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A practical guide for advisers considering the use of AI
K&L Gates

How the right employee benefits will optimise your organisational wellbeing in 2025
Gallagher

and more...

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Message from AIMA's CEO

This edition of the AIMA Journal reflects just how truly global AIMA is. Featuring insights that span from the golden opportunities emerging in Japan to the increasing allure of Italy as a domicile. Our contributors provide invaluable perspectives on key industry trends that challenge and redefine how fund managers operate, from the increasing role of artificial intelligence to shifts in tax policies across major jurisdictions.

AI and technology remain at the forefront of industry innovation. This edition explores the increasing role of AI in risk management and fund operations, shedding light on the opportunities and risks of integrating new technologies into investment processes, including lessons from DeepSeek that truly shake up the AI landscape.

Elsewhere, operational efficiency remains a key focus for fund managers. The rise of outsourced trading and middle-office solutions reflects a broader shift toward scalability and cost-effectiveness. Our contributors examine the opportunities this presents in an increasingly digital industry.

To learn more about these trends, I encourage you to explore AIMA's 2025 global events calendar. Whether it's our Digital Assets Conference in New York, Technology & Innovation Day in London, or the AIMA Global Investor Forum in Toronto, these gatherings provide essential opportunities for learning, networking, and collaboration. We encourage all members to take advantage of these forums to stay ahead.

Finally, I implore members to visit AIMA's newly revamped Investment Manager DDQ library. Key new enhancements include a decision tree tool to simplify module selection, a new Private Markets strategy module, a streamlined question structure, reducing redundancy, and improved flexibility in responding to data requests.

As always, thank you to our contributors, members, and partners for making this journal an essential source of industry knowledge.

Sincerely,

Jack Inglis
CEO, AIMA

Upcoming AIMA Conferences

Learn, connect, collaborate.

AIMA
THE ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION

2025

25 Mar	AIMA Singapore Annual Forum, Singapore
9 April	Acorns of APAC - Emerging Manager Outreach, Hong Kong
24 Apr	AIMA Digital Assets Conference, New York
15 May	AIMA Japan Annual Forum, Tokyo
28 May	AIMA Next Generation Manager Forum, London
17 June	Montreal Alternative Investment Forum, Montreal
2 July	AIMA Putting ESG into Practice, London
11 Sept	AIMA Technology & Innovation Day, London
22 Sept	Alternative Credit Council Australia Investor Forum, Sydney
25 Sept	AIMA Australia Annual Forum, Sydney
8 Oct	Alternative Credit Council Global Summit, London
15-16 Oct	AIMA Global Investor Forum, Toronto
28 Oct	AIMA APAC Annual Forum, Hong Kong

For more information on AIMA's events, to view playbacks and to register for upcoming events visit www.aima.org/events

The rise of middle office: A new era of efficiency and growth

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Head of Middle Office Solutions
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In recent years, the alternative investment industry has witnessed a significant shift towards outsourcing for middle office, driven by the need for increased efficiency and scalability. Indeed, Citco data revealed a 27% year-on-year increase in the value of outsourced treasury transactions processed, reaching almost US$2 trillion, in 2024.

While treasury management has historically been handled internally, the mindset among alternative asset managers, corporates and banks, is changing. Firms are taking note of the new opportunities for growth and innovation that arise when partnering with a specialist provider.

Balancing growth and efficiency

Many asset managers face a challenging mandate: to increase their assets under management (AUM) without increasing headcount. This ambitious goal is becoming increasingly unattainable without leveraging outsourcing solutions. As firms focus on their core competencies – risk management, portfolio management and, of course, generating alpha for investors – they're increasingly looking to partner with specialists to handle progressively complex middle office functions such as treasury and collateral management, OTC settlements, trade matching, and portfolio management.

What's more, there are various developments across financial markets that are driving this trend, from regulation to investor requirements. In today's world, managers are not trading in a single region, but across multiple jurisdictions around the globe. With new regulation coming in – such as the T+1 settlement which took effect this year in Canada, the US and Mexico – managers are now recognising the increasing value in turning to service providers to deliver follow the sun coverage, saving them the expense of building global teams in-house.

Trade operations is another case in point. Managers want their trades matched efficiently and effectively – and having a third party take responsibility for this function gives them peace of mind.

However, this transition isn't a "big bang" approach. The success lies in the ability to develop technology, take over services, and provide clients with comprehensive data solutions tailored to their specific needs. Indeed, outsourcing providers must address concerns about relinquishing control over internally developed processes and demonstrate the value they can add.

Data integration is at the heart of this success. Leading providers have built connections for every major middle office, portfolio management, and accounting system, with the goal to take on processes and make them more efficient. Cloud-based systems now provide a single point of entry for all wire transfers – addressing the challenges faced by organisations with multiple administrators and providers.

On top of the automation solutions already established in Treasury, the introduction of Artificial Intelligence (AI) in treasury management is transforming the way corporate treasurers handle their cash inflows and outflows. Again, data is key here, as the main advantage of AI in treasury is that it helps make sense of huge amounts of technical information.

AI solutions can go further than just helping to make processes more efficient. They can also actively assist in decision-making. Based on the analysis of large amounts of data, AI models can provide valuable insights and can make decisions independently based on predefined rules and algorithms.

The age of the middle office

We are on the cusp of a generational shift, with managers starting to see the benefits of major advancements outsourcing and the technology offered which they can utilise to help scale their own businesses faster. Citco's data revealed that collateral transactions outsourced in 2024 climbed by nearly a third, while the value of margin movements processed surged by 75%.

This shift in mindset among alternative asset managers, corporates, and banks is comparable to the adoption of cloud technology over the past decade. As businesses have moved from on-premises solutions to cloud-based services, the middle office is experiencing a similar transformation.

As we look to the future, a new model is taking hold across alternatives and beyond. Most operational work will be outsourced, allowing in-house teams to focus on oversight and true value-add tasks. This shift will enable firms to achieve growth, efficiency, and scalability in an increasingly competitive and complex financial environment.

The alternative investment industry is embracing outsourcing as a means to achieve these goals. As technology advances and service providers continue to innovate, we can expect this trend to accelerate, reshaping the landscape of alternative investments and capital markets. Firms that successfully navigate this transition will be well-positioned to thrive in the evolving financial ecosystem.

Data integration is at the heart of this success. Leading providers have built connections for every major middle office, portfolio management, and accounting system, with the goal to take on processes and make them more efficient.

Securing large language models: Lessons from the DeepSeek AI breach

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As the world increasingly turns to artificial intelligence (AI) and large language models (LLMs) for enhancing business operations, cybersecurity risks have escalated. The recent breach at DeepSeek AI, where over a million critical records were exposed, serves as a stark reminder of the vulnerabilities LLMs pose to organisations. This breach underscores the importance of robust cybersecurity measures, particularly penetration testing, to secure these powerful technologies.

The importance of penetration testing for LLMs

Penetration testing, a process where security experts simulate cyberattacks to identify weaknesses, is essential for securing AI systems, just as it is for traditional applications. However, securing LLMs requires a unique approach. Traditional methods used for websites or mobile apps are not sufficient to address the complexities and specific risks posed by LLMs.

The DeepSeek breach highlights that LLMs, while transformative, are prone to exploitation when not properly tested. Malicious actors can manipulate these systems to access sensitive data, alter information, or even bypass security measures. The critical question organisations must ask is: How can they safeguard their LLMs from these emerging threats?

Unique vulnerabilities in LLMs

LLMs introduce several security challenges that differ from traditional software. One of the most concerning vulnerabilities is prompt injection, where an attacker manipulates input to influence the AI's output. In the case of DeepSeek, this kind of exploitation could have played a role in the breach, as prompt injection allows attackers to manipulate responses, potentially exposing sensitive information.
Other risks associated with LLMs include insecure plugin designs that could allow unauthorised access to critical systems, as well as data poisoning, where attackers influence the training data to compromise the integrity of the model. The DeepSeek breach emphasises the potential for LLMs to expose data and underscores the need for proactive security measures.

Penetration testing for LLMs: A specialised approach

Penetration testing for LLMs goes beyond traditional web app security testing. LLMs are powered by complex neural networks that require a tailored approach to identify vulnerabilities. At Abacus Group, our cybersecurity experts use specialised methodologies to assess LLM systems for security weaknesses, including prompt injection, flawed plugin configurations, and other AI-specific vulnerabilities.

We work closely with clients to understand the unique architecture of their LLM systems, ensuring that we identify potential threats early in the development process. This proactive approach helps us pinpoint not only existing vulnerabilities but also emerging risks, ensuring that organisations can secure their LLM applications before they are exploited.

Lessons from the DeepSeek AI breach

The DeepSeek breach offers valuable lessons for businesses deploying LLM technologies. First, it emphasises the importance of proactive cybersecurity measures. Delaying security testing or assuming that off-the-shelf solutions are secure can lead to catastrophic consequences. Organisations must invest in regular penetration testing to ensure their systems are protected from emerging threats.

Delaying security testing or assuming that off-the-shelf solutions are secure can lead to catastrophic consequences.

Second, the breach highlights the need for specialised expertise. As LLMs are a new frontier in cybersecurity, traditional penetration testing approaches may not suffice. Firms should collaborate with cybersecurity experts who understand the nuances of AI systems and have experience in securing LLMs specifically.

Lastly, the DeepSeek breach shows that vulnerabilities can exist not just externally but also within the system's configuration. Improper access controls, poor data handling, and insecure integrations can all open the door for attackers. Organisations must implement robust security practices throughout the lifecycle of their AI applications.

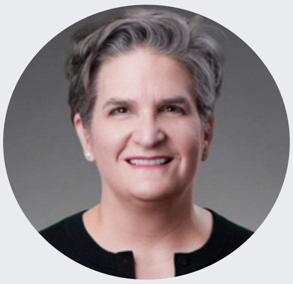
The road ahead: Future-proofing LLM security

As LLM technologies continue to evolve, the cybersecurity landscape will need to keep pace. AI systems, including LLMs, will only become more integral to businesses, and securing them will become increasingly challenging. Organisations can no longer treat LLMs like traditional software; they must take a proactive, tailored approach to security.

