, management and backing begin to create the banks, asset managers and insurance companies of the future. This will be gradual - the model will win the hearts and minds and confidence of the 2%, who in time will be the 10%, the 20% and then the 90%.

So, what will accelerate change and transition our industry into a more technologically savvy one? Many asset management firms and service providers have recently adopted Robotic Process Automation (RPA) solutions, applying these solutions to routine and repetitive tasks. I've witnessed clients using RPA as a solution for processing bond and OTC trades, where the RPA effectively mimics the actions that a person would have historically performed. I've also witnessed a use case where trade analysts have utilised an RPA solution to scrape multiple data sources in order to build themselves a research paper, ready for the analyst to assess the moment they arrive at their screen to work!

Blockchain also has a role in the future, with the potential to reduce settlement cycles to nanoseconds rather than days. Across the asset servicing space, firms are exploring whether blockchain can replace traditional transfer agency models with digital ledgers and smart contracts with the potential for more secure transacting and recording of trading in a fund, with AML and KYC processes built in from the outset.

And as for artificial intelligence, vast potential exists. Each week Spotify introduces me to 30 new songs it thinks I'll like. On average, it has a 50% hit rate - that's impressive and maybe with music it's easier. Or is it? Their algorithm works by defining your age, previous likes, genres, beats per minute etc etc. How different is this to measuring demographics, risk appetite, benchmarking stock, market, index and FX performance charts to select the optimal portfolio for you? I don't know, but I do know someone out there is investigating this right now.

Me: "Alexa, what's the future of financial services?"

Alexa: "I'm sorry, I don't know that one."

Not entirely surprising! Our industry isn't so easy to parse together. Partly as a result of legacy technologies that have been added to over time as client and regulatory requirements have changed.

In addition, technology change is complex. There are just enough bad experiences out there for management groups to try and steer clear of these choices for as long as possible.

There may however be a starting point, with the potential to accelerate technology transformation right across financial services. That starting point is the establishment of financial services data standards and their associated taxonomies and naming conventions. Such an initiative would remove layers and layers of complexity, misunderstandings and mistakes from financial services businesses. A standard taxonomy would also facilitate deep dive data mining, trend and investment analysis, real time transparency, greater control and move us much faster into the future, which by the way, is now.

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> While Ireland is a key player in the global asset management industry in general and specifically in the asset servicing industry, Private Equity is one area in which we have lagged behind.

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ILP: the potential for the upgraded legislation for Irish PE service providers

The past few years have seen tremendous growth in the asset management industry. Alternatives and especially Private Equity have been responsible for a significant portion of this growth fuelled by the need of investors for diversification, long-term investment and the search for yield.

While Ireland is a key player in the global asset management industry in general and specifically in the asset servicing industry, Private Equity (PE) is one area in which we have lagged behind. As this is one of the fastest-growing areas of alternatives, it is critical that we get this right.

Limited Partnerships in Ireland

Although Ireland has a range of structures to choose from, Limited Partnerships (LPs) remain the preferred structure for the PE industry. Yet only a handful of such structures have been established in Ireland under the Investment Limited Partnerships Act 1994 (ILP Act). Instead, managers have chosen to set up in other EU jurisdictions which have a more fit-for-purpose LP vehicle. This is in spite of our vast expertise in servicing all types of structures and asset classes and having almost all global players within the Irish market.

The industry has therefore been seeking enhancements to the ILP Act to rectify this anomaly. As of September 2019, the Investment Limited Partnerships (Amendment) Bill 2019 is currently before Dáil Éireann, through its third out of five stages. At EY's Funds Forum, held in December 2019, Michael McGrath, TD & Fianna Fáil Spokesperson on Finance provided an update on the long-awaited Investment Limited Partnership Bill, which he expects to be in place by January or February of 2020 at the latest.

The way forward

To understand the potential for Ireland, a close look at the current needs and future direction of PE managers is important. EY released its Global Alternative Funds Survey in November 2019, which considers the Alternative Funds industry's current state and future direction. The survey findings revealed that PE managers are focussed on: expanding internationally, looking for new pools of talent, reducing costs harnessing the reach of technology/data and; increasing their corporate responsibility footprint through ESG initiatives.

Ireland has a clear opportunity here, but along with getting a fit-for-purpose PE vehicle, we will also have to rethink our strategy in areas such as talent deployment, ESG and

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> Asset servicers in Ireland must continue to change the way in which they work and focus on developing a culture of innovation.

ILP: the potential for the upgraded legislation for Irish PE service providers

technology/innovation, to get back momentum lost to other jurisdictions.

Talent

Our talent proposition remains our lynchpin. Ireland has a young, dynamic, highly educated, English-speaking workforce with extensive experience in asset management. Many of the PE funds within Europe are already being serviced out of Ireland and we are helping seed cross-border hubs of the PE service offering. Our people's extensive experience with asset management regulations makes us prime candidates for helping US and Asian managers navigate their way through a complex European regulatory framework. However, to keep up our competitiveness, we need to do more.

We need to invest in further education, at a grassroots level, designing courses and degrees in asset management, risk, compliance and portfolio management. We also need to upskill our people in the workplace to specialise in the areas of middle and back office which are most useful to PE managers. The opportunity for Ireland is clear; EY's survey found that access to new talent pools is one of the reasons for alternative funds' international expansion.

ESG

In response to investor demand and a desire to improve public perception of their industry, asset managers are also looking to align ESG with their investment decisions and their internal operations. To succeed, managers will ultimately require their service providers to align with their values. This presents an opportunity for Irish service providers to take the lead in being an ESG aligned jurisdiction and gaining a first movers' advantage, taking it a step further by helping managers to navigate this new landscape.

Technology/Innovation

There is no question that the asset management industry is in the midst of digital disruption. The industry will undergo major changes over the next few years as it incorporates advanced technologies such as AI, RPA and blockchain. Asset servicers in Ireland must continue to change the way in which they work and focus on developing a culture of innovation. They also need to increase their collaboration with FinTechs to gain access to leading-edge thinking and enable delivery of a wider range of client products.

