# Virtuelles Investmentforum 2020:

# Asset Management Perspektiven


Break-Out-Session
Christian Gürtler und Dr. Utz Helmuth
23. Juni 2020

pwc strategy&

# Agenda

"It's March 11, 2020. As Wei boards her train in the suburbs of Beijing, heading for her office in the capital of the world's biggest economy, she checks her mobile device. She has been sent a message from international dating company eMatch's sister site, eMatch Investments."

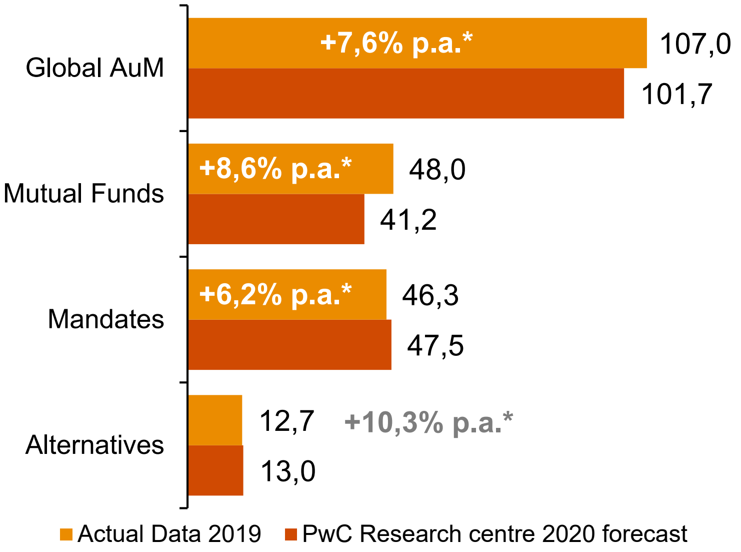
*PwC Asset Management 2020: A Brave New World © 2014*

# 1

## A look back and where we stand now

# Close to the target: What we predicted in our global Asset Management 2020 report and where we actually are today

## Global AuM development (in USD tn)




CAGR 2012 - 2019

Forecast (also from a German perspective) was too conservative, especially for active funds; last decade with **extraordinary growth in AuM**

## Forecasts and Reality

### AM Landscape 2020

| | |
|---|---|
| Huge rise in assets and shift in investors base | Major bull run; sweeping asset growth since 2012 |
| Pressures on the asset management industry | Rising costs, lower margins and new entrants |
| Nothing to hide, nowhere to hide & nothing at risk | Regulatory tsunami in full force |

### Gamechangers

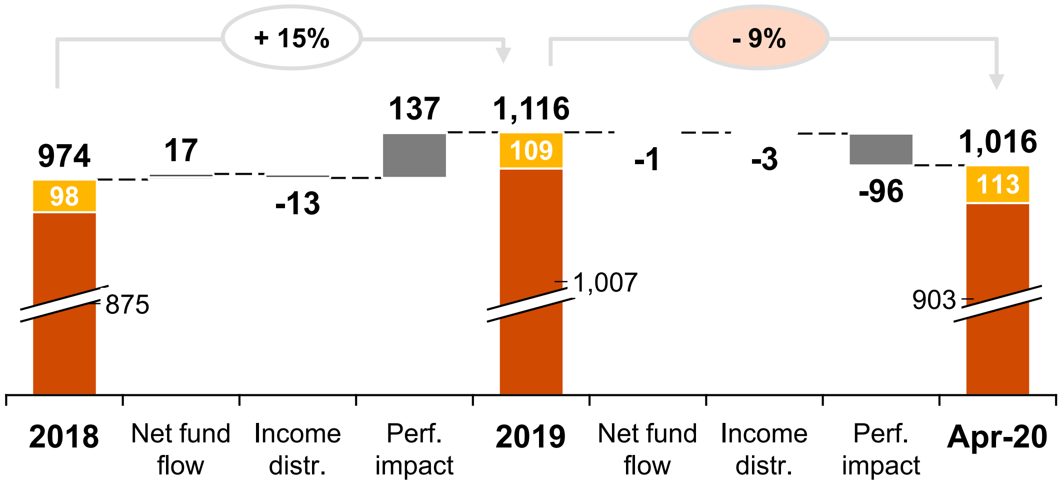
| | |
|---|---|
| Asset management moves centre stage | Outperformed FS sector; more independent firms |
| Fee models are transformed | Inducement restrictions, move to discretionary PM |
| Alternatives become mainstream, ETFs proliferate | Became a must have for sophisticated investors |
| Distribution is redrawn – regional and global hubs | Asian passport / China opening slower than expected |
| A new breed of global managers | True for passives; local fund managers prevail |
| Asset Management enters the 21st century | Mostly still at the beginning of the digital journey |

Achieved Partially Achieved

# After a very good year for German AM in 2019, Covid-19 led to a 5% decline in fund assets by end of April 2020

## Mutual funds (in EUR bn)

- Securities funds impacted by market crisis in Q1, but **recuperating in April**
- Real Estate (so far) **little affected,** but slower fund sales in March / April