Conclusion

The breach at DeepSeek AI is a critical reminder of the vulnerabilities that LLMs present. As organisations continue to deploy AI-powered systems, it is essential that they take cybersecurity seriously and adopt a comprehensive, tailored approach to penetration testing. By doing so, they can mitigate risks, protect sensitive data, and confidently leverage the power of LLMs to drive business success.

A practical guide for advisers considering the use of AI



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The increasing prevalence of artificial intelligence (AI) in the financial services industry offers advisers the potential for greater efficiency, improved client experiences, and enhanced advisory capabilities. However, advisers must understand the unique risks of the technology to navigate the regulatory framework. Before integrating AI into an advisory business, advisers should consider a range of factors, including technological limitations, regulatory compliance, and governance frameworks.

Understanding AI and its capabilities

There is no universal definition of AI. AI is an umbrella term encompassing various longstanding technologies, including machine learning (ML) and deep learning (DL). ML enables computers to learn from data and make predictions or decisions without explicit programming. DL, a subfield of ML, uses neural networks to analyse complex data and identify patterns. These technologies can be, and in many cases have been, applied in numerous ways within the asset management industry, such as algorithmic trading.

More recently, the term AI has become synonymous with generative AI (GenAI), which is a subset of AI that can create new content, such as text, images, and models. In asset management, GenAI can assist in summarising and digesting large volumes of investment research, transcribing calls and meetings, optimising portfolios, managing risk, generating investment summaries and marketing materials, and engaging with clients through chatbots and natural language processing (NLP) tools. The considerable focus on AI from both an industry and regulatory perspective is largely attributable to recent developments in GenAI.

US regulatory considerations

Advisers operate in a highly regulated environment, and the adoption and use of GenAI must align with existing compliance requirements. The Securities and Exchange Commission (SEC), under former Chairman Gensler, explored the use of digital engagement practices and proposed, but ultimately did not adopt, controversial rulemaking restricting the use of predictive data analytics.[1] To date the regulatory framework for advisers under the Investment Advisers Act of 1940 (Advisers Act) is based on general principles of fiduciary duty and disclosure, compliance with existing rules (e.g., recordkeeping and marketing rules), and maintenance of appropriate policies and controls. Key elements of the regulatory framework include:

1 *See Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice,* Exchange Act Rel. No. 34-92766 (Aug. 27, 2021); Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers, Advisers Act Rel. No. 6353 (July 26, 2023).

Fiduciary Duty. Advisers are fiduciaries that owe clients a duty of care (including having a reasonable belief that their advice is best interest of the client based on the client's investment profile) and a duty of loyalty (including disclosing material conflicts of interest that could affect the advisory relationship). One of the most tempting use cases for advisers is incorporating GenAI into the investment decision-making process. The challenge, however, is that in order to do this, advisers need to have a clear understanding as to how investment decisions are being made to satisfy their duty of care. Advisers also need to understand the AI's output to ensure that they are making full disclosure of all material conflicts of interest. This puts a premium on the transparency and explainability of the AI tool, as well as the management of data sources and the adviser's model risk management, testing, and verification processes. To the extent advisers are using AI to provide investment advice or recommendations, AI-driven investment strategies should be carefully monitored to ensure that they align with each client's investment profile. In addition, advisers should regularly review AI models to confirm that their outputs remain in the best interest of clients.

With respect to conflicts, advisers should consider whether AI-driven portfolio allocations disproportionately favour proprietary funds or otherwise optimise the results to generate additional revenue or fees for the adviser. Given the significant regulatory risk, and the transparency limitations of the technology itself, most advisers either have not yet incorporated AI (or GenAI) into the investment decision-making process or require robust human verification of the output before implementation. Further, the limitations and risks of AI should be disclosed in Form ADV and client communications.

Data management. The effectiveness of the output of AI-driven tools depends on the quality of the data that AI applications use to train and fine tune models, conduct analyses, identify patterns, and make predictions. Accordingly, it is critical that advisers understand the underlying data that is used by the AI-driven tools and develop a process to confirm the legitimacy of the data sources and evaluate any potential biases that may affect the output of the AI models.

Privacy considerations. Advisers should adopt controls to prevent proprietary or confidential information of the adviser or its clients from "seeping" out into the public domain through the adviser's use of GenAI, particularly if using publicly available AI tools. The risk of seepage highlights the potential privacy and data security risks. Advisers should ensure that AI applications comply with data protection regulations, such as the General Data Protection Regulation (GDPR) and California Consumer Privacy Act (CCPA) and implement appropriate security protocols to safeguard client information against breaches.

Marketing rule compliance. Advisers are responsible for the content, supervision, and recordkeeping obligations associated with AI-generated content to the same extent as communications generated by humans. Accordingly, advisers should be cautious about how they discuss their use of AI, including on social media and in marketing materials. The SEC has brought enforcement actions relating to so-called "AI-washing," where advisers overstate the role of AI in their business and investment process. Do what you say, say what you do.

Books and records. As with marketing content, all AI-generated communications are potentially subject to the Advisers Act Rule 204-2 (requiring advisers to maintain certain books and records). For example, using AI to generate written summaries of meetings or calls creates a record that may, depending on the topic of the meeting, be required to be retained. Similarly, relying on chatbots to interact with clients creates written records that may need to be retained if those communications relate, for example, to recommendations or advice, the receipt, disbursement, or delivery of funds or securities, the execution of orders, or otherwise would be considered advertisements under the Marketing Rule.

Third-party vendor oversight. Many advisers rely on external AI tools or work with vendors that increasingly are integrating AI into the services they provide. In either case, advisers should augment their existing service provider oversight processes to address initial and periodic due diligence about the use of AI and the vendor's related controls. Among other things, advisers should consider contractual provisions that require advanced notice before a vendor can incorporate AI (and particularly GenAI) into existing services and restrictions on the ingestion of the adviser's data to develop, train, or improve the vendor's AI system.

AI governance best practices

To integrate AI responsibly, investment advisers should adopt a structured approach to AI governance. Best practices include:

1. Employee training: Employees should be trained to recognise AI-related risks and effectively use AI tools. Advisers may also consider developing educational programmes to help employees remain knowledgeable about AI advancements and compliance requirements.

2. AI use policy: Firms should consider adopting acceptable use policies for AI that outline how employees may engage with AI for business purposes and what uses are prohibited. This includes whether employees may only interact with specific systems for business purposes, requirements around the use and verification of output generated by AI, and restrictions on uploading proprietary or confidential information (including client information) into publicly available AI systems. In the absence of an AI policy, advisers should consider blocking access on work devices to publicly available AI systems.

3. Governance frameworks: Establishing a formal governance committee to oversee AI applications helps promote accountability and proper oversight, including by evaluating the introduction of AI-based tools based on business needs and risk mitigation. These governance committees should include compliance officers, data scientists, investment professionals, and risk management personnel to consider potential regulatory risks, monitor AI use and evaluate the effectiveness of the firm's controls.

4. Model risk management: Advisers should establish or enhance existing model risk management controls to address risks that are unique to the use and complexity of AI applications. These include policies and procedures that govern the development, updating, testing, and verification of outputs from AI models. The model risk management framework should also include data source evaluation (as discussed above) and a focus on the explainability and transparency of AI tools.

5. Testing and verification: Regularly testing AI models for accuracy, fairness, and explainability is a critical component of any control structure. Advisers may also conduct scenario analysis and stress test AI-driven tools to help firms understand how AI performs under different market conditions and evaluate AI model resilience.

6. Disclosure: Advisers should clearly communicate to clients how AI is being used in their investment strategies and disclose the limitations of AI-driven advice and any related conflicts of interest.

Conclusion

As AI continues to evolve, it is important that advisers understand both its risks and opportunities. Firms that prioritise regulatory compliance and proactively implement strong governance will be best positioned to leverage AI's potential while fostering long-term client confidence and managing risk.

Outsourced trading: Solving cost, scale and execution challenges for hedge funds

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Co-head of International Prime Brokerage and Outsourced Trading
Marex

Outsourced trading is on the rise, and fund managers of all sizes across the globe are reaping the benefits of this growing trend. Outsourced trading is not simply a way to cut costs, but can be a key component in scaling operations and accessing expertise, liquidity and infrastructure that might otherwise be out of reach.

Once considered a niche service used primarily by smaller, US-based fund managers trading equities, outsourced trading is now used by firms of all sizes worldwide to bolster trading capabilities across asset classes and markets and enhance operations. This has been driven by the need for cost efficiencies, operational flexibility and access to expertise.

A Coalition Greenwich report confirms the shift in attitudes towards outsourced trading over the last few years. According to its findings in 2023, 39% of asset managers recognised the value of supplementing their internal teams with outsourced providers, up from just 5% in 2020.

In 2024, industry publications, The TRADE and Global Custodian highlighted an even more significant trend in their annual Outsourced Trading Survey, conducted amongst fund managers, asset managers, hedge funds and other buy-side firms. They noted that a number of firms are migrating to a full outsourced trading model rather than using an outsourced provider to supplement their existing offering, such as adding an asset class or extending into a different time zone. This shift from a hybrid (or co-sourced) model to full outsourcing is important. It reveals that once clients try outsourced trading, they see the benefits and often want more – it validates the model.

Regardless of whether a fully outsourced or a hybrid partnership is required, it is important that fund managers understand the totality of the offering available from their selected outsourced trading partner. They may choose to opt for one or two services from the outset, but their requirements may change as their business evolves.

Based on experience in supporting new launches through to multi-billion-dollar funds with a high-touch, complete and hybrid outsourced trading solution, the top five reasons why clients opt for outsourced trading are as follows:

1. **Diversification to new asset classes**
   Launching and managing a new asset class in-house requires specialised expertise, along with substantial investments in infrastructure, technology and additional personnel. An outsourced trading partner can simplify and speed up this process by providing instant access to experienced traders who are skilled in a wide range of asset classes, the required infrastructure and post-trade set-up.

   Leveraging the relationships that outsourced trading providers have with top-tier banks and non-banks, they can also offer access to deep liquidity pools and competitive spreads across a multitude of asset classes. Additionally, they can handle oversight, monitoring and reporting for new asset classes, ensuring compliance with regulatory requirements.