EY's survey revealed that although most PE investors expect innovation, not many of them want to pay for it. For all but the largest managers, these costs would indeed be prohibitive. Ireland can offer solutions to such managers who want to tap into scaled expertise without having to make their own investment. Developing innovative solutions for front, middle and back office which include data analysis and deployment capabilities will help put us ahead of the curve as PE managers, focused on growth, have little time to focus on these aspects of their business. Increased focus on cybersecurity and the robustness of IT infrastructures will also pay dividends.

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Ireland has a tremendous opportunity to lead this change as it has done for other parts of the industry.

ILP: the potential for the upgraded legislation for Irish PE service providers

Conclusion

The private equity industry has operated in the same way for so long that most players within the sector expect that transformational change is inevitable. Powered by 25 years of experience and 16,000 professionals, Ireland has a tremendous opportunity to lead this change as it has done for other parts of the industry. We must continue to innovate our service offerings and be the drivers rather than followers of change.

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> Despite their strong track record, ETF providers can't assume that what has worked well to date will guarantee future success.

Innovation driving growth in ETFs

Despite market volatility, the compound annual growth rate for 2019 reached 31% worldwide, according to data published by independent research consultancy ETFGI. This exceptional growth not only reflects the global shift to passive investing – a trend ETFs helped to create – but also ETFs' tradability and flexibility.

Even so, the ETF industry can't afford to ignore the global economic situation of political uncertainty and slowing growth. Despite their strong track record, ETF providers can't assume that what has worked well to date will guarantee future success. This means that ETF product innovation, always central to the industry's story, is more important than ever for growth. In an increasingly crowded market, innovation also allows new entrants and second-tier firms to compete with the industry's leaders.

Bond ETFs have grown rapidly into the mainstream and look poised to move up another gear

Fixed-income ETFs have dramatically shrugged off their "niche" label in recent years. Global bond market ETFs recently exceeded the US$1trn mark– quite a milestone for a product created in 2002, which accounted for less than US$50bn of assets in 2008. The future will see more innovative uses of ETFs by investors and more innovative design by ETF promoters.

In the short-term, there are certain potential headwinds for bond ETFs around slowing economic growth and liquidity concerns among investors and supervisors. Even so, we expect fixed-income ETFs to continue their strong growth. After all, they still account for a tiny slice of global bond markets – less than 1% in 2019, and the industry agrees, with some promoters predicting that fixed-income funds will double in size to US$2trn by 2024.

Looking further ahead, we also expect continuing product innovation to play a key role in driving greater inflows to fixed-income ETFs. Future areas of innovation will include:

- A greater range of maturity profiles, including target date funds
- More smart beta products, introducing style factors, such as quality or momentum into fixed-income ETFs
- Incorporating environmental, social and governance (ESG) techniques
- Greater geographical choice for fixed-income investors:
    - Many bond markets remain difficult for foreign investors to access – mainland China being an obvious example.

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> Asset servicers in Ireland must continue to change the way in which they work and focus on developing a culture of innovation.

Innovation driving growth in ETFs

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Combining ETFs with ESG offers huge growth potential – if the two concepts can be grafted together

The market for ESG-themed ETFs is far less mature than the bond ETF market. Investment research provider Morningstar reported that ESG ETFs had global assets of £13.5bn at the end of August 2019 – around a quarter of 1% of all ETF assets. It's not an asset class but an investment philosophy, which is comparatively new to many investors and relies heavily on qualitative judgments.

So why look at ESG ETFs at all? The answer is simple: they're growing very fast, albeit from a low base. Global assets under management (AUM) increased by 50% in 2018 and during the first eight months of 2019, AUM again increased by 36%, according to Morningstar data. At this rate, ESG ETFs could attract US$500bn within a decade, but many firms feel that even this may understate their potential. Demand is soaring among European pension funds and other institutions, and this appetite will only increase as millennial investors receive an unprecedented financial inheritance. The Global Sustainable Investment Alliance reports that there are now US$22.9trn (€19.2trn) of assets managed under responsible investment strategies worldwide; ETFs currently represent less than 0.1% of that total.

A clear focus on the risks and rewards for investors holds the key to sustainable, successful innovation

Innovation will help ETF providers to grow their fixed-income and ESG inflows, but it is not a panacea. These will not be markets in which every firm can succeed. Leaders will need to keep innovating to stay ahead, while challengers and new entrants will need a distinctive, compelling advantage if they're to compete. We expect future growth in fixed-income and ESG ETFs to be accompanied by:

- Increasing competitive pressures, as existing players and new entrants vie for a slice of growth.
- Lower fees and additional competition on price, leading to margin pressure and – for firms unable to achieve economies of scale – falling profitability.
- Growing disparity between those firms with the scale or expertise to succeed in specific product areas and those struggling to remain competitive.

Firms that want to overcome these competitive challenges need to be mindful of the risks of innovation – and keep a clear focus on the needs of their investors.

Get innovation right now to accelerate ETFs into the 2020s

Product innovation is central to the ETF industry's plans to build on the rapid growth of the past decade. In our view, fixed-income and ESG ETFs stand out for their potential to create sustainable demand. But the EY ETF team doesn't believe that "more of the same" will be enough to steer ETF markets toward continued expansion. ETF providers need to pursue smart, continuous improvement if they're to accelerate in an increasingly competitive market – and change investing for the better.

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> As well as the general growth of the industry, a significant factor contributing to the rapid growth of assets held by CCFs is the management of on-going tax risk.

Spotlight on the Common Contractual Fund as Irish assets exceed €100bn

1/2

The Common Contractual Fund (CCF), first introduced in 2003, is enjoying significant success and a surge in popularity. Net assets held by CCFs have almost doubled in the past two years, now exceeding €100bn.

While some of this growth is a side-effect of Brexit, it is also a reflection of a wider trend where global managers are increasingly choosing Ireland as their EU base. The CCF is benefitting from the continuing and rapid evolution of the industry and its participants in Ireland.

As well as the general growth of the industry, a significant factor contributing to the rapid growth of assets held by CCFs is the management of on-going tax risk. Asset managers operate in a complex and dynamic global tax environment. The CCF offers a level of certainty in a post-BEPS environment.

