

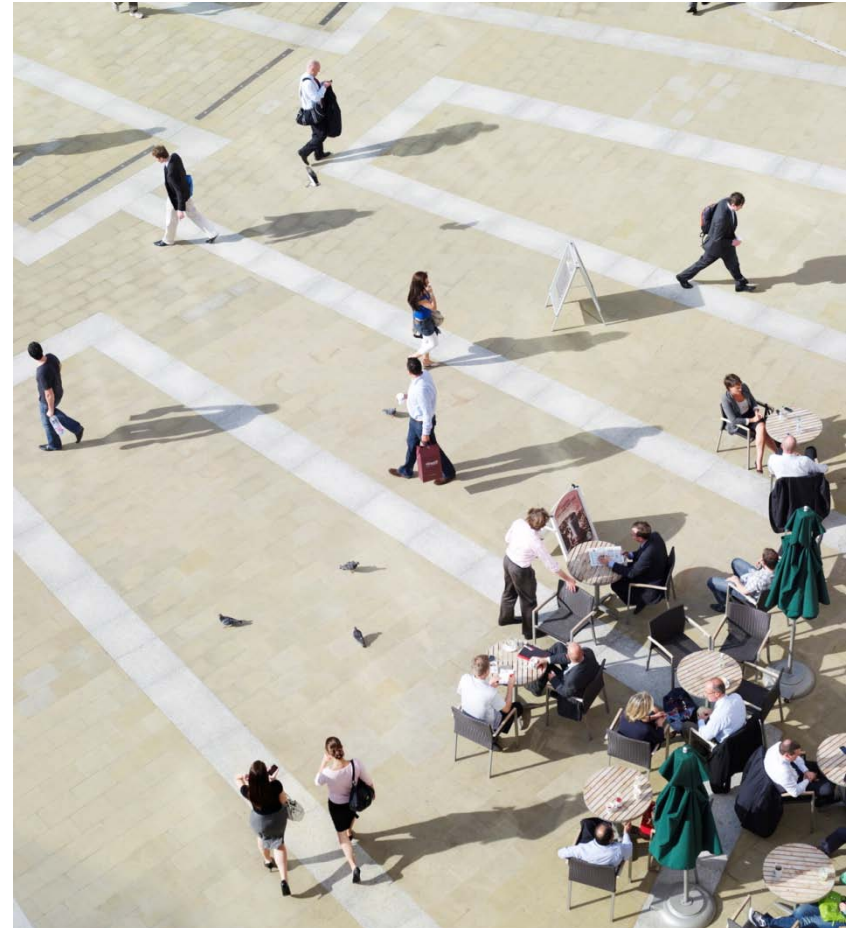
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Asset Management

Trish Johnston

Agenda

- Introduction
- Recent changes in International Financial Reporting Standards
- Trends in product innovation
- Reflections & questions