2. **Access to new territories**
   Outsourced trading gives access to new geographic territories, offering fund managers a seamless way to expand their market reach in both emerging markets and developed regions without the complexities of having to establish a local presence like larger outsourced trading firms have. Managers gain access to experienced professionals who are familiar with regional market dynamics, local regulations and trading nuances. This enables them to access new markets quickly, while mitigating the risks and costs associated with navigating unfamiliar territories.

   Additionally, outsourced trading provides the flexibility to test a new market (or asset class, as highlighted above) before making a long-term commitment. If they wish to, managers can later transition to an in-house team as they build upon their initial market insights and experience.

3. **Reinforcing day-to-day execution bandwidth**
   Whether a fund manager requires holiday cover, temporary cover or permanent additions to their trading or support team, outsourced trading partners can flex to meet specific requirements, as and when needed. They can provide cover for a particular time zone, 24-hour cover or just for periods of high volatility – whatever is required. It is this level of flexibility which makes outsourced trading such an attractive proposition. As the manager's needs evolve, they can lean on their provider to quickly scale up to meet increased demand.

4. **Access to expertise and resources that aren't available in-house**
   Different outsourced trading providers offer different models and capabilities. One of the most significant advantages of outsourcing is the ability to leverage buy side expertise, backed by experienced support staff and sophisticated trading and reporting infrastructure, without the financial and operational burden of investing in these capabilities in-house.

   Services include trade execution, pre- and post-trade activities, settlement, portfolio reconciliation, reporting, trade cost analysis, commission management and access to valuable research. Capital introduction is part of the package for some outsourced trading providers.

   Outsourced providers' networks and broad reach give them access to deeper liquidity pools, improving trade execution and overall performance. Additionally, with experience across multiple clients and sectors, they can also implement operational workflows that can be more advanced than most individual funds are able to build internally.

5. Cost efficiencies
   The reduced operational costs from savings on technology, salaries and other administrative expenses are evident. A further benefit is that outsourcing shifts fixed costs to variable ones, providing greater flexibility for funds to manage financial pressures, and freeing up the balance sheet for other key investments.

   The importance of cost-effective, streamlined operations is underscored by the Standing Strong: Emerging Manager Survey 2024 by AIMA and Marex, which highlights how investors increasingly value lean and efficient operating models when evaluating fund managers. Outsourcing functions such as trading shows investors that resources are being used strategically and efficiently in order to drive results.

By leveraging one or many of the use cases highlighted above, fund managers can focus on their investment strategy and alpha generation.

Keeping control

It's worth noting that one of the biggest concerns about outsourcing trading often raised by management is that it could result in a loss of control or won't deliver the performance needed. This couldn't be further from reality. We have seen fund managers benefit from full transparency during the entire trade lifecycle, from the time the portfolio manager sends an order to the time the trade is executed – and having an experienced team of buy-side traders can result in deeper expertise and more refined processes. Far from a loss of control, outsourcing can provide access to a level of best practice and operational excellence that can be difficult to achieve with in-house resources.

Selecting the right provider

As outsourcing continues to gain momentum and new players enter the market, the importance of selecting the right provider remains key. Proper due diligence on the breadth and depth of services on offer is critical.

Key questions to ask include: How much operational support will there be? What is the pricing model? What level of transparency, trade aggregation and reconciliation is provided by the outsourced trading solution? How many traders do they have, and what level of buy-side experience do they possess? What is the breadth of the broker network and asset class coverage?

Asking the right questions from the outset and getting the relationship right can go a long way to securing a mutually beneficial arrangement. A well-chosen provider becomes a true partner, fully integrating with your team and reflecting your values. They will be a valuable ally, strengthening operations and adding value, without sacrificing control or quality. Think about the solutions that you need as opposed to the solutions being offered. This will ensure that the outsourced provider tailors the solution to fit your specific needs, aligned with your goals.

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Partner – Financial Services Tax
EY

Lodovico Bolis
Manager – Financial Services Tax
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The increasing number of investment management executives relocating to Italy highlights the attractiveness of Italy's tax incentives for high-net-worth individuals. These incentives particularly appeal to investment managers with significant future co-investment and carried interest income. Meanwhile, other countries are reviewing long-standing tax incentives, such as the UK's removal of the remittance basis for non-UK domiciled individuals.
The most appealing scheme for investment management executives is the Lump Sum Tax Regime. This elective regime allows qualifying taxpayers to pay an annual EUR 200k lump sum tax (recently increased from EUR 100k) for all non-Italian source income, instead of standard income taxation. The regime applies to individuals who were non-resident in at least nine of the ten years before election and lasts up to 15 years. However, taxpayers may leave Italy as early as the second year without an exit tax. This regime covers foreign-source income regardless of remittance, value, or jurisdiction and it can be extended to family members, with an incremental EUR 25k charge per member.

An anti-avoidance rule applies to capital gains from the transfer of substantial shareholdings in the first five years, with some exceptions. Other benefits include exemptions from wealth, gift, and inheritance taxes on non-Italian assets and foreign asset disclosure (except for substantial shareholdings in the first five years of residency).

The Inbound Workers Regime is another election available to new residents, which underwent changes in December 2023 that reduced its appeal. This regime allows highly qualified taxpayers working in Italy for most of the year to benefit from a 50%-60% exemption on Italian-source employment income for five years, subject to a EUR 600k gross income cap.

Despite recent amendments reducing the attractiveness of these incentives, the current legislative framework suggests in new elections both regimes could apply concurrently: if an individual works most of the year in Italy and the rest abroad, they may combine both regimes. The Italian-sourced income could benefit from the Inbound Workers Regime, while the foreign-sourced income could be subject to the Lump Sum Tax Regime. Further guidance from the Italian tax authorities (ITA) is expected on this topic.

When carried interest income earned qualifies as financial income under Italian tax law, it is taxed at 26%. However, under the Lump Sum Tax Regime, if financial instruments are issued by a foreign entity and held via a non-Italian custodian bank, all income can fall in the lump sum taxation.

Taxpayers can secure advance tax rulings from the ITA to confirm their eligibility for the Lump Sum Tax Regime and its application to carried interest.

These rulings, which take about 90 to 150 days, are binding only on the ITA.

In addition to the above, new Italian residents enjoy one of Europe's lowest inheritance and gift tax rates (4%-8%), with exemptions up to EUR 1m per heir/donee, depending on kinship.

IME and corporate taxation

Before an investment management function relocation to Italy is made, the relevant facts should be analysed to ensure that the management activities that the individuals would perform in Italy do not trigger an Italian Permanent Establishment – PE – (i.e., an Italian taxable presence) of any of the non-resident entities that benefit from such activities – i.e., the investment fund and its subsidiaries, the investment management or advisory entity.

Investment Management Exemption

To mitigate the risk of PE exposure of foreign investment funds, Italy introduced the Investment Management Exemption (IME). This exemption establishes a safe harbour rule for investment funds dealing with a restricted range of financial instruments, preventing the activity of Italian-based managers from creating a PE under certain conditions.

The requirements for the application of the IME regime are as follows:

i. The fund (and its subsidiaries) is established/resident for tax purposes in a foreign jurisdiction included in the list of countries that allow an adequate exchange of information with Italy – white-list countries;[1]

ii. The fund qualifies as an independent vehicle, as per the criteria set out by a Ministerial Decree published on 4 March 2024. This Decree distinguishes between:

   a) Undertakings for collective investment (UCIs) compliant with the UCITS IV and AIFMD Directives (EU Directives),

   b) UCIs which have substantial features similar to those under letter (a) above and they or their investment manager are subject to regulations substantially equivalent to the EU Directives,

   c) Entities other than UCIs that are subject to prudential supervision, with an exclusive or principal purpose to invest the capital raised from third parties in accordance with a predetermined investment policy, and for which the following conditions are met:

      1. No person holds more than 20% of share capital or assets,

      2. The capital raised is managed upstream in the interest of the investors and autonomously from them;

iii. Regarding the foreign investment vehicles described under ii.c) above only, the investment manager operating in Italy does not hold any role in the management and control bodies of the fund, or any of its foreign subsidiaries and does not hold an interest granting more than 25% in the profit of the fund;

iv. The remuneration received by the investment manager entity, to the extent arising from intercompany transactions, is supported by local qualifying transfer pricing documentation, prepared consistently with the recent Revenue Agency guidance on the application of the arm's length requirement to the investment management sector.

1 Please be aware that the US, Cayman Islands, Jersey, Ireland and Luxemburg – i.e., the jurisdictions in which funds are commonly established – qualify as white-list countries for IME regime purpose.

ITA[2] provided critical clarifications confirming that:

i. The IME regime does not apply to the investment manager and its affiliates. Consequently, foreign investment managers must continue to assess their Italian PE risk on a case-by-case basis;

ii. The independence requirement for an investment manager entity can be deemed to be met where a delegation of functions occurs, to the extent that:

  a. The delegation complies with EU Directives (or, for UCIs non-EU, with the foreign regulatory law framework substantially equivalent to EU Directives) – i.e., the delegating manager must ensure that delegations do not result in the manager becoming a mere "empty-box" entity.

  b. The delegated entities are resident in Italy or in a white-list country.

  c. For non-EU based UCIs, the foreign jurisdiction's regulatory framework provides for delegation rules that adhere to EU Directives principles.

Challenges of the IME regime and need for reform: a case study

While the IME regime provides valuable protection for funds, it does not extend to foreign investment managers employing executives who relocate to Italy. Consequently, the management entities remain exposed to PE risk.

Moreover, under the "multiple-taxpayer approach" adopted by ITA, the relocation of a single individual may result in multiple PEs, particularly when a foreign investment management entity delegates services to another entity under a sub-management agreement. This raises significant concerns, as the ITA could recognise a PE not only for the employing entity but also for any other delegating entity above the chain.

