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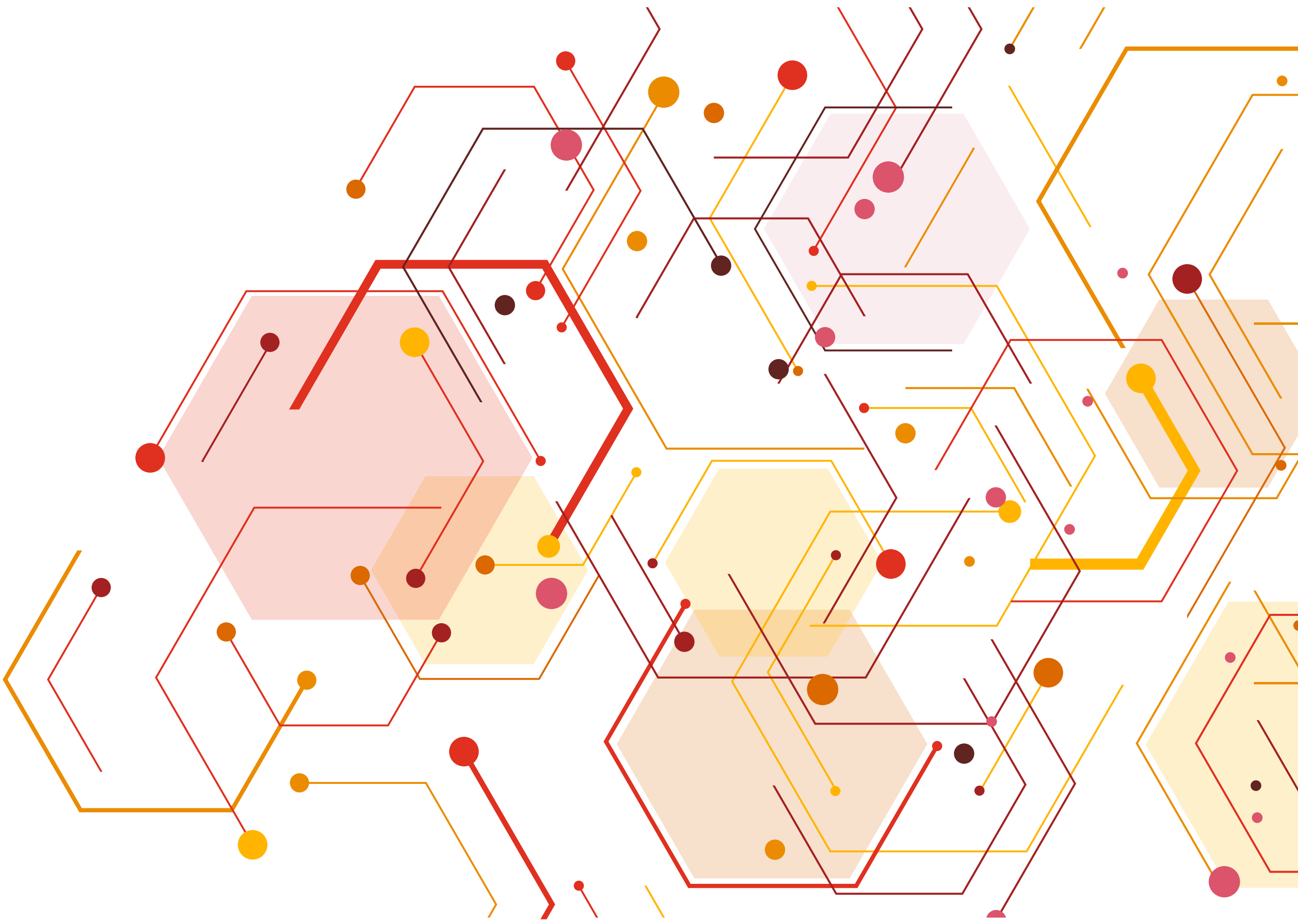
2017 Annual PwC Asset and Wealth Management Conference

Navigating the unexpected

27 October 2017



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Introduction

On 27 October 2017, PwC Hong Kong hosted its 11th annual Asset and Wealth Management conference. This year's conference – ***Navigating the Unexpected*** – took a close look at some of the game changers impacting the sector. Presenters and guests discussed how prepared the industry is to respond to them.