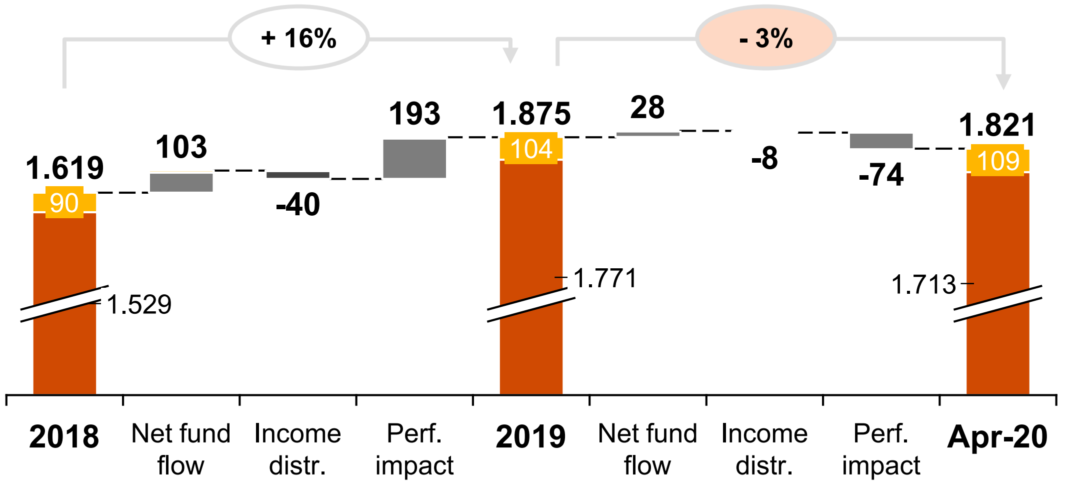



| | Net fund flow | | Income distribution | | Performance impact | |
|---|---|---|---|---|---|---|
| | 2019 | Apr-2020 | 2019 | Apr-2020 | 2019 | Apr-2020 |
| Real Estate | 10.9% | 4.0% | -2.2% | -0.5% | 2.3% | 0.5% |
| Security | 0.8% | -0.5% | -1.2% | -0.2% | 15.4% | -9.6% |

Change in percent of fund assets at beginning of period

## Institutional funds (in EUR bn)

- Institutional clients invest **more conservatively** than private clients
- Net fund flows largely stable in Q1, but **significant redemptions in April**



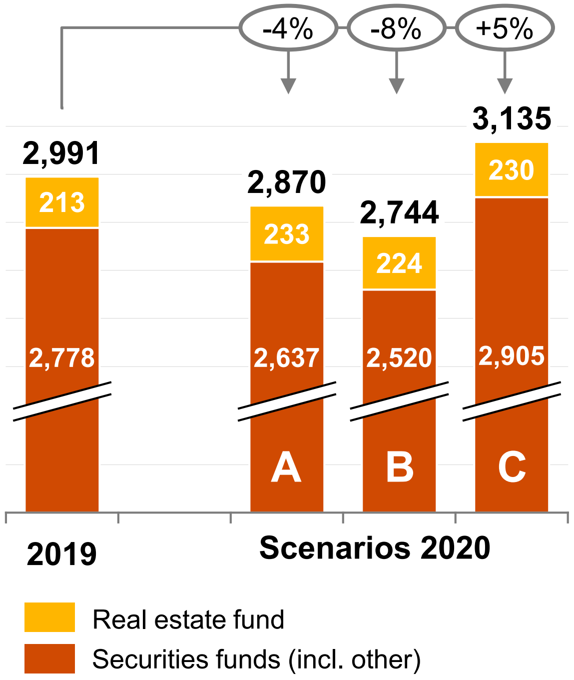

| | Net fund flow | | Income distribution | | Performance impact | |
|---|---|---|---|---|---|---|
| | 2019 | Apr-2020 | 2019 | Apr-2020 | 2019 | Apr-2020 |
| Real Estate | 11.8% | 2.4% | -3.7% | -0.7% | 7.7% | 2.7% |
| Security | 6% | 1.5% | -2.4% | -0.4% | 12.2% | -4.3% |

Change in percent of fund assets at beginning of period

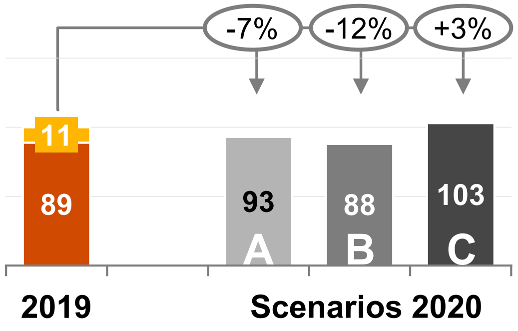
Source: PwC projection based on BVI (FV deducted; adjusted) and Bundesbank; rounded

# Effects in Q1 2020 similar to financial crisis in 2008 – if recovery continues, decline can still be overcompensated

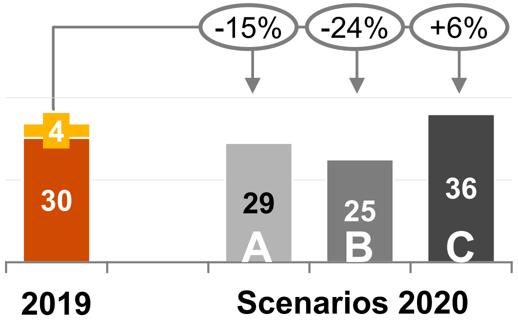
## Fund Assets (in EUR bn)




## Net Revenues




## Gross Profits




## Scenarios

**A**

- Extrapolation from April 2020 to the end of the year
- Current net fund flows annualized; valuation levels unchanged as of end of April

**B**

- Covid-19 with similar effects on asset management as the financial crisis
- Net fund flow and changes in individual asset classes same level as in 2008

**C**

- Situation returns to normal and May-Dec 2020 is in line with the long-term average
- Stock markets recover and remain at current levels (05 June 2020)

Source: PwC projection based on BVI (FV deducted; adjusted) and Bundesbank; rounded; Net Revenues and Gross Profits normalized at 2019 = 100

# We have to carefully analyse the main developments over the past weeks to learn our lessons and to prepare for future crises


**Assets under Management**

+23%

**Difference ETF market price to iNAV**

- 4,85% Before
+3,25% After

* Based on 12 ETFs included in Fed SMCCF program; period 16 Mar 2020 to 05 Jun 2020

