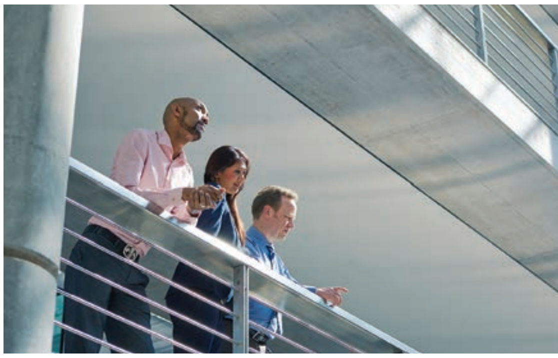
Anticipating opportunities for growth p4 / Looking for different people p6 / How to foster trust? p7 / The tensions of globalisation p8 / Complacent about technology? p9 / Prepare for rapid change p10

Asset & Wealth Management: a new era of growth, disruption and opportunity



185 AWM CEOs from 45 countries took part in PwC's 20th CEO Survey

***65%** of Asset & Wealth Management (AWM) CEOs see technology reshaping or significantly impacting competition*

***68%** of AWM CEOs have changed their people strategy to reflect future needs*

***92%** of AWM CEOs are confident or very confident about 2017 revenue growth*

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Introduction

For the past 20 years, PwC's CEO Survey has asked business leaders around the world about trends reshaping business and society at a time of tremendous growth for Asset and Wealth Management (AWM).

In the past 11 years alone, asset managers' assets under management globally have more than doubled from $37.3 trillion in 2004 to $78.7 trillion in 2015.[1] Meanwhile, the wealth management industry has expanded rapidly, with Asia-Pacific's private wealth growing fastest and quickly catching up with Europe's.[2]

Our 20th Annual Global CEO Survey comes at a time when technology and globalisation are powerful forces of change. It reveals an AWM industry that's set for growth but also one uneasy about how ready AWM firms are to address the opportunities and challenges these forces will bring. Our client experience, and the CEO interviews showcased in this report, shows some larger firms with their eyes firmly on the future. But the survey also shows many AWM firms planning to continue business as usual. This contrast may partly be because our sector includes a higher proportion of small firms than the rest of the CEO Survey.[3] Even so, the sector appears slow to innovate and adapt.

"Technology is a disruptive force and I am amazed by how low the sector's survey responses are around digital and cyber security. This industry is not thinking as agilely around technology and disruption as it should. How do customers interact with these firms and how will they want to in the future? When we think of demographic changes with huge wealth transfer where people do not work the same way as their parents – do we even have the right model to address their needs? Some CEOs are looking into this but our survey shows too many of them are not. There's a real risk of firms being swept aside," says Barry Benjamin, PwC's Global Asset & Wealth Management Leader.

The following pages reveal an industry that's confident about its growth, but struggling to adapt to changes in talent, trust, globalisation and technology.

Barry Benjamin
Partner
Global Asset & Wealth Management Leader
PwC (US)

1 PwC analysis of past data based on Hedge Fund Research, ICI, Preqin, Towers Watson and the City UK data.

2 Predictions made by the PwC Market Research Centre.

3 Of the 185 AWM firms that took part in our survey, 71% had fewer than 500 employees. That compares with just 28% of the 1,379 firms in the entire CEO survey.

Anticipating opportunities for growth

"There are a number of markets which are primed for above average growth. I would cite Asia simply because of the wealth creation that's going on, the maturing of those markets. Same is true in South America, where again you're seeing new markets, like Columbia, opening up, which previously hadn't been part of that."

Peter Harrison
Group Chief Executive of Schroders plc

While growth was uneven in 2016, there's irrepressible optimism about 2017. Over the past year, buoyancy in Asian wealth management contrasted with flat US asset management. Yet 92% of CEOs say they're 'very confident or somewhat confident' about their firms' revenue growth in 2017. This level of confidence is even greater than in 2016, when 90% expressed this high level of confidence. And, CEOs maintain 2017's level of confidence for the next three years, indicating optimism about the medium term.

But there's acknowledged pressure on profit margins. "You never know what's coming in three years but we know it'll be challenging," opines Brian Conroy, President of Fidelity International. "We know that margins will continue to compress and that our clients will continue to demand more tomorrow than they did yesterday."

CEOs are less sure of the global economy. After a year of mounting uncertainty – caused chiefly by populist surprises in the US, UK and Italy – they're not so sanguine. Just 29% anticipate the economy will improve in 2017, while 50% expect 2016's anaemic growth levels to persist. For comparison, in 2016, CEOs were similarly uncertain, with 30% looking for improvement.

