The future is bright
Asset Management Conference
Executive Summary

Just six years from now, the asset management industry is likely to look very different from the way it does today, as nearly 100 delegates gathered in both Sandton and Cape Town for PwC’s South African Asset Management Conference held in April.

An ever evolving regulatory landscape, the disruption of traditional business models by high-tech and social media platforms, the rise of a new breed of asset managers, and greater scrutiny from global tax authorities are likely to have an effect on an environment that will be uncomfortable for some, but will also offer many benefits and opportunities for others.

In a rapidly changing and challenging industry, asset managers are trying to maintain their growing volumes and revenues, while at the same time manage the cost base, deliver satisfactory customer outcomes, and generate acceptable returns for their shareholders. This all has to be done under increasing regulatory scrutiny with specific focus on customer protection and fairness, and taxation.

The PwC asset management conference marked the launch of a study issued by PwC, titled Asset Management 2020, A Brave New World, which focuses on the likely changes in the asset management industry over the coming years. It identifies key trends which are expected to have profound implications for asset management.

The study sets out how the operating landscape for asset managers will change by 2020 and explains how asset managers can prepare for the challenges ahead and turn them into competitive advantages.

Pressures on the asset management industry

The study predicts that global assets under management (AuM) will rise to around $101.7 trillion by 2020, from a 2012 total of $63.9 trillion. However, alongside this rising asset base, there will be increasing costs. The costs of complying with regulation will remain high. Commercial cost pressures will rise as firms grow their distribution networks, compelled to go regional and international as clients want access to financial markets across numerous geographies. Investment in technology and data management will need to be maintained or increased to maximise distribution opportunities and to cope with regulation and reporting. Fee income will also be under pressure amid the ongoing push by clients and authorities for greater transparency and comparability.
**Nothing to hide, nowhere to hide, and nothing at risk**

Regulators are at an advanced stage with their work with the banking sector and have now turned the spotlight on to the asset management industry. Full transparency over investment activity and products will exist at all levels; there will be nowhere for non-compliant managers to hide as regulatory and tax reciprocal rights criss-cross the globe.

Clients are becoming more sophisticated. Retail clients want their asset managers to communicate with them through social media – and they want to communicate back in this way. They are also interested in less traditional investments and are showing an appetite for passive exchange traded funds but also for products from hedge fund managers and private equity houses. The emerging countries are offering notable opportunities in their mass affluent and high net worth markets. Sovereign wealth funds have their own unique requirements, urbanisation is driving growth in infrastructure funds, corporate credit funds have their own appeal, and longevity is driving the need for suitable healthcare funding products. Asset managers should be equipped to service these emerging and growing investment needs at optimum levels through tailored solutions.

**South African players**

For South African asset managers, these same challenges, trends, opportunities and game-changers are evident. An equivalent of the UK’s Retail Distribution Review legislation is being implemented in South Africa. Additionally, South Africa is part of the SAAAME region which is becoming increasingly attractive to global asset managers. The African continent is an attractive market, with many countries boasting significant GDP growth rates, and South Africa's emerging consumer base is building up wealth which can be invested. South African asset managers must respond to all of these opportunities in their own geography - or risk that regional and global players will.

**Prepared for the 21st century**

Global, local and niche asset managers need to be equipped for the 21st century. This means being prepared in terms of compliance, transparency, technology, client service levels, and a range of products - while effectively managing the cost base.
The world today: an overview of key trends we are seeing globally

“The asset management industry is experiencing a pleasing recovery and growth post the 2008 crisis, but uncertainty and volatility remain,” says Barry Benjamin, PwC Global Asset Management Leader (and US Asset Management Leader), leading a PwC asset management specialist panel.

Panel debate and discussion emphasised similar themes and common trends seen across the world in the asset management industry. In many jurisdictions we are witnessing extensive regulatory changes and a move towards globally coordinated tax rules. Technology has been neglected during the post-crisis years, with asset managers often relying on legacy systems, necessitating urgent need for investment in IT.

