WHITE PAPER
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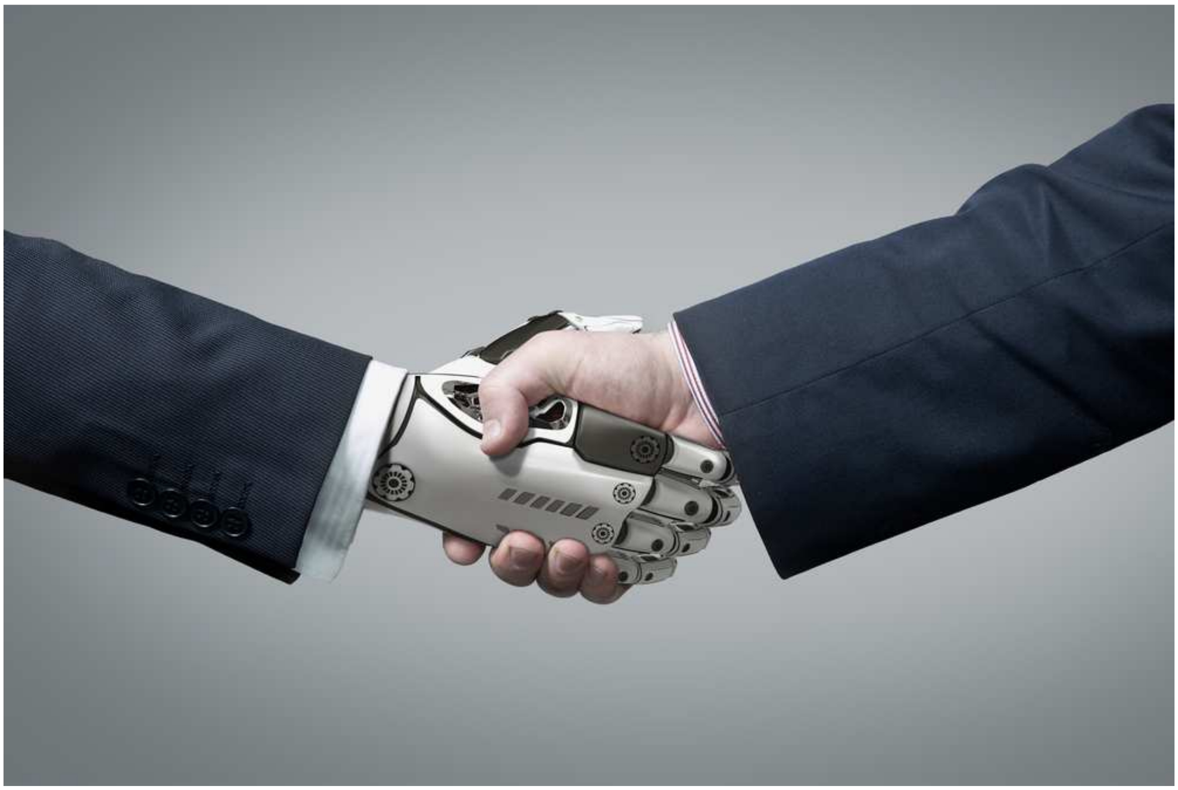
For professional investors

ROBECO
The Investment Engineers

The future of asset management



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Executive summary

During the past decade, the asset management industry was mostly occupied with regulatory changes dictating costly compliance procedures. The increase in regulatory burden was mainly felt by small asset management firms. In addition to increased regulatory costs, fee pressure has had a large impact on the industry as well. In the coming years we believe these two forces will remain top of mind, but they have different drivers now.

Technology has entered the asset management industry. This will add costs because asset managers have to live up to ever-increasing customer demands regarding immediacy, connectivity and ubiquity. At the same time, this leads to an increase in fee pressure due to growing transparency, comparability and competition from non-financial companies. We think the asset management pie is still growing strongly, but not everyone is invited to take a piece.

Plenty of threats to incumbents

Next to the broad thematic changes within technology, regulation and demographics we observe some changes that are more specific to the asset management industry. Index funds are gaining popularity and make up almost a third of assets under management in the USA. This has led to the separation of alpha and beta which in turn is impacting fees. Partly due to the low fees and ETF opportunity we also observe a growth in demand for multi-asset solutions and liability-driven-investment solutions.

Next to changing products we also see changing customer profiles. As a result of regulation, low commodity prices and central bank policy we observe a shift from the institutional client towards the retail client. Most asset managers have optimized their sales effort on the institutional side, while retail investors require different methods of engagement. We also think the role of the middle-man (wholesale) will be re-defined in the coming years.

Customer centric multi-asset scale required

We think the impact on the asset management industry can be summarized as higher costs, lower fees and a battle for the customer relationship. We think the first two impacts will lead to consolidation because scale is essential in this new environment. The customer relationship requires a complete mind shift and perhaps even alliances with the technology sector. Not every asset manager will be able to adapt to this changing mind-set. We look for asset managers with scale, multi-asset solutions and integrated technology. Companies that offer investment advice face a more challenging environment.

Introduction

The asset management industry is going to change substantially in the coming years. Regulatory and demographic trends have already had a transformative impact on the sector. In general, the direction of these two trends is clear and the pace of change is slow. However, the technology dimension is putting speed into the transformation equation. Customers require immediacy, connectivity and ubiquity in a simple and transparent service offering. These requirements are more often being fulfilled by non-traditional players. To incumbents, the control over the customer relationship is at stake. They will have to make a strategic choice between spending on technology to offer satisfactory services to their clients, or losing the customer relation and becoming the very efficient infrastructure to the newcomers from the technology sector.

Not necessarily bad for incumbents

In this paper we limit the scope of the asset management industry to the service of actually managing money for end clients, which does not include insurance companies and pension funds that manage mostly internal money and are in our definition therefore more customers than competitors to the asset management industry. Contrary to doom-thinkers, the odds are not necessarily against traditional asset managers. In general it can be concluded that the pie for asset management is still growing. Demographic trends combined with a diminishing role of governments concerning pensions and social security bode well in terms of demand for asset management services. By means of incorporating technology, the customer relationship that was built up during many decades can be preserved and new customer groups can be served.