## Key observations during the March 2020 Covid-19 market downturn

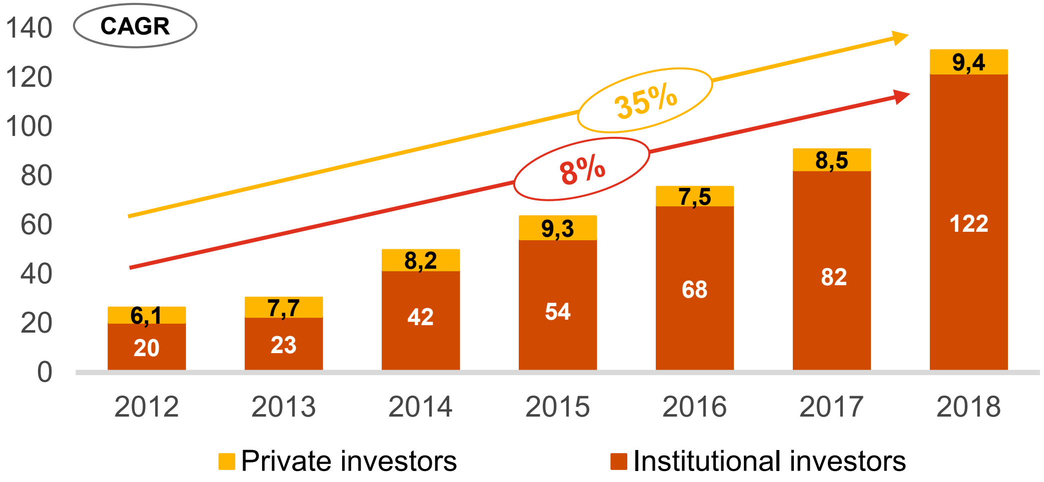
- Operational resilience of most asset managers and service providers; minor hick-ups despite high volumes
- Suspension of redemptions in a number of EU products; liquidity gates in Germany not yet implemented
- Regulators with increased scrutiny regarding and surveillance of fund liquidity risks
- Valuation issues with some instruments due to volatility of markets (some funds with no NAV)
- Collapse of some investment strategies in turbulent markets (e.g. short vola products)
- Increase in volatility causes change in fund risk indicators -> up to 40% of UCITS require KIID updates
- ETF market making provides additional liquidity, but exchange prices with deviations from iNAV
- Passive products (Crude Oil ETFs) contribute to collapse of US WTI futures market
- US Back-Stop saves the corporate bond market from drying out
- Crisis, what crisis? FS sector seems decoupled from real economy
- Still too early to judge impact of Covid-19 on investor behavior and asset performance (e.g. real estate)

# 2

## Six theses on the future of asset management

# Thesis #1: Comprehensive ESG positioning is already a must for a growing client segment with an eco-social focus

## Sustainable investments for private & inst. investors




Source: Sustainable Investment Forum

- **Institutional investors** account for around **93%** (2012: 77%) of sustainably invested funds in Germany
- The average **annual growth of sustainable investments for institutional investors (35%)** is much higher than for private clients (8%)
- **Church institutions and welfare organisations** remain the most important group of investors

## Regulation in the financial sector is evolving

**Objectives**

1. Orientation of capital flows towards a sustainable financial system
2. Environmental, governance and sustainability aspects as a standards in risk management
3. Promotion of transparency and sustainability

**'Green recovery alliance' launched in European Parliament**

An informal alliance has been launched in the European Parliament on the back of calls from 12 EU environment ministers who have signed an appeal for a green recovery from the COVID-19 pandemic.

euractiv.com

Technical Expert Group on sustainable finance

## ESG outperforming conventional investments

- **MSCI** reports that **15 of 17 of their sustainable indices outperformed** broad market counterparts during **COVID-19**
- **Long-term effect**: New study from **Morningstar** supports **outperformance of ESG funds** compared to conventional investments **over the last 10 years**

# Thesis #2: Fund distribution will be redrawn – how to master the Thermomix® challenge?


**Traditional distribution models remain intact (for now)**
Inducement led advice will prevail in retail banks and with (captive) financial advisors, but with diminishing overall importance

**Asset gatherers become increasingly indifferent towards fund providers**
Private banks, wealth manager, robo-advisor, B2C platforms etc. are driving demand for clean share classes and ETFs while looking for ways to stay / become profitable

**Fund platforms consolidate - European champions in the making**
Large players position themselves as neutral providers and get in the way between asset manager and distributors as well as institutional clients

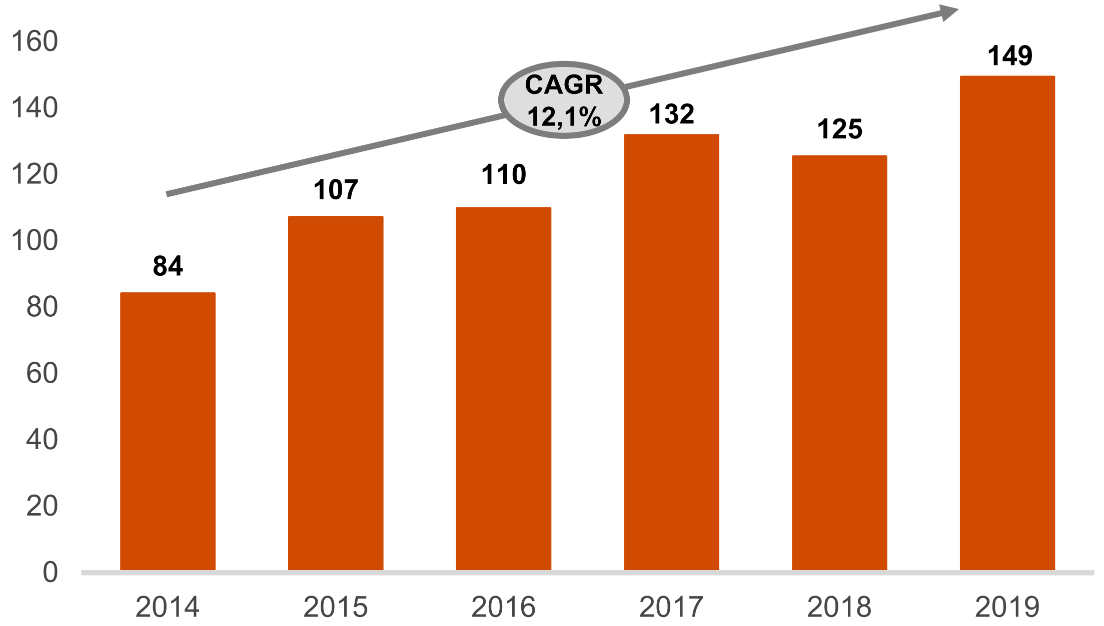
**The number of unsolicited customers is on the rise**
Changing consumer behavior and cost pressures in the financial sector reduce the active sale of investment funds; government sponsored retirement solutions with big impact