OECD economies are viewed as the most important for AWM growth in 2017. As the world's largest AWM market, the US is unsurprisingly judged the most important country outside home markets by 54% of our CEOs. Among the other leaders, China is thought the most important by 28%; Germany by 25%; the UK by 18%. There's been a big shift towards the US since 2016, when 39% viewed the country as their most important source of growth.

"There are a number of markets which are primed for above average growth," explains Peter Harrison, Group Chief Executive of Schroders plc, the UK-headquartered international asset management group. "I would cite Asia simply because of the wealth creation that's going on, the maturing of those markets. Same is true in South America, where again you're seeing new markets, like Columbia, opening up, which previously hadn't been part of that."

"Specifically, for Schroders, there are a huge number of opportunities in North America because we are coming from a small base that we can expand our market share both in the intermediary and in the institutional market places. Across the world there are opportunities also to grow private assets for pension funds."

For the first time, we have also asked which three cities will be most important for growth in the next 12 months. While New York is ranked as one of the three by 23% of CEOs, London and Beijing both receive votes from 21%. This appears to suggest CEOs believe London will remain a leading global financial centre despite Brexit's imminence; it also shows Beijing emerging as a global wealth management centre as the number of wealthy Chinese expands every week.[4] Also benefiting from rising Chinese wealth, Hong Kong is voted for by 17% and Shanghai by 15%. Surprisingly, Singapore is only mentioned by 9%.

Many of the sector's CEOs are planning some kind of corporate activity to drive profitability. 52% are looking to strategic alliances or joint ventures, while 41% are plotting a merger or acquisition. In 2016, there were several mergers in the sector as smaller firms combined to gain distribution power and larger firms did so to gain scale at a

4 Billionaires: Master architects of great wealth and lasting legacies. UBS / PwC. 2015. (In China in Q1 2015 a new billionaire was created almost every week.)

time when active asset managers face dwindling sales, rising costs and fee pressure. For example, towards the end of 2016, Henderson and Janus Capital announced their intention to merge, and Amundi revealed its acquisition of Pioneer Investments.

Andrew Formica, CEO of Henderson Asset Management, explains the logic for his firm's merger. "I would say, over the last few years, it has become harder to be able to invest in the business for future growth, as some of the more mandatory requirements, driven by regulatory change, have eaten into any budget you would have in that.

"That was actually one of the key drivers of the decision that we took at Henderson to merge with Janus to create Janus Henderson. Janus Henderson is about getting back that ability to give us sufficient scale to meet our regulatory and mandatory responsibilities to our clients and the investments we need to make. But also carving out additional ability to invest in innovation areas, new areas, technologies that we're not sure if they'll work or not, but we do believe that they can add significant benefit for our clients."

There are likely to be more mergers, not only because firms are seeking distribution power and scale but also as some seek to break into new markets through buying talent. "The need for further globalisation and the need for talent that AWM firms have is dramatic," explains Barry Benjamin. "When I think about where the CEOs are looking at movement, it is these deals, JVs, acquisitions, etc. A lot of these deals are likely to be about trying to break into new markets by accumulating talent. That's not just Western companies buying into emerging markets but also the other way around."

That just 27% of CEOs are looking to collaborate with entrepreneurs or start-ups confirms the picture of a sector reluctant to innovate. By comparison, 31% of CEOs from banking and 37% from insurance plan to do so. They're working with FinTech companies to develop new products and business models that may transform their sectors.

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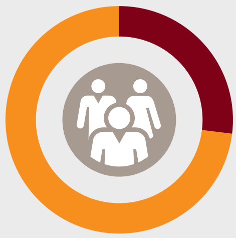
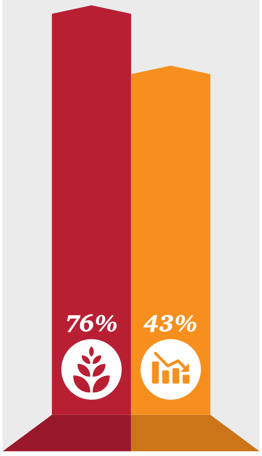


***76%** of our sector's CEOs are prioritising organic growth and **43%** cost reduction.*



AWM companies are still looking at more traditional ways to enhance profitability. Some 76% of our sector's CEOs are prioritising organic growth and 43% cost reduction.