Not all asset managers will be able to develop the required skills in-house. Strategic alliances between technology providers and asset managers are very likely, but the stability of those alliances boils down to a prisoner's dilemma. When both sides cooperate, the payoff for society is largest and the pie is divided Pareto efficiently. However, the prospect of a bigger piece of the pie is very tempting to some.

Three central questions

In this white paper we try to answer three questions:
1. What is driving change in the asset management industry?
2. How will this influence asset management?
3. Who will win versus lose?

What is driving change in the asset management industry?

In answering this question, we will look at a broad range of categories which we believe to be indicative of change in asset management. We start by looking at the overarching themes of demographics, regulation and technology. Several of these themes are not just relevant for the asset management industry, but rather for the financial sector as a whole. After addressing these themes we will zoom into three trends that are changing the asset management industry in particular, namely the popularity of indexation, the shift from institutional to retail money and the growth in demand for multi-asset solutions.

Demographic tailwinds expected…

Most drivers of the demographic category are well known and documented. In our paper about the future of pensions[1] we highlighted the most important trends, and figure 1 summarizes these again. The blue outer circle represents the demographic changes that will have an impact on the asset management industry in the coming years. In general it can be concluded that all of these trends are positive for asset management. The pie is growing. The demographic trends combined with social security provide an additional tailwind, given the fact that more and more people need to take care of their own pension (shift from defined benefit to defined contribution) and can rely on government funding to a lesser extent.

…but social dynamics can spoil the fun

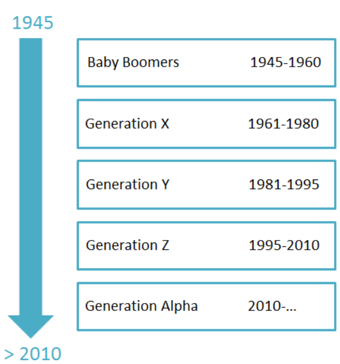
The orange inner circle represents the social trends. These trends can either magnify certain demographic developments, or counter their positive effect. An example of the latter would be the increasing influence of the developing world on asset management in combination with social, political and cultural differences. In itself the asset shift towards developing countries is positive for asset management, because both on the retail side and on the institutional side there will be new clients that are currently not served. However, in several emerging markets the attitude towards investing is very different from that in the developed world. Investing is sometimes seen as gambling and to a lesser extent as a way to accumulate long-term wealth. Most of the social trends require investments by the asset management industry. Immediacy, transparency and high levels of personalization are impossible without the right technology.

[1] Getting old and staying wealthy, van Oerle (March, 2015)

Figure 1. Socio-demographic trends impacting asset management

Source: KMPG, Robeco internal resources

Generational differences require agile processes



An additional complicating factor is the problem that the social trends as shown in figure 1 are a cross-section of the entire population. Generational differences play an important role and lead to very different outcomes. This requires agility from asset managers in order to cope with differences in customer expectations. Being simple and transparent to one, while creating a complex but personalized approach for another, is an organizational challenge. As we will discuss later on, technology is an enabler to cope with this challenge. The fact that current wealth is with the baby boom generation is not a good reason to tailor to this generation's needs only. In the coming years, assets from the baby boom generation will be passed onto younger generations. If current asset managers have alienated this group of future investors, they will have a hard time regaining their trust. The investment style also differs a lot. The baby boom generation is focused on asset preservation (most of them are retired or will retire soon), while younger generations require asset accumulation. Different generations have different thoughts about using technology, trusting advisors and managing money. They also have different risk profiles. All in all, demand for customization increases.

Digitization versus digitalization

Technology is the fast changing element in the transformation equation, but it is wrong to generalize technological progress. It is very important to differentiate between digitization and digitalization. Referring to the definitions as described in the Oxford dictionary, digitization is the process of making analogue input digital. Digitalization, on the other hand, refers to the process of using technology to better interact internally and externally (with clients). The asset management industry in particular is at the forefront of digitization, but is far behind in terms of digitalization.

Trends in digitization don't pose a threat to incumbents, but do cost money

One of the competitive advantages of asset management versus technology companies is their abundance of decade-long customer data. Contrary to popular opinion the growth of data as well as the introduction of tools such as blockchain[2] is in itself not a disruptive threat to the asset management industry. Software and capabilities are readily available to many companies. Both internally developed and externally generated tools are used to optimize the process of storing and transferring data. Although not a threat to incumbents, it is costly to maintain records and implement new technologies. Companies that are only focusing on costs will have a hard time making the crucial strategic investment decisions.

Trends in digitalization should be more worrisome to incumbents

Whereas the asset management industry is on top of developments in the processing of data, it is lagging far behind developments related to the interaction with clients. Customers that were previously not interesting to serve (low-wealth individuals) are now becoming a new market because technology allows serving them at low costs and in large volumes. The emergence of robo-advice is one of the most recent results. These technology companies step in between the asset management industry and their clients. The threat of losing the customer relationship is a real one in our opinion. In order to counter this threat, asset managers as well as financial planners need to invest heavily in technology and form strategic alliances with technology providers.

New technology, new opportunities, new players, new threats

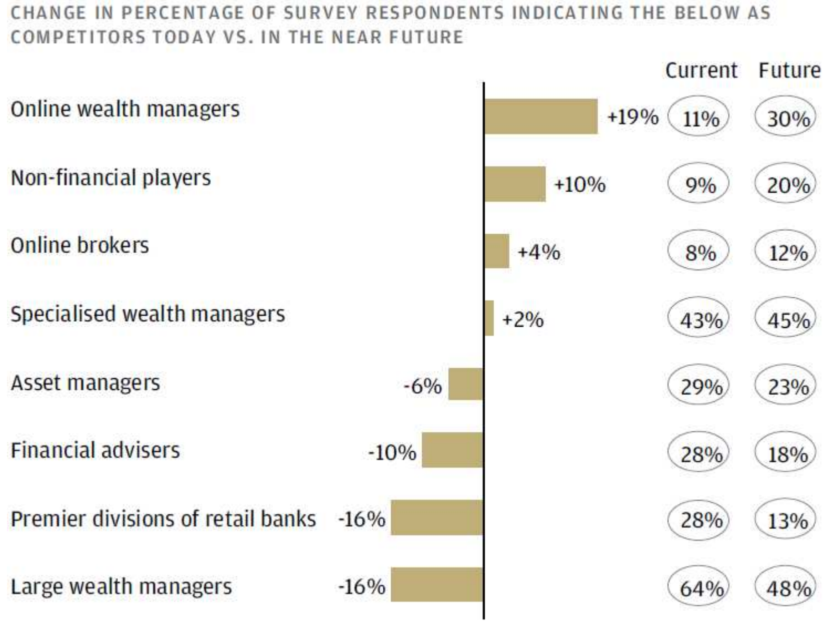
The key difference between the technology trend and other trends is the fact that it allows for non-traditional players to enter the market. Within asset management the most notable introduction has been that of robo-advisors. These companies did not emerge from the asset management industry, but from the technology industry after which strategic alliances with companies in the financial sector were created.