**Antiquated sales severely limits the success of product innovation**
However, legacy distribution channels are required to finance ongoing operations

Fund companies need to modernize their distribution strategy and develop new ways to interact with investors and intermediaries

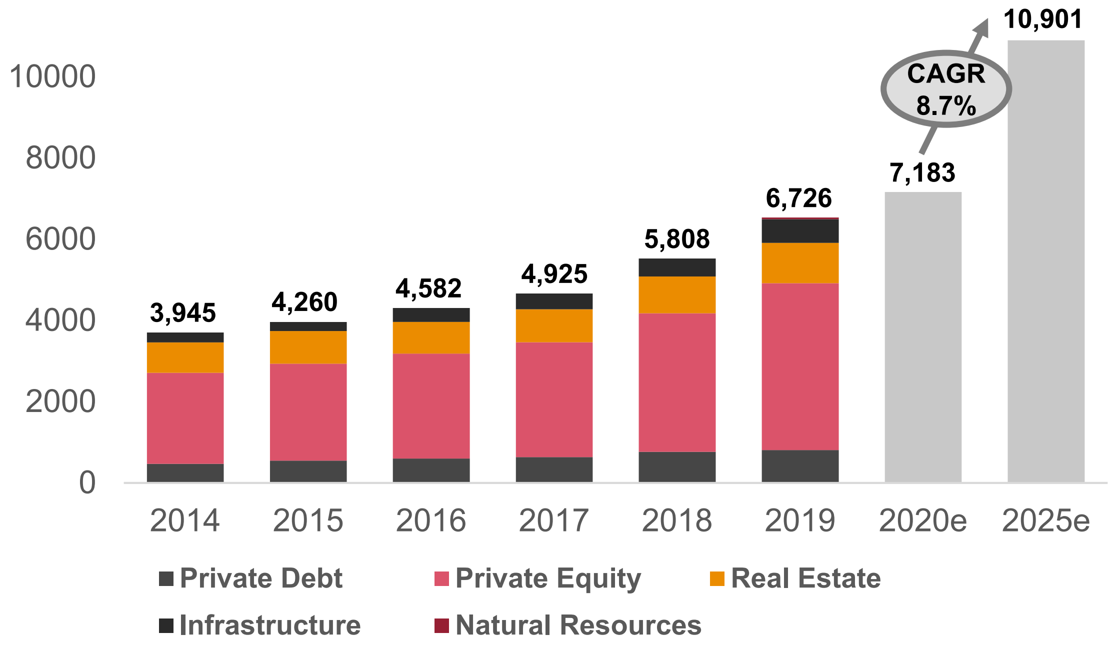
# Thesis #3: Structural change persists – ETF megatrend and continued shift into alternative investments

## ETF volume in Germany (in EUR bn)




- **Continued growth expected in the German ETF market** mainly driven by:
  - Core/satellite asset allocation by institutional investors
  - Increasing potential in the retail business due to changing client behavior
- **Still comparatively low absolute volume** compared to US

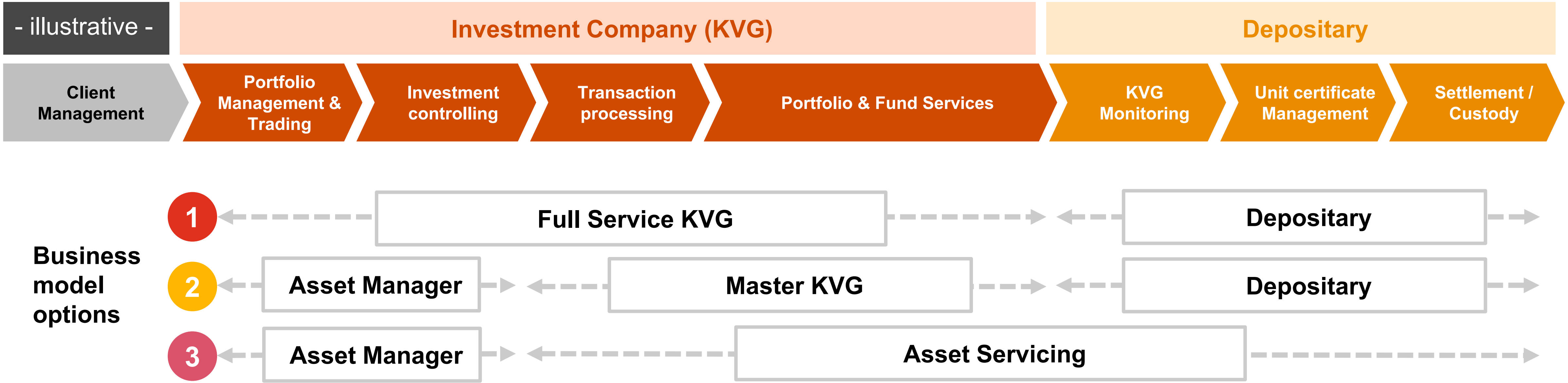
## Global volume of alternative investments (in USD bn)