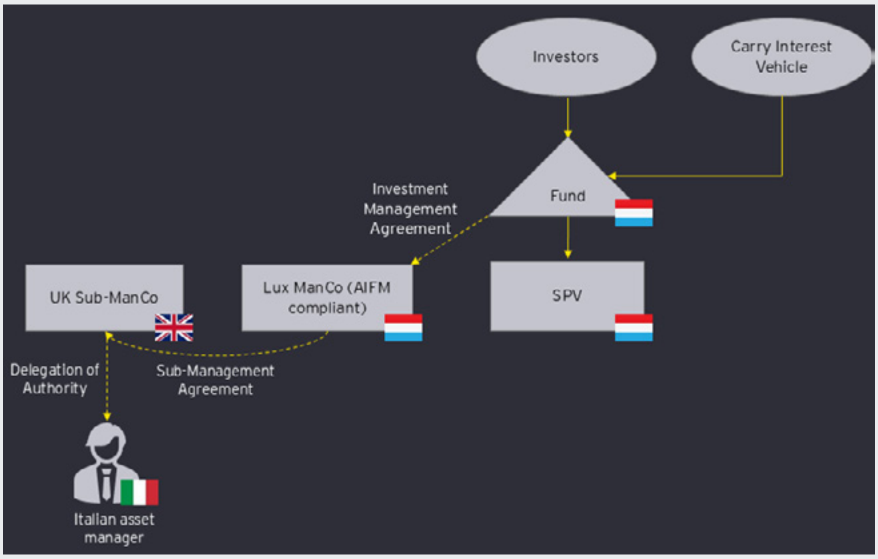
In Figure 1 the Lux AIF/Lux SPV should be covered by the IME regime considering that:

i. The Lux AIF/Lux SPV are established for tax purposes in a white-list country;

ii. The Lux ManCo is compliant with AIFM Directive

iii. The UK Sub-Manco is established for tax purpose in a white-list country and the delegation complies with EU Directives

Figure 1



However, since Lux ManCo has delegated functions to UK Sub-Manco, if an individual employed by the latter is relocated to Italy the ITA might in principle assess a PE for either the UK entity or the Luxembourg entity.

2 Please refer to Circular Letter No. 23/E/2024-

To address this issue, a structural amendment could be introduced to the Italian permanent establishment provisions of Article 162 of the Italian Corporate Income Tax Act (CITA) to limit the multiple-taxpayer approach and broaden the IME regime's coverage. Specifically, when an investment management entity already has a subsidiary or an existing PE in Italy and an arm's length amount of income is attributed to the risks/functions undertaken in Italy, this existing taxable presence should prevent the assessment of a taxable presence of other non-residents. At most, the Italian statutes could require the PE exemption of the manager to be subject to prior clearance with the competent Italian office under an advance pricing agreement.

Referring to the above example, if the UK entity already had a PE in Italy or incorporated a subsidiary there, and all income generated from activities conducted in Italy were determined under an OECD compliant arm's length approach, an amendment of the Italian statutes could provide for clearance from other PE risk, for IME to result in a much more effective incentive to the growth of the local industry.

Conclusion

Revising Article 162 CITA and the multiple-taxpayer approach would boost Italy's competitiveness, enabling business growth without unfair tax burdens. While Italy attracts high-net-worth individuals and investment professionals, the success of these regimes depends on ongoing refinements and the ITA's practical oversight of their expanding taxpayer base.

BlueCrest v HMRC salaried member case: Court of Appeal decision on Condition B

On 17 January 2025 the Court of Appeal (COA) judgement in the case of BlueCrest Capital Management (UK) LLP v HMRC was released, overturning the previous decision of the First Tier Tribunal (FTT) and Upper Tribunal (UT) in relation to Condition B. The COA ruled in favour of HMRC materially narrowing the interpretation of 'Significant Influence' under Condition B to legally enforceable rights and duties of members. Although the COA has sent the case back to the FTT to apply the law to the facts of the case, the expectation is BlueCrest will appeal to the Supreme Court, therefore the case may still have long way to go. This is a particularly disappointing outcome for Limited Liability Partnerships (LLPs) in the asset management industry who will review both the historic and future positions.

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Legislation

The UK's salaried member rules were introduced in 2014 and are contained in ITTOIA 2005 s.863A-863G. The rules operate by re-characterising a member of an LLP as an employee for UK tax purposes, where all of the following three conditions (A to C) are met:

- Condition A – The individual is reasonably expected to receive remuneration that is at least 80% "disguised salary";
- Condition B – The individual does not have significant influence over the affairs of the partnership; and
- Condition C – The individual does not have capital contribution equal to at least 25% of their disguised salary.

To be treated as a genuine self-employed partner for tax purposes an individual must breach one or more of these conditions. If all three conditions are met then the partner will be classed as an employee imposing PAYE/NIC obligations on profit allocations.

Case summary

In 2009 BlueCrest adopted an LLP structure (the 'LLP') through which to operate its UK investment management functions and notably decided to close its funds to outside investors in 2015. The case covers the five tax years immediately following the implementation of the new rules from 2014/15 to 2018/19.

During the period in question, approximately a third of the appellant's workforce in the UK were partners in the LLP. The majority of the partners made minimal capital contributions, and their remuneration was largely linked to their individual performance. The LLP had an executive committee (the 'ExCo') which initially consisted of the COO, GC, CRO and CFO, but was later expanded on tax advice.

HMRC's view was Condition A and C were met for all the partners, and that only the original four ExCo members should be classified as partners for tax purposes (as they had significant influence, therefore, failing Condition B). BlueCrest argued that Conditions A and B were not met for the partners. It was common ground that Condition C was met for all the members.

FTT and UT Decision

The FTT released its judgement in June 2022 with the following findings:

Condition A: The FTT concluded that where profit allocations are varied, then they should be varied by overall profits of the LLP. This was not found to be the case for the BlueCrest partners. Personal performance alone was used to determine discretionary allocations which could fall within the definition of a disguised salary therefore Condition A was met for all partners.

Condition B: The FTT established two key principles:

1) The first principle is that significant influence should not be limited to managerial influence.

2) The second principle is that the expression "affairs of the partnership" should not be restricted to the affairs of the partnership generally but can be over an aspect of the affairs of the partnership.

Based on these principles the FTT found that a portfolio manager ('PM') partner with a capital allocation of $100m should be regarded as having significant influence, therefore breaching Condition B. However, in the case of the non-PMs the FTT concluded that (apart from the four members on the original ExCo) there was insufficient evidence to form a view of whether they demonstrated significant financial or operational influence, as such it concluded Condition B would be met. Importantly in arriving at these decisions it was also noted that significant influence does not need to be exercised through a formal constitutional procedure but requires a realistic examination of the facts.

Both, HMRC and BlueCrest appealed the decisions, but the FTT's conclusions were upheld by the UT in September 2023, following which HMRC appealed to the COA with the case being heard in November 2024.

COA Decision

In January 2025 the COA concluded:

Condition A: The COA agreed with the earlier tribunals in relation to Condition A with the conclusion remaining unchanged.

Condition B: The COA upheld HMRC's appeal in relation to Condition B, however, this was not on the basis HMRC had expected. Instead, it was determined that both earlier tribunals erred in law in accepting the wider construction of Condition B. It noted that the FTT approached its examination and evaluation of the evidence on the mistaken basis that the necessary qualifying influence on the affairs of the LLP could be found not only in the LLP agreement and any other sources of enforceable mutual rights and duties, but also in any de facto arrangements which were in place. The UT did not pick this up at the initial appeal, and it is notable that HMRC had previously agreed with the approach which was in line with their guidance.

Viewed in a wider statutory context, the COA stated that it was clear "significant influence over the affairs of the partnership" must derived from the mutual rights and duties of the members of the LLP (both horizontally, as between the members themselves, and vertically, as between the members and the LLP) as conferred by the statutory and contractual framework which governs the operation of the LLP, and the relevant provisions of the LLP agreement. Therefore, the main focus should be on the terms of the LLP agreement itself.

The Judge further discussed the concepts of 'qualifying and non-qualifying influence'. Where the rights and duties of a member connote legal enforceability (whether found in a relevant statute or in the contractual agreement governing the LLP) this was referred to as 'qualifying influence'. Conversely, 'non-qualifying influence' was referred to as where influence over the affairs of the LLP lacked any identifiable contractual and/or statutory source. Although such non-qualifying influence was to be excluded from consideration of significant influence, it may still remain highly material in deciding whether the 'qualifying influence' was 'significant'.

There was also a further point discussed by the COA about the alleged unfairness to BlueCrest in relation to possible further evidence. Having relied on HMRC's published guidance, BlueCrest in its previous responses had stated that there was no statutory requirement to look only at the LLPs governing documentation and that to do so would be to ignore the factual reality of how influence is exercised. HMRC in their response agreed with the approach and accepted that significant influence can arise in other ways than under the LLP Agreement. As the point was thought to be common ground, it was not elaborated. Despite this consideration the COA concluded that it would have been prudent for BlueCrest to prepare its evidence to deal with other possible sources of actual influence on the conduct of the LLP's affairs, and that it could not plausibly be maintained that the LLP was misled by HMRC's published guidance.

Impact on LLPs

LLPs have traditionally been advised that it would be prudent to structure their affairs such that at least two or more of the conditions are breached, a valuable approach given the latest developments. The COA decision creates a more stringent framework for assessing Condition B, however we will have to wait until the FTT / Supreme Court re-assess the case before a final view can be made.

LLPs will again need to reconsider the application of the rules under their governance structures and partnership agreements, in particular where reliance was placed on the FTT / UT's interpretation of Condition B. Failure to do so could result in the incorrect application of the salaried member rules and the associated PAYE and NIC implications. The Court's emphasis on formal documentation may also lead to a broader review of LLP practices across the financial and professional services sectors, where informal arrangements may be prevalent. Caution should be given to simply amending LLP agreements in light of the anti-avoidance rules, unless it is genuine long-term restructuring. Firms should begin reviewing their LLP agreements to assess whether the rights, powers, and responsibilities of members are appropriately codified to meet the newly clarified interpretation of Condition B.

Action to be taken

With majority of LLPs having a 31 March year end date, immediate action may be required, as such sensible steps would include action to:

- Re-evaluate the application of the legislation following the COA decision, in particular given the tighter interpretation of Condition B;
- Consider the implications for current, historic and future periods, with some appropriate stress testing including worst case scenarios (noting the increase in employers' NIC from 13.8% to 15% in April 2025);
- Quantify the probable financial impact on the business, future projections, cash flow and capital requirements;
- Review existing compensation structures and promotion / recruitment options for partners;

- Consider interaction with established co-investment structures and deferral structures (e.g. the AIFMD mechanism) for partners recharacterised as employees for tax purposes;
- Assess possible accounting treatment, impact on financial statements (including disclosures) and regulatory reporting;
- Review LLP agreements, profit allocation methodologies and side letters to determine with whom any potential liability ultimately rests;
- Consider interaction with other areas of tax legislation, e.g. employment related securities, notification of uncertain tax positions;
- Document the position in advance of the year end, noting that aspects of the legislation hinge on expectations at the beginning of the accounting period. Also include correlation analysis to assess how allocations have historically worked in practice;
- Review at LLP board level (with meeting minutes) and keep detailed records of analysis, advice and decisions.

