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2025

Regulatory Outlook

ORGANIZED CHAOS

Making sense of the organized chaos

Entering 2024, I spoke about great uncertainty and altered investment paradigms. Despite numerous changes and perils, both the global stock markets, financial institutions and asset management have overall proved resilient.

While geopolitics have taken a turn for the worse overall, interest rates and inflation continue to undulate, and the impact of rapid technological change continues to make its mark, we've also seen positive developments. Two regulatory highlights of 2024 include the roll out of US T+1 and preparation for DORA (ongoing at the time of publication with the January 17th deadline imminent).

What's ahead in 2025?

2025 will be heavily influenced by the global shift in political composition across the globe. A less centrist, more right leaning political class could portend a period focused on increased competition while championing protectionism and an acceleration of de-globalization, deregulation, and a spur for innovation.

In this report, we'll take a closer look at eight areas set to have significant impact in 2025:

- DORA
- Private markets
- SEC
- UCITS
- T+1
- Artificial Intelligence
- Evolution in the EU
- Tokenization

Hopefully the overview on the following pages helps you organize the chaos, at least a little. I'd welcome the opportunity to further discuss the outlook with you in more detail.

Best,

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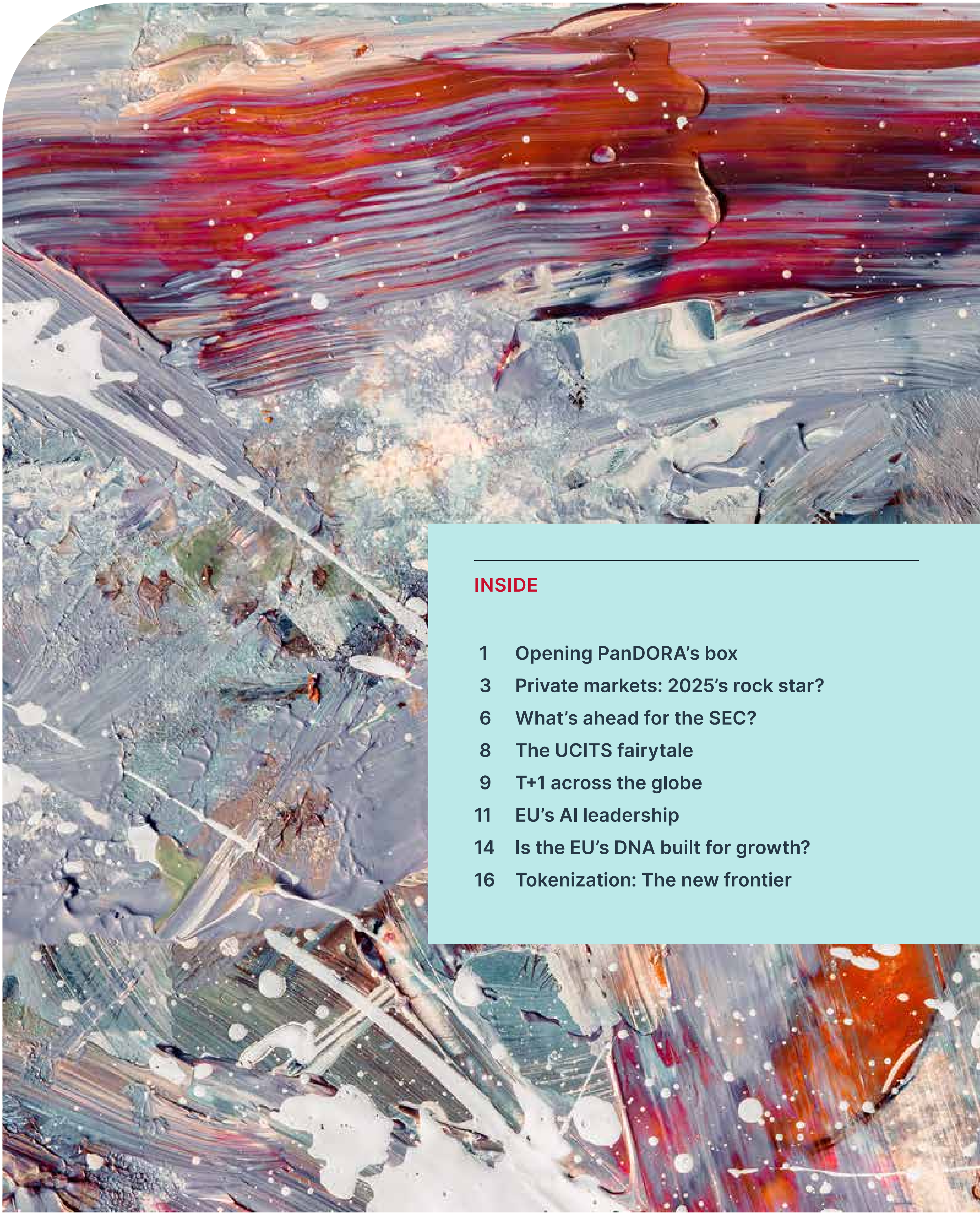