- **Real estate, infrastructure, private equity and private debt** are most popular among institutional investors in Germany
- In the next twelve months, **82% of institutional investors plan to increase their exposure** to alternatives

Source: BVI, Prequin, BAI Investor Survey 2019, PwC analysis

# Thesis #4: Business models are shifting with a fundamental impact on market strategies and operating model design




## 1 The Classic Model

- The **initial business model** of the AM industry consisting of a full service KVG and depositary
- This model is still available in the market, however, declining in importance

## 2 The Master KVG Model

- Separation of value chain into **asset management, administration and depositary**
- Investors select individual providers as preferred; fund companies strive for efficiency

## 3 The Manager and Servicer Model

- **Master KVG and depositary functions merged** into asset servicing division
- Integrated solutions incl. provision of front office platforms to asset managers

# Thesis #5: Digital transformation is still in an infant stage – Fintechs will fill the functional void left by core systems

## Asset Management IT - Development Curve

*Degree of digital maturity*

Stable operational core systems are essential for the development of a digital asset management platform

***Core Systems***

Systematic processing of transactions and position management.

***Service- oriented architecture & integration***

Provision and standardization of data as scalable services

***Workflow***

Process optimization through digitalization

***Analytics & Visualization***

Dashboards on on mobile devices that map the entire ecosystem of a company

***Emerging technologies***

Distributed ledger (Blockchain), robotics, artificial intelligence, etc.

**[ Client Lifecycle Management ]**

salesforce, UNITED SIGNALS Follow Financial Intelligence, KURTOSYS, kompany, JobRouter®, DocuSign®

**[Product and Investment Process]**

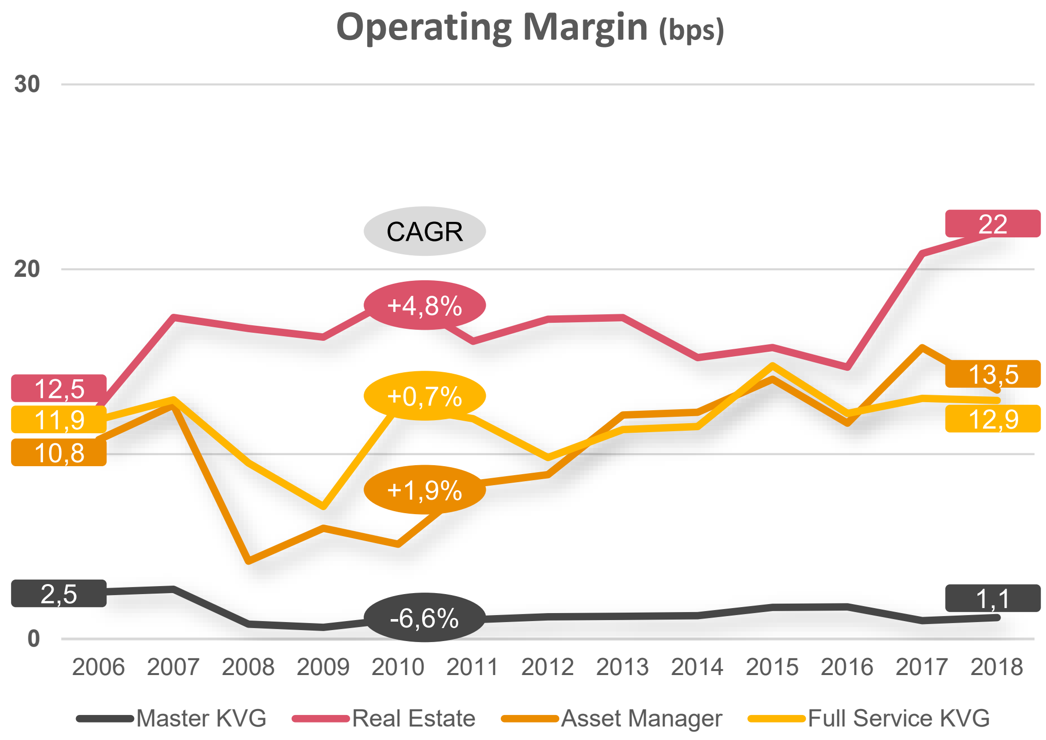
fiserv. TradeFlow, VERMILION A FACTSET Company, UiPath Robotic Process Automation, FondsDesigner®, Remote Trader Monitoring

**[Support Functions]**

PADA tool, SHIELD FC, celonis, tableau, EAGLE INVESTMENT SYSTEMS A BNY MELLON COMPANY

# Thesis #6: Structural cost transformation will be an imperative in times of flat or falling markets

## Profitability of the German asset management sector




Source: PwC estimates based on financial statements (eBanz), BVI and Bundesbank

## Rising sector profits mainly caused by growing fund assets

- **Assets grow on average by +6,7% p.a. with significant variance**
  - Main contributor are steady net fund flows with +5% p.a.
  - Every year about -2,4% p.a. of assets are paid out as distribution of income
  - Performance impact of +4,1% p.a. and major source of variation
  - Correlation to equity markets lower than expected due to asset class mix and shift of funds to cash in crisis (with missed opportunity post turnaround)
- **Revenues are highly correlated with AuM at on average 27 bps**
  - Erosion of fee margins (competitive pressure, ETFs) by -1,1% p.a.
  - Impact limited due to change in product mix (alternatives, multi asset funds)
- **Costs also highly correlated with AuM at on average 17 bps**
  - Limited scale effects (savings) of -1,6% p.a., but limitations in time sample
- **Operating margins stable at on average 10 bps**
  - Sticky costs and falling variable revenues as profit killers during economic downturn