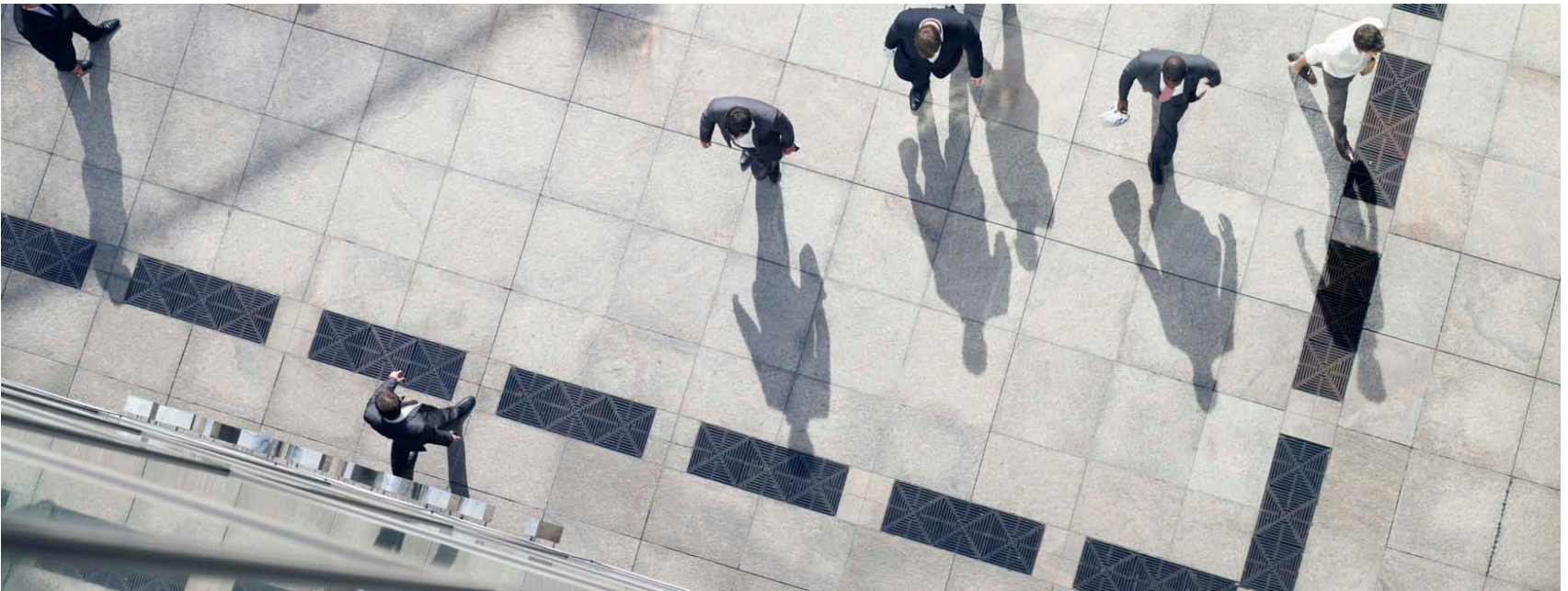


The trauma of the financial crisis left me deeply convinced of the need for transparency and investor protection... High quality financial reporting standards are essential for improving transparency in the markets.

Hans Hoogervorst, Chair of the IASB, speaking at IFRS Foundation/AICPA conference, Boston October 2011

Key new standards issued or under development

- IFRS 13 – Fair Value Measurement
- IFRS 9 – Financial Instruments
- Exposure Draft: Investment Entities



IFRS 13 - Fair Value Measurement

The bid / ask pricing currently required by IAS 39 may no longer be required under IFRS 13

- On 12 May 2011 the IASB issued new guidance on fair value measurement and disclosure requirements for International Financial Reporting Standards (“IFRSs”) – IFRS 13 “Fair Value Measurement”.
- IFRS 13 is effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. It is applied prospectively. However, it is not yet endorsed by EU.
- IFRS 13 explains how to measure fair value where it is required by IFRSs and aims to enhance fair value disclosures.
- Although the project converges IFRS and US GAAP on how to measure fair value, there will continue to be differences in certain respects, including when fair value measurements are required and when day 1 gains and losses can be recognised.

IFRS 13 - Fair Value Measurement

Defining fair value as an exit price

- The use of bid prices for asset positions and ask prices for liability positions is permitted if those prices are most representative of fair value in the circumstance, but not required.

Principal and most advantageous markets

- In the absence of evidence to the contrary, the market in which the entity would normally enter into a transaction to sell the asset or to transfer the liability is presumed to be the principal market or, in the absence of a principal market, the most advantageous market.

Measuring the fair value of a liability

- Estimate a transfer price for a liability using the fair value of a corresponding asset.
- Fair value reflects the risk that an entity will not fulfil an obligation (non-performance risk). Non-performance risk includes, but may not be limited to, an entity's own credit risk (as defined in IFRS 7 *Financial Instruments: Disclosures*).
- Fair value should not be adjusted for the effect of a restriction on its transfer if the restriction is already included in the other inputs to the fair value measurement.

Measuring the fair value of financial instruments within a portfolio

- Assumes that fair value is maximised by using the asset on a stand-alone basis.
- Proposed an amendment to IAS 39 specifying that unit of account for a financial instrument is the individual financial instrument at all levels of the fair value hierarchy i.e. levels 1, 2 and 3.