There are plenty of background risks that CEOs are concerned might hamper their businesses' growth. They're 'extremely or somewhat concerned' about uncertain economic growth (84%), over-regulation (79%) and the increasing tax burden (77%). Reflecting global instability, they're also focusing on geopolitical uncertainty (69%), the future of the Eurozone (64%), exchange rate volatility (63%) and social instability (69%).

Within their businesses, CEOs' biggest concerns are availability of key skills (71%), speed of technological change (66%), changing customer behaviour (64%), lack of trust in business (61%), cyber threats (59%) and new market entrants (59%). However, echoing the theme that recurs through this survey, they appear far less concerned about technological change and cyber threats than their peers in banking and insurance.

As the millennial generation becomes its main customer, the industry will need to simplify its offering, according to some of the CEOs we interviewed. Fidelity's Brian Conroy says: "Over the next 20 years, I think there'll be a drive to make what has been a complex financial services industry much more simply delivered to clients globally."

Given 2017's business environment, CEOs have differing ideas about the areas they'd most like to strengthen to capitalise on new opportunities. The greatest number, 21%, prioritise human capital, as has always been the case in a sector that depends on the skills of portfolio managers and client advisors. Competitive advantage ranks second at 14%, which is logical. Then M&A and partnerships come third (11%). But digital and technology capabilities are prioritised by just 10% – by contrast, 32% of banking CEOs and 28% of insurance CEOs want to strengthen this area.

Looking for different people

"We need to focus on taking the 'best athletes' – those who are leaders or with clear leadership capabilities versus those with specific qualifications or subject matter expertise"

Joe Sullivan
CEO of Legg Mason

79%

of CEOs either 'agree or agree strongly' that they promote diversity and inclusiveness.

Turning to how CEOs plan to leverage talent to take advantage of opportunities arising from technological changes and globalisation, the picture is mixed. While CEOs see the need to re-engineer their approach to the workforce, the sector doesn't appear to be prioritising relevant areas such as digital skills to the same degree as other sectors. But the relatively small size of AWM firms may make them less likely to do so.

That many AWM CEOs are planning to expand their workforces is also what one would expect from small, often young, companies. 64% of CEOs plan to increase headcount in 2017, in line with the 65% that planned to in 2016.

There's a drive to adapt the workforce to the broader set of skills, agility and creativity needed for the future. For instance, 79% of CEOs either 'agree or agree strongly' that they promote diversity and inclusiveness. Similarly, 68% either agree or agree strongly that they've changed their people strategy to reflect the skills and employment structures needed for the future. Both topics elicited much higher positive responses from CEOs in the other financial services sectors of banking and insurance.

"I think our business will require very different people," says Peter Harrison of Schroders. "It'll require a far more diverse set of staff with a much greater understanding of broader social issues. We're changing our workforce very markedly in terms of the diversity of thought which goes on in the business, having external influences."

In a 2016 paper called 'The power to perform: Human capital 2020 and beyond', PwC argued that just as financial services companies are being transformed, so too is the talent they need to succeed. By 2020, we predicted, the make-up of your workforce and how it's recruited, organised and rewarded will look very different from today.

In line with this conclusion, 55% of our sector's CEOs either agreed or agreed strongly that they're rethinking their HR function. While a less emphatic response than received in banking and insurance, nonetheless this response shows what direction the more progressive firms are heading in.

The human qualities that CEOs value illustrate the need for agility. Those that they judge very important or somewhat important are: problem solving (98%); adaptability (95%); leadership (91%); risk management (87%); creativity and innovation (86%); digital (72%). From these, they view creativity and innovation, along with leadership, the most difficult to find. While the emphasis on creativity and innovation is notable, the fact that CEOs don't attach more importance to digital skills is striking.

Joe Sullivan, CEO of Legg Mason, believes rising to the challenges AWM is facing demands dynamism. "We need to focus on taking the "best athletes" – those who are leaders or with clear leadership capabilities versus those with specific qualifications or subject matter expertise," he says. "Diversity is also important on many levels, with culture, background and perspective all leading to diversity of thought."

How to foster trust?

Turning to the issue of low levels of trust in an increasingly digitised world, more than half (62%) of AWM CEOs 'agree or agree strongly' that it has become more difficult to gain and keep trust. With this in mind, 83% 'agree or agree strongly' that it has become more important to run their businesses in a way that accounts for wider stakeholder expectations, while 90% think it's important to have a strong corporate purpose that's reflected in their values, cultures and behaviours.