Welcome address

Marie-Anne Kong, Asset and Wealth Management Practice Leader for PwC Hong Kong, welcomed our guests to this year's conference and set the scene by referring back to *PwC's Asset Management 2020 – A Brave New World* paper. This paper, launched in 2014, successfully forecast the rapid growth in assets under management (AUM). It also foresaw the shift from active to passive management, the rise of ETFs and the continued expansion of alternatives – as well as changes in regulation and in investors' expectations.

PwC has recently launched a new report – *Asset & Wealth Management Revolution: Embracing Exponential Change*. This latest study predicts that global AUM will have almost doubled to US$145.4 trillion by 2025.

The past decade has seen the emergence of new opportunities, threats, and changes within and without the industry. The paper identifies four interconnected trends that will drive revolution within the AWM industry:

1. The industry is facing a buyers' market;
2. The adoption of digital technologies is a do-or-die decision for the industry;
3. Investing in real assets, trade finance, peer-to-peer lending and infrastructure will dramatically increase;
4. Ultimately, outcomes matter. This will force the industry to be more customer-centric and to focus on differentiating capabilities.

These four trends have major implications for the industry in three areas:

Strategy – firms need to reorganise to support differentiating capabilities;
Technology – this will impact all functions within the firm;
People – firms need new skills and new models for retaining talent.

Keynote address – Sir C K Chow

Our keynote speaker shared his thoughts on the opportunities and challenges facing the asset and wealth management industry in Hong Kong.

He started by emphasising Hong Kong's strategic physical and economic position, as well as its role in connecting Mainland China to the rest of the world. An important milestone was the launch of the H-share market in 1993 – this was when Hong Kong started to transform its securities market and become an important international player. Its success attracted professionals from around the world in fields such as wealth management, accounting, law, financial services and compliance. This diverse and international financial eco-system helped Hong Kong to become the number one IPO market in the world for the first time in 2009, and in several years since then.

Perhaps the biggest of the many changes since 1993 is that China has become the world's second largest economy. This has created many new opportunities for Hong Kong – especially in the asset and wealth management industry. Mainland Chinese investors still have relatively few options when it comes to diversifying their portfolios. An important piece of cross-border infrastructure was Stock Connect, launched in 2014. This provides Mainland Chinese investors with new options and offers global investors a convenient channel to access the Chinese market. Its success has led to other developments – such as ETF products, RMB interest rate and currency instruments, as well as RMB futures contracts. Bond Connect is just the latest development to be welcomed by the market.

Sir C K Chow concluded that Hong Kong remains in the best position to capture the new opportunities arising from China. Challenges for the asset and wealth management industry include IT platform enhancement and information security. But he is confident that Hong Kong can overcome these challenges because of its deep pool of professional talent and its history of strong governance.

Panel 1: Innovation and the future of financial advice

The China market represents an unrivalled range of opportunities for the industry. Despite rapid growth in recent years, there is still a very limited list of options for investors. Choice is partly constrained by regulation, as the authorities seek to rebalance the economy and address credit concerns. So, forthcoming developments – such as ETF Connect and the southbound leg of Bond Connect – are likely to be very well received.

Among recent innovations, robo-advice is seen as one of the most significant – although the shift to passive funds has generated more value. The potential of robo-advice and other next-generation investment technology is tantalising: to what extent can analysts' work be automated? The impact of AI on algorithmic trading processes is also hard to quantify at this stage.

Technology not only creates new products and services – it can also better address investors' needs. Most people are time-starved and are more interested in tangible outcomes than the precise details of a fund. How much they need for retirement or for their children's education is something they can relate to – the technical specification of a fund is not.

What digital can do to bridge this gulf remains to be seen. Many younger investors would simply like an app on their phone that can instantly tell them if they are on track to their savings goals. They are also much more comfortable about sharing data across platforms – they might be perfectly happy to invest through a social media channel such as Snapchat. KYC and other requirements may hamper this sort of ease of access – particularly for start-ups, which are likely to be less equipped than incumbents. From this perspective, the real driver of change is less the technology and more how people interact with these new products.

Artificial Intelligence (AI)could be the real game-changer if it delivers better customer experience while deploying human judgement where it can add the most value. AI's main strength is in finding patterns that can create structured data out of apparent noise. This could help augment a fund so that it generates more alpha. If you are fundraising, AI tools can scan the media and find out who is likely to be cash-rich, so that you can focus your energies productively.

AI will be able to automatically calculate a client's risk profile from their past behaviour. It will be able to detect if they have had a promotion or whether it is a good time for them to buy a house. These capabilities will free up the financial advisor to devote more time to those clients who will really benefit from tailored help.