As the CCF is a tax transparent vehicle, income and gains arising on investments held by a CCF are considered as arising directly to the investor. The resultant tax certainty can offer a significant benefit to investors, particularly for investors that are entitled to an exemption from withholding tax in certain jurisdictions, which could be lost if they invest through opaque funds or if not, is now uncertain as jurisdictions implement the provisions of the OECD's multilateral instrument. Investing via a CCF, investors can maintain their tax position and access double taxation treaty benefits as if they had invested in the fund's underlying assets directly.

As investors and asset managers become more tax-savvy and more engaged with tax, they are increasingly looking to understand the impact of tax on their investment portfolio. Global pension schemes are significantly invested in global equities, with many of those schemes unaware of the implications of withholding tax structures. As an example, a CCF could allow certain pension funds to save up to 40 basis points on a typical active global equity strategy. We have seen a notable increase in requests from global pension schemes examining their investment structures from a tax perspective, signalling a clear desire from them to address the inefficiencies in how they are investing. This growing awareness is no doubt another factor contributing to the growth of CCFs.

Putting aside the recent drivers of the attractiveness of CCF, it is also worth recapping on the "staple" benefits of a CCF. The CCF was specifically developed to enable asset managers and asset owners to pool their investments (primarily in the context of pension funds and institutional investors) in an efficient manner, creating economies of scale and a resultant lowering of costs. It offers a clear governance and risk management framework for pension trustees and other stakeholders. It

Spotlight on the Common Contractual Fund as Irish assets exceed €100bn

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> Given the ever-increasing complexity for today's investors, delivering simple, transparent, tax-efficient solutions is clearly a driving factor behind the recent swell of popularity for the CCF.

is also a flexible structure that can be established as a single or multi fund vehicle, with single or multiple managers. CCFs offer investors the opportunity to diversify their portfolio and spread portfolio risk without being adversely affected by tax status. For managers, the centralised process, reduced administrative burden and consistent, standardised reporting is a significant driver in accessing CCFs.

In other words, CCFs provide all the advantages of pooling but with none of the potential tax downsides – that is, an Irish fund that is not a CCF would have its own tax status that may not be equal to a non-taxable investor such as a pension fund.

Given the ever-increasing complexity for today's investors, delivering simple, transparent, tax-efficient solutions is clearly a driving factor behind the recent swell of popularity for the CCF.

With all the benefits of tax transparency, it is fair to ask why the CCF has not been more popular up to now. One of the main barriers in terms of setting up a tax-transparent fund has been the perceived practical complexities. The process of achieving tax transparency in jurisdictions can be a time consuming and costly exercise. However, it is well established that a CCF can avail of tax transparency in most EU investment markets, the US, Canada and Australia.

The Revenue Commissioners have also sought to safeguard the tax transparency of the CCF in new double tax agreements, with several Irish double tax agreements confirming CCF transparency outright. As is the case with any new product, as the number of investors, markets and service providers become more familiar with the CCF, the time and cost investment for set up reduces. We are certainly seeing new entrants into the market benefit from those that went before!

Armed with the CCF, Ireland's fund industry is fully equipped to meet the ever-growing global appeal for tax transparent fund structures and stands ready to meet the growing demand from global investment houses.

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Investors are realising they can control more than cost, they can control taxes.

Tax alpha strategy

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How does your organisation handle tax risks and opportunities? The current market response is highly fragmented. For an industry that is hyper focused on expense ratios and basis points, it is only a matter of time until the industry becomes equally focused on taxes and the effect that taxes can have on their bottom line. Taxes in many cases can be a greater cost to funds than management fees.

More and more we are seeing a shift in focus from cost to taxes coming from investors. Investors are realising they can control more than cost, they can control taxes. Investors are becoming more tax savvy, more focused on tax suffered in their investment structure; can withholding be reduced? Are funds distributing and realising gains efficiently? How is income reported for tax purposes? Are securities within a fund being sold (generally a taxable event) to raise cash?

Up to now increased focus on taxes within fund structures have been mainly driven by enhanced transparency measures and new reporting requirements, many brought about by OECD's base erosion and profit shifting (BEPS) initiative and EU regulation. Increased focus from tax administrators has meant increased reporting, increased documentation requests and increased controversy. All of which have meant increased costs for investors but very little in the way of reducing tax cost for investors.

The quality of an organisation's tax infrastructure is now seen as an alpha characteristic and a key enabler of growth - this equally applies to funds, fund service providers and asset managers. As demands increase for tax transparency, the business of tax is undergoing a fundamental shift.

Organisations are struggling with managing this new business risk. We have seen clients attempt to strengthen their in-house tax resources. However, they have been restrained either by the business, as they don't see the value add or by the small talent pool of experienced operational tax professionals.

Given the potential reputational damage, operational tax risk already outweighs the historical corporate tax risk faced by financial organisations. For example, an enquiry and fines levied by a tax authority on an organisation's corporate tax return may not be apparent to its investors however a fine or an inquiry on an investment product will most likely directly impact those investors. Organisations should ensure that already scarce tax management resources are focused on managing the more complex tax affairs associated with their products and to what extent tasks should be outsourced.

Best in class organisations will be able to produce a tax policy, a governance model and in some cases an operating manual that includes the obligations of the fund, mapped to responsible parties backed up by current service level agreements.

Getting the balance right between over managing and not managing tax risk is a challenge. More and more we are assisting clients in redefining their tax needs for business

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Merely keeping pace with legislative tax change is not a successful long-term strategy in this new world.

Tax alpha strategy

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purposes. We become an extended part of our client's business providing an integrated service model designed for client needs. We coordinate, manage and oversee a global fund organisation's tax needs and provide the necessary information to exercise appropriate governance and oversight.

Merely keeping pace with legislative tax change is not a successful long-term strategy in this new world. Once an organisation decides to act, we typically see one of three approaches.

The first option is rebuilding or transforming the existing tax function and embedding tax within the business. This option can cause disruption however it offers the most control. It requires management focus and can be hard to staff due to a shortage of talent with the right blend of skills. Further it requires constant vigilance to ensure people, processes and technology keep pace with change.