Structural cost transformation (reduction & variabilization) is essential in times of limited asset growth

# 3

## Cost transformation as a key success factor

# With high pressure on profitability already before COVID-19, reducing cost should be on top of the strategic agenda

## Challenges in AM before Covid-19

**Slow growth of AM in Europe**
(2012 to 2017)

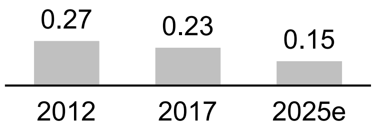
**Germany & Switzerland** +33%

**Top 20 AM worldwide** +75%

**Pressured management fees**

Active Mgmt. Fees Europe (in %)


Passive Mgmt. Fees Europe (in %)




## Additional challenges caused by Covid-19

**Sharp decline in AuM**

**Decline in AuM caused by overall stock market decline**

~12%

**Strain on operations**

- **Record Volumes** (in the short term) - price challenges, phone & web traffic
- **Large redemptions** currently being seen could lead to a **lack of liquidity**
- Transition to **remote work** environment
- **Hiring freezes** and anticipated reduction in headcount, although more personnel would be needed in the short term

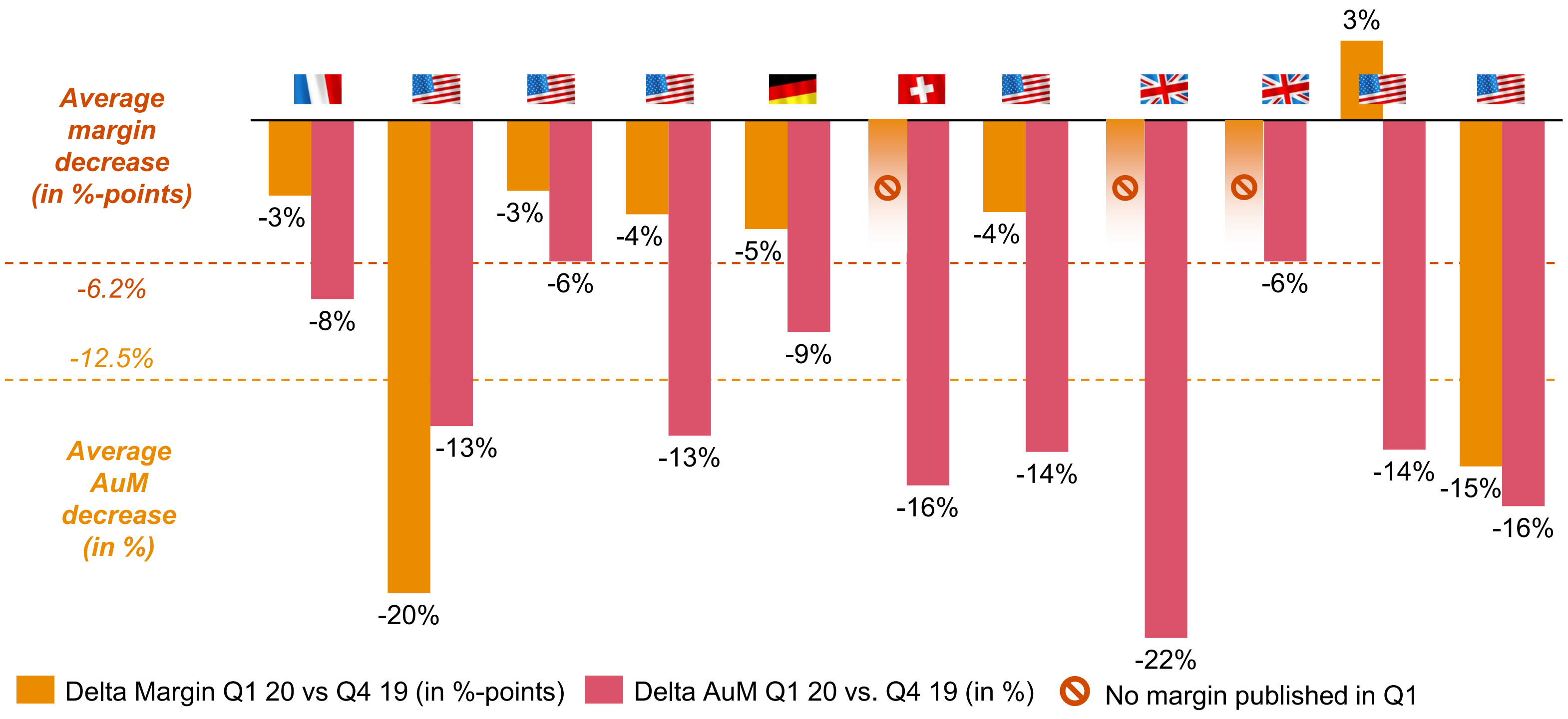
- **AuM decreased through the COVID-19 crisis**
- **AM margins under pressure**

**Costs and strategic positioning on top of the agenda**

Source: PwC Global AWM Research Centre analysis based on Lipper, annual reports, Bloomberg, ICI, EFAMA, City UK, Hedge Fund Research and Preqin; strategy& analysis

# AuM and margin decreases in Q1 are severe but less than first expected due to market recovery end of March and net inflows