Update to the Cayman Islands Proceeds of Crime Act – Changes to suspicious activity reporting

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Key takeaways

The Cayman Islands Proceeds of Crime Act (**POCA**) applies to all Cayman Islands individuals and entities, including Cayman Islands investment funds structures and service providers. Amendments to the POCA came into effect on 2 January 2025 and include important revisions to the suspicious activity report (**SAR**) process to the Financial Reporting Authority (**FRA**). In addition to a SAR, a person must now also receive prior consent from the FRA in order to have a defence against money laundering (**DAML**).

The FRA has published industry guidance on how the new DAML consent regime will work, including a seven working day notice period during which the DAML SAR must be responded to by the FRA, failing which the applicant is deemed to have received consent. This will mitigate practical difficulties where consent to a transaction is urgently required.
Introduction

Until 2 January 2025, a defence was available whereby if a person suspected that property they intended to deal with was criminal property, thereby risking committing a money laundering offence under the POCA, they would not commit a Core Money Laundering Offence under POCA if they had first made a SAR to the FRA.

This defence was revised when certain expected amendments to POCA pursuant to the Proceeds of Crime (Amendment) Act, 2023 came into force on 2 January 2025. In order not to commit a Core Money Laundering Offence the person must now also have received prior consent, known as a DAML, from the FRA following the making of the SAR.

What are the Core Money Laundering Offences?

Sections 133, 134 and 135 of POCA set out the money laundering offences of: (i) concealing, disguising, converting or transferring criminal property or removing criminal property from the Cayman Islands; (ii) entering into or becoming concerned in an arrangement which that person knows or suspects facilitates (by whatever means) the acquisition, retention, use or control of criminal property by or on behalf of any other person; and (iii) acquiring, using or having possession of criminal property (together, the "**Core Money Laundering Offences**").

Other key money laundering offences

Other key money laundering offences are, in summary, as follows.

A person commits an offence under section 136 of POCA if they have reasonable grounds to know or suspect criminal conduct, having come by such information in the course of their business, and fails to make the required disclosure to a nominated officer of FRA (the "**Failure to Disclose Offence**").

A person commits an offence if they know or suspect criminal activity has taken place, is taking place, or will take place, and makes a disclosure which is likely to prejudice any investigation (the "**Tipping Off Offence**").

Practical considerations

Legitimate businesses including investment funds may develop suspicion in relation to an investor or counterparty such that they consider they may be exposed to criminal property. As well as being required on a mandatory basis to make a SAR in order to avoid committing the Failure to Disclose Offence, the fund may also want to make the SAR to obtain a DAML, in order not to inadvertently commit one or more of the Core Money Laundering Offences – such as possessing or transferring criminal property.

Often, the first instinct of a fund which finds it is exposed to a potential criminal is to exit the relationship pursuant to compulsory redemption provisions or similar. However, this could result in it committing a transfer of criminal property offence unless a DAML is first obtained.

The business must also avoid committing the Tipping Off Offence. Based on experience of other countries with consent requirements, funds and other financial services businesses can find themselves in a difficult position if, say, a customer or investor has asked to withdraw or redeem funds and the business has not yet received consent from the FRA to do so.

Deemed consent

In order to address potential practical difficulties which could arise from a consent requirement absent deemed consent provisions, the FRA issued an Industry Advisory on 10 January 2025, introducing a deemed consent regime, similar to that in other countries. The FRA intends to consult on draft regulations shortly.

The FRA has a seven working day period (the "**Notice Period**") to consider all DAML requests, unless the FRA considers that the request is incomplete, when it may specify a longer Notice Period. The Notice Period starts from the first working day after the SAR is submitted. The FRA will analyse the DAML request, consulting with domestic and international law enforcement partners as necessary. During this period the activity that is the subject of the request should not be carried out, otherwise the person risks committing a Core Money Laundering Offence.

Often, the first instinct of a fund which finds it is exposed to a potential criminal is to exit the relationship pursuant to compulsory redemption provisions or similar. However, this could result in it committing a transfer of criminal property offence unless a DAML is first obtained.

If the FRA does not respond to the DAML request during the Notice Period, then DAML consent is deemed to have been given.

Should a request for a DAML be refused, the FRA will notify the business. A moratorium period of 30 calendar days then begins, starting on the first working day after the FRA provides notice that the DAML request has been refused. During this time law enforcement will be working to take positive enforcement action against the criminal property identified in the SAR. This could include property freezing orders or restraint orders.

The FRA requires certain information to be disclosed in a SAR in order to make an informed decision on requests for a DAML and the SAR must provide full details of the activity that the DAML is being sought for. It is important, when submitting a SAR, to highlight to the FRA that a DAML is required (as opposed to only to avoid committing the Failure to Disclose Offence), so that the FRA can prioritise those SARs which require a DAML. The SAR should state in the 'Reason for Suspicion' section of the form the reason for the DAML request.

Conclusion

The introduction of the deemed consent regime is to be welcomed and will help to mitigate practical difficulties for businesses where consent to a transaction is urgently required.

Trend-following and long-short quality: Loading the dice

Rupert Goodall
Client Portfolio Manager
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Practitioners have often touted trend-following strategies as being 'long volatility'.[1] While this statement may hold true when evaluated over weeks or months, it can cause confusion during sudden, short-lived volatile periods, such as the collapse of Silicon Valley Bank in March 2023 and the yen carry trade unwind in August 2024. In both instances, we saw a rapid increase in volatility (as represented by CBOE Volatility 'VIX' Index), sharp reversals across markets and the underperformance of trend-following strategies.

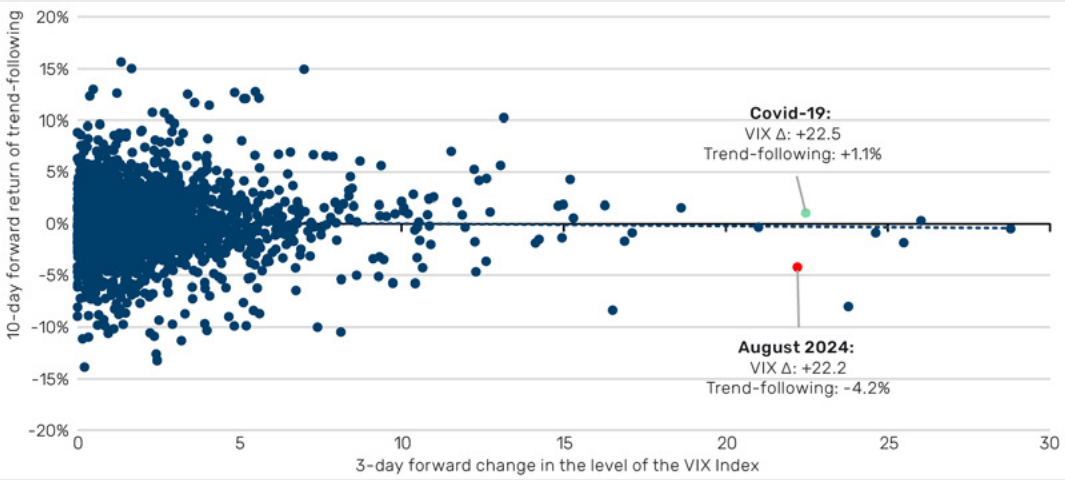
The key issue is the sharpness of volatility spike. Trend-following has historically performed well during more sustained drawdowns, lasting months or longer. However, performance over shorter and more volatile episodes is akin to a roll of the dice and depends on how the strategy is positioned at the onset of the volatility.

These events highlighted the limitations of trend-following as a first line of defence in portfolios. To address this, combining trend-following with complementary strategies like long-short quality can provide more reliable protection and enhance portfolio defensiveness. In this paper, we explore how these strategies can work together effectively.

Rolling the dice

Figure 1, below, highlights the unpredictability of trend-following returns during sudden volatility shocks. We plot the 3-day forward change in the level of the VIX volatility index against the forward 10-day return of the *Société Générale (SG) Trend Index* – an index of ten trend-following managers designed to be representative of the managed futures space – dating back to 2000. We opt for a 3-day window for the VIX index as it aligns with the duration of the volatility spike in August, and a 10-day window for the SG Trend Index, as this is typically much shorter than the trends the trend-following industry attempts to capture.

Figure 1: Trend-following performance during volatility spikes



Source: Société Générale and Bloomberg; between 1 January 2000 to 31 August 2024. Trend-following represented by SG Trend Index.

1 Fung, W., and D. Hsieh, "Empirical Characteristics of Dynamic Trading Strategies: The Case of Hedge Funds", The Review of Financial Studies, 2, 275-302

At first glance, it is obvious that trend-following performance during rapid volatility spikes follows no discernible pattern. For instance, the initial VIX spike during the COVID-19 outbreak in March 2020 (green dot in Figure 1, page 31) was profitable for trend-following, with the SG Trend Index gaining +1.1% as a result of long fixed-income and US dollar positions. In contrast, in August 2024 (red dot in Figure 1, page 31), trend-following performance was sharply negative (-4.2%), with long stocks and US dollar positions being the main culprits. As we said, a roll of the dice.