Most robo-advisors are not offering alpha creation, but focus on the unmet need for beta allocation. By combining the need for beta with low-cost technology, it has become available to a group of people that previously were not servable. In a survey, 70% of US financial advisors indicate they want more digital investment oriented advice from their asset managers[3]. Besides robo-advisors we also see initiatives of technology companies entering the asset management market. A good example of this would be Tianhong Asset management, which has gathered 81bn dollars in assets under management (AUM) in the nine months' time after Alibaba announced a partnership. Figure 2 shows that the most likely impact of non-traditional players is on advice and wealth management.

[2] Blockchain is the underlying technology behind Bitcoin and has potential to revolutionize back offices.

[3] CaseyQuirk, 2015

Figure 2. Entrance of non-traditional players in the asset management industry



Source: JP Morgan, Oliver Wyman November 2014

No end to regulatory pressure

In the aftermath of the financial crisis, regulation dealt with the over-the-counter market, wholesale and derivative trading. After these first patches, focus shifted to the banking sector, followed by the insurance sector and is likely to return to the investment management sector again in the coming years, with a focus on retail client protection.

It was long thought that the definition of 'systemically important', as seen in the banking sector, would be used in asset management as well. Under the originally proposed definition of systemically important, a balance sheet of USD 100 billion or more, or AUM of USD 1 trillion or more, were set as qualifying criteria. This would imply only US asset managers would qualify. Although it is less likely that asset managers will be designated as systemically important, regulatory focus on capital, liquidity and market stability has grown. As shown in appendix A, the amount of regulatory change that will be fired at the asset management industry in the coming years will be substantial. This is estimated to increase compliance costs by an average of 1-5 percentage points[4]. All costs added up, the operational margin impact is estimated to be between 50 and 100 basis points. This burden will most likely hit smaller asset managers hardest, because the large asset managers have already been preparing for regulatory compliance for a long time. The biggest allocation of costs goes to complying with trading capabilities, collateral management and risk management regulation.

Europe and the US take a different approach

We have already seen that the US and EU took a different approach to regulating money market funds. In an effort to reduce systemic risk of money market funds after 2008 (due to the dry-up of liquidity as a consequence of money market funds' holdings of synthetic products like CDOs), the EU and US imposed stricter regulation. However, the focus differed substantially. The US focus was on the representation of 'true value', represented

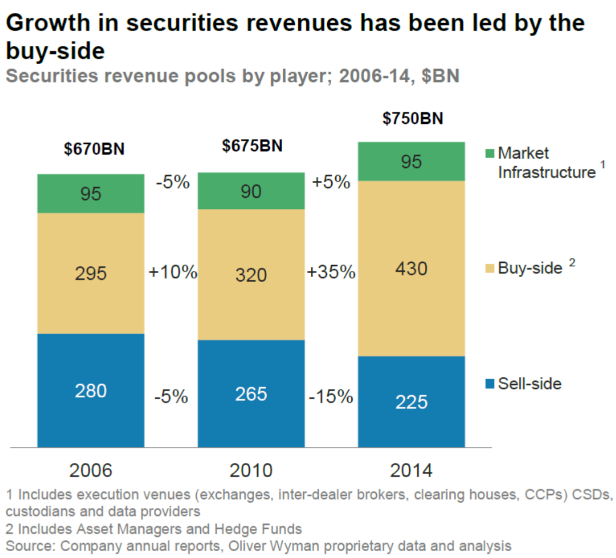
[4] Morgan Stanley, 2015

by a floating NAV as opposed to the stable USD 1 NAV prior to 2008. The EU took it a step further with the introduction of a prescription of eligible assets, diversification and liquidity requirements as well as a higher level of disclosure and stress testing. In a broader perspective we see the same. In the US the Volcker rule had the biggest impact and we expect to see only incremental changes to regulation going forward, although this is far from certain. In Europe MiFID II and UCITS V (Undertakings for the Collective Investment in Transferable Securities) are the most important regulatory developments. The introduction of MiFID II, however, has been delayed until January 2018. The long-term implications for global asset managers are increased costs to comply with different local standards.

Regulation has pushed liquidity to the buy-side

Regulatory change has impacted the market structure. The US Volcker rule caused many banks to stop proprietary trading activities. This has driven capacity out of the sell-side. Quantitative easing on the other hand has been good for buy-side assets. The end result has been a shift in revenue towards the buy-side as shown in figure 3. This also implies a shift in liquidity (risk) to the buy-side. Combined with rapid flows in passive products this might be an additional factor that leads to a prolonged period of high volatility.