The second option is outsourcing tax to a third party. The third party is generally expert in the area with a global network. Under this option, the IT costs, knowledge retention and upskilling are shifted outside the organisation.

However, it ensures that organisations can establish and agree foundations of tax service with service providers that will reduce tax costs for investors for future payments and enable:

- effective oversight and governance of service providers;
- new product tax sign off;
- on call tax structuring hotline with particular investors needs in mind;
- identification and recovery of excess withholding taxes (past view);
- identification of potential gaps in service;
- provided by other services providers.

It may be a significant change to the business. It will require a management and governance model.

The third option is a blend of the first two options as organisations look to maximise effectiveness and control while still reducing the overall cost of the tax.

Time to act? With the challenges for operational tax risk only building and investor focus shifting from cost to tax, it is imperative to act. No matter what stage you are at in the reimagination process, we can provide insight into each stage of the journey from strategy to implementation.

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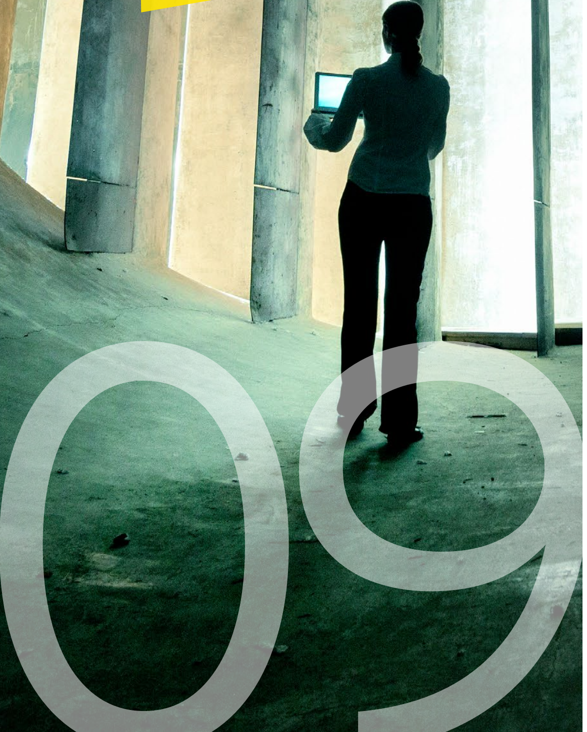
> One of the outcomes of the 2008 global financial crisis was a collapse in the public's trust in financial institutions and their leaders.



Individual accountability - SEAR and SMCR

In July 2018, the Central Bank of Ireland (CBI) announced proposals to introduce a Senior Executive Accountability Regime (SEAR) in Ireland. This will result in significant changes to the CBI's existing Fitness and Probity Regime, as well as its enforcement process.

The proposals are similar in aspect to key elements of the UK's Senior Manager and Certification Regime (SMCR). Implications for both individuals and firms will be significant. Legislation to progress these proposals is expected over the course of 2020, to be followed by CBI Guidance and Standards.

One of the outcomes of the 2008 global financial crisis was a collapse in the public's trust in financial institutions and their leaders. Globally conduct regulators have been focused on winning back this trust by raising the standards of individual accountability of those in senior management positions within financial services firms.

To understand the proposed changes under the SEAR, we must first look back at the efforts of the Central Bank of Ireland to regulate and enforce greater standards of accountability and overall conduct within the industry over the past ten years:

- The Central Bank Reform Act 2010, and the revisions under the CBI Fitness and Probity Standards (2014), introduced a revised and significantly enhanced fitness and probity regime, which applies to all Regulated Financial Services Providers authorised by CBI. The core function of the Fitness and Probity Regime (F&P) is to ensure that persons in senior positions are competent and capable, honest, ethical, of integrity and financially sound. The F&P also enhanced the CBI's enforcement powers to investigate, suspend or prohibit individuals from holding current and future Control Function and Pre-Approved Control Function roles. While the F&P represented a significant overhaul of the CBI's powers to ensure Board members and Senior Management meet the necessary levels of fitness and probity for the roles they hold, the regime fell short of holding individuals accountable for their conduct.

- Subsequently, the CBI introduced the Fund Management Companies Guidance (Dec 2016), referred to in industry as CP86, which came into effect on 1 July 2018. CP86 sets out the Regulator's expectations in relation to the culture and environment in which (delegate) oversight is undertaken; the role of the independent director with responsibility for the specific task of reviewing the effectiveness of the fund management company's organisational effectiveness; and the role of the six pre-identified Designated Persons. Implementation of the CP86 requirements has already focused board attention on the newly regulated iNED role, in addition to assessing the effectiveness of how the board functions through reviewing its composition, capacity, meeting materials, power and delegation and oversight of board committees and how conflicts are identified/managed, particularly

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Individual accountability – SEAR and SMCR

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For senior management, specifically those holding Designated Persons roles, implementing CP86 has required firms to review the effectiveness of engagement between key first line business, operational and control functions.

perceived conflicts relating to promoter relationships. For senior management, specifically those holding Designated Persons roles, implementing CP86 has required firms to review the effectiveness of engagement between key first line business, operational and control functions, together with the oversight of the first line by the second line risk and compliance functions. Key to the successful implementation of the CP86 requirements will be evidencing the change of focus of fund management company boards away from a supportive subsidiary culture to a demanding client culture driven to achieve the best outcomes for investors. Crucial to this is how fund management companies will evidence this through the documentation of decision-making and the rationales for same, up through the governance structure.

The 2020 phase of the CBI's culture enhancements will see the implementation of an Irish Individual Accountability regime, the SEAR, which they have indicated will be similar to the UK's SMCR. While the legislation and guidance have not been published we know the following:

- It will initially include investment managers, and may extend further than the entity types identified within the CBI's current proposals.
- The recent thematic review of UCITS performance fees has indicated that some entities may not have been acting in the best interests of their investors.
- Once individual accountability is introduced, in-scope entities will be required to document governance arrangements in accordance with the requirements and also to comply with the relevant conduct rules.
- The CBI has indicated the regime will include the following conduct enhancements:
  - **5 clear enforceable conduct standards** for all employees in all regulated firms. Additional standards for senior executives and overall business standards for firms; CBI is actively engaged with the Department of Finance on the scope of the SEAR.
  - **Enhancements to the current F&P regime** to strengthen onus on firms to proactively assess individuals taking up of senior positions.
  - Proposed **enhancements to overcome some current limitations of the CBI's F&P oversight function**, e.g., ability to investigate some people who performed controlled functions in the past.
  - **Unified enforcement process and removal of "hurdle of participation"** so that the CBI can pursue individuals directly.
  - SEAR would initially apply to credit institutions, certain insurance and investment firms and third country branches of all of these.
  - Senior Executive Functions under the regime would include board members, executive functions and heads of critical business areas.