IFRS 13 - Fair Value Measurement (continued)

Premiums and discounts

- Fair value measurement incorporates premiums or discounts when they reflect a characteristic of the asset/liability that market participants would take into account in a transaction for the asset/liability.
- Prohibits the application of a 'blockage factor' – discount that reflects size as a characteristic of the holding rather than as a characteristic of the asset/liability being measured at fair value.

Measuring fair value when markets become inactive

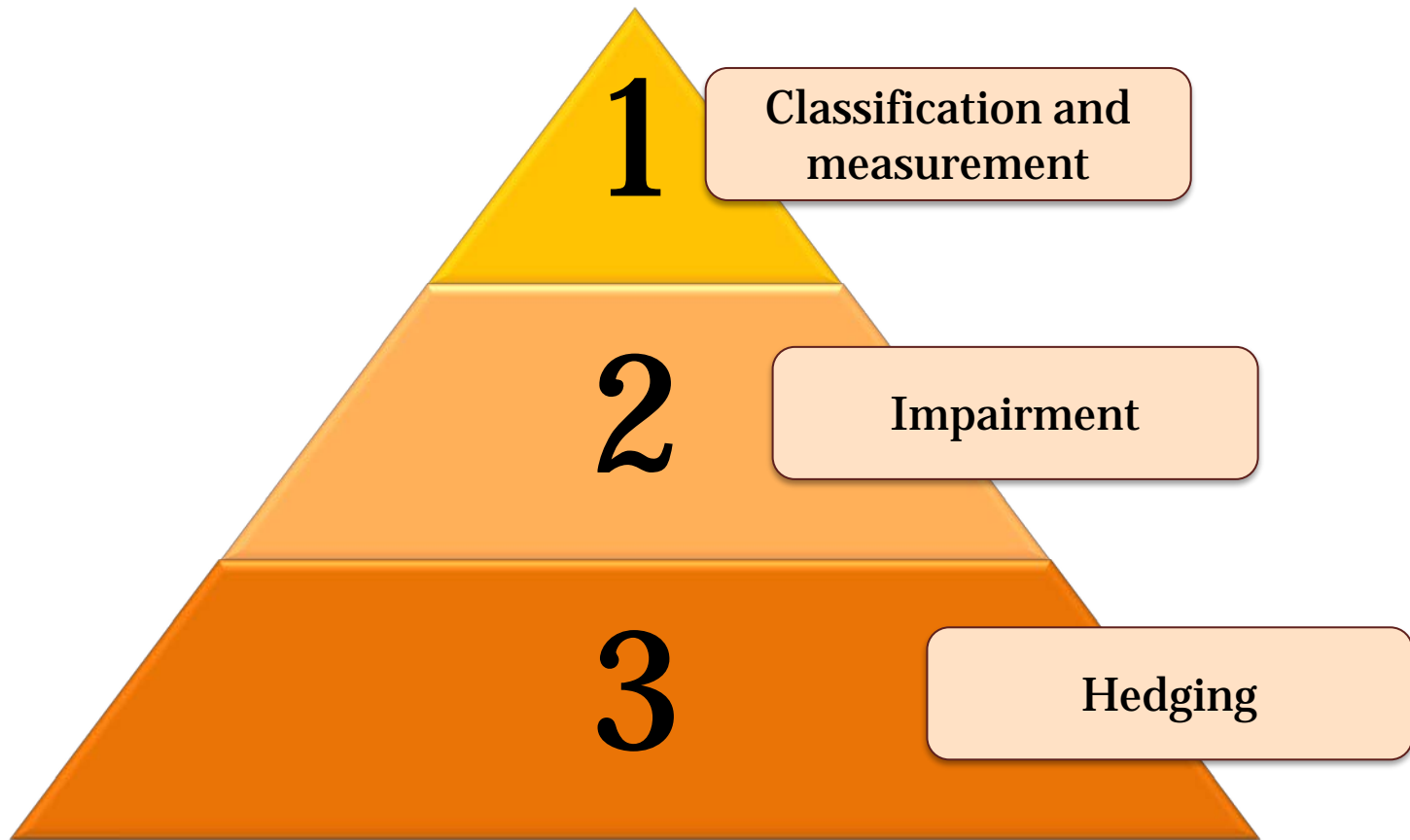
- Entity must use a valuation technique to measure fair value when market activity declines.