Our CEOs see the biggest threats to trust as cyber security breaches affecting business information or critical systems (53% worry about this to 'a large extent') and IT outages and disruptions (42%). Consequently, 38% of them are addressing cyber security to a large extent, with 41% saying they're doing the same for IT outages and disruptions. Surprisingly, CEOs aren't especially worried about risks from use of social media or from artificial intelligence and automation (including blockchain).

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The tensions of globalisation

When it comes to the benefits of globalisation, our CEOs see pros and cons. For instance, 64% judge that globalisation has helped 'to a large extent' by improving the ease of moving capital, people, goods and information. There's scepticism about the extent to which it has helped with the fairness and integrity of the tax system, with 35% of CEOs saying it hasn't done so at all. They're a little more positive about how globalisation is helping to harmonise regulations, with 24% saying it has done so to a large extent.

But CEOs are ambivalent about the benefits for society. Just 10% think globalisation has helped to close the gap between rich and poor to a large extent. Similarly, only 18% believe it has helped with the management of geopolitical risks.

From a business perspective, managing a global AWM company can be difficult. "Where I do see a clash is corporations are trans-national, trying to straddle many different borders, many different interest groups, and politicians are elected by a narrow electorate in one geography," says Peter Harrison. "As an international company, understanding those different stakeholder groups is really very difficult."

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Complacent about technology?

48%

of our sector's CEOs profess to have strong digital skills, this compares with an average of 55% across all sectors participating in our survey.

AWM CEOs' views about technology beg the question: is the sector preparing fast enough? Personally, and commercially, they appear less acquainted with new technologies than their peers in other sectors. So far, these technologies have disrupted AWM less than banking, for example. But will technology now start to disrupt AWM?

Fidelity's Brian Conroy has no intention of being left behind. "In order for any firm to successfully deliver financial products to clients going forward, they're going to absolutely depend on being at the cutting edge of technology," he says.

But while 48% of our sector's CEOs profess to have strong digital skills, this compares with an average of 55% across all sectors participating in our survey. Similarly, while 37% say that they're active on social media, this level compares with 43% across all sectors.

Looking back 20 years, technology has had less impact on AWM than other financial services sectors. So, while 74% of banking and capital markets CEOs believe it has 'completely reshaped or significantly impacted' competition in their sector, only 53% of AWM CEOs say it has.

Looking forward five years, AWM CEOs anticipate technology will cause more disruption. Some 65% see it completely reshaping or significantly impacting competition. Yet, still they appear to underestimate the threat; across financial services as a whole, 77% of CEOs anticipate this happening.

Schroders' Peter Harrison thinks technology will certainly lead to considerable change. "Well, I think the advent of artificial intelligence is the thing which will really change the way in which we approach our work," he explains. "We haven't really started on how we process information without behavioural biases. As individuals, we all bring far too much behavioural bias into the workplace.

"Once artificial intelligence is up and running, we will be way better at making informed, relevant, consistent decisions. It will cause its own problems too, but it will be the thing which changes most over the next 20 years undoubtedly."

But the contrast between the views of the CEOs of large AWM firms interviewed and those of the general survey population recall the surprising complacency about technological innovation that surfaced in our latest PwC FinTech survey, 'Beyond automated advice'. Blockchain, the use of artificial intelligence in portfolio management and a range of digital applications, promise significant opportunities for AWM that should not be ignored.

"We are all technology companies now; just expressing it in different ways," notes Legg Mason's Joe Sullivan.

Prepare for rapid change

The results of our 20th CEO survey couldn't come at a more interesting time for AWM. Much of the natural revenue growth has shifted from the West to Asia, while there's pressure on fees, passive strategies are proliferating and robo advisors are being introduced. As if this weren't enough, the pace of technological change appears to be accelerating and the destination is unclear.

Our survey respondents are relentlessly optimistic about their own growth – indeed, the sector appears to be set fair for rapid growth as the world saves more. Yet it's difficult to escape the conclusion that some AWM firms are ill-prepared for the huge change technology, shifting consumer preferences and globalisation may bring. Where are the collaborations with FinTech entrepreneurs that are increasingly common in banking? AWM firms face disruption but there are also opportunities.

"I couldn't be more optimistic about the future of the asset management industry," says Brian Conroy. "I think it's going through a rapid change. There'll be competitive threats and pressures, but where there is disruption there is also opportunity, and I think those that are successful through this period will be the ones that embrace the challenges and look to the future as opposed to looking to the past."

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Brian Conroy
President of Fidelity International

Contacts

If you would like to discuss any of the issues raised in this report in more detail, please contact me.

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