Large corporations, such as Google and Facebook, have a lot more customer data than the banks and so may be able to identify if there is customer demand for broader asset classes, such as infrastructure or real estate. These have tended to appeal more to institutions that are looking to illiquid classes.

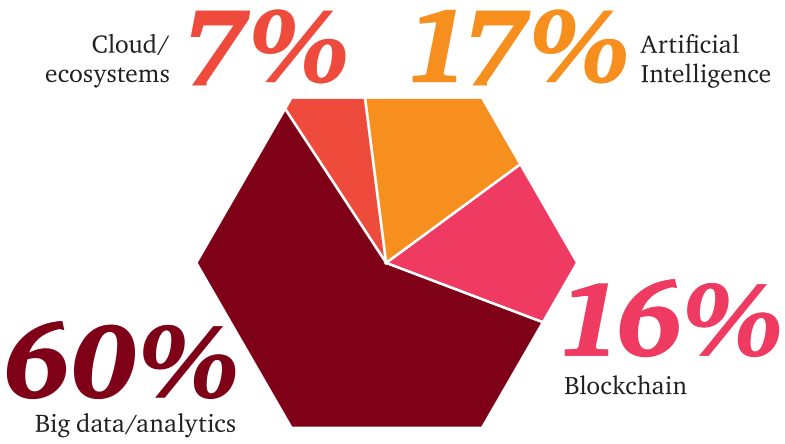
KYC is a priority area for technology. Data is static in Hong Kong – there needs to be a central facility which is used by everyone. The situation is somewhat better in China, as real time data is reviewed by AI. The use of regulatory technology (RegTech) is essential for Hong Kong to become a centre of innovation. Firms should consider switching to cloud computing, so that they are paying on a usage basis rather than per licence. Open Application Programming Interfaces (APIs) should also be adopted, so that people can access information from multiple banks in one application.

While regulation is a challenge, the regulators themselves are becoming much more innovative and are maintaining a dialogue with the industry. In large institutions, regulatory compliance is often one of the least automated areas – so there are opportunities for industry players to make the burden more manageable. India's centralised database, where all KYC is done automatically, is an example of a regulator using technology to meet the needs of the industry and its clients.

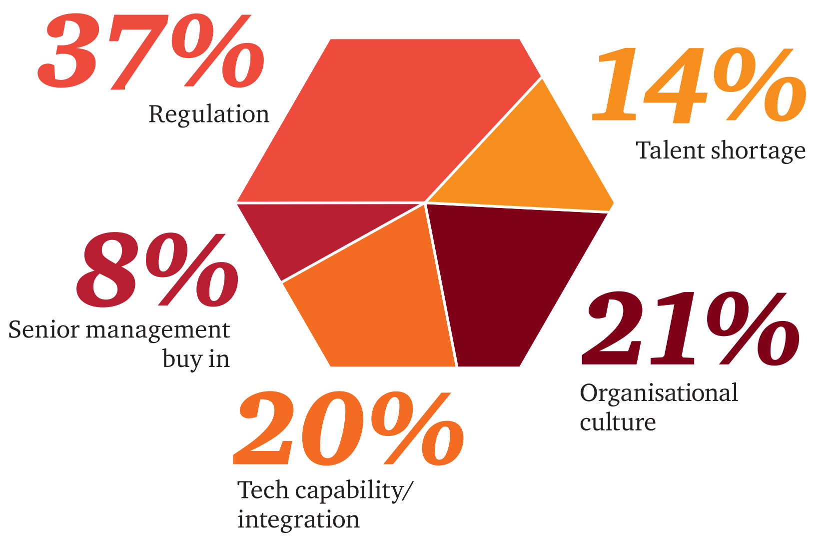
When formulating their online strategies, firms need to make a distinction between advice and execution. By some estimates, 40-50% of execution is online now. Arguably, this could rise to 70% in the next five years. However, this will vary by segment and market. In China, a combination of offline and online sources will facilitate education, advice and portfolio monitoring. In five years' time, all customers will expect online access to their portfolio. Those with less money invested are more likely to expect a real time view. Wealthier customers may want a monthly statement and human interaction.

Poll Question:

Which of the following FinTech innovations do you think will be most transformative for your organisation over the next three years?



What is the biggest challenge to innovation you see in your own organisation?