Disclosures about fair value measurements

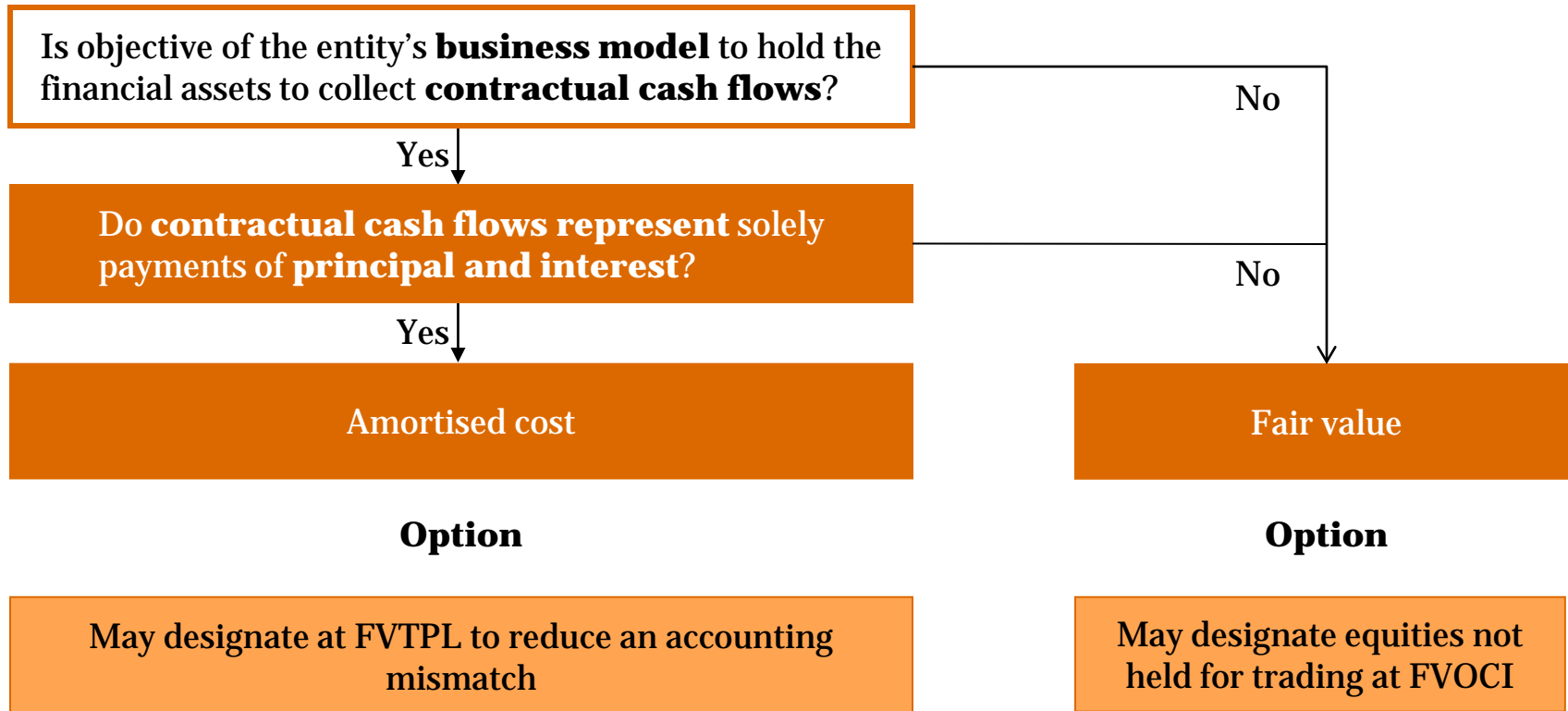
- Level 3 positions – i) reconciliation from opening to closing, ii) quantitative information about significant inputs into valuation technique, iii) valuation processes used by the entity and iv) sensitivity to changes in significant unobservable inputs – narrative for all fair value measurements and quantitative analysis for financial instruments.