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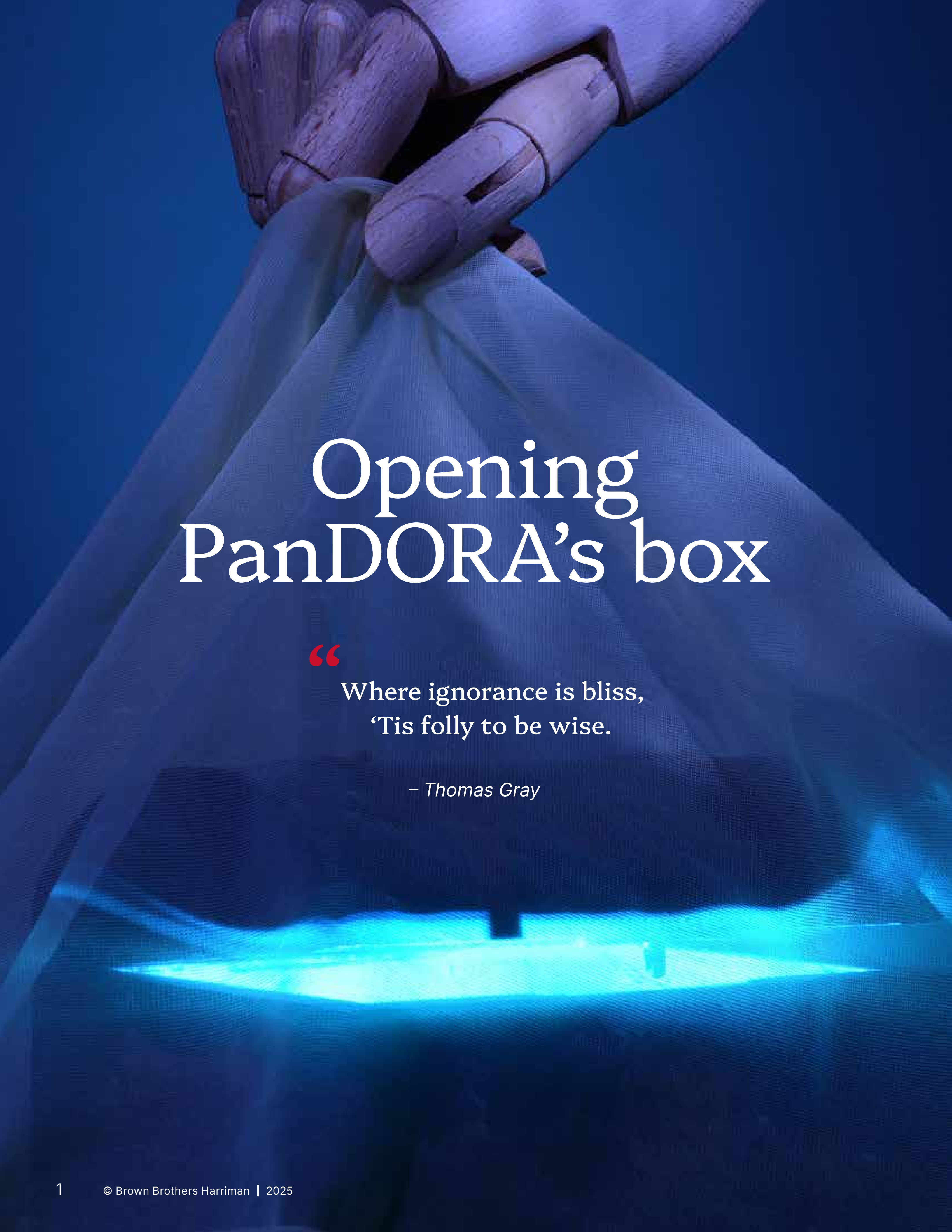

Opening PanDORA's box

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Where ignorance is bliss,
'Tis folly to be wise.

– Thomas Gray

The EU's Digital Operational Resilience Act (DORA) comes into effect on January 17, 2025. DORA sets a far higher bar for compliance than any previous operational resilience regulation and breaks new ground in terms of its granularity, extra territoriality, and its weighty penalty regime with its focus including:

- Information and Communication Technology (ICT) risk management
- ICT incident management, classification, and reporting
- Digital operational resilience testing
- Management of critical ICT third-party service provider risk
- Information sharing arrangements

Anyone who has been close to DORA's roll-out will agree that it has spawned a higher level of operating model introspection for in-scope entities than ever before.

DORA has shone a searing light on operational complexities, interdependencies, and, in turn, risks in modern financial services that have not yet been uncovered. This is especially true for EU firms, with some forced to better understand their ICT risks and others reminiscing for the pre-DORA time where supply chain dependencies, concentration risks, and interconnectedness didn't have to be considered for regulatory or commercial purposes.