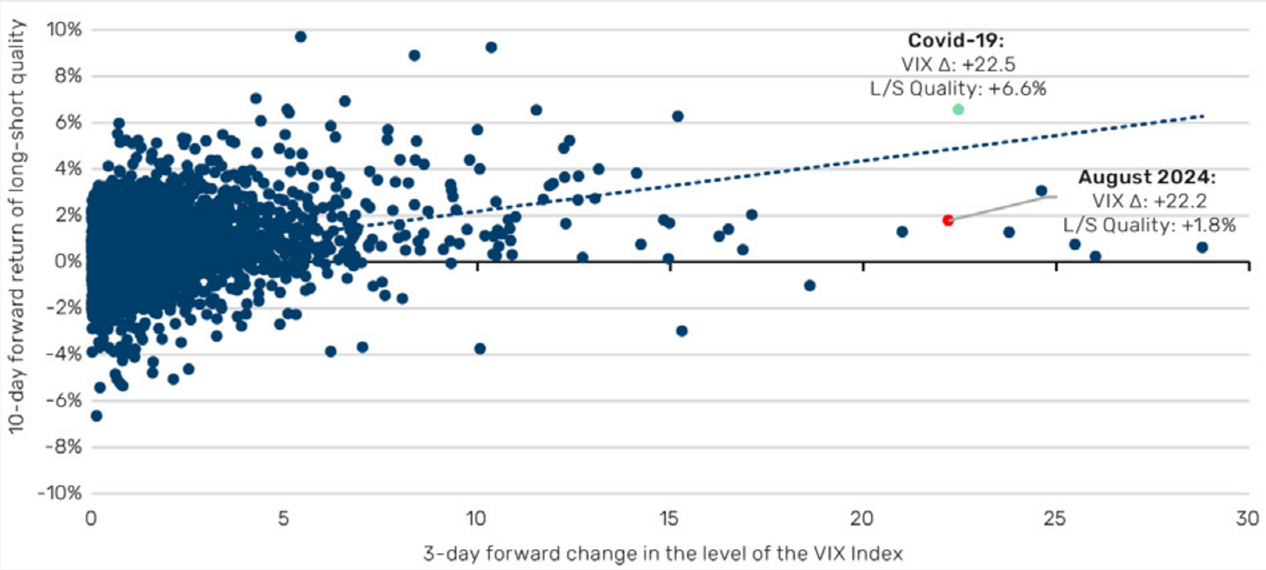
Where the dice are loaded in trend-following's favour, however, is when the initial volatility spike is followed by a protracted window of deleveraging across markets, à la the Dotcom bubble and the Great Financial Crisis. Here, trend-following comes into its own, with its 'crisis alpha' properties and observed positive skew (as we discussed in a previous article) generating a worthy second line of defence in portfolios.

Loading the dice

But what about a first line of defence? Option-based strategies, such as a rolling long put, fit the bill but they are expensive. We propose a long-short quality cash equity strategy, which we have highlighted before. Intuitively, these strategies should benefit during a sudden sell-off in risk assets, which generates a 'flight-to-quality' effect in markets.

To illustrate this, we replicate the analysis of Figure 1, page 31, to observe the 10-day forward performance of a long-short quality strategy[2] from the onset of the same 3-day duration volatility spikes. As we noted in a previous paper here, the strategy has been constructed in a dollar-neutral way, which results in a negative correlation to equities. While this negative equity beta undoubtedly contributes to performance during a 'flight-to-quality' event, we find that an internally constructed beta-neutral strategy exhibits positive convexity over the same 10-day window following a volatility spike.

Figure 2: Performance of long-short quality during volatility spikes



Source: AQR Capital Management and Bloomberg; between 1 January 2000 to 31 August 2024. Long/Short Quality represented by QMJ Global Daily Returns.

In contrast to the observations made for trend-following, sudden increases in volatility typically benefit long-short quality strategies, which profited during both the COVID-19 and August 2024 events.

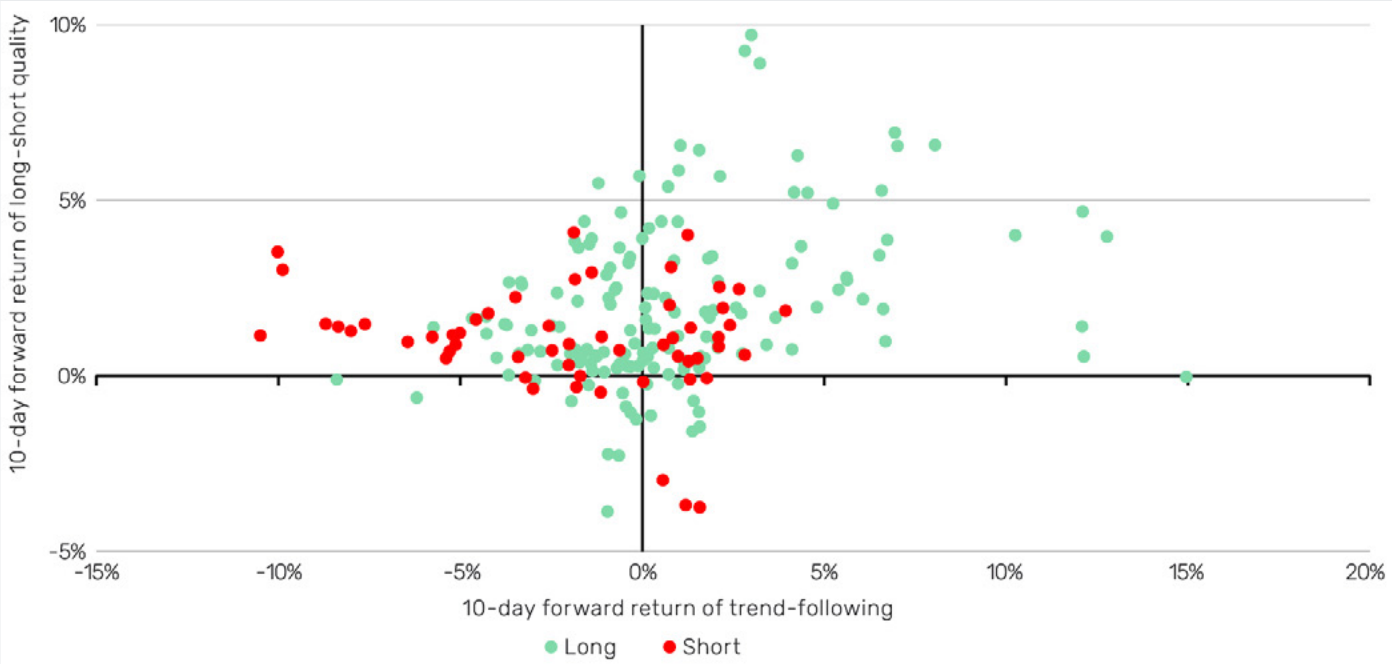
2 Asness, Cliff S. and Frazzini, Andrea and Pedersen, Lasse Heje, Quality Minus Junk (June 5, 2017). Available at SSRN: https://ssrn.com/abstract=2312432 or http://dx.doi.org/10.2139/ssrn.2312432. Daily returns available at https://www.aqr.com/Insights/Datasets

Beating the house

Figure 1, page 31, suggests that the vulnerability of trend-following may be dependent on how the strategy is positioned coming into the spike, or more specifically, whether it is positioned to benefit from a 'flight-to-quality' event or not.

Assuming that bond positioning is a key determinant here, in Figure 3, below, we plot the 10-day forward performance of long-short quality and trend-following strategies during the periods where the VIX has increased by five points or more (97th percentile of moves) over the same 3-day window. The points are then colour-coded based on whether trend-following is long and short on bonds prior to the spike.

Figure 3. Performance of long-short quality and trend-following during volatility spikes, conditional on how trend-following is positioned in bonds prior to the spike



Source: Société Générale, AQR Capital Management and Bloomberg; between 1 January 2000 to 31 August 2024. Long/Short Quality represented by QMJ Global Daily Returns. Trend-following represented by SG Trend Index. Trend-following positioning based of Société Générale's SG Trend Indicator.

Straight away, we can see that long-short quality strategies are well-suited as a first line of defence, with positive returns in nearly 90% of cases. In contrast, trend-following is positive only half the time, with an average return of 0.1%. What drives this uncertainty becomes clearer when we consider how trend-following is positioned coming into a spike, with the average return increasing to 0.9% when the strategy is long bonds, compared to a loss of 2.0% when it is short. This is intuitive as during a 'flight-to-quality' event investors flock to safe-haven assets, such as bonds. Of course, bonds are not the only potential explanatory variable here; positioning in other safe-haven assets, such as the US dollar, will likely also play a part, as would trend-following's overall equity beta.

Ensuring that trend-following is positioned the right way, however, is unfeasible. While leaving things to a roll of the dice may appeal to some, those seeking more certainty could consider a long-short quality strategy to supplement trend-following and bolster defensiveness. For those looking to load the dice further, adjusting allocations based on how defensively trend-following is positioned can enhance strategic advantage, turning chance into calculated opportunity.

All data Bloomberg unless otherwise stated.


Man
AHL
Spot the signals.
Follow the trends.
Discover trend-following
at Man Group:

Golden opportunities in Japan: A new era for global asset managers

Nick Harrold
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Introduction

Japan's investment landscape is undergoing significant transformation, with a growing interest among Japanese investors in private markets. Japan's evolving economic conditions, coupled with demographic shifts, such as an aging population, are prompting Japanese investors to seek higher returns through alternative asset classes. This shift is creating a golden era for global asset managers, who are increasingly focusing on Japan's investor-driven market evolution.

Institutional investors and market dynamics

The growing interest in private markets among Japanese institutional investors has been providing substantial opportunities for global asset managers. The diversity of Japanese institutional investors and asset classes has expanded in recent years, drawing increased attention from international managers.

Japan's rapidly aging population is likely to further drive institutional investors, such as pension funds and life insurers, toward alternative investments as they seek higher yields to meet increasing liabilities. Currently, 29.1% of Japan's population is aged 65 or older, a figure projected to exceed 34.8% by 2040.[1]

However, as of June 2023, Japan-based private capital funds manage assets totalling US$115 billion, according to Preqin data. This figure includes foreign investments but represents only about 4% of Japan's pension fund assets. This proportion is insufficient to satisfy the investment needs of all Japan-based institutional investors, prompting them to allocate funds to international managers in the US, EU, and beyond.