IFRS 9 – Financial Instruments

IAS39 Replacement Agenda



IFRS 9 – Classification model for financial assets



Exposure Draft: Investment Entities

- IASB issued its exposure draft in August 2011. The comment period deadline is 5 January 2012.
- 6 qualifying criteria proposed. Those entities that meet the criteria would be exempt from consolidating their subsidiaries in accordance with IFRS 10.
- If adopted, the proposals would require investment entities to account for their subsidiaries at fair value through profit or loss.
- Proposed disclosures complement the disclosures required by IFRS 7, IFRS 12 – *Disclosure of interests in other entities* and IFRS 13 – *Fair Value Measurement*.

What is an investment entity?

Definition

No substantive activities besides multiple investments

**Purpose is investment for income / capital appreciation
- exit strategy documented**

Ownership units entitled to proportionate net assets

Pooled investors and significant ownership by unrelated investors

Manages and evaluates investments on fair value basis

**Reporting entity - provides financial information on its investments
to its investors**

Exposure Draft: Investment Entities (continued)

Disclosures

The exposure draft proposes a disclosure objective that would require an investment entity to provide information to enable users of the financial statements to evaluate the nature and financial effect of the investment activities in which it engages.

The exposure draft includes some examples which **may** be appropriate to meet the disclosure objective:

- Some of the highlights of application guidance:
 - **Per-share information** calculated on the basis of a share outstanding throughout each period to be disclosed
 - **Ratios of expenses and net investment income to average net assets** including methodology for computing the ratios
 - **Total return** including methodology

Exposure Draft: Investment Entities (continued)

Consolidation

- Scope exception for investment company entities.
- Exception is not extended to non- investment entity parents i.e. They must consolidate
- However, investment company accounting retained for associates and joint ventures.

**“Change creates
opportunity...**

**...Opportunity
is satisfied by
Innovation”**



Recent Asset Management trends

Some good news...

Overall, 2010 better than 2009 → 2011 is still in flux

- Global AuM rose 8% to ~\$56.4 T over 2010, some gains eroded in 2011
- Continued volatility - AuM growth driven principally by equity market recovery
- Lots of money in motion, search is on for top managers

Assets under management continue to grow globally

- New inflows remained marginally positive, vary greatly by geography
 - Inflows into asset classes vary by region, increased penetration into emerging markets
- Retail growth (9% to \$22.8 T) stronger than institutional (7% to \$33.6T)
 - Retail driven by gains in discretionary mandates and unit-linked , pensions
 - Retail gaining on institutional mainly due to equity investments over fixed income

Profitability continues to improve

- Driven by shift in asset structure, pricing has held up ex-alternatives (and cost focus)
- Lower consolidation among asset managers → deals focus on products, geographies

Recent Asset Management trends

... in a tough environment

Economic uncertainty

- Low interest rates, inflation risk, continued market volatility, recession fears

The underlying investor is cautious, smart, less trusting, loyal, and now demanding better service and clearer value

- Demanding transparency
- Better understanding of alpha and beta (broad index) and paying for it differently¹
- Seeking customized solutions (e.g., outcome-based investing, liability-driven investing²)

Distributors are increasingly important gate keepers

- Determine which products and which firms to offer to end-users
- Exerting fee pressure on investment managers

¹As early as 2005, investment plans either making or considering making a distinction between alpha and beta performance was 55%.

Source: J.P. Morgan Asset Management survey – “New Sources of Return” May 2005.

²In 2010, LDI is being used by close to 40% of pension funds in the UK and more than 90% of the Netherlands. In the US, 50% of pensions funds are employing some form of LDI strategy.