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> In 2020, boards and senior management will need to ensure their entities have developed a strategy to implement the regime and have identified the key areas of impact and change focus.

Individual accountability – SEAR and SMCR

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It is worth noting that the SMCR would not have been extended to the asset management sector in the UK had it not been considered a success.

In light of the CBI's challenge to industry not to wait for the legislation to be put in place, but to act now to address the key culture concerns the regime seeks to address, the question for fund management companies is what actions they should take.

In 2020, boards and senior management will need to ensure their entities have developed a strategy to implement the regime and have identified the key areas of impact and change focus.

The illustration below provides a summary of the potential implications of the SEAR:

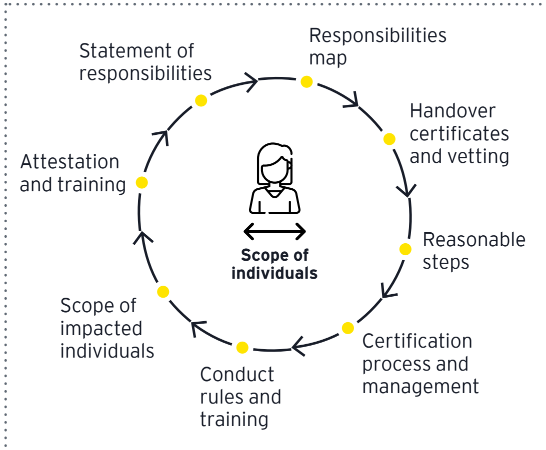
Summary of the potential implications of the SEAR

Senior Executive Functions
- Organisational design
- Responsibilities map
- Basis for presumption of responsibility
- Risk culture and tone

Business lines
- Impact of certification regime
- Conduct rules
- Reasonable steps framework

HR
- Renumeration and reward strategy
- Performance management
- Communication
- Training and development

Technology
- HR systems enhancements
- Reasonable step solutions
- Enhancements to support reasonable steps
- MIS provision



Legal and Compliance
- Rule change interpretation
- Application and authorisation framework
- Implementation and monitoring

Internal Audit
- Implementation assurance
- Monitoring
- Effectiveness testing

Other control functions (Risk, Finance, Ops)
- Impacted individuals
- Alignment to new requirements
- Enhance existing control frameworks

Governance
- Governance framework
- Reporting lines
- Management information
- Committee protocols

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In an era of disruption, evolving market dynamics and digital challengers, compliance teams are under pressure to confirm that new services, delivered through new channels, meet regulatory expectations.

Compliance and balancing agility

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For more than a decade, and in the context of increasing pressure from regulators, financial service firms have continued to increase expenditure on risk and compliance. However, with concerns around compliance, conduct and culture persisting, boards and senior executives are asking whether there is a more effective and more efficient way to deliver compliance objectives.

In the meantime, more is being asked of compliance professionals. In an era of disruption, evolving market dynamics and digital challengers, compliance teams are under pressure to confirm that new services, delivered through new channels, meet regulatory expectations. With pressure to get the 'minimum viable product' into the market place at break-neck pace – something has to give!

And it is. A change in mindset is gradually occurring that is bringing the traditional 'first lines' and 'second lines' closer together:

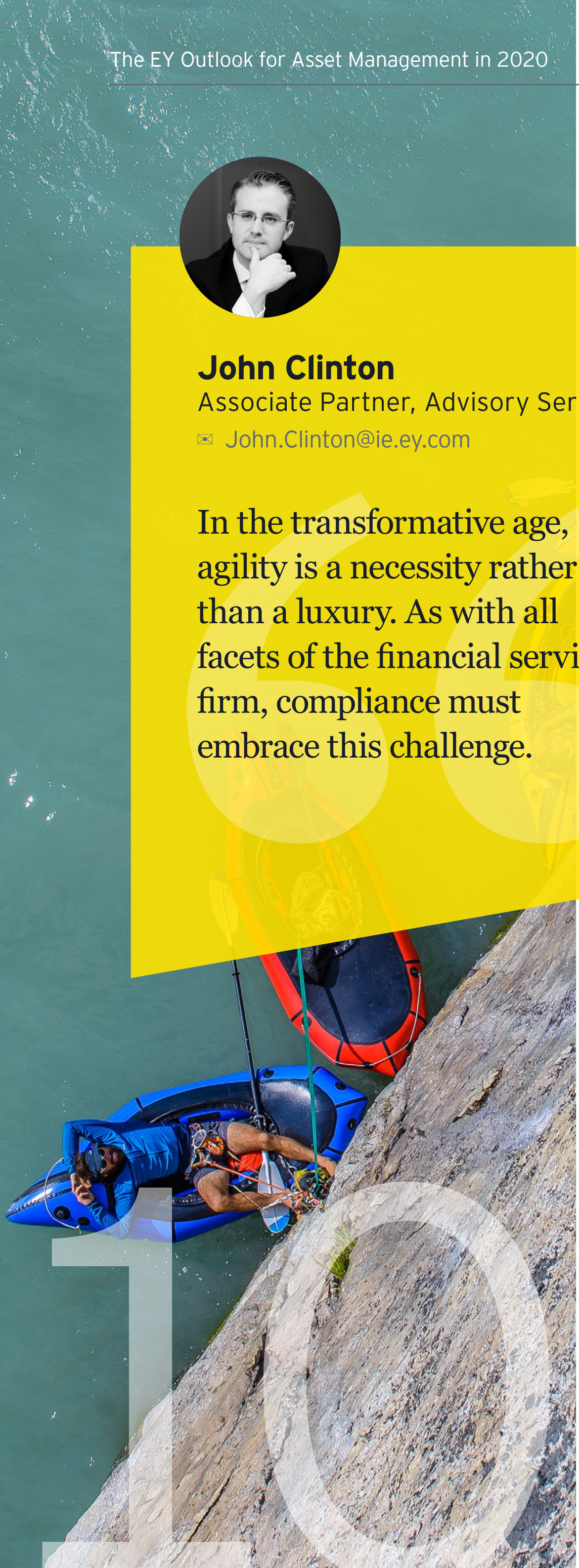
1. Businesses are starting to realise that conduct risk will never be properly managed until the first line understands and embraces the notion that it is their responsibility to design and sell products that meet their customer needs – and not a second line responsibility to constrain their innovation. This is a first step in a cultural change, shifting away from a 'compliance' mentality to a 'conduct' mentality;