The rise of social media is posing its own challenges, and retail distribution channels in particular are working out how best to use this phenomenon – not only in terms of the messaging they should be sending out, but also in how to effectively use the information they receive and how this can improve their product offerings and client service levels.

The clients of today’s asset management industry are more informed, tech savvy and have heightened expectations. They want to be able to access investments across countries and this is driving a revolution in digital distribution platforms and cross-selling. They are cost conscious and are challenging fee models and scrutinising what they are paying for. Fee transparency is a priority for both clients and regulators, and the longstanding ‘all-in’ fee model is starting to disappear.

Clients are also more informed when it comes to products and are increasingly seeking out less traditional products such as exchange-traded funds and alternative asset classes including hedge fund and private equity offerings. The traditional asset managers are now looking at how they can offer these progressive products to their clients, and the non-traditional players are looking at how to penetrate the more traditional distribution channels. Overlap and convergence are becoming evident.

Asset managers are being challenged on both revenues and costs – as fees come under pressure, there is margin compression; and costs are always a concern, with regulatory compliance now adding significantly to the cost base of an asset manager.

Benjamin highlights the clear trends of today’s industry. “We are seeing the rise of asset management in the broader financial services sector, a revolution in product distribution channels, fee transparency and scrutiny from global tax authorities, greater use of alternative investment products, as well as global mega-managers who want a far-reaching presence. All of these trends are pushing transformation in the asset management industry and the response should be an industry fit for the 21st century.”
John Parkhouse, PwC EMEAI Asset Management Leader, says: “The study goes on to examine six powerful game changers that asset managers will have to analyse and address in order to capitalise on the opportunities that the changing landscape presents.”

The world tomorrow: Game changers that will redefine the industry

We believe the six game changers will be the following:

• **Changing demographics force asset management to take centre-stage**: Asset management has long been in the shadows of its cousins in the banking and insurance industries. By 2020, it will have emerged definitively from their shadows.

• **Distribution is redrawn – regional and global platforms dominate**: By 2020, four distinct regional fund distribution blocks will have formed which will allow products to be sold pan-regionally. These are North Asia, South Asia, Latin America and Europe. As these blocks form and strengthen, they will develop regulatory and trade linkages with each other, which will transform the way that asset managers view distribution channels.

• **Fee models are transformed**: Most markets today operate with a model that embeds distribution and management fees in some shape or form and misaligns distributor objectives with those of the investor. By 2020, virtually all major territories with distribution networks will have introduced regulation to better align interest for the end-customer, as shown in the UK’s Retail Distribution Review (RDR) and MiFID II. This is likely to increase the pressures of transparency on asset managers, with a resultant significant effect on the cost structure of the industry.

• **Alternatives become more mainstream, passives are core and ETFs proliferate**: Traditional active management will continue to be the core of the industry as the rising tide of assets lifts all strategies and styles of management. But traditional active management will grow at a less rapid pace than passive and alternative strategies, and the overall proportion of actively managed traditional assets under management will shrink. The study predicts that alternative assets will grow by about 9.3% a year between now and 2020, to reach $13 trillion.

• **A new breed of asset managers emerges**: 2020 will see the emergence of a new breed of global managers, one with highly streamlined platforms, targeted solutions for the customer and a stronger and more trusted brand. These managers will emerge not only from the traditional fund complexes, but also from among the ranks for large alternative funds, too.

• **Asset management enters the 21st century**: Asset management operates within a relatively low-tech infrastructure. By 2020, technology will have become mission-critical for driving customer engagement, mining data for information on clients and potential clients, improving operational efficiency, and regulatory and tax reporting. At the same time, cyber risk will have become one of the key risks for the industry, ranking alongside operational, market and performance risk.
Asset management takes centre stage

Highlighting the unprecedented structural changes triggered in the industry by the recent economic crisis, Raj Kothari, PwC Global Assurance Leader: Asset Management, and the facilitator of the panel discussion on the game changers for the industry, notes that the industry is recovering with increased AuM. “Despite this resurgence, there are still many challenges. There are heightened expectations from clients and regulators, and asset managers will need operational excellence to drive their performance.” Raj notes that optimism is prevalent in the industry. “Asset managers are hiring new staff, planning mergers and acquisitions, entering into joint ventures, and investing in new technology. But costs still remain an issue, as does regulation,” he adds.