Recent Asset Management trends

... in a tough environment (continued)

Product trends are shifting

- The 'flight to safety'
- Bonds over? Increased passive, index, ETF interest? Return of the hedge fund/absolute return?
- Growth of passively managed, alternative, and outcome-based products
- Asset allocations shifting geographically to Latin America and eastward

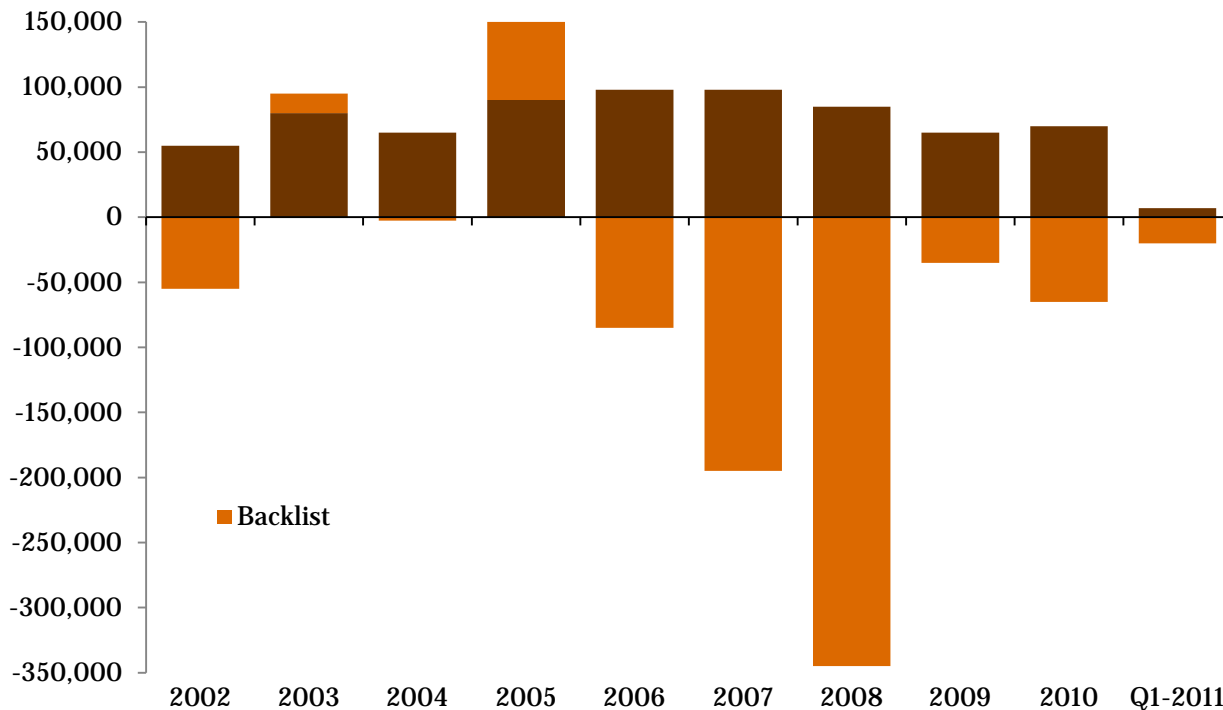
More demanding regulation will continue to challenge existing business models

- SEC continues to ramp up its oversight efforts
- Many managers are struggling to keep adequate governance, controls and procedures in place with the changing regulations and complexity of their platforms
- More geographies, more (compliance) problems

Recent Asset Management trends - Europe

Launch of new funds is still attracting the majority of the capital and did so even during the crisis!