Panel 2: Regulations in the brave new world of Asset and Wealth Management

Developments in the crypto-currency environment have been startling. The value of crypto-currencies now stands at close to US$200bn; a huge sum considering this has developed outside of the traditional financial services sector. For the ten months to the end of October 2017, nearly US$2bn was raised through initial coin offerings (ICOs). ICOs are very varied in nature, but can generally be described as a combination of blockchain and crowdfunding. They vary considerably, with the spectrum of ICOs ranging from what is essentially charitable fundraising – right through to those which are better viewed as securities issuances.

Many ICOs have come and gone quickly, which has left regulators unsure how to respond. But the approach that has been seen by regulators in both the US and China suggests that their efforts are focussed on attempting to curb fraud – rather than seeking to regulate ICOs per se. So, ICOs may not necessarily be facing a wave of regulation.

That said, with the range of potential uses of blockchain (i.e. distributed ledger) technology (DLT) in the financial services world – particularly for clearing and settlement – regulators' interest levels are high. Pilots from the HKMA, NASDAQ and other bodies may result in changes to the regulatory landscape.

No-one could have predicted quite how crypto-currencies would grow since 2009. As non-sovereign competitors to fiat currencies, they have prompted concerns around counter-terrorism financing (CTF) as well as AML/KYC. The hype around ICOs, including celebrity endorsements, has heightened those concerns. Despite this, there are plenty of potential investors – especially among younger people. At this stage, though, institutional investors are largely avoiding these as an asset class – the risks are still considered too great.

Risk culture has become a major point of discussion for regulators since the global financial crisis (GFC). Concerns about risk culture – prompted by the LIBOR and FX scandals, among others – have led to a massive increase in regulation across financial services. This includes institutional and individual accountability systems in the UK, US, Hong Kong and Singapore. Regulators are waiting to see which of these approaches will work.

Hedge funds seem to have been replaced by crypto-currency firms as the objects of regulators' closest attentions. In both cases, small teams of people working together create a distinctive culture. This is why it is important to encourage appropriate behaviours – peer pressure and incentives help in this regard.

RegTech may have a role in monitoring risk culture. The introduction of new technology means that it is now readily possible to review and scrutinise every transaction that is recorded. Software can spot unusual behaviour that can trigger an internal investigation before the regulator gets involved. Regulators have a lack of tolerance now for firms that fail to monitor the activities of their employees effectively.

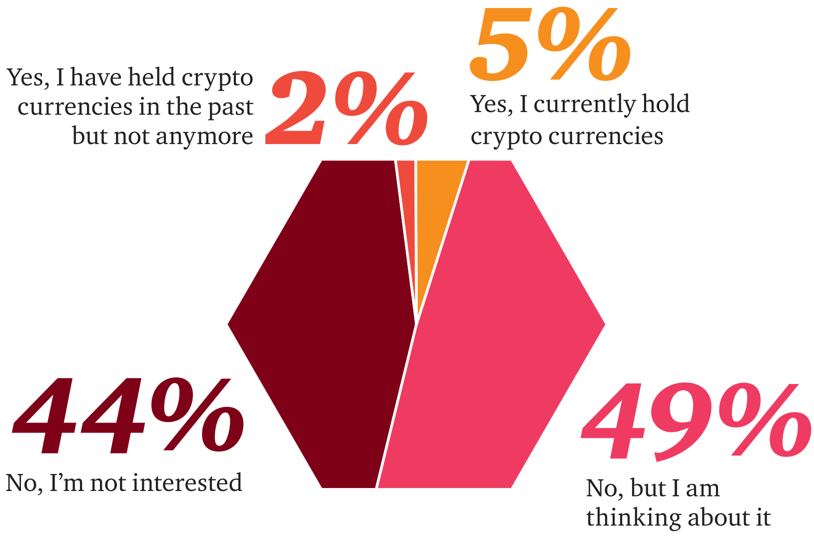
Risk culture is not only an issue for regulators, but also important to institutional investors. While investors may always be on the lookout for investment products that will deliver performance, this cannot be at the cost of reputational harm or litigation. Firms that are perceived to have a poor risk culture are likely to be avoided or suffer redemptions.

Regulatory convergence is something that is taken for granted in many industries, such as aviation. But, in the current climate, it seems unlikely that all asset managers will be complying with one rule book any time soon. Some areas will have global regulation – cross-border derivatives trading, for example. But trade policy from the US and events such as Brexit challenge the idea that we are all pursuing a common vision of globalisation.