Reflecting on the experiences of the Asia-Pacific region, Robert Grome, PwC Asia-Pacific Asset Management Leader, says there are “great stories” in the asset management industry in this region. “Fortunately the financial crisis was not unkind to Asia. And over the past few years, significant funds have been flowing into emerging markets. Australia has a large retirement landscape with huge pools of money that require investment. There are also enormous funds sitting in Japanese banks.”

Grome showcases China as being the obvious headline story in the region. “China is a huge investor in Africa and has the only sovereign wealth fund dedicated to development in the continent. It is also an innovative and experimental presence in the asset management industry and we are seeing the creation of huge online funds in the country aimed at the retail investor who can transact for very small investment amounts.”
Distribution is re-drawn

Parkhouse, points out that distribution models are being significantly redrawn, largely due to advanced technology such as digital platforms as well as cross-border developments that allow selling into different geographies. “We are seeing initiatives such as the Asia Region Fund Passport, the emergence of regional blocks, and accommodating legislation which facilitates the worldwide distribution of products.” Parkhouse notes that alongside these new distribution modes are the non-asset managers, such as the global technology firms. “They are able to use their platforms for distribution and for fund data purposes, and could have a disruptive influence on the industry.”
Fee transparency goes global

The advisory fee is also a consistent theme in the asset management industry currently, and regulators are evaluating payment models in an effort to rebuild customer trust and professionalise services. “The regulators are scrutinising commissions, increasing disclosure, unbundling the various components of advisory fees and even excluding certain points in the value chain from forming part of the fee charges,” adds Parkhouse. “The PwC theme of ‘Nothing to hide, nowhere to hide, and nothing at risk’ is clearly evident in the tax and fee reforms.”
A new breed of global mega-manager

Parkhouse cautions that the mega-managers should avoid a ‘too big to fail’ mentality. However, he is highly optimistic that the evolving asset management industry will be able to take centre stage and move out of the shadow of the insurance and banking industries. “Asset management will no longer be a banking adjunct. The industry should be able to offer solutions on retirement and health care, and service sovereign wealth funds in its own right. Asset managers now have the opportunity to be role models of the financial services sector.”

Highlighting regulatory developments such as the Volcker Rule in the US, the Retail Distribution Review in the UK, and the EU’s Alternative Investment Fund Manager’s Directive, PwC UK Asset Management Leader Paula Smith urged the industry to accept that legislative changes will be a key feature of business. “We cannot ignore these regulatory issues and should rather embrace them head on. It is not good enough to play catch-up or simply tick the boxes. Firms must take a friendlier approach to their regulators and actively participate in discussions on how they want to be regulated.”

Smith also noted that longevity was driving a shift to healthcare products in the asset management industry. She highlighted the rise of sovereign wealth funds, and observed that urbanisation trends were driving the demand for infrastructure. “Asset managers can play a key role in infrastructure funding needs.” Looking at the US asset management industry, Michael Greenstein, PwC Global Asset Management Alternatives Leader, says fund managers will need to look at how best to leverage their businesses through the use of prime brokers and third party administrators.
Tax revolution comes to asset management

Will Taggart, PwC's Global Tax Leader: Asset Management, says that the industry has become a focal point for tax authorities, who are demanding more information and transparency. “We can expect to see more global co-ordination regarding issues such as offshore funds and non-resident investments. As a result of these pushes by the tax authorities, investors are now putting a lot more questions to their fund managers about tax issues.”