Figure 3. Liquidity shift from the sell-side to the buy-side



Source: Morgan Stanley, 2015

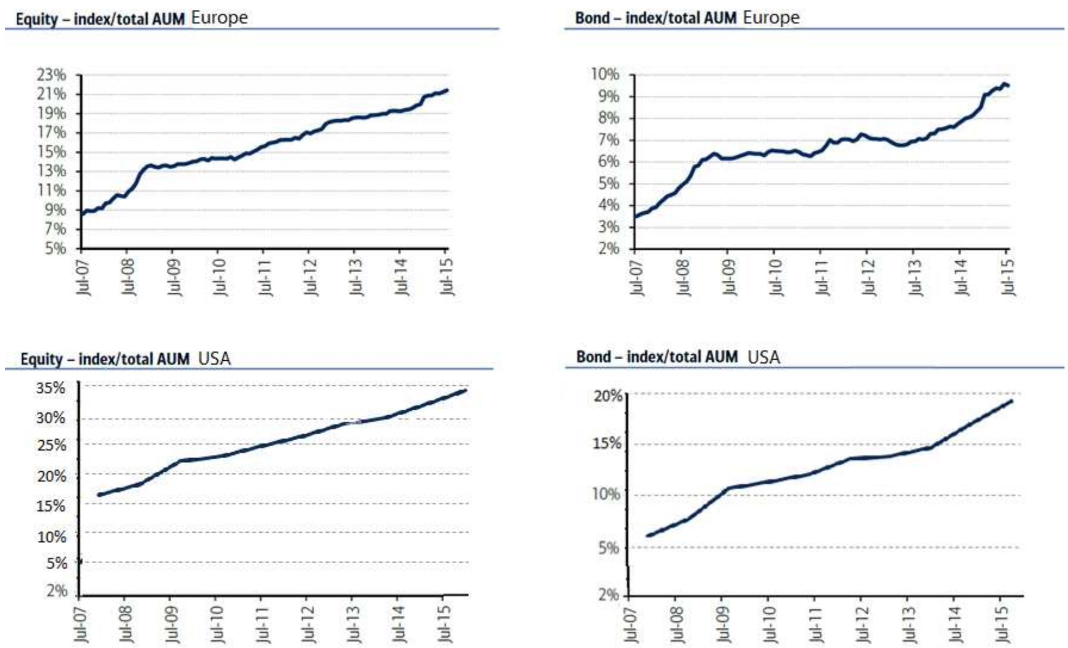
Index fund growth continues

A trend more specific to the asset management industry is the popularity of index funds. The US regulator hinted towards the introduction of ETFs in the early 1990s to increase transparency and reduce costs for investors. Exchange traded funds are currently a USD 3 trillion market with 6,780 products traded on 60 exchanges[5]. Total AUM were estimated at around USD 74 trillion in 2014. Although the cost component is often assumed to be the main reason for switching from active to passive, this is not complete. The reason why people are looking for lower cost solutions is that the alpha and the beta component are being separated. A lot of institutional portfolios are not willing to pay for the alpha component anymore and therefore search for the cheapest way to get beta exposure. 69% of asset managers use ETFs primarily for core allocation in their institutional portfolios[6].

[5] Bloomberg analysis, 2016
[6] Greenwich Associates, 2014

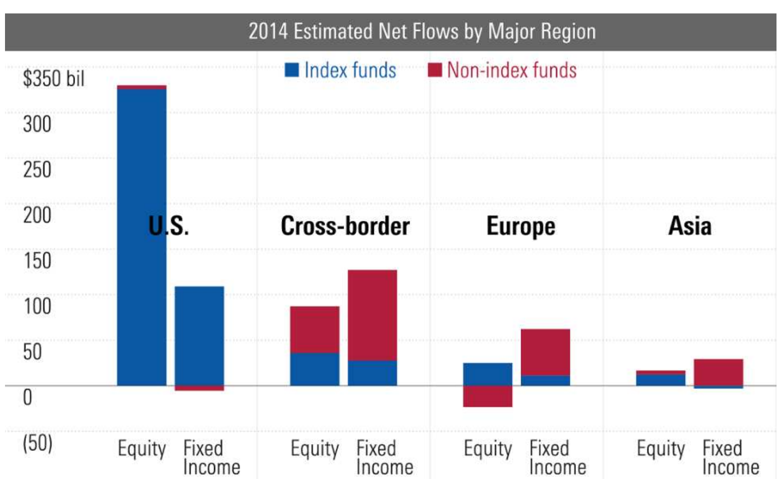
When combining the separation of alpha and beta with a greater focus on risk and the lower expected returns on the fixed income side, the rise of index funds becomes more than just a cost consideration. The high liquidity and flexibility of core index funds also offer an easy route to obtain and rebalance tactical asset allocation. Figures 4 and 5 show the US is leading in absolute and relative index fund flows. Index funds concentrating on bond markets were long out of favor, but have also gained a lot of attention lately. An important side-note to the popularity of index funds is that illiquidity in niche products can lead to a brake-down of the pricing mechanism. We expect regulation to intensify in the form of required capital buffers for large ETF providers if this risk increases.

Figure 4. Equity and bond index funds over total AUM Europe and USA



Source: BofA Merrill Lynch, 2015

Figure 5. Money flows index- and non-index funds



Source: Morning star, 2014

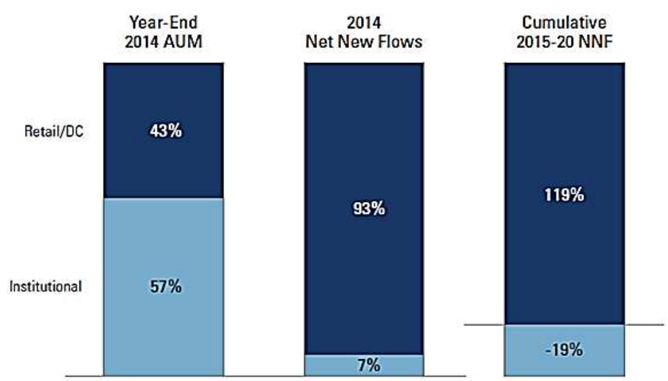
The growth in passive has consequences for active

Since alpha and beta can now be separated, the customer is only willing to pay for true alpha creation which implies 'benchmark hugging' is no longer acceptable. Going off-benchmark to add alpha can work against portfolio managers that use a benchmark to calculate relative performance though. ETF flows currently represent 35 percent of the US equity market and it is estimated index funds will make up between 40 and 50 percent of global equity flows in the long run. Add to that the portfolio managers (or mandates) that increase active share by means of selecting different weights within their benchmark, instead of going off-benchmark, and somewhere between 60 to 80 percent of fund flows are concentrated on benchmark stocks only. This has a big impact on off-benchmark stocks and on the fundamentals of investing because benchmark inclusion becomes a primary driver of stock performance instead of fundamentals. This could lead to an over-investment in benchmark stocks if remuneration is dependent on relative performance and will also make it harder for off-benchmark companies to find funding for growth.

Client base shifts from institutional to individual

Another strong and very important trend observed in the asset management industry is the shift of power from institutional investors to retail investors. There are several drivers for this development, but they all come back to a declining role of the institutional side, with as a natural result that retail becomes more dominant. The declining role of institutional clients is a result of pension withdrawals by retirees, sovereign funds that are no longer growing (some oil related sovereign funds are even withdrawing institutionally managed assets) and the insourcing of asset management capabilities by large asset owners such as insurance companies. As we discussed under regulatory trends, the regulator is mostly focusing on retail client protection. With an increasing piece of the pie allocated to retail we think it is likely that the regulatory environment continues to be challenging.