Industry has shared several hesitations with the post-DORA world, including:

- Establishing contract remediation
- Adequate construction of the ICT and maintenance of ICT register of information
- Extra territorial impacts
- Adhering with existing global operational resilience, testing, and reporting standards
- Growing regulatory focus on cybersecurity and threat-lead penetration testing

As firms open PanDORA's box they must understand, engage, and actively communicate each aspect of their operating model and supply chain technology stack. Over time, the underpinning measures and standards of DORA will inevitably become the global market standard resulting in commercial wins and losses as some firms clear this new operational resilience benchmark, while others falter.

Private markets: 2025's rock star?

Private capital performance has been held back by higher interest rate environments and recent equity market runs. The geopolitical uncertainties have probably hindered private markets to a much greater extent than public securities.

However, zoom out from the short-term hiccups and you'll find a number of factors leading to more investors looking for increased portfolio diversification via private asset return premiums.

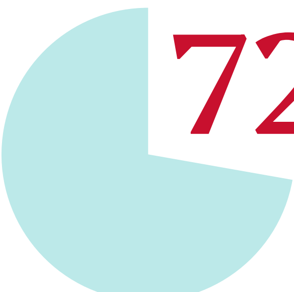
The result is an expected rise in private market investment activity in 2025 with:

- Certain targeted policymaking laying ground for future growth
- Financial advisers becoming more educated about how these structures work and potential diversification benefits to their customers
- Platforms which support inflows and outflows recalibrating themselves to join the democratization story
- Access to funds such as ELTIFs, interval funds, evergreen funds, and funds with diverse liquidity parameters becoming as important to increasing private market participation as asset managers and regulators

10 reasons why industry is feeling bullish about private markets heading into 2025:

1 Dry powder and pent up demand

Cash on sidelines is already bolstered by new entry points for a wider cohort of investors. The pent up demand to access entry points to private markets is much larger than ever before.



72%

expect higher deal volume in 2025 compared with 2024[1]

2 Decarbonization and sustainability

Despite the political discourse and regulatory frustrations surrounding ESG investing globally, the drivers of the sustainability movement remain valid. Real-world investments in sustainable industries have continued, but there is still contentious debate around ESG financing and the influencing of public companies by proxy to disclose or change business practices.

3 Geopolitics

A consideration for all asset classes but longer-term horizon assets could benefit as returns extend long past election cycles – patient capital is apolitical. No matter what, public markets are likely in for a series of volatile events.

Private market investments with longer holding periods have historically been a way of avoiding short-term undulations of market shocks and change in the ever increasing volatile political environment.

4 Political will

A mixture of fiscal ceilings and already stretched public balance sheets means not only are governments more likely to cede much of the required infrastructural and development financing to the private sector, but a wish for their own citizens to be able to participate in the available returns directly and by way of their pension investments.

There is also an increased appetite to co-invest through public-private partnerships on large scale projects. With projects linked to infrastructure from bridges and roads to those linked to digital and sustainable transitions, there is fertile ground for private assets.

1 Source: Preqin: Three trends shaping private capital in 2025

5 Global infrastructure demands

Social infrastructure inclusive of healthcare, travel, sustainable energy, and the manufacturing requirements for digital and artificial intelligence, are increasing globally. With government and bank balance sheets at a breaking point, private markets and public private partnerships will be key in delivering the infrastructure for the world to live in, in 2025 and beyond.

6 Portfolio resilience

With so much uncertainty on global economies and public markets expected to enter a period of ever-increasing volatility and concentrated risk, many investors are considering the benefits of riding out the short-term storm by taking longer-term positions in sectors or asset classes that are both stable and will pay back a premium for those willing to be patient.

7 Private credit

The growth of the private credit market has made it more competitive, transparent, and trusted by investors. With good returns and low levels of default or issues, the space has proved extremely resilient even with interest rate changes. The size, diversity, and trustworthiness of this segment is drawing more and more investors to this asset class.

8 Continued democratization of private markets

It appears that a virtuous cycle of investor demand, improved regulatory wrappers, and easier access for a much wider cohort of investors into funds of different private assets with a diverse spectrum of liquidity parameters, will result in continued growth.

Interval funds, BDCs, evergreen funds, ELTIF 2.0, UK LTAF, and others are providing appropriate regulatory wrappers to increase confidence and draw in more and more types of new investors to the private funds market.