HNWs, retail investors and government initiatives

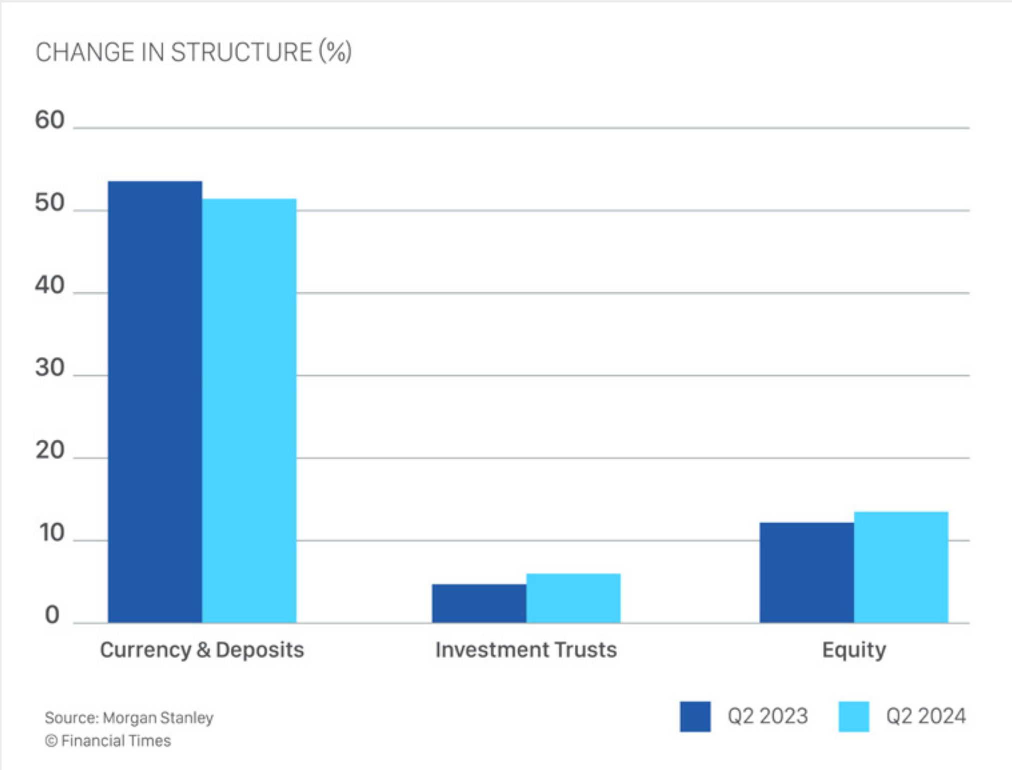
Japanese households possess approximately US$14 trillion in assets, with over 50% of this amount held in cash and deposits.[2] In contrast, US households keep a mere 13% in similar liquid forms.[3] The Japanese government, acutely aware of the increasing pressures on the public pension system, is seeking to shift the national mindset from saving to investing and has a stated aim to double household investment income. One of the ways it is actively promoting investment is through

1 National Institute of Population and Social Security Research
2 https://asia.nikkei.com/Economy/Japan-households-financial-assets-hit-record-14tn-onstock-Rally
3 Financial Times article dated 14 December 2023 "Can Japan's Legendary Savers Spark a Stock Market Boom".

the expansion of the Nippon Individual Savings Account (NISA), a tax-exempt investment scheme for individuals. The recent authorisation for investment trusts to include unlisted shares in NISA portfolios is anticipated to enhance retail access to alternative assets.

The result of these government initiatives has been an increasing number of private placement and public offerings of global asset managers' semi-liquid funds in Japan, providing HNW and retail investors with exposure to private markets. It appears that these policies are beginning to have some success - the graphic below illustrates the beginning of the shift from cash to equities, although clearly there is still some way to go and, as a result, there remains significant opportunities for global asset managers.

Figure 1



Favoured asset classes

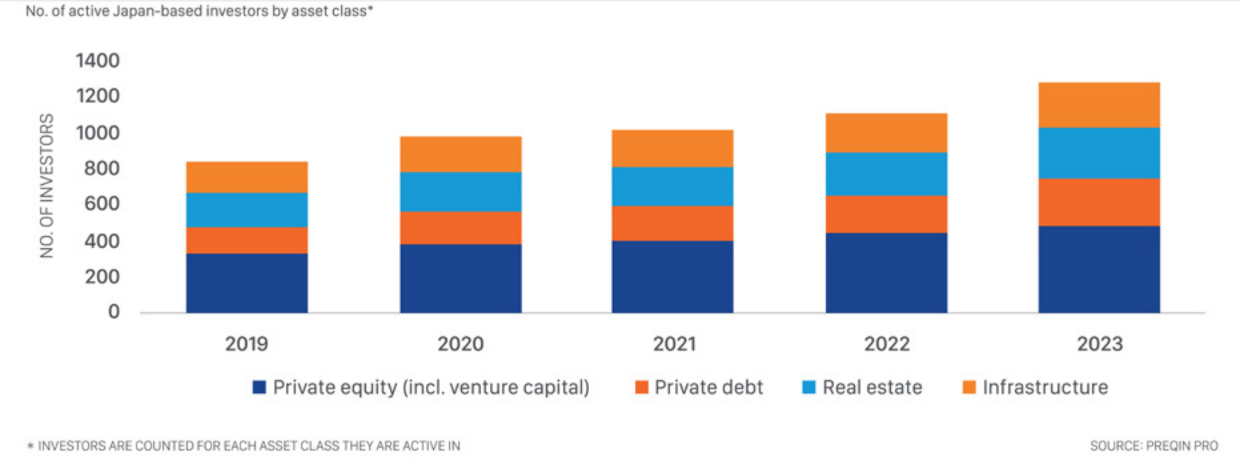
Private credit: This asset class is becoming more attractive to Japanese investors due to its potential for higher yields compared to traditional fixed-income products. The divergence in monetary policy between the Bank of Japan and other central banks has led to a devaluation of the Japanese Yen, making hedging against foreign bond investments more costly. As a result, investors are turning to private credit for its higher return potential.

Private equity: Japanese institutional investors are increasingly drawn to private equity for its potential to outperform traditional equity markets, and retail investors are following suit. The public offering in Japan of unit trusts that serve as feeders to private equity strategies is a notable example of this trend.

Real estate: Real estate is increasingly becoming a popular asset class among Japanese investors, driven by several compelling factors. The search for stable and predictable returns in a low-interest-rate environment has led investors to consider real estate as a viable alternative to traditional investment channels. The asset class offers the potential for capital appreciation and income generation, which is particularly appealing in the context of Japan's aging population and the need for higher returns to secure retirement.

Infrastructure: With their stable, predictable cash flows often linked to inflation, infrastructure investments are increasingly favoured by Japanese institutional investors as a hedge against market volatility. Recent developments include the use of various fund structures to provide exposure to infrastructure investments.

Figure 2: Japan Investors icreasingly active in alternatives



Types of investment vehicles used by Japanese investors

Japanese investors utilise a diverse array of investment vehicles across various jurisdictions. The unit trust and the exempted limited partnership (ELP) are typically the investment structures of choice for Japanese investors. The ELP is particularly well-suited for situations where contractual flexibility and tax transparency are paramount. However, the surge in interest in alternative investments has also led to the development of a novel unit trust investment vehicle, the Private Equity Type Unit Trust. This structure can offer several benefits for investors seeking exposure to alternative investments, including investor familiarity, tax advantages, off-balance sheet accounting, and the potential for JPY hedging.

Conclusion

The increasing interest in private markets across all Japanese investor types, HNWs, retail and institutional, coupled with supportive government initiatives, presents significant opportunities for asset managers and is resulting in an increasing number of global asset managers entering the Japan market. Asset managers looking to capitalise on these opportunities should consider the unique preferences and needs of Japanese investors when structuring their investment products.

How the right employee benefits will optimise your organisational wellbeing in 2025

David Cartwright Forbes
Divisional Director, Head of Specialist Markets
Gallagher

In 2023/2024, disengaged employees are reported in our State of the Sector as the second highest barrier to success, with 32% of employees indicating it as an ongoing issue. What's more: the wider cost of this decline in employee engagement is astronomical, causing UK businesses to lose around £257 billion each year. So, what's the culprit of this downward trend in workplace engagement?

Before you rush to invest in more beanbag chairs, healthy office snacks or social mixers, I'm here to tell you the answer lies somewhere far deeper than these surface-level benefits. In fact, research shows that while most workplaces believe they're promoting top-tier benefits in the office, very few are actually embodying what it truly means to care for your employees and cover the most important facet of employee engagement and retention today: employee wellbeing.

What if I told you that truly investing in a proper wellbeing programme goes far beyond simply attracting talent and crossing it off your list for legality's sake? Research from a leading benefits app in the UK has proved taking it a step further and adding gamified wellbeing benefits into the mix has the potential to 3x benefits engagement and drive a 181% ROI on your benefits investment.

Not to mention, an ERS report that monitored the impact of better health and wellbeing programmes in organisations found that 82% of those surveyed companies saw a significant decline in absenteeism.

Organisational wellbeing has been overlooked for far too long, and now is the time to truly start leveraging the biggest asset in your business: your people. This doesn't have to mean significant changes or blindly investing in costly perks. We're going to talk about the simple, data-backed ways you can make employee wellbeing a priority, and how to implement these strategies for success.

Your monthly social events aren't cutting it

While many businesses believe they're running a people-first business and offer every benefit under the sun to keep their employees happy, very few address the true meaning of workplace wellbeing and how to effectively deliver it to their employees.

That's why the first thing businesses need to start with is a full assessment of your benefits and approach to wellbeing in the workplace, then measure it up against what your employees actually need.

Recent studies have shown that while 2/3 of employers (66%) believe their employees "very much" appreciate their benefits, only 21% of employees express that same sentiment. That's a huge gap, and it's because employers aren't communicating enough with their employees.

The best way to understand what your people care about is simple: ask them.

Use anonymous surveys, one-on-one meetings, focus groups and regular internal reviews to truly understand what's working and what isn't. Although what matters most to your employees will depend on your demographic and will be specific to your industry, here are three leading priorities of employees across industries today:

1. Wellbeing benefits

The best way to truly understand if there is a sense of wellbeing in the workplace is to ask yourself: *Do my employees feel psychologically safe?*

Wellbeing can only be fostered when mental wellbeing is considered just as much as physical wellbeing. It's key in fighting burnout, presenteeism and has been proven to have an impact on overall wellbeing of an individual. If you've been able to craft a culture where people aren't afraid to speak up, take time off, and create healthy boundaries without fear of punishment, you also won't have an issue with employees speaking out about what matters most to them.