## Delta in Margins and AUM of Q1 20 to Q4 19



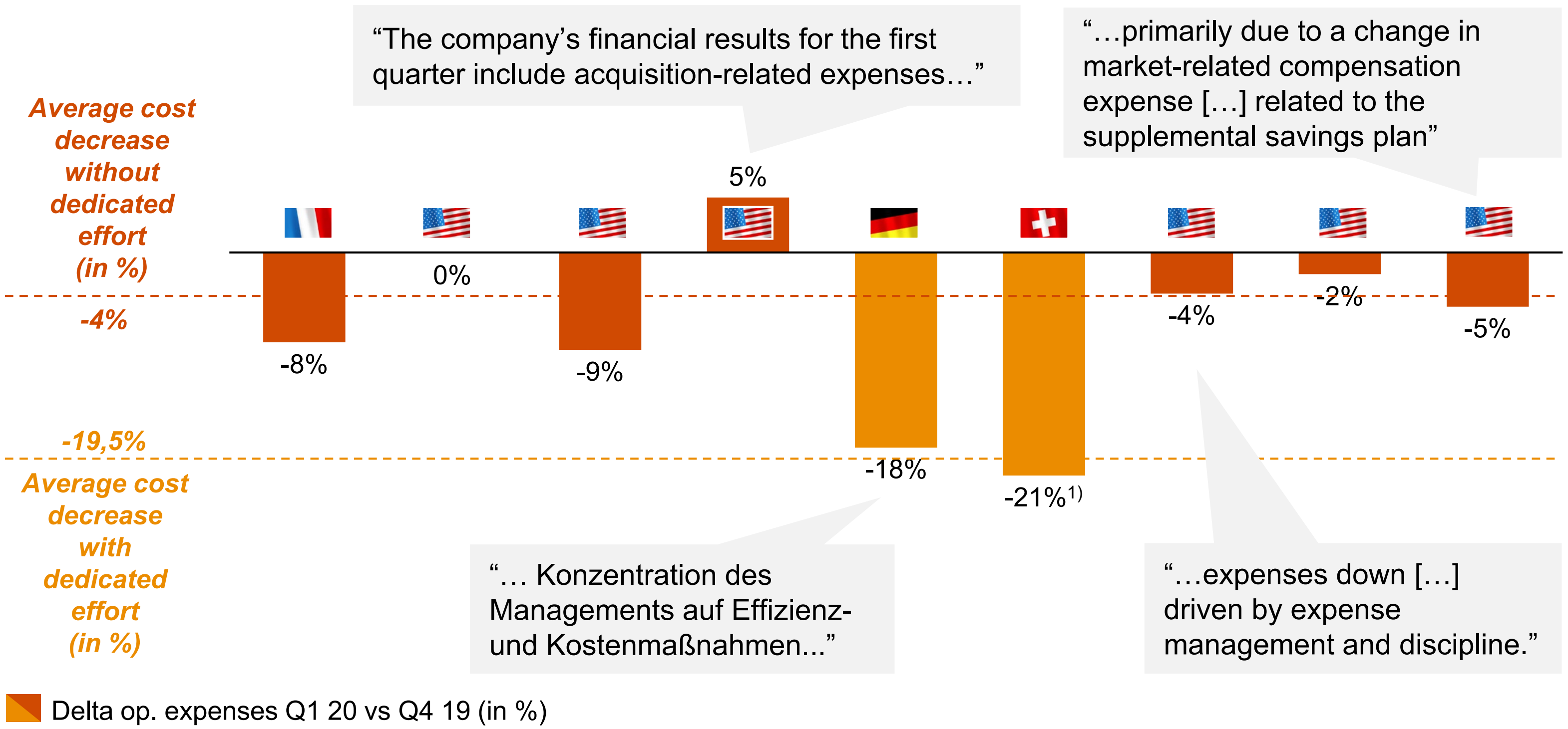

## Insights

- AuM decrease in Q1 less than first expected due two effects:
  - Some market recover towards the end of Q1
  - Net inflows for most AM, despite significant outflows in March
- Margins have been decreasing mostly in accordance with the decrease in AuM (with the exception of a few outliers)
- Large scale asset managers overall with smallest decreases in AuM and margins
- Due to large differences in AuM and consequently margins, asset managers should put cost on their agenda

Source: Quarterly reports from selected, exchange-listed Asset Managers, reporting Q1 2020 from 1st of January to 31st of March and Q4 2019 from 1st of October to 31st of December; strategy& Analysis