Figure 6. Global asset management industry net new flows by investor type

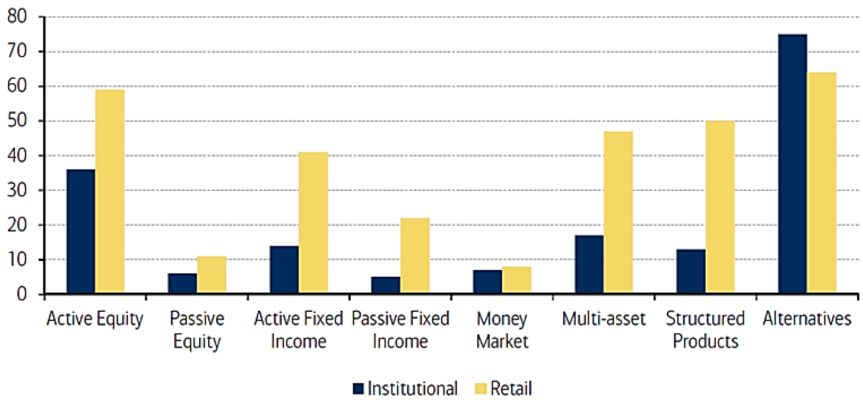


Source: Casey Quirk Analysis

Multi-asset solutions offer high value at low costs

Changing demographics require a change in asset mix. Pension changes across the world are increasingly supportive of liability driven investing (LDI) and low-volatility solutions. Both require a mix of equity, fixed income and alternative investments. However, the growth in demand for multi-asset solutions does not only come from aging. The fact that multi-asset product solutions have become available at very low costs is also contributing to their popularity. Compared with active equity products, the fee for the average multi-asset product is much lower, as can be seen in figure 7.

Figure 7. Fee margins (bp) by product

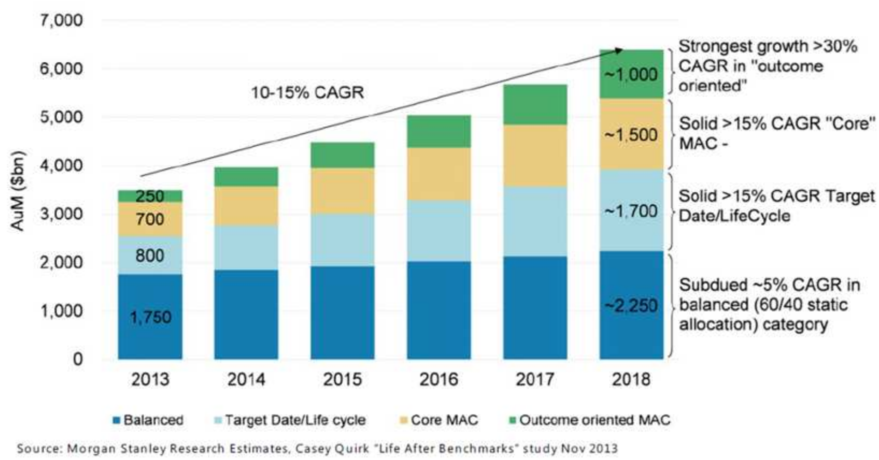


Source: BofA Merrill Lynch, BCG

Growth in multi-asset driven by multiple pillars

The three largest contributors to multi-asset growth are shown in figure 8. Shifting pension schemes lead to higher demand for target date solutions. The combination of equity and fixed income in order to reduce risks at low fees drives the demand for core multi-asset solutions. The biggest growth comes from the inclusion of alternative asset classes such as real estate and private equity to form outcome-oriented multi-asset solutions. Multi-asset strategies are not easy to implement though. Managers need scale and a very highly skilled team that can handle the complexities that come with combining multiple asset classes. There are only a few asset managers that can offer these services in a cost-efficient way. GARS (Standard life) and Amundi are examples of successful multi-asset managers.

Figure 8. Demand for multi-asset solutions from different sources



Source: Morgan Stanley and Casey Quirk, 2013

How will this influence asset management?

We believe the trends as described above will impact several layers of asset management. We look at the general impacts on the industry, the impacts specific to institutional and those specific to retail clients. The informed reader might notice that we left out wholesale. We think the introduction of technology and the shift of client demand will overhaul the wholesale proposition and put more focus on retail.

Asset management consolidation likely

We think the general impact of the trends in asset management will be on three themes. First, there is a need for scale. When adding the trends of fee pressure, regulatory cost increase and demand for multi-asset solutions, the importance of scale becomes clear. Fee pressure is likely to continue. Not only has competition from within the industry increased by the introduction of low cost passive solutions, the competition from non-traditional companies is also growing. Increasing regulatory cost is another reason why scale is important. Compliance costs are simply too high for small asset managers in order for them to be cost-competitive. We think this will lead to consolidation within the asset management industry.

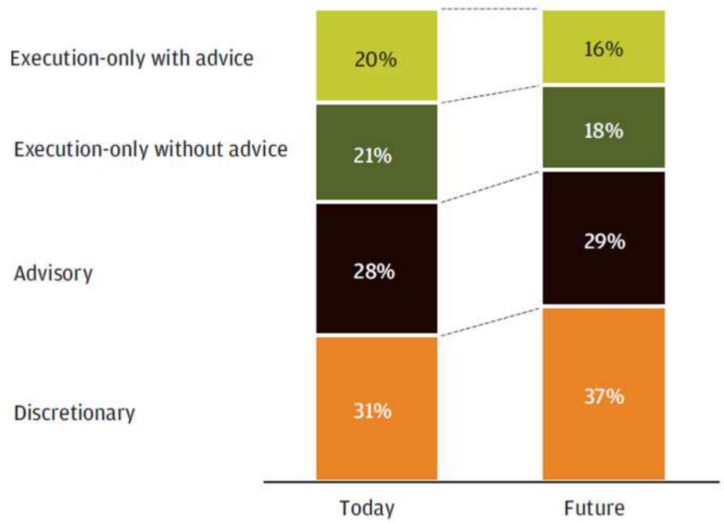
Sales force needs rethinking

The second general impact from the trends we described above is in our view the re-organization of the sales force due to the shift from institutional to retail. Currently many asset management sales teams are focused on creating cost-efficient ways to target institutional clients. These processes are generally efficient in terms of 'sales effort per unit AUM'. The sales process to retail clients is very different and in many cases less efficient if described as the effort per unit of AUM. The only solution to this is to use technology and standardize.