9 Deregulation ahead

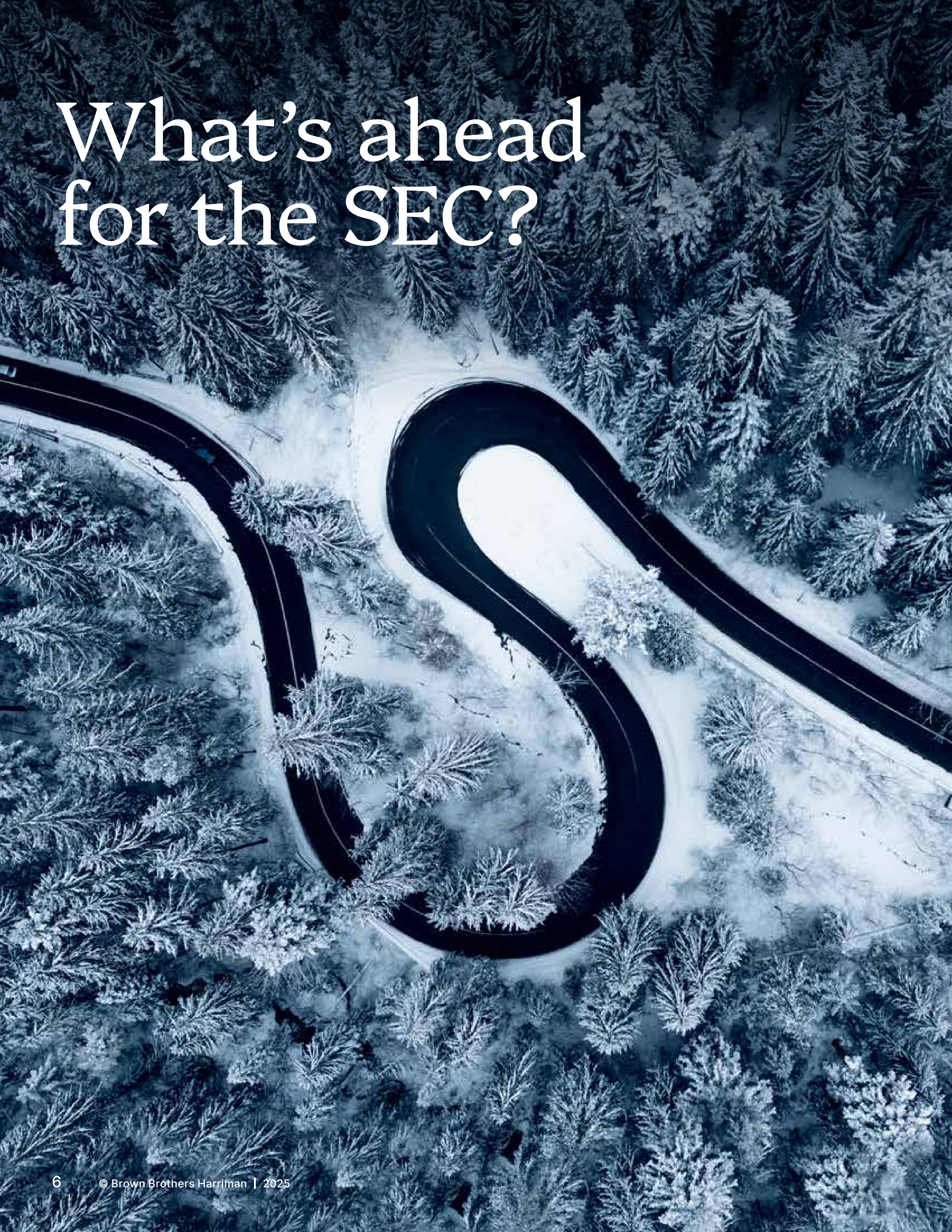
While a wide scale roll back of regulations seems unlikely, a more business centric focus, shift to a greater participation in capital markets, and increasing participation in private markets are a positive sign for the industry after a challenging period of global regulatory roll outs.

10 Macro-economic shifts

Interest rates are normalizing. Many are starting to talk about investment, growth, and competitiveness again after a period of contraction and restrictions aimed at curbing rampant inflation.

Cautious optimism permeates as market resilience and societal needs are expected to be a good formula for private market growth in 2025 and beyond.

What's ahead for the SEC?



Gary Gensler, Chair of the Securities and Exchange Commission (SEC), will officially leave the SEC on January 20th. Paul Atkins, a former SEC Commissioner and veteran Washington DC powerbroker, will begin in early 2025 if approved by the Senate.

Initial market commentary confidently predicts that under Atkins, the SEC focus will be widespread deregulation, organizational restructuring, and fostering a cryptocurrency boon. However, life in the SEC is rarely that simple, and there will be plenty of work for all in the market regardless.

The new Chair is possibly the most experienced candidate who could have taken up the seat, having previously acted as SEC commissioner during the George W. Bush administration and a staffer to two previous SEC Commissioners before that. Atkins has consistently stated the SEC's role should always encompass capital formation, increased competition, and efficiency in the markets, as well as rulemaking and enforcement actions.

Much more than just the SEC affect rulemaking

While it is natural to personalize issues and compare Gensler and Atkins directly, in terms of their influence on the Commission, one must remember the SEC is made up of five members and all votes are conducted on simple majority. The SEC also has an existing workplan for 2025 – changing priorities and changing course would take time. Most importantly, the SEC is not the be all and end all for securities markets in the US. Here are the other players worth watching after inauguration day:

– **White House Chief of Staff:** Usually issues a memorandum requesting all agencies to refrain from pursuing regulatory actions until such time as the new team has a chance to review them.

– **Congressional Review Act:** Allows Congress to disapprove agency rulemakings made in the later sessions of the previous Congress. Many of Gensler's SEC rules could come under scrutiny, as well as some of Treasury's latest anti-money laundering rules.