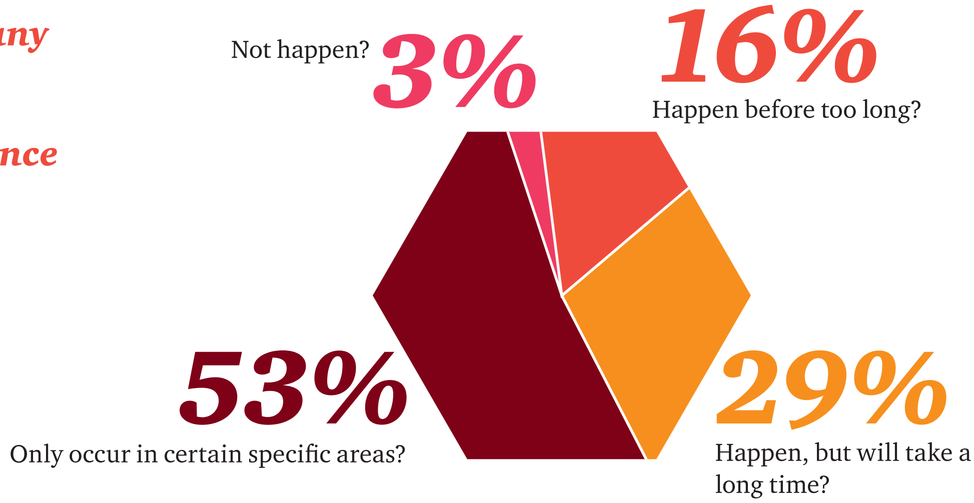
Local policy agendas are tending to triumph over global ones. Japan is trying to revitalise its economy; Hong Kong wants to integrate more with China; Singapore is focussed on employment in financial services – and so on. BEPS is an area where at a high level there seems to be global agreement, but where local implementation is decidedly mixed.

But it is not all one way. Developing technology has changed how regulators interact with the AWM industry – they are interested in its potential for a positive impact on the economy, as well as the associated risks. Compliance should become easier and cheaper due to technology, with the majority requiring no human involvement. Regulators are generally being pragmatic and flexible when it comes to FinTech, with a sandbox approach now becoming the norm with the more progressive regulators. This is encouraging a two-way collaborative approach, which is encouraging and hopefully lays the ground for close collaboration between regulators and regulatees to increasingly become the norm.

Have you held, currently hold or plan on holding crypto currencies?



Do you believe that any continued move towards global regulatory convergence will:



Debate session: The role of asset and wealth managers in a brave new world – Expectations of stakeholders beyond managing assets

Debate Statement 1: In 2025, the asset management industry will be dominated by low cost products and wealth managers will evolve to become "well-being managers"

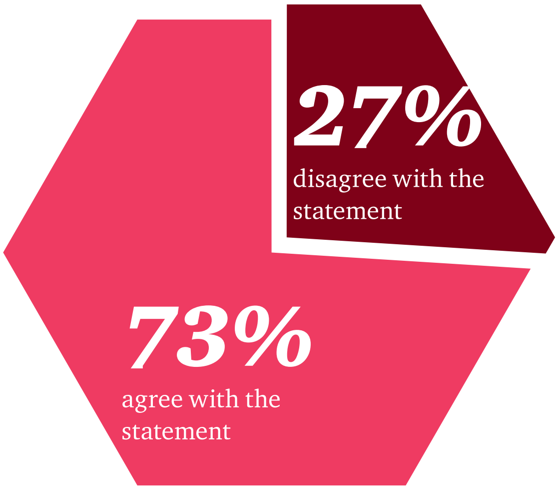
The trend towards low cost passive investing has worked in the low-volatility market of recent years. But when the market turns, there will be a slow-down in passives and a chance for fund managers to show their talent. Face to face interaction will be critical then.

People want to use low-cost technology but they also want human interaction. One reason why talent retention is such an issue in wealth management is that relationship managers can take clients with them. This is not because they always deliver great returns, but because of the relationship.

The best wealth managers are already 'well-being managers', but they are only about 1% of the industry. The rest can't move into well-being until they achieve a high level of trust. But this is hard to monetise – getting clients to pay anything other than a transaction fee will be really difficult.

Concierge services have been an important part of private banking for a long time. Clients want advice on philanthropy, education, etc. The personal touch and the ability to be insightful is an increasingly important part of the value proposition. These are things that you can't automate. Clients may go online to buy a wealth-management product, but they still need someone to talk to.