This can begin simply by opening regular meetings with mental health check-ins, educating on the matter, and training your managers to host authentic, one-on-one catch-ups that foster a more psychologically safe space.

2. Competitive financial benefits

More people than you would think are worried about their financial wellbeing and this stress has been shown to negatively impact workplace performance. Part of improving employee engagement is considering physical, mental and financial wellbeing as part of your overall people strategy.

The specific type of financial benefits will vary depending on your demographic, which is why it's important to research into your unique team's needs and find what type of financial resources would benefit them the

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most at their stage in life. This can help to keep them engaged and away from spending their mind space worrying about their finances.

3. Flexibility in the workplace

Flexibility in the workplace is high on the list of important benefits for employees of all ages. Research done by YouGov and Investors in People (IIP) found that 90% of employees who were offered flexible working opportunities felt it to be the most important influencer of wellbeing at work.

While the return-to-office movement is clearly visible, you might want to take a step back and re-assess what this does for engagement and overall employee satisfaction. Although it might satisfy the need to have an eye on your employees, flexibility not only makes life more manageable for those with families and responsibilities, but also allows them to feel trusted and respected at work.

When you look at surveys highlighting the top-rated employee benefits, flexibility is always close to the top of the list. This can be very much role-dependent, with front office positions needing and wanting to be in the office the majority of the time. Flexibility does, of course, have to be balanced, with remote working often cited as a barrier to learning on the job and therefore impacting personal development and career progression longer-term.

So, how do you make this a success?

Now, you might already offer comprehensive benefits, so what's going wrong? Oftentimes, the problem lies in the execution of workplace benefits and clear, regular, effective communication.

Gartner reported in their research that 96% of organisations were offering mental wellbeing support but only 42% of employees were actually aware of them. This is a prime example of offering the right type of benefits but using the wrong delivery methods. It's worth asking yourself: How are you reaching your employees with information surrounding benefits? How are you optimising communication around those benefits? Is it easy for them to regularly engage with those benefits?

Here are some simple ways to think about this:

Make them accessible: Mobile apps and technology are becoming increasingly popular amongst insurance and benefits companies, allowing benefits platforms to be easily accessible, and removing any barriers or extra steps to make claims and file paperwork. Opt for a benefits platform that makes your employee's ability to benefit from their benefits easier, not harder.

Make them compelling: The story you tell around your benefits is key. Let them know often, let them know with enthusiasm and let them know in detail just how easy it is to take advantage of the resources you're offering. Many benefits providers are trying to be relatable, simple and more appealing to the eye so that when engaging with their benefits, it's not a stuffy or mundane experience, but an appealing and attractive one.

Make them rewarding: A simple method that many insurance and benefits providers are investing in to boost engagement in wellbeing initiatives is gamification, where there are game mechanics built into the benefits platform to drive engagement. Not only are these gamified benefits platforms allowing the employee to engage more with their wellbeing, but they can also provide them with financial rewards and lower insurance premiums as a result. It becomes a win-win scenario for the employee and your insurance costs, not to mention your engagement rates, will also reap the rewards. In fact, implementing game elements at work has been shown to make 87% of employees feel more socially connected.

Next steps

Highly-engaged employees are 57% more effective and 87% less likely to leave an organisation, according to Deloitte's 2021 Engaging the Workforce Report. If your goal is to boost engagement in 2025, you have to truly understand the impact of employee benefits and wellbeing in the workplace, and that all of these changes begin from the top down.

Truly caring for your employees value goes beyond monthly free lunches, healthy snacks in the kitchen and the occasional work-from-home days. None of the above matters if your employees aren't operating in an environment where they feel valued, compensated and psychologically safe. Wellbeing is weaved into the small, mundane and fundamental approaches in your business. How you greet your employees and how you give feedback; if it's not fostering a positive workplace culture, your engagement is going to suffer as a result.

So, if you're going to take away anything from this article, let it be this:

1. Focus on building psychological safety before anything else
2. Invest in a wellbeing programme with benefits people actually want
3. Invest in financial benefits that align with your workforce demographic
4. Offer flexibility – because benefits aren't a one-size-fits-all solution

If you can accomplish these four things, you're on track to a healthier, happier workplace in 2025.

Mastering employee compliance: Essential strategies for CCOs

Mastering compliance is no longer just about ticking regulatory boxes – it is a strategic imperative that drives future growth. An effective compliance programme requires leadership that has a deep understanding of regulatory requirements and creates a culture where compliance is built into everyday operations.

Chief Compliance Officers (CCOs) and compliance leaders should promote continuous education and empower employees to take a proactive role. When employees see compliance as a shared responsibility rather than an obligation, adherence improves, ethical decision-making strengthens, and organisations establish themselves as trusted leaders in their industry.

By leveraging robust training programmes, regulatory technology, and a strong compliance-driven culture, firms can mitigate risk, enhance operational efficiency, and gain a competitive edge.

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Engage employees with meaningful compliance training

Training programmes form a vital pillar of compliance; if training falls short, employees will disengage, and critical information is quickly forgotten. To embed compliance into company culture, training must be dynamic, continuous, and applicable to the real-world scenarios. For some firms, training must go beyond generic compliance topics to cover specialised areas such as insider trading laws, personal trading policies, and regulatory reporting requirements.

Enhance the effectiveness of your firm's compliance training by implementing these strategies to improve engagement and retention.

- **Commit to continuous learning:** Regularly update employees on the latest regulations and industry trends. Effective training programmes should include frequent updates to keep staff informed and prepared.

- **Introduce interactive learning:** Incorporate engaging methods such as gamification, simulations, and scenario-based exercises. Interactive training helps employees retain information better and apply it in real-world situations.

- **Perform regular assessments:** Use mock exams and periodic reviews to evaluate employees' understanding of compliance requirements. This approach will help identify knowledge gaps and reinforce key concepts.

Optimise compliance with technology and expert support

The most effective compliance programmes strike a balance between risk management, resource management, and repeatable processes. Utilising technology and outsourcing is key to optimising efficiency and maintaining a balanced risk management strategy.

Here are some best practices to enhance compliance operations with the right mix of automation, outsourcing, and proactive industry engagement.

- **Explore regulatory technology tools**: Utilise technology to streamline employee compliance processes and automate routine tasks. Regulatory technology can enhance efficiency and accuracy in daily compliance-related activities. Early adoption of regulatory technology allows your firm to establish a solid compliance foundation that can easily scale as your business grows, helping to mitigate risk and adapt to increasing regulatory demands.

- **Integrate technology with a compliance-driven culture**: It's important that technology doesn't work in isolation. Ensure that regulatory technology is seamlessly integrated into your organisation's compliance culture, where employees at all levels understand its value and how it supports overall compliance goals. This integration enhances adoption and maximises the technology's effectiveness.

- **Outsource with confidence:** Collaborate with compliance consultants and industry experts to gain insights and best practices. Leveraging strategic alliances can provide valuable support and elevate your firm's compliance programme.

- **Stay ahead of regulatory shifts:** Participate in industry conferences and stay up-to-date on regulatory changes. Actively participating in industry networks and regulatory discussions helps ensure your firm stays ahead of new trends and evolving compliance demands.

Cultivate a compliance-first culture

With a proactive, strategic approach to compliance, your business is not only safeguarded, but primed for growth and longevity. When compliance is embedded into daily workflows rather than treated as an obligation, adherence becomes second nature.

Compliance must be integrated into every decision-making process, especially in industries where decisions are often made in real-time.

The most effective compliance programmes strike a balance between risk management, resource management, and repeatable processes.

Utilising technology and outsourcing is key to optimising efficiency and maintaining a balanced risk management strategy.

This approach helps ensure that employees understand how their actions influence the firm's long-term success, not just in terms of compliance, but also in building a reputation for integrity and sound judgment.

Cultivate a compliance-first mindset across your organisation with some of these key strategies.

- **Establish clear communication:** Clearly articulate compliance expectations and the importance of adhering to regulations. Open and transparent communication helps employees understand their roles and responsibilities.
- **Encourage open dialogue:** Create an environment where employees feel comfortable discussing compliance issues and seeking guidance. Encourage proactive communication to address potential concerns before they escalate.
- **Set the tone at the top**: Embed compliance into leadership priorities to showcase its value as a business advantage rather than a regulatory obligation.
- **Set clear expectations:** Implement clear compliance goals and performance metrics. Ensure that employees understand how their actions impact the organisation's overall compliance efforts.

Strengthen employee compliance, strengthen your firm

By integrating these strategies, firms can move beyond regulatory checklists and to-do's and start fostering a culture where compliance becomes instinctive. A proactive approach does more than mitigate risk; it strengthens operational efficiency, reinforces accountability at every level, and ensures firms are prepared to meet regulatory challenges with confidence. Compliance should not be viewed as a series of isolated tasks, but as a dynamic part of business success.

For CCOs and compliance leaders, the goal is not only to enforce policies, but to establish a framework where compliance is embedded into every decision. A compliance-first mindset helps employees understand how their actions affect the firm's reputation, stability, and long-term success, making compliance an integral part of their daily responsibilities. Organisations that cultivate this perspective are not only more resilient to regulatory scrutiny, but also position themselves for sustainable success in a competitive market.

Thank you for reading the
Edition 141 of the AIMA Journal.

If you would like to contribute to future editions, please email Caterina Giordo and Jorge Palmero.

PUBLICATION PLAN 2025

- Q2 Edition 142

Deadline for submission 5pm UK time Monday 19 May | Publication Monday 23 June

Please note the deadline for reserving a spot for the Q2 edition of the AIMA Journal is 5pm UK time Friday 2 May.

- Q3 Edition 143

Deadline for submission 5pm UK time Monday 21 July | Publication Monday 22 September

Please note the deadline to reserve a spot for the Q3 edition of the AIMA Journal is 5pm UK time Friday 4 July.

- Q4 Edition 144

Deadline for submission 5pm UK time Monday 20 October | Publication Monday 24 November

Please note the deadline to reserve a spot for the Q4 edition of the AIMA Journal is 5pm UK time Friday 3 October.

Please note that availability is limited, and we cannot accept any additional contributions once all the spots have been filled.

We kindly advise all contributors to email us prior to submitting to make sure we can include the contribution. We can't guarantee the inclusion of any last-minute submissions.

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