– **Presidential Executive Orders:** A power exclusive to the President which can cancel or modify a predecessor's order or set new policy and can be under judicial review under the "arbitrary and capricious" standard of law.

– **Committee on Appropriations:** One of the easiest ways to de-regulate and reduce enforcement actions is to de-fund and de-prioritize funding of the SEC so its inspection and enforcement agenda is less resourced. This will be less impactful on industry participants and an easier alternative to affect deregulation, without putting rule changes to industry consultation or House and Senate votes.

SEC Priority Shifts

HIGH

Digital assets

Artificial intelligence

Capital formation

STATUS QUO

Off-channel communications

Anti-money laundering

Mutual fund to ETF conversions

LOW

Corporate enforcement actions

ESG and "woke" shareholder activism

Private funds rules

UCITS

The UCITS fairytale – onto the next chapter

UCITS represents one of the EU's most successful policy frameworks ever implemented. Since being introduced in 1985, they've established themselves with over 14 trillion euros and investors from over 100 countries globally. UCITS blend a standardized operating ruleset and diverse range of investment permissions, offering investors a wide range of asset exposures with investor protection mechanisms naturally baked into the framework.

Despite the huge success and minimal regulatory issues in the space, policymakers are not complacent and want to ensure UCITS remain the pre-eminent global cross-border fund structure. As such, in 2025 we expect a number of tweaks that will directly or indirectly impact UCITS, including:

- Continued reviews of fund liquidity, completion of the Eligible Asset Directive review, and ongoing macro-prudential debate that will impact all UCITS.
- Changes to ESG rulemaking, tokenization of UCITS money market fund, and the rolling implementation of the UK's Offshore Fund Regime (OFR).
- For specific fund types, developments on UCITS ETF portfolio transparency, active ETF growth, EU consolidated tape, and increased oversight of authorized participants and market markers will be worth watching.

While UCITS has been a fairytale success for almost 40 years, there is no time to be complacent as plenty of policy areas are being worked upon to ensure it remains the gold standard of cross-border fund structures.

T+1 across the globe

Having successfully navigated the T+1 transition across the US, Canada, and Mexico, many are looking back on lessons learned while at the same time looking ahead to the shift coming when the EU, UK, and Switzerland take on T+1.

It's clear there are many salient learnings for banks and asset managers from the US transition, however, fragmentation and other complexities will make European acceleration of security settlement cycles more challenging.

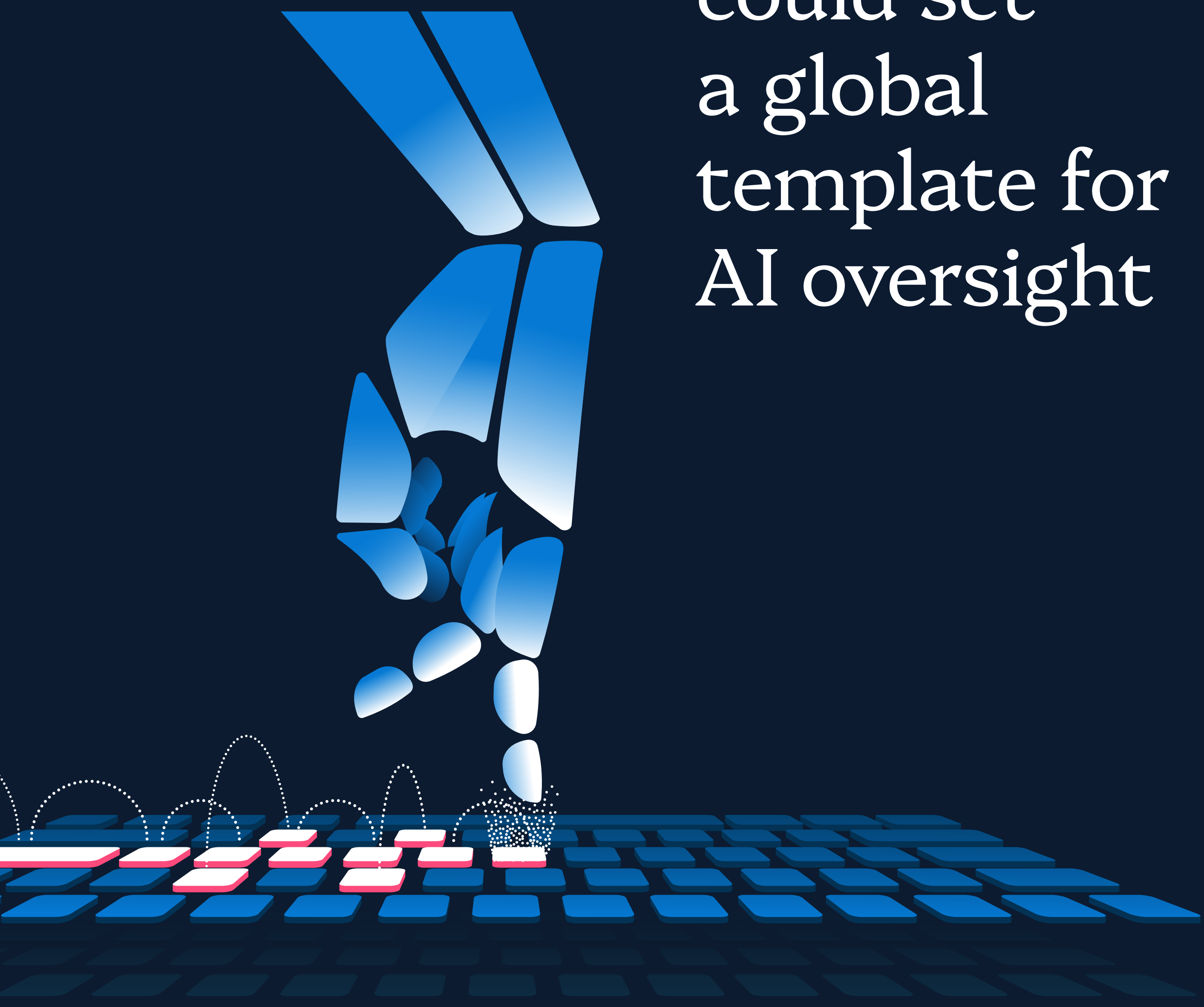
Lessons learned from US T+1:

1. Early industry engagement and leadership (DTCC, ICI, and SIFMA) are crucial for industry success.
2. Set a target date and stick to it.
3. Expect impacts to mutual funds and ETFs as well as ancillary activities including foreign exchange, repo, and securities lending, as well as extraterritorial effects.
4. Firms should prioritize system flexibility, process automation, and global coverage models.
5. Firms need to plan, budget, and allocate resources well in advance to maximize automation of their trading and reconciliation processes. Removal of manual handling to the greatest extent is crucial to successfully delivering an accelerated settlement project.
6. The US imposed T+1 through rule changes directed at trading counterparties (especially broker-dealers), while Europe's law and regulation bites initially at the other end of the chain (with CSDs). This is a crucial difference to consider in addressing how new requirements will apply.

There are several key considerations for Europe T+1 ahead of transition:

1. Teamwork: Go it alone or coordinated togetherness?
2. Deadline: Is October 2027 appropriate?
3. With the EU's complex governance model, who's taking the lead?
4. What impact and additional costs might CSDR have on European T+1 and as the CSDR re-fit amendments are made, how does this fit into your wider Europe T+1 game plan?
5. What 41 trading exchanges and 31 CSDs does T+1 drive consolidation and simplification of? Or does it maintain status quo?
6. Legislative roadblocks: What law and regulation must be addressed and where do industry standards fit in?
7. Multi-currency and cross-border dynamics: 16 European currencies further complicate operating models, what can investors expect? How will cross-border legal, timing, and operational issues be impacted?
8. Trading venues and CSDs: What should be expected as they amend their rulebooks to reflect shorter deadlines and extend operating hours?

Why the EU Artificial Intelligence Act could set a global template for AI oversight



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The European Union regulates; the United States innovates.”

I’ve heard this phrase quite a lot in recent months within discussions on inter-continental competitiveness and productivity. It is likely to continue to be discussed throughout 2025.

The above statement is framed primarily as a criticism of EU bureaucracy resulting in lower market productivity than more “market friendly” jurisdictions. However, life is rarely as simple as that. Despite its bureaucratic reputation, EU policymaking historically sets the barometer for fair ruling for investor/consumer protections, safety standards, civil liberties, and general rulemaking for the new and different.

That is why everyone across the globe should pay attention to the European Union Artificial Intelligence Act (“AI Act”), which officially entered into force in May 2024, but implementation of its various components is staggered from 2025 onwards.

Applicability to asset managers and banks

The AI Act doesn’t specifically target asset management nor asset servicing, but it does capture explicitly retail banks and some insurers as a public utility. That is not to say that it has no applicability for asset managers operating in Europe. The Act will generally inspire asset management regulators globally as it’s a decent guidebook to areas of consideration that regulators will likely leverage in framing their own rules.

It has already spurred other national regulators (FCA in UK, US Treasury) to look at how AI fits into the current prevailing rule sets. Regulators like to say they are “technology neutral,” meaning once you comply with the direct rule as written, we will not micro-manage your business and dictate to you the technology nor operating model a regulated firm uses to comply with the prevailing rules. The takeaway is that if you do change or use a new system of any kind you must be in a position to explain to the regulator how you continue to comply with the applicable regulations.

Details of the Act

Foundation of ethical principles

The AI Act itself is framed based on seven overarching ethical principles, namely:

1. Human agency and oversight
2. Technical robustness and safety
3. Privacy and data governance
4. Transparency
5. Diversity, non-discrimination, and fairness
6. Societal and environmental wellbeing
7. Accountability

These demand that all use of AI has a formal governance structure around it, there are responsible human parties who understand the AI, and that policies and procedures akin to any other operational practice within the business model exist, are reviewed, and updated as required.