Before the debate:



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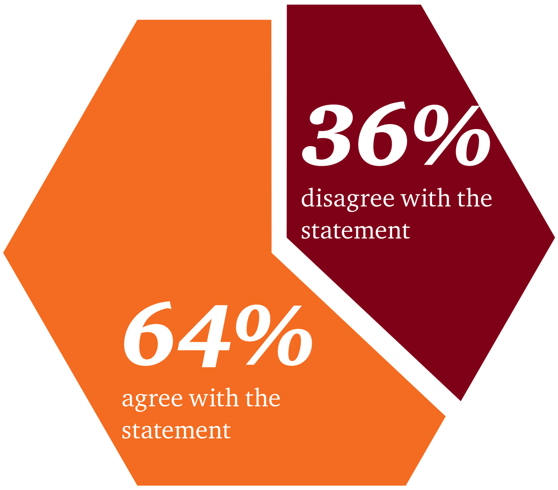


Debate Statement 2: By 2025, investors will prefer to interact with robots for AWM services. Human wealth managers will be a rarity.

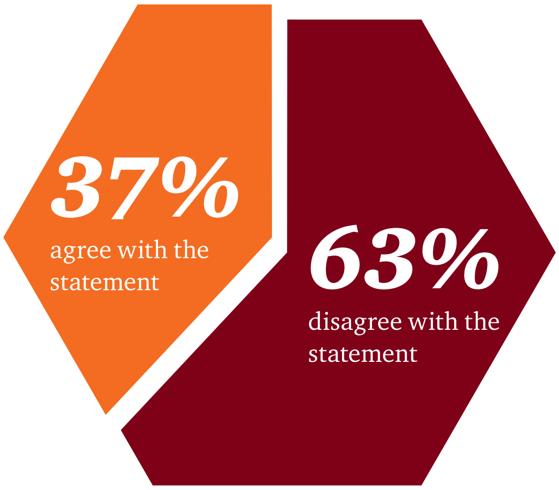
Part of the reason for the success of Uber and other services is that there is less interaction with people you don't want to talk to. By 2025, the young people who are driving these changes will have come into their own money. They will be perfectly happy dealing with robots.

All trading is now algorithmic, but there are still humans in equity departments who decide what the best algorithm is. The same will happen with asset management. There will be more passive funds driven by AI. But clients will turn to humans in order to choose between them. Some jobs will definitely be replaced, but many will migrate to a higher level.

Robo-advisors have opened up this market to a whole new audience. But as wealth and product complexity increases, things become too complex for robo-advice. You need to include tax and succession planning, etc. Clients will want to speak to wealth managers.

People definitely want to take advantage of the best technology. But, in the end, someone has to recommend which tech is best for you. Trust is the core of the AWM industry.

Before the debate:



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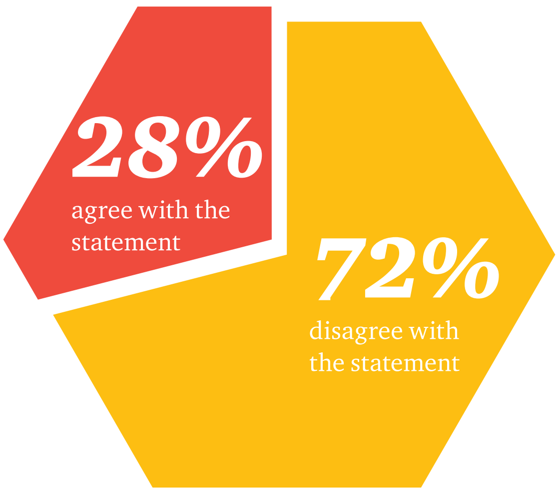


Debate Statement 3: In 2025 investors will be willing to sacrifice returns for favourable ESG outcomes

It is a mistake to try to target fund managers with ESG products. They should be marketed directly to those clients who will accept lower returns. This is a very small proportion of the investor population - ESG won't get bigger for a long time.

The individual components of ESG seem to make sense. But it doesn't work as a single proposition.