Wholesale will change dramatically

The final general impact is on the changing role of wholesale. We believe we will end up with two customer groups for asset managers, either retail or institutional. We think the retail client is either going to be approached directly by asset managers that use customer-centric technology, or will search aggregator platforms for solutions. Paying a hefty sum of money in order to receive fund advice is likely to become a less appealing proposition, given the abundance of comparability enabled by technology. The potential for aggregator sites and robo-advice to cut out business from wholesale is large. Figure 9 shows the execution-only model is likely to shrink with discretionary management proposition demand increasing. We believe the growth in advisory will not be through traditional wholesale, but rather through online platforms.

Figure 9. Change in engagement model preferences



Source: JP Morgan, Oliver Wyman November 2014

Institutional requires cost efficiency and alpha generation

The effect of the trends on the institutional side of asset management is mainly concentrated in cost efficiency. Fees are coming down while reporting costs are increasing. Institutional asset managers will have to add alpha (after fees) in order to remain competitive versus index funds. Although that sounds logical, only a small percentage of active managers have been able to generate positive returns after deducting fees. Figure 11 shows that Eurozone active equity managers have a bad long-term track record . The performance of active managers in 2001 especially weighs down heavily on the 15-year performance numbers. If we were to add 2014 and 2015 to figure 11 and exclude 2001, the picture would look a bit better, but still more than half of the active equity managers are underperforming their benchmark before fees in this period.

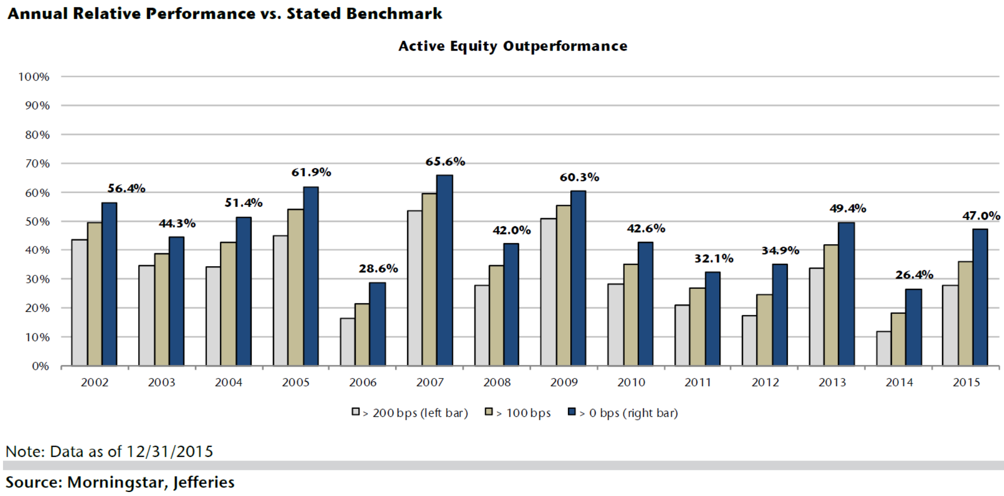
On the fixed income side the underperformance in the long run is even worse. In the past this relative alpha underperformance was accepted because investing in active mutual funds was a way to generate international diversification in a cost-efficient way. It was often the best way of beta allocation versus internal direct investment strategies. With the introduction of exchange traded funds this has changed. Beta exposure is available at low costs and the 'true' added value of active management in terms of generating alpha is becoming a focus point. Please note that not all benchmarks are investable through an exchange traded fund alternative.

We believe the focus on performance will grow further on the institutional side. Establishing alpha will increasingly be measured versus investible ETFs rather than 'un-investable' benchmarks. We think transparency and immediacy in terms of reporting will become the standard. This all implies institutional asset managers have to become lean and mean alpha generating machines.

Blockchain technology can facilitate required cost savings

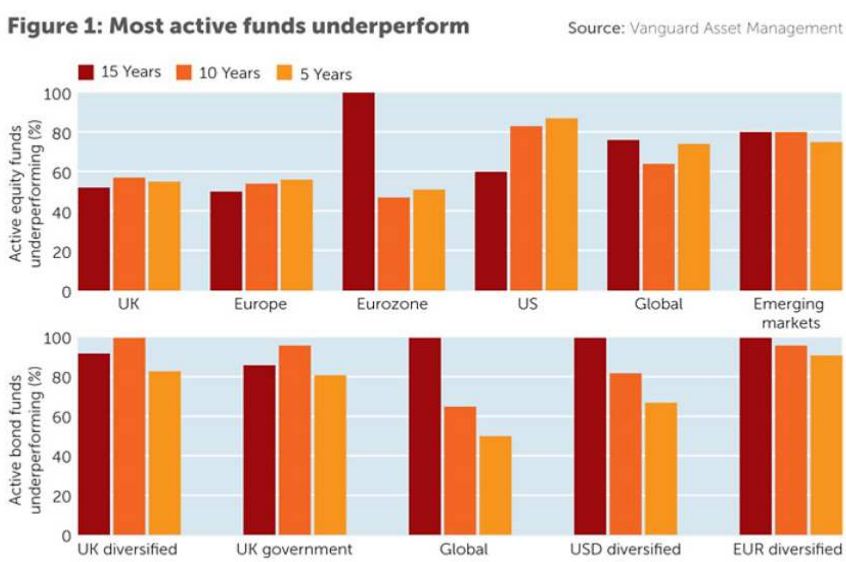
Although we will not go into much detail on blockchain technology in this paper (we will dedicate a white paper to this topic), it might be one of the best possibilities for cost savings in the long run. It requires legacy system replacement and a high level of investments at first though.