2. Equally, the second line is starting to engage in a different way with their first line colleagues – adopting a more collaborative and advisory approach and eschewing the traditional 'waterfall' model of engaging, for example, throughout product design iteration, launch and product evolution – rather than as a final 'gate keeper'.

EY is supporting its clients in making this transition in a number of different ways. The first is the adoption of a 'trust by design' mentality, whereby firms adopt a customer-oriented focus on trust from top to bottom; from organisational purpose, strategy and governance through product design and delivery. With this mindset, the lines of defence, and particularly risk and compliance can increasingly become a trusted advisor to the business rather than a perceived hinderance to it.

The second is to assist our client's risk functions to be digitally led to strengthen trust and increase business performance. Successful organisations are challenging themselves with the right questions to differentiate with trust:

- **Adaptive governance:** How is our strategy and operating model designed to create the foundation for trust?



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In the transformative age, agility is a necessity rather than a luxury. As with all facets of the financial service firm, compliance must embrace this challenge.

Compliance and balancing agility

2/2

- **Customer journey:** How do we design and protect customer trust?
- **Intelligent decisions:** How are we empowered to make strategic decisions?
- **Data and technology ecosystem:** How are we harnessing the power of data and technology to increase performance?
- **Cybersecurity and business resilience:** Will our organisation sustain trust through the biggest tests?

We are helping clients in a number of ways to engage with and meet these challenges. For example:

- We are assisting Boards and C-Suite executives who are asking for better risk and cyber intelligence aligned to their business imperatives;
- We are assisting risk and compliance functions to re-evaluate their governance structure and to harness technology to better manage risk throughout the organisation;
- We are helping clients so design blueprints and roadmaps to protect their future through better risk data intelligence and continuous monitoring;
- We are supporting financial service clients who are developing and deploying product and service management programs with digitised controls; and
- We are supporting clients in the journey to embrace emerging technologies such as AI, RPA, drones, and advanced analytics to collect risk intelligence and monitor controls to make better decision.

In the transformative age, agility is a necessity rather than a luxury. As with all facets of the financial service firm, compliance must embrace this challenge. Part of this journey involves engaging with and utilising emerging technologies to enhance efficiency and effectiveness. In parallel, compliance and risk functions must continue to support their colleagues in putting customer trust at the centre of everything they do.

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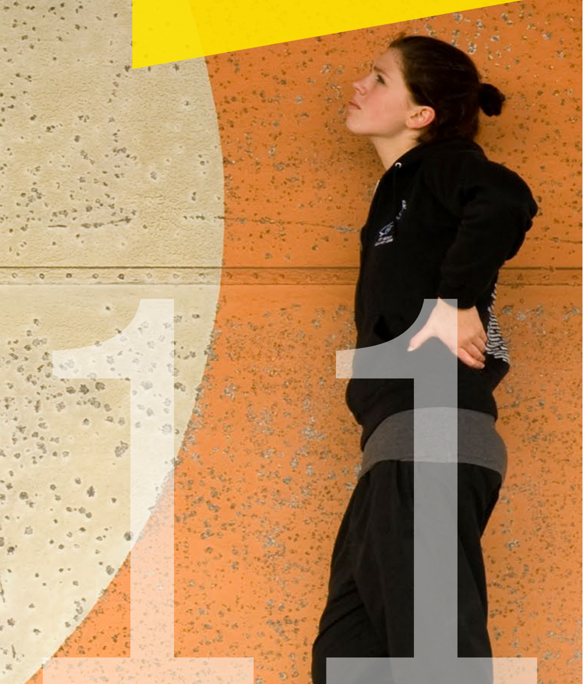
While much of the effort on IBOR programmes was concentrated in banks initially, other industries have realised the scale of the change involved and are setting up transition programmes.



IBOR reform - impact on asset management

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Inter Bank Offered Rates (IBORs) are referenced in more than $350 trillion financial contracts.

Until recently, IBORs were the global standard for short term interest rates in most currencies, driving the interest rate paid on a vast suite of financial products, from loans to complex financial derivatives. Beyond financial instruments, it is also common to see IBORs incorporated within investment management fee arrangements as hurdles for either management or performance fees.

Why are IBORs in demise?

IBORs represent the rates at which banks borrow from each other on an unsecured basis and historically have been calculated based on information provided by panel banks. In the UK and the US, the rate is the London Interbank Offered Rate (LIBOR). In Europe the equivalent is the Euro Interbank Offered Rate (Euribor).

Since the financial crisis, there has been a decline in unsecured lending between banks. Since banks were no longer borrowing as much from each other, the panel banks have increasingly had to use their judgement to estimate the IBOR rate, which makes the system vulnerable to manipulation. Recognising this, the central banks looked to make a change. In the UK, the FCA took the first steps announcing that, from 2021, UK panel banks would no longer be compelled to submit rates – which is expected to result in the demise of LIBOR and USD LIBOR.