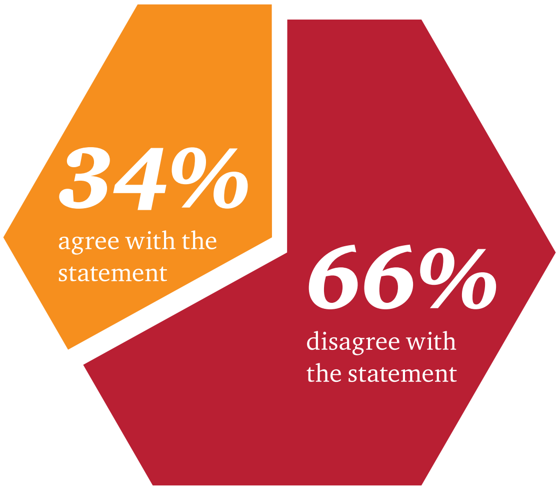
We are already seeing people putting their money into investments based on the ESG policies of the underlying companies. And we are seeing these investments paying off.

Diversity in the boardroom has been empirically proven to work. As governments get stricter, it will also make sense to back firms with sound environmental policies.

When millennials look for a job, they look for employers with these ESG attributes. So when they get older and start investing, they may think along the same lines. Talent is such a huge issue for the financial industry that this can't be ignored, especially as the recruiter may be competing with start-up employers.

Governments are hugely influential in the market and they think long term, so they will take ESG seriously. Japan's lost decades were due to poor governance – no country wants to repeat that.

Before the debate:



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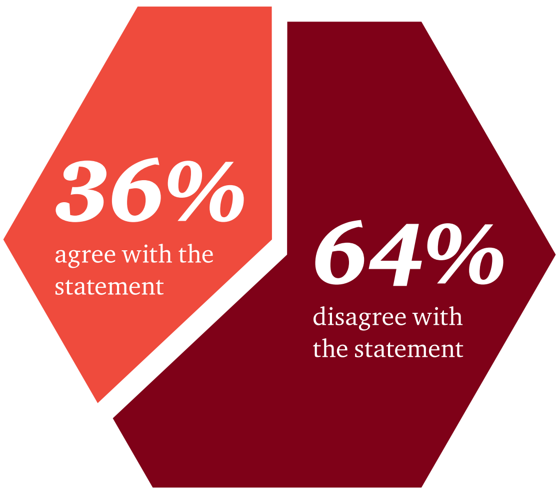


Lunch with guest speaker – Bill Majcher

Over lunch, we were fortunate to have a guest speaker whose 33 year career has encompassed working in both financial markets and law enforcement. He has been involved in multiple covert operations that resulted in successful money laundering and financial crime prosecutions.

Our guest speaker argued that what often distinguishes honest from dishonest behaviour is opportunity. Any environment that offers plenty of opportunities – trade finance, for example – is therefore a target-rich environment for money-launderers. Money always follows the path of least resistance and where there is the least scrutiny.