# Asset managers that started reducing their cost consequently before the crisis are now in an advantageous position

## Delta in operating expenses of Q1 20 to Q4 19




## Insights

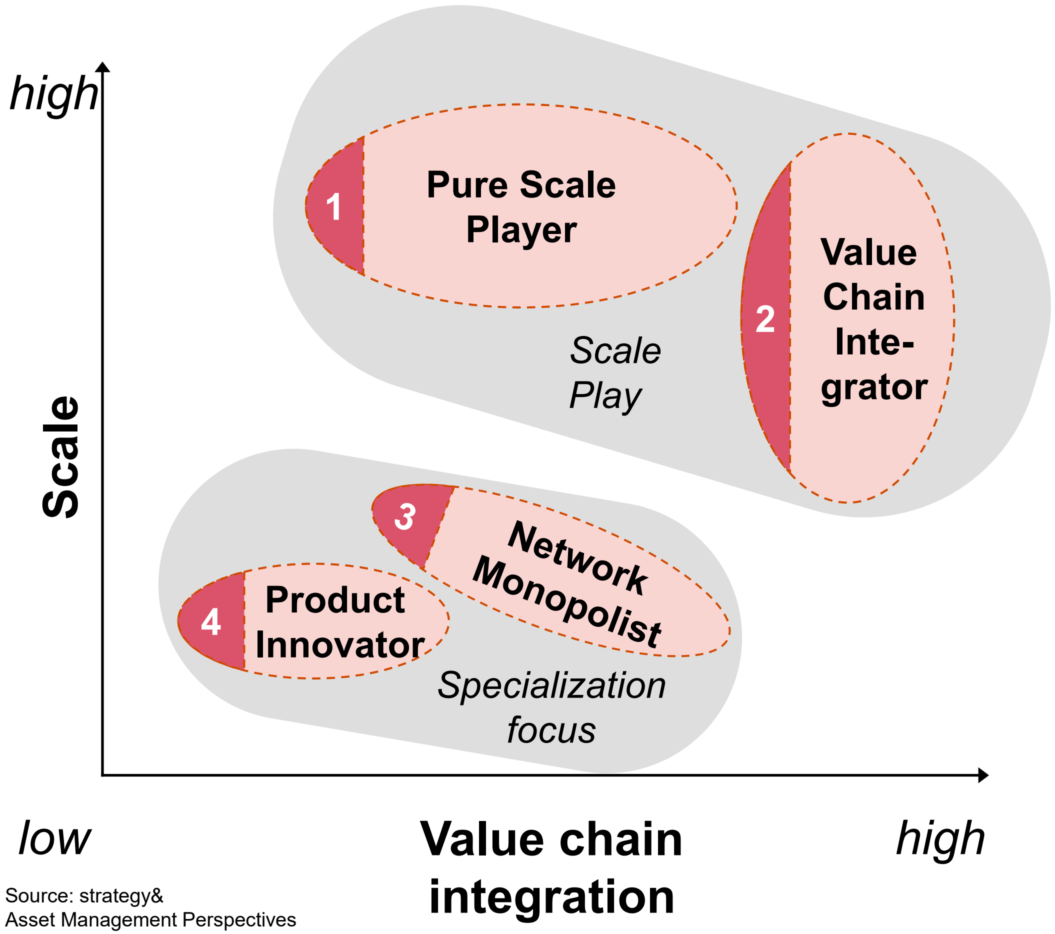
- 2 of 10 asset managers in focus mention **dedicated cost programs**
- Cost programs show **potential to reduce cost** and strong effect compared to cost discipline
- Both short-term and structural measures taken (e.g. simplify corporate structure)

1) Estimation according to projected savings and total expenses 2019

Source: Quarterly reports from selected, exchange-listed asset managers, reporting Q1 2020 from 1st of January to 31st of March and Q4 2019 from 1st of October to 31st of December; strategy& Analysis

ILLUSTRATIVE

# In the market we see four promising Ways-to-Play for asset managers – scaling and specialization as leading themes




| Ways-to-Play | | Description |
|---|---|---|
| 1 | Pure Scale Player | • Holistic offering and coverage paired with relatively low costs<br>• Standardization and operational excellence<br>• Leverage global platforms |
| 2 | Value Chain Integrator | • Aggressive extension of existing businesses into additional, profitable parts of value chain<br>• Either Front-to-Back, Back-to-Front or across sectors |
| 3 | Network Monopolist | • Part of captive FS network / group and thus close relationship specific clients<br>• Product offering tailored to target client segment, broad enough to keep competitors out |
| 4 | Product Innovator | • Niche, innovative product positioning<br>• Strong brand around investment capabilities<br>• Prominent fund manager / "Star" |

Source: strategy&

# Leading asset managers position themselves with ambitious cost targets and a broad collection of cost-cutting measures

**ILLUSTRATIVE**

<table>
<tr><th colspan="2">Type of asset manager</th><th>SHORT TERM MEASURES<br>*1-3 months*</th><th colspan="2">LONG TERM MEASURES<br>*3+ months*</th><th>COST AMBITION<br>*(Operating Expenses to AuM in BPS)*</th></tr>
<tr><th></th><th></th><th></th><th>*General measures*</th><th>*Type specific measures*</th><th></th></tr>
<tr><td>1</td><td>**Pure Scale Player**</td><td rowspan="4">**Projects and Products**<br>• Re-prioritize projects<br>**Organization and workforce**<br>• Temporarily reduce compensation, especially bonus<br>• Reduce number of externals (especially in IT, compliance and operating-functions) and replace with internals<br>**Sourcing and locations**<br>• Analyze optimization of office space (with everyone in the home office, think about how much office space you really need, what business units might actually profit working from anywhere)</td><td rowspan="4">**Projects and Products**<br>• Rationalize portfolio<br>• Strategic portfolio shift towards more crisis resistant investments (e.g. ESG)<br>**Organization and workforce**<br>• Consolidate capabilities and organizational entities/ simplify structure<br>• Capabilities zero-basing<br>• Optimize distribution of capacities<br>**Operations and IT**<br>• Optimize IT spend (maybe even in-crease spend to accelerate digitization)<br>• Migrate from legacy core to ecosystem platforms to realize scale effects<br>**Sourcing and locations**<br>• Review sourcing/ shoring strategy and consider outsourcing/ shoring<br>• Consolidate suppliers<br>• Optimize locations (use of office space)</td><td>• Optimize offshore setup<br>• Improve process excellence<br>• Increase scale with possible acquisition</td><td>< 10</td></tr>
<tr><td>2</td><td>**Value Chain Integrator**</td><td>• Redesign operating model<br>• Extend value chain with possible acquisition</td><td>~ 10 -15</td></tr>
<tr><td>3</td><td>**Network Monopolist**</td><td>• Reduce intra-group complexity and improve intra-group collaboration and sourcing<br>• Assess joint ventures</td><td>~ 5</td></tr>
<tr><td>4</td><td>**Product Innovator**</td><td>• Re-assess differentiating capabilities along the value chain and increase outsourcing in order to improve flexibility and fixed cost base<br>• Assess joint ventures</td><td>~ 10 - 20</td></tr>
</table>

Source: strategy&

# Thank you

Christian Gürtler
Director

Bernhard-Wicki-Straße 8
80636 München

Tel. +49 89 5790 6830
Mobil +49 160 979 163 34
christian.guertler@pwc.com

Dr. Utz Helmuth
Principal

Birchstrasse 160
8050 Zürich

Tel. +41 58 792 3180
Mobil +41 77 4094571
utz.helmuth@strategyand.pwc.com

pwc.de/asset-management