Benjamin says: “The tax authorities in many countries globally are focusing on the extensive regulatory changes, as well as the move towards globally co-ordinated tax rules. The authorities are becoming more connected and asset managers must consider this new approach in their compliance, operational risk and technological designs.”

Benjamin also notes an urgent need for IT investment. “Many asset managers still rely on legacy systems and have neglected their technology spend in the years following the financial crisis of 2008. They need to make key decisions on their long-term IT budgets, and look at what should remain in-house and what should be outsourced in order to maximise capital allocation.”

The real estate sector can also provide opportunities to asset managers, and although the global real estate market has recovered, PwC Global Real Estate Leader Kees Hage says it no longer offers easy moneymaking opportunities. “One current trend is that investors are looking at secondary cities and secondary assets, and are being drawn to more interesting locations rather than the obvious ones.” Hage also noted the effect of changing demographics and an ageing EU population on the real estate market.

“Germany is now very attractive, while Eastern Europe has lost its appeal; and Southern Europe is at a turning point, offering some attractive opportunities to investors.”

Moving to the US, Hage says the outlook there is positive. In Asia it has become more difficult to generate returns, but countries such as and Vietnam are now attracting interest. Linked to real estate trends such as urbanisation, infrastructure will need to grow exponentially, he says, and this means governments will have to start sourcing private capital. “This is already being seen in the large increase in the UK market’s infrastructure funds.”

Asset management CEOs are increasingly optimistic this year, reflecting the recent rise in equity markets and a strong outlook for their businesses over the years to 2020. They’re actively investing for growth, looking to make acquisitions, add headcount and increase technology spending.
“As part of PwC’s Asset Management 2020 research, we also conducted the Project Blue survey to enable us better understand the thinking of market players” says PwC Asset Management for Africa, Ilse French. 117 asset managers from 16 countries participated in the survey. The respondents represent a total of 31 trillion USD assets under management. There were 11 respondents from South Africa. The survey findings are divided into two regions; those from developed countries, which include Canada, France, Germany, Ireland, Italy, Japan, The Netherlands, Sweden, Switzerland, UK and US as well as SAAAME respondents which include Brazil, China, Hong Kong, Singapore and South Africa.

This survey looks at four key areas for asset managers:

- future growth strategies;
- revenue and margins;
- product development; and client relationship management and social media.

In addition, the PwC 17th Annual Global CEO Survey was carried out during this time, and certain observations have been included from this study.

**Future Growth Strategies**

The majority of asset managers are focusing on their home base for future growth and expansion, with 62% of SAAAME managers and 54% of developed country managers indicating that their own country is their strategic focus. For those looking to foreign markets for opportunities, the US, China and the UK are most appealing.

Regulatory compliance was identified as the main barrier to entry or restrictor to expansion for both operations and distribution. The CEO survey further indicates that when making decisions on where to operate, 70% of CEOs see the competitiveness of local tax regimes as a key strategic factor.

Increasing regulation affects all aspects of business and growth strategy, and while 83% of CEOs say that regulation has increased operating costs, and 46% believe it has hampered their ability to innovate, 46% also state it has improved product and service delivery standards. “The majority of CEOs simply ask for clear regulations, designed for the long-term, that allow them to plan” says French.

In the SAAAME countries, respondents consider the local country asset managers to be the major threat to their long term strategy - whereas respondents from developed countries are more threatened by the global asset managers.
“Competition in the industry now comes from traditional as well as non-traditional participants,” says French. “However, the non-financial services entities are not yet seen as threats by our respondents.” French points to a non-traditional player in the South African context.

“We currently have about 5.7 million financially active people without access to financial services, so the role of these players could become more important in the longer term. The Post Office has just launched its product for savings clubs, and given the huge cell phone and retail penetration in our country, the landscape may indeed change for some market segments.”

The intended growth strategy of most asset managers is dominated by organic growth. However, 43% of SAAAME asset managers who have a strategic focus on foreign markets consider joint ventures to be an important growth strategy. “This demonstrates the importance of local knowledge, local people and is often driven by regulation and distribution capabilities,” says French.