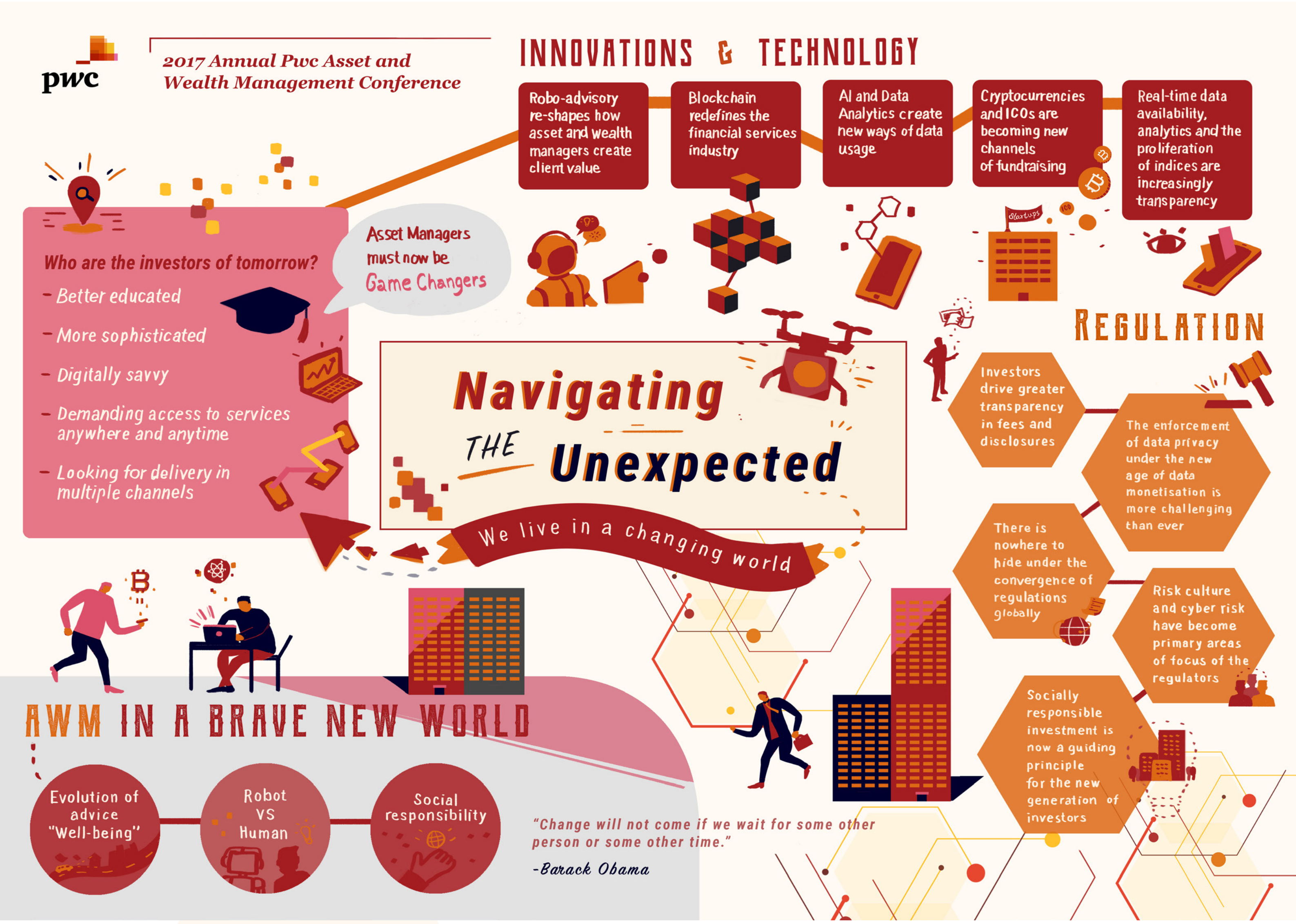
Even in the most compliant organisations, individuals can make bad short-term decisions. They may not start out with criminal intent, but everyone is susceptible to either greed, power or ego. One of the difficulties with money laundering is that 99% of the ways people do it are perfectly legal – it is the source of the money may not be. Any store of value can be used for laundering, which is why crypto-currencies are such a concern.

Another misconception is when technology is seen as either a friend or foe in the fight against money laundering. Technology is merely a medium for behaviour that has existed for centuries.

Conclusion

In the context of our forecast that AUM will almost double from its 2016 level by 2025, it is clear that asset and wealth managers need to be ready for increased regulation and competition – including from new entrants looking to disrupt the industry. A consistent theme from this year's conference, which also features in our new report, is that the industry needs to embrace technology in every part of the value chain. Younger clients, in particular, want ease of use and are more focussed on the outcomes of their investments than on the detail of individual products.

Technology needs to deliver a better customer experience and help develop new products and services. At the same time, recruiting and retaining people with the right mix of new skills will be ever more challenging. The winners will be those firms that deploy people and technology in a way that meets the evolving needs of an ever-more demanding customer base.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2017 Annual Pwc Asset and Wealth Management Conference
INNOVATIONS & TECHNOLOGY
Robo-advisory re-shapes how asset and wealth managers create client value
Blockchain redefines the financial services industry
AI and Data Analytics create new ways of data usage
Cryptocurrencies and ICOs are becoming new channels of fundraising
Real-time data availability, analytics and the proliferation of indices are increasingly transparency
Startups
Who are the investors of tomorrow?
- Better educated
- More sophisticated
- Digitally savvy
- Demanding access to services anywhere and anytime
- Looking for delivery in multiple channels
Asset Managers must now be Game Changers
Navigating THE Unexpected
We live in a changing world
REGULATION
Investors drive greater transparency in fees and disclosures
The enforcement of data privacy under the new age of data monetisation is more challenging than ever
There is nowhere to hide under the convergence of regulations globally
Risk culture and cyber risk have become primary areas of focus of the regulators
Socially responsible investment is now a guiding principle for the new generation of investors
AWM IN A BRAVE NEW WORLD
Evolution of advice "Well-being"
Robot VS Human
Social responsibility
"Change will not come if we wait for some other person or some other time."
-Barack Obama

A special thank you to all of our speakers for sharing their insights

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