In Europe, similar concerns have also led to the reform of Euribor. The market is currently expecting reformed Euribor to continue past 2021, however, there remain uncertainties as to how long it will continue.[1]

Alternative reference rates:

Given these changes, IBORs are expected to be replaced by a new set of rates, alternative reference rates (ARRs). ARRs which are overnight rates rather than the familiar term rates of the IBORs, have been established for most major currencies. For example, for GBP the ARR is reformed SONIA (Sterling OverNight Index Average), for USD it is a new rate called SOFR (Secured Overnight Financing Rate) and for the EURO the ARR is €STR (Euro Short Term Rate). Switching from IBORs to ARRs will require a significant effort from the entire global financial community.

As we move towards 2021, liquidity in ARRs, particularly in GBP and USD will increase, while it is expected that liquidity in IBOR instruments will decrease, as the market migrates towards the new rates. We believe that this change in liquidity will accelerate the market transitioning from IBORs to ARRs across all products, as they become the new market norm. In the UK, the working group on sterling risk free reference rates has introduced a series of targets, which will also likely accelerate the pace of transition, especially in GBP. These targets include that there would be no further GBP LIBOR based cash products, maturing beyond 2021, issued by the end of Q3 2020 and that firms would "significantly reduce the stock of LIBOR referencing contracts by Q1 2021". As well as requiring firms to introduce a new ARR dependent product suite, these targets also require accelerated action on firms existing stock (back book) of IBOR contracts.

[1] 3 July 2019. ECB letter to Banks, 'Banks' preparation with regard to interest rate benchmark reforms and the use of risk-free rates.

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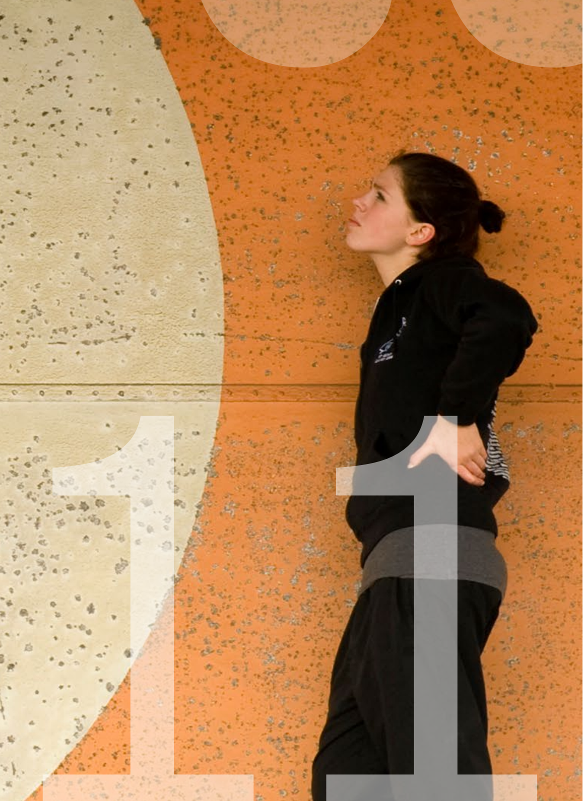
The sooner companies take action to start this journey, the smoother the transition will be.



IBOR reform - impact on asset management

Substituting rates like these in place of IBOR rates will have an enormous impact across financial services. It will require financial institutions to understand the dynamics of the new rates and how the change will impact internal systems, processes and models, including the recalibration of reporting and valuation models. It will also require the 'repapering' of all impacted legal agreements, as the existing IBOR dependencies are removed. Institutions will also need to understand how this change will impact their financial statements and what additional disclosures may be required.

While much of the effort on IBOR programmes has been concentrated in banks, other sectors are beginning to appreciate the scale of change involved and are in the early stages of tackling the impact on their businesses.

What do asset management companies need to do?

The immediate challenge for asset management companies is to identify where IBOR rates are currently embedded across their products and processes, what systems have dependencies on IBOR and also whether any fee arrangements exist that have historically referenced IBORs. For each IBOR exposure, companies will then need to assess the appropriate course of action, for example transitioning contracts to reference ARRs.

In terms of timeline, for LIBOR and USD LIBOR, transition will need to be complete by end 2021 but this could be earlier as regulatory targets and market practice force acceleration. In addition, there have been a small number of bank bonds which have, through obtaining bondholder consent, switched reference rates from IBORs to ARRs. In these circumstances, holders of the securities would need to have a plan to deal with the ARR and the basis for the interest calculation.

There is tangible business risk in not taking action. An entity's processes and systems may not be able to accommodate the 'new normal' in financial instruments thereby rendering them unable to process simple transactions. Valuations models may become obsolete, not being able to accommodate new, required market data. Fee arrangements may no longer function as they reference an obsolete benchmark. In addition, failure to act might expose a reporting entity to a number of risks, including operational, conduct and reputational risk.

Our advice to asset management firms is to address the impact of this change now, through putting in place:

- An IBOR transition project team with responsibility to complete a comprehensive impact assessment, which at a minimum should cover:
  - Product assessment – identify IBOR linked products and consider transition to ARRs
  - Legal contract assessment – identify all contracts with IBOR references
  - Risk assessment (including conduct risk) – What are the risks of transition?
  - Model assessment – Size the extent of model recalibration required
  - Process and infrastructure assessment – consider what changes are required to accommodate ARRs
- A transition programme with a clear timeline

Depending on the investment strategy being run, there could be significant costs and risk associated with transitioning from IBOR rates to ARRs. As always, the sooner companies act to start this journey, the smoother the transition will be.