Figure 10. Relative outperformance versus benchmark for active managers (before Fees)



Source: Morningstar, 2015

Figure 11. Relative performance active equity and fixed income until 2013 (before fees)



Source: Citywire, 2013

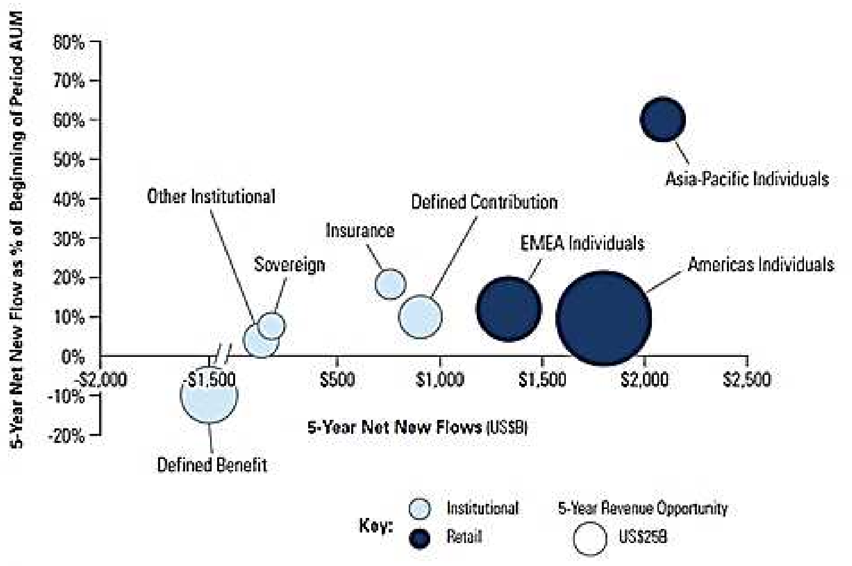
Retail requires customer centricity

Costs on the retail side are of lesser importance in our view. The average retail client does not view a couple of basis points fee difference as material. The complexities that come with managing individual investments versus aggregate institutional investments are large. For the retail client the focus is on different areas such as transparency of fees and the investment process, advice and customer centricity. Also thinking in terms of solutions instead of pushing products is an import difference with the institutional side, where this is already more common. This all requires investments in technology which add to the cost base. There are not many asset managers that can efficiently service both institutional and retail clients because of the difference in required operational costs. We think the majority of asset managers will have to choose which clients to service and rethink their strategy if they change focus.

Revenue opportunities are within certain pockets of the retail side

As we described in the trends above, we expect retail to become a more dominant part of the asset management client basis. As figure 12 shows, especially the American and European retail investor are expected to grow in importance. The shift of pension money towards defined contribution is seen as institutional growth in figure 12 but we think that with the increase of financial planning tools more people will start to invest their money directly. In terms of assets under management the institutional side is still larger, but fees are larger on the retail side as figure 7 already showed. As was shown in figure 6, the retail side might be smaller in terms of AUM, but the fees are about double as high throughout the asset classes. We expect retail to become the dominant revenue driver.

Figure 12. Global revenue opportunities by client segment, 2016-2020E



Note: Revenue opportunity = fees from net flow and manager turnover.
Source: Casey Quirk Global Demand Model

Source: Casey Quirk, November 2015

Technology investments are essential for retail

In order to serve the retail client, asset managers need to invest in technology. Not only must they become more transparent in terms of the investment process and the associated costs, but also provide financial advice services. The risk for the asset management industry is that if they do not invest in technology and platforms, they will lose the relationship with their clients and become dependent on the allocation of those who own the customer relationship. A short period of good or bad performance can lead to large flows in such a scenario, which can be costly.

The asset management industry is lagging behind in terms of introducing new technology. Customization of products as well as thinking in terms of solutions versus pushing products is not common yet. There are, however, examples of asset managers that are recognizing the need to invest in technology. Most of them do so via strategic alliances, but it is interesting to observe the lack of true customer knowledge. We think there is a great opportunity for asset managers to use technology to deepen their customer understanding. Competition is not sleeping though, and partnerships might be a good strategy that allows for a quick roll-out.

The unreachable reached by robo-advice?

During the past years a lot of so called robot advisors were launched in the US and the UK. These are online platforms that, in their current form, offer personalized asset allocation advice which is mainly used for pension investing. Motif, Nutmeg, Betterment and FutureAdvisor are examples of companies that have launched advice solutions. Since actually advising people on investments is strictly regulated, these companies are not truly advising, rather 'informing' clients. In that way they do not have to comply with all regulations within asset management yet, but we expect regulation to pick up quickly.

Most robot advisors use ETFs in their product offering because of the costs. Companies like FutureAdvisor use extensive checklists to create risk profiles of their clients and provide easy to understand and transparent information on product solutions. As these tools can be customized, yet are low cost compared with the human advisor, they offer the opportunity to service the previously unserved lower income customers.

Figure 13 shows the different market segments. Whereas prior to the introduction of cost efficient technology only the high- and ultra-high net worth individuals were being served by customized financial advice, robo-advice allows for basic services to be offered to the less wealthy segments. This implies the total potentially addressable market for robo-advice could be as large as USD 10.8 trillion currently. Global AUM of automated services was USD 20 billion in 2015 and is forecasted to grow to USD 450 billion in 2020[7].

Figure 13. Robo-advice targets the mass market

Source: Enst & Young, 2015

Robot or Cyborg advice?

We do not think pure robot advice is the future. We believe there will be a mix between human advice and pure robot advice which we would like to call Cyborg advice. This hybrid really represents a paradigm shift in the path of change in the asset management industry. As figure 14 shows, the bottom of the pyramid can easily be served through internet solutions, while the top of the pyramid requires a human touch. The Cyborg advice market is estimated to be a USD 3,700 billion market in terms of assets under management by 2020 and USD 16,300 billion five years later[8]. This implies the Cyborg advisor would represent about 10 percent of total investable wealth. Pure robot advice is expected to represent no more than 1.6 percent of global wealth in 2025 and will represent only the advice to the lowest asset individuals. The average break-even AUM of current robot

[7] MyPrivateBanking, 2015
[8] MyPrivateBanking, 2016

advisors is about USD 20 billion[9] which implies that scale advantages will rather lead to a winner takes all scenario. We expect consolation in this area too. Strategic alliances between large asset managers and robot advisors are already happening. Blackrock bought FutureAdvisor, Schwab has started its own robo-advice unit and Schroders took a stake in Nutmeg.