Prohibited use of AI

Primarily the AI Act is focused on protection of citizens’ rights, mitigation of AI-related fraud and crime, national sovereignty and security, as well as electoral integrity. As such there are elements of AI usage explicitly banned, e.g. social engineering, biometric categorization systems, untargeted scraping of facial images to create facial recognition databases, social scoring systems, and so on. This is towards the more dystopian end of AI usage and (for now) is not hugely relevant for asset managers or banks.

High risk systems

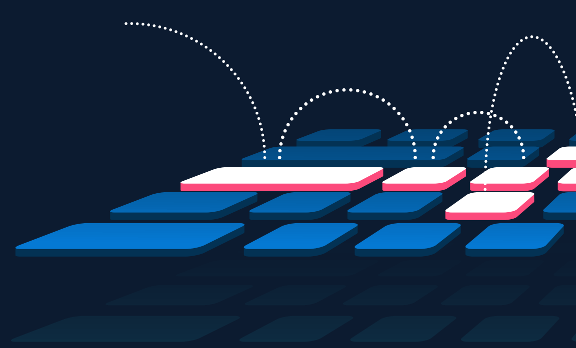
There is basically a 'license to operate' regime and regulator permission must be granted to operate within the EU if deemed too "high risk." Retail banks and insurers may be considered high risk and are required to address additional requirements if using AI within their business model or customer interactions.

AI systems considered to pose limited risks are subject to very light transparency obligations, such as disclosure labels declaring that the content was AI-generated to allow users to decide on how to use it or direct them to human contact to discuss further.

Sanctions and penalties

In classic EU style, the AI Act has "teeth" (quite like GDPR). A contravention of the Act may result in heavy fines. Depending on the type of infringement and the size of the company involved, fines will start from 7.5 million euros or 1.5 % of global annual turnover, rising up to 35 million euros or 7% of global turnover.

In conclusion, the EU AI Act is the first of its kind and it will likely form a basis for which global rules, regulations, and market practice are calibrated. One thing is clear: the days of unregulated and unfettered usage of artificial intelligence are over and it is clear that global regulators do indeed wish to regulate robots to a degree.



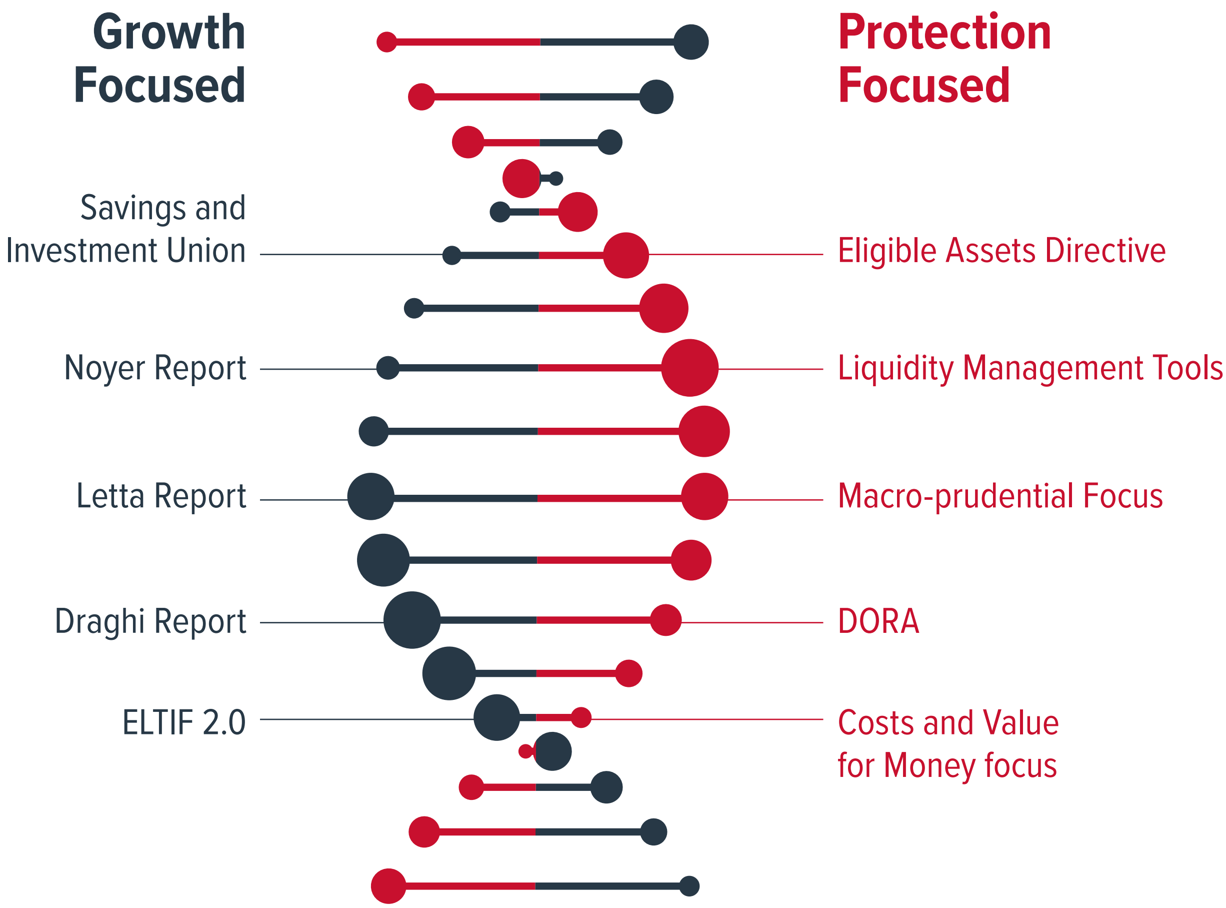
Is the EU's DNA built for growth?