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The table below notes some of the main areas within asset management entities that may be impacted by the change and an indication as to the action required in each case:

Potential area of impact	Potential change	Actions / considerations required
IBOR linked floating rate assets and liabilities	• Reference rate and potentially margins may change • While a market convention has not yet matured, there is some early traction on ARR based reference rates being available at the end of an instrument's interest period rather than the start	• Engage with legal teams to advise on changes required • Consider risk and economic impact of rate and margin change • Assess any systems implications arising from reference rate being available at the end of the interest period
Derivatives	Reference rate and potentially margins may change	• Monitor market practice (where applicable, ISDA have been introducing protocols) re amending derivatives • Consider risk and economic consequences of change
Offering documents that reference IBOR rates	Future offering documents that quote historic or forecast future returns relative to an IBOR benchmark will need to change	• Determine new benchmark rate • Amend calculations to embed new benchmark rate • Update brochureware
Performance fees that reference IBOR rates	There is an IBOR component to the calculation of performance fees, which may need to change	• Determine appropriate replacement rate • Embed new rate in calculations • Engage with legal and conduct risk teams to advise on changing fee calculation for existing products • Determine if customer consent is required

Potential accounting changes	The accounting for assets, liabilities and derivatives could change as a result of IBOR transition related changes	• Evaluate potential accounting changes arising in relation to:
		  • Application of hedge accounting
		  • IFRS 9 business model assessment
		  • Derecognition of assets/ liabilities

Fund administrator IBOR transition plan	The fund administrator's IBOR transition timetable may not be aligned to that of the asset manager	• Discuss transition plans with fund administrator and ensure that delivery timelines and functional requirements are aligned
Systems capability	New features of amended products may require enhanced system capabilities	• Systems may need to be enhanced to process new products (eg daily compounding of interest)
Impact on net asset value	Transition to ARRs could have an impact on the value of an instrument	• Quantify valuation impact of transition • Enhance valuations systems as required to produce new valuations • Implications of clearing houses' transition to RFR discounting (June - October 2020)
Impact on operational processes	IBOR rates are embedded in the processes in the Bank	• Catalogue processes with an embedded IBOR rate and formulate a transition plan

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As the labour market continues to be compressed in Dublin with the influx of tech companies, the regions have provided the solution for the Asset Management industry with a highly skilled workforce facilitating the expansion of our industry outside of Dublin.

The Irish asset management footprint outside of Dublin

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The asset management industry is one I had always associated with major financial centres such as London, New York, Hong Kong and Singapore - the megacities with a dense concentration of public and private banks and trading companies, and from which the idea of Dublin's IFSC was born in the 1980s.

Part of an urban regeneration project on an 11 hectare site in central Dublin, the IFSC had the goal of making Dublin a major financial services hub. With over 38,000 people now employed and opportunities stretching far beyond Dublin, it has been a real success story.

In September 2019, EY Ireland established our second Financial Services office here in Cork. In the preceding 15 months we analysed just how much of our business was being serviced from outside of Dublin and whether it made sense for us to set up an office closer to our client's service providers. Equally compelling was the people side as it offered us a means to both attract and retain talent that wanted to work with the firm, just not in Dublin.

Some of the largest financial services firms have developed regional footprints in Ireland. In 1999, Citco first entered the Irish market with the establishment of offices in both Dublin's IFSC in Dublin and Cork Airport Business Park. Within seven years, the company's headcount had grown to 250 in its office in Blackrock's Tellengana House in Cork. With over 350 people now based in Cork, the location has been key to Citco's success in Ireland.

In 2004 Northern Trust was appointed administrator for one of the first Irish domiciled hedge funds. Fast forward to 2007 and Limerick was chosen as its regional location with over 1300 people employed coming from 13 counties.

Over the last number of months, I have had the opportunity to talk to leaders in the asset management industry and I have been taken aback by the activity that is happening outside of Dublin. Clearstream, under the stewardship of David Brosnan, has gone from strength to strength in Cork since its acquisition by Deutsche Borse in 2014, with over 700 people now employed in Cork. BNYM has major operations with 300+ people located in each of its Cork and Wexford offices, and Alter Domus has doubled its headcount, harbouring ambitions to increase significantly with capacity for 400 people at its new site in Cork Airport Business Park. Hegdeserv employs over 150 people in Mahon Point Business Park, having started in Cork with just Fergus Grogan back in 2015, Apex added another 50 jobs in 2018 to its Cork office, and the list goes on.

The Irish asset management footprint outside of Dublin

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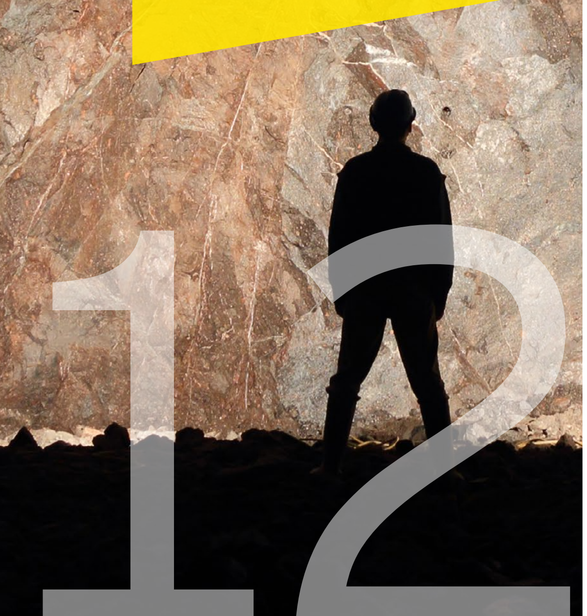
> There were numerous job announcements for the regions throughout 2019 from existing and new fund administrators, from an influx of management companies on the back of Brexit and of course EY's own expansion with 600 new jobs announced.

It is not just the major cities in the South that are benefiting from the success of our asset management industry. Opus has selected Enniscorthy for its centre of operations and will employ over 100 people in its new location. DMS Governance announced 50 new jobs for Cashel, Fidelity Investments now employs 350 people in Galway, and State Street with 2,500 people now in Ireland has offices in Drogheda, Naas and Kilkenny.

As the labour market continues to be compressed in Dublin, the regions have provided the solution for the asset management industry offering access to a highly skilled workforce, coupled with increased retention rates and supported by our regional universities who are focused on developing graduates tailored for the asset management sector. Improved quality of life, the ability to find an affordable house and the decreased commute times are key factors in the success of the regions.

The Indecon Assessment of the Economic Impact of the Funds Industry on the Irish Economy cited that 30% of the workforce was located outside of Dublin as of December 2018. There were numerous job announcements for the regions throughout 2019 from existing and new fund administrators, from an influx of management companies on the back of Brexit and of course EY's own expansion with 600 new jobs announced, 234 of which will be outside of Dublin. It is clear that the regions have played a vital role in the success of our industry and with continued challenges in the housing and rental sectors in Dublin, the role of the regions will be even more prevalent in the years to come.



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