Figure 14. Product bifurcation driven by internet technology

Source: CREATE research, 2015

Asset management's 'job to be done' still intact

Although we described a lot of changes for the asset management industry, the core business has not changed. Understanding the risk-return relationship, allocating assets, generating alpha, integrating smart beta and manage pensions are all examples of services that belong to the core capabilities of asset managers. New industry entrants have been nibbling on the borders, but have not yet reached the core activities. Winners will recognize their strategic advantage and will either develop the missing capabilities internally or acquire them.

[9] Morningstar research, 2015

Winners and losers

There are three possible scenarios to deal with the trends we described.

1) Asset managers keep customer connection through technology integration
2) Asset managers become infrastructure and lose customer relationship
3) Cooperation between the asset management industry and technology companies

We think it would be best for the eco-system as a whole if scenario 3 were to unfold. However, this outcome boils down to a prisoner's dilemma. Cooperation is indeed the Pareto-efficient outcome, but the incentive not to cooperate is large as it is still not clear how the current market potential will be divided. Taking the entire market is better to some than having to share it with others.

Figure 15. Characteristics of winning asset management proposition

Source: PWC, 2015

Non-alpha generating asset managers and advisors are challenged

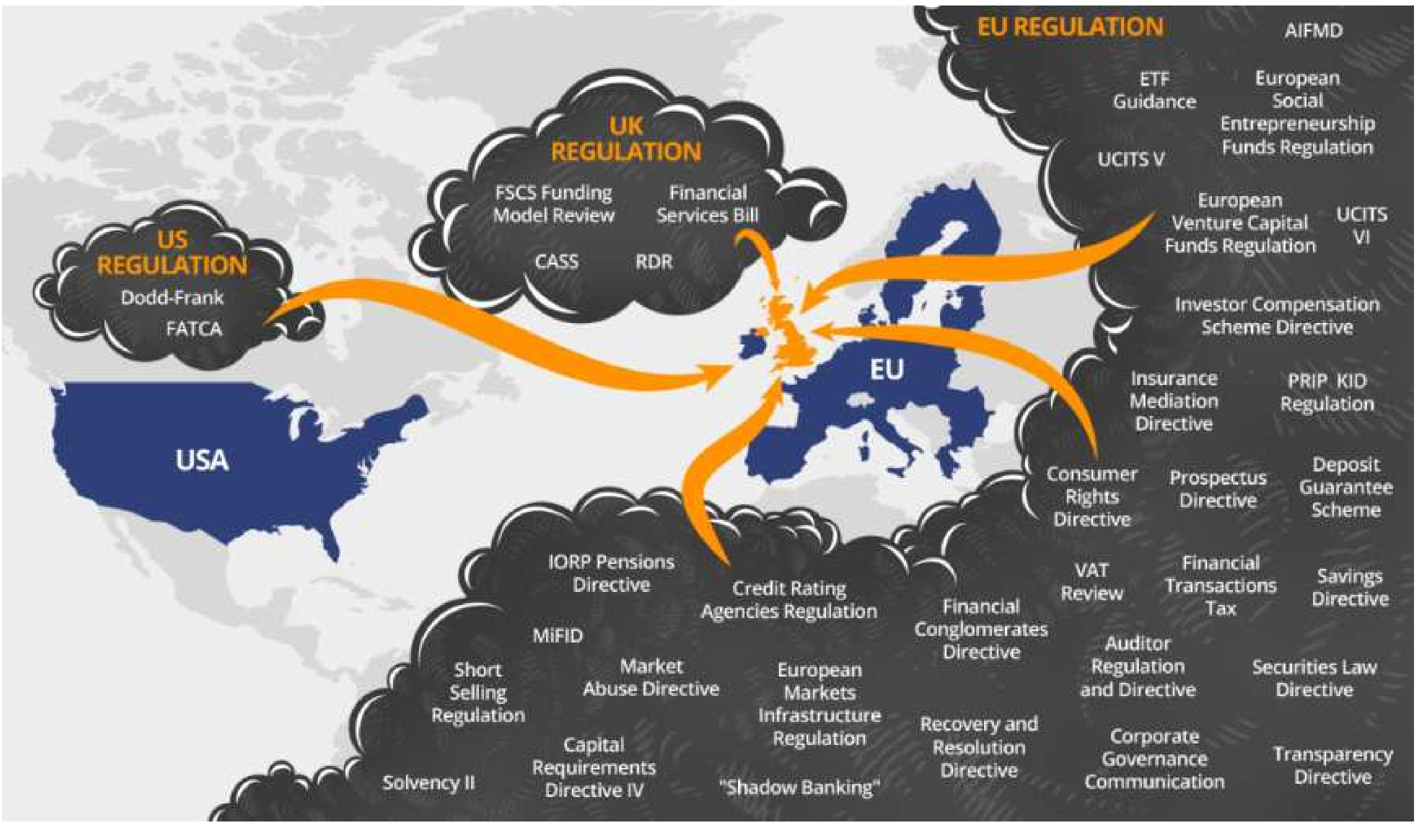
ETFs enable the separation of alpha and beta. Increased transparency combined with aggregator technology will expose non-alpha generating asset managers. In addition, we expect asset managers to integrate advice capabilities into their platforms. This is likely to have an effect on fees for advisors. Although we expect Cyborg advice, fee pressure for human advice is likely to continue. We believe the integration of technology is vital for asset managers, which implies that those managers that have not invested in their technology capability (both internally and externally focused) will be challenged.

Winners have scale, integrate technology and can offer multi-asset solutions

In our view, winning companies excel at the five focus points shown in figure 15. Important characteristics of companies that are able to implement the steps from figure 15 are scale and investments in technology. The winners will convert digital into a competitive advantage. A better understanding of the client can be created by implementing platforms and omni-channel communication. We mentioned that cost efficiency is key for institutional clients. The integration of technology is also essential here. Automatic market monitoring, report generation and a high level of customization can for example only be implemented if the right technology investments have been made. We believe Schroders is well advanced in integrating technology, multi-asset solutions and robo-advice capabilities. Next to Schroders we think Fidelity is well advanced in technology, Standard Life in multi-asset solutions and Hargreaves Lansdown together with Schwab in robo-advice.

Appendix A: Regulatory changes in asset management

Overview of global regulatory initiatives specific to the asset management industry



Source: IMA, 2013

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