**Revenue and Margins**

Revenue growth of over 10% in the next 12-24 months is expected by 55% of participants. In contrast, only 25% expect a margin growth of over 10% in the same period. SAAAME participants are more optimistic about both revenue and margin growth.

“With an eye on tight margins, cost containment or even reduction is still important to this industry,” says French. “But it is becoming less of a priority as CEOs make plans for growth. In fact 58% of CEO’s surveyed plan to hire more staff this year.”

**Product Development**

Almost two-thirds of respondents do not have, or plan to have, differentiated product offerings regarding the age profile of customers. For those who do profile their offerings, the target market is mainly 40-60 year-olds.

Unfunded pension liabilities are seen as an opportunity for the majority of asset managers, in particular for those in developed countries looking to foreign markets. French points out: “In South Africa government policy in respect of retirement reform will have a significant impact in this space”.

Asset managers are putting a stronger emphasis on the development of low risk strategies and absolute return or market neutral products, reflecting investors’ demand for such products.

**Client Relationship Management & Social Media**

Significant or moderate investment in CRM systems was expected by 75% of asset managers in order to meet the needs of their long-term strategic plan. In SAAAME this investment is more moderate.

Social media is considered important, especially in the long-term (five years or more) and particularly for SAAAME asset managers focusing on their own country. The use of apps, social media and digital strategy together with the customer agenda were current key areas of focus for most South African players interviewed.

“Big data, social media and digital communications have the power to revolutionise asset management,” says French.
Asset Management 2020: A South African perspective

Although the South African asset management landscape is small by international standards, it is nevertheless a highly sophisticated industry with increasingly demanding clients. “There are a number of opportunities for industry growth in South Africa, as well as in Africa,” says Pieter Crafford, Financial Services Advisory Leader for PwC South Africa. “But there are a number of challenges, with increased regulation frequently being singled out as one of the key changes impacting the industry”

Crafford highlighted that all the game changers identified in the Asset Management 2020 publication have relevance in the South African market.

Amongst other points, he notes that distribution modes in South Africa will be re-evaluated in the light of the changing regulatory landscape and that industry statistics are confirming the growing prominence of alternative and passive investments. He also points to transformation in fee models as regulators examine and modify fee structures, and warned that legislative changes such as the Retail Distribution Review have notably impacted margins in the asset management industry in the UK.

Crafford emphasises the importance of the SAAAME region, as well as Africa and its many opportunities. “Africa is still small in world terms, but with significant GDP growth forecast for the continent, there will be industry opportunities from its growing mass affluent and high net worth individuals. South African Asset Managers are uniquely positioned to take advantage of the growth across the African continent, but should be well aware that more than 40% of asset managers in developed countries believe the most important geographical area of focus will be the SAAAME region. Competition in this market will be fierce”

Lastly, Crafford gives a short overview into the South African customer of the 21st century, demanding a seamless, integrated and tailored solution.

Panel discussion

The conference concluded with a lively panel discussion on topics specific to AM 2020 in both Sandton and Cape Town.

Panel members included:

Sandton
- Stewart Rider, Chief Operating Officer at Stanlib
- Boshoff Grobler, Chief Executive Officer at Ashburton Investments
- Ian Hamilton, Group Chief Executive Officer at IDS Fund Services

Cape Town
- Johan van der Merwe, Chief Executive Officer at Sanlam Investments
- Rob Dower, Chief Operating Officer at Allan Gray
- Ian Hamilton, Group Chief Executive Officer at IDS Fund Services

Conclusion

It’s an exciting time for the asset management industry worldwide. The coming years will bring the industry higher volumes of assets than ever before which places more responsibility on firms to manage these assets to the best of their collective ability. Asset managers must clearly outline the value they bring to customers while being fully transparent over fees and costs.
South African Asset Management Team

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