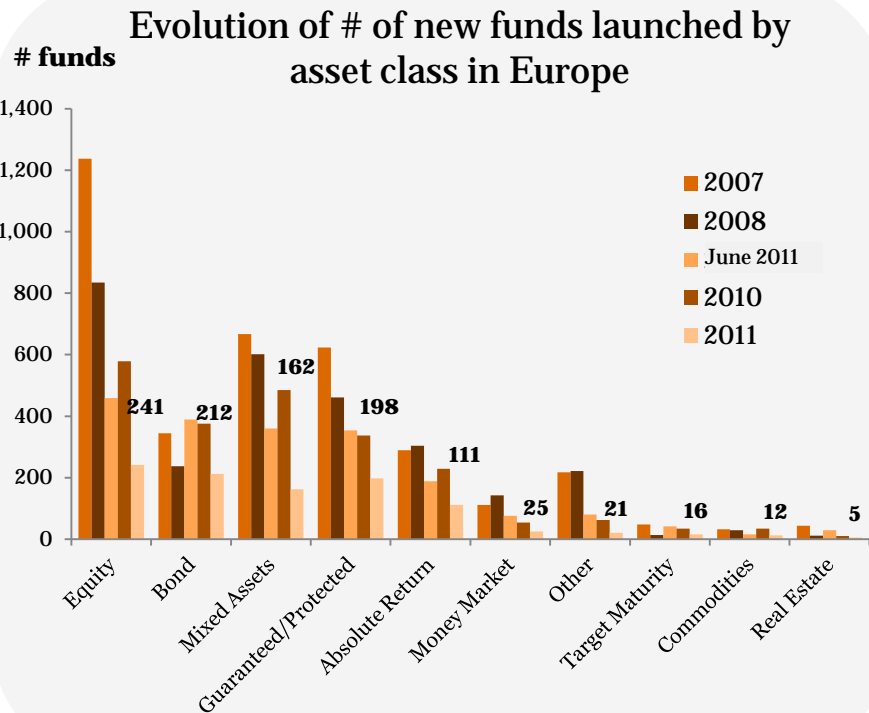
Net sales of Continental European Domestic Funds (i.e. excluding Cross-border and UK)



Source: Lipper

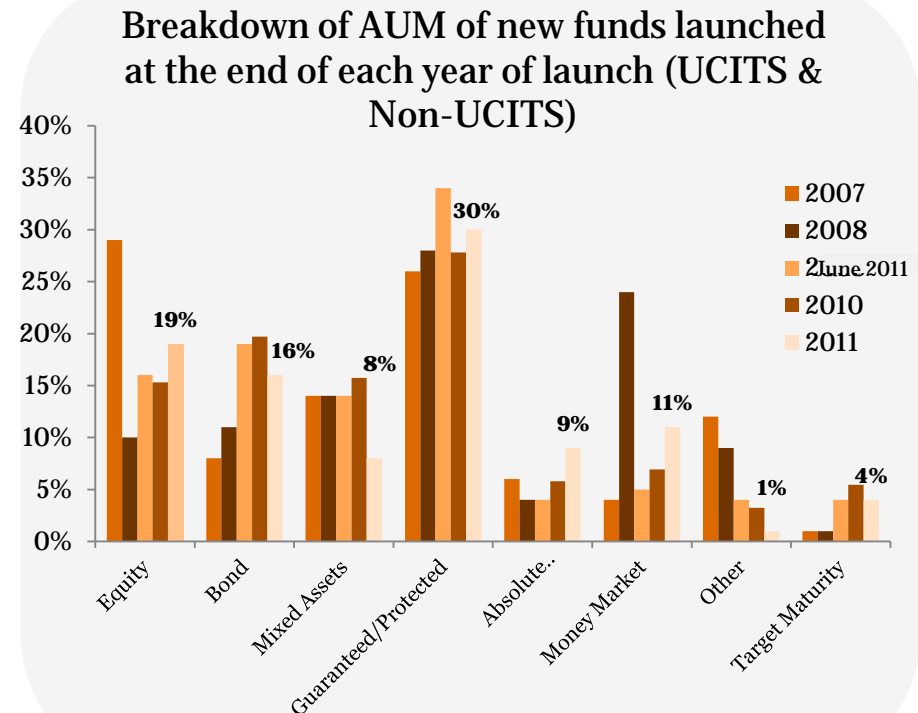
Recent Asset Management trends - Europe

Equity asset class top number of new fund launches, however, guaranteed/protected funds attract the highest AUM