The global landscape is presenting new innovations and related regulations every day. While countries like the US and China continue to advance, Europe continues to lag. The big question: is the EU as a construct capable of thinking and acting in a way that can foster progressive policy decisions and genuinely trigger a period of market growth and increased investor participation?

The US innovates, the EU regulates – can the EU make policy for growth?

It's a concept that I've been thinking about recently as some very bold statements and commitments have been made in Europe around various policy initiatives that aim to reinvigorate capital market growth.

The EU has categorically proven itself as a highly effective leader in framing investor protection and activity restricting regulation. However, the jury is out on whether or not its composition, inherent mentality, and method of delivering unified coherent policy across member states is sufficient.



Let's take a look at recent industry reports that outline plans to encourage competitiveness, innovations, and economic development.

The Noyer Report supports the development of European long-term saving products that invest primarily in the EU economy and are tax incentivized. The report also aims to revitalize the European securitization market in its re-distribution of risks to further grow EU capital markets while also creating an integrated supervision of capital markets. This includes the recalibration of capital requirements for banks, LCR eligibility improvement, and an extension of regulatory relief for securitizations which can broaden the prospective investor base and improve EU competitiveness.

The Letta Report addresses European fragmentation with proposed enhancements to the decision and rulemaking framework and to global economies' access of Europe. The report also encourages the creation and connection of a savings and investment union with green and digital public investments to maintain credibility in their international role.

The Draghi Report covers the challenges of maintaining the EU's competitiveness. The report shares several solutions including more spending, consolidated capital markets, common debt instruments, and less reliance on China. It also proposes increasing innovation to commercialization and establishing a unified industry strategy, along with simplifying the path to new EU policy.

Tokenization: The new frontier

> “To explore strange new worlds,
> to seek out new life
> and new civilizations,
> to boldly go where
> no one has gone before.
>
> *– Captain James Tiberius Kirk*

Tokenization will be an area of keen focus in 2025. While there are currently some discrete use cases of fund tokenization in the institutional space, the policy frameworks and demand for proliferation remain ill-defined. Opinions differ on how much and how quickly fund tokenization will grow. Tokenization is currently a huge area of industry focus, especially with structural drawbacks, such as asset rail (tokens) and the payments rail (currency) currently running on parallel lines.

Tokenization advocates cite numerous benefits including:

– Operational future proofing

– Transaction speed, accelerated settlement, and increased liquidity

– Reduced counterparty risk

– Immutable records and real-time reporting

– Access to a digital native customer base

– Open access to certain asset classes to wider cohort of investors (e.g.: Fractionalization of real assets and lower investment threshold to participate in private markets)

– Digital identity and credentials

– 24/7 trading possibilities

Global asset managers are focusing on three distinct areas in the tokenization space:

1. Use of tokenization within existing funds structures and regulations

2. Portfolios comprised of tokenized assets and investor registers residing on DLT

3. Full use and benefits of tokenization/DLT capabilities inclusive of smart contracts and self-executing components

Refresher course:

Digital asset tokenization is the process whereby ownership rights of an asset are represented as digital tokens and stored on distributed ledger technology (DLT or Blockchain). Tokens can act like digital certificates of ownership that can represent almost any object of value, including physical, digital, and traditional securities.

The tokenization trajectory:

Happening today

MUTUAL FUNDS

1. DLT native fund (all shares and records on DLT register)
2. Hybrid tokenized fund/share class (DLT and traditional register)
3. Use tokenized money market funds (TMMFs) as HQLA collateral for margining
4. Tokenized money market funds

On the horizon

PORTFOLIO INVESTMENT OPPORTUNITIES

1. Real Asset portfolio contains only tokenized securities (asset and payment rails not aligned – fiat currency and DLT assets)
2. Tokenized secondary market for interval funds and ELTIFs/LTAFs and BDCs
3. Portfolio containing both globally tokenized securities and EU MiCA regulated crypto assets
4. Truly multi asset portfolio – equities, bonds, private assets, tokens, and other digital assets housed in a single portfolio (the new normal)

The final frontier

TOKENIZED PORTFOLIO MANAGEMENT

1. Smart contracts trading with embedded security, due diligence, and ESG data
2. Digital Vaults for cash management, on-chain derivatives, and borrowing via DeFi
3. Rules-based smart contracts – automatically executing trades per rules
4. Scalable individual portfolios freely available to digital natives – active or passive – will not require collective funds

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