Absolute return includes HF and FoHF
Business Leaders' Conference
PwC

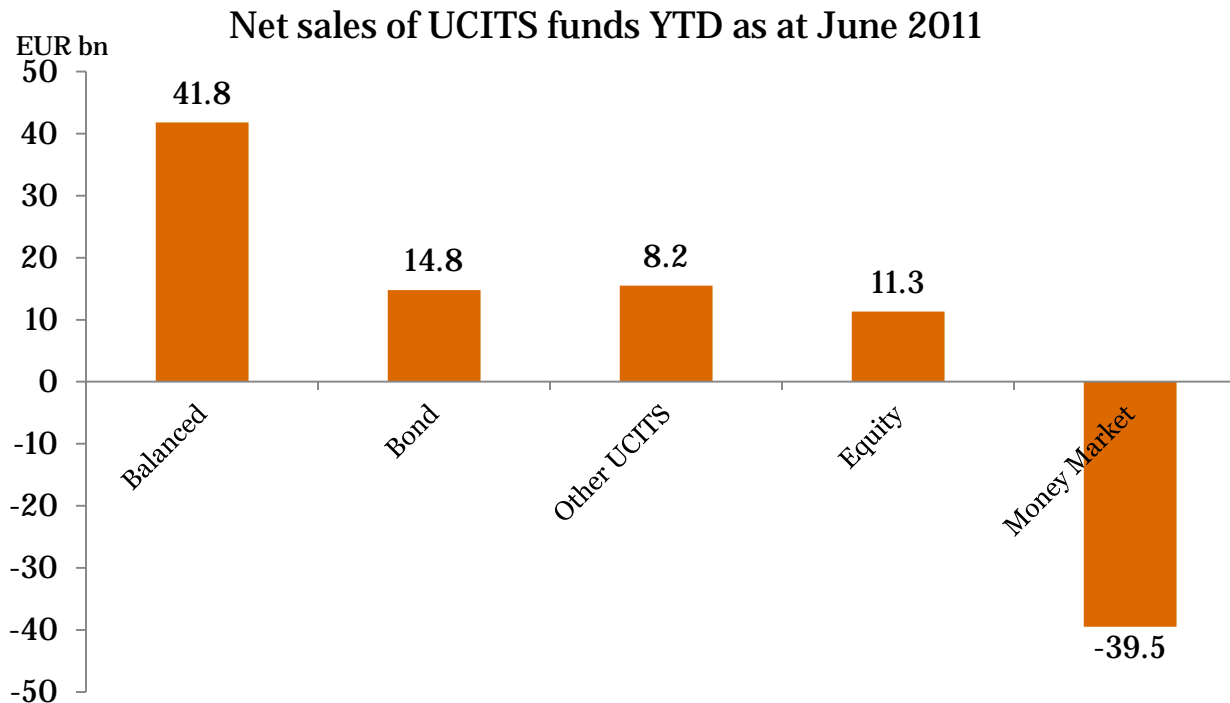
Source: Lipper LIM



Source: Lipper LIM
November 2011
Slide 19

Recent Asset Management trends - Europe

The bulk of investors are moving from money markets to balanced funds



Source : EFAMA

Around the Globe...

- Less investment “house style” push, more solution driven
 - Low volatility “flight path” funds
 - Dynamic asset allocation returning
 - Absolute return/infrastructure funds
- Social media/mobile telephony as a means of product distribution
 - Early stages but on its way

Around the Globe...

- Opportunities with regulation – how can asset managers develop products to maximise opportunities;- Solvency II funds?
- A pan Asian “UCITS type” product.
 - How far into the future?
 - What effect on UCITS?

What is an asset manager to do?

Learn more about the end customer

- Develop deeper understanding of market penetration, win/loss analysis, product/service limitations
- Know what investors prefer in terms of products, services, and channels
- Improve customer analytics (e.g., segmentation analysis) to determine whether products are aimed at the right targets via the right channels

Give the customer what they want

- Product deepening rather than product widening – improving the old rather than creating the new.
- Fill the gap → customized solutions, new products, increased levels of service, education (embedded advice), clear reporting
- Asset Managers should go south and east for products and customers (e.g., protect in developed markets, emphasize Latin America, grow in Asia)

What is an asset manager to do? (continued)

Investment managers must improve relationships with distributors

- Enhance relationships to better understand customers, create product 'pull'
- Make it easier to market products (e.g., product training/user groups, desktop apps, make firm resources increasingly available, social media?)

Achieve operational excellence

- Ensure that service and product offerings are adequately supported with the right technology
- Realize greater returns on IT and Ops investments
- Consider outsourcing for non-competitive capabilities

Anticipate regulation, work collaboratively with regulators

Reflections and questions

Thank you

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