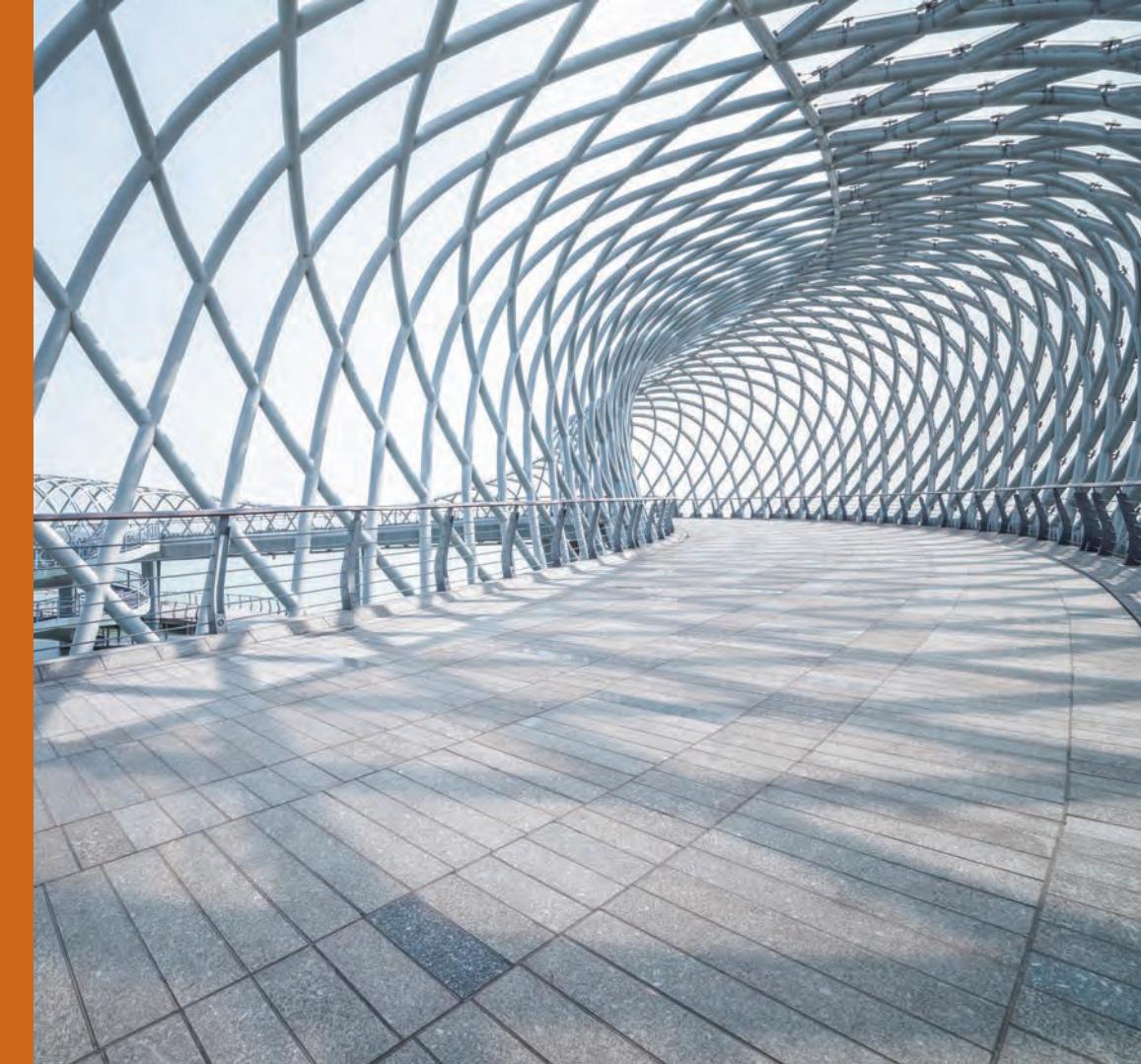


Asset and wealth management revolution: Investor perspectives

Rethinking purpose and performance





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Introduction



In August 2019, smoke from the fires raging across the Amazon rain forest blew, albeit metaphorically, into the marbled halls of Biarritz's Hôtel du Palais, where G7 leaders were gathering for their annual summit. The symbolic threat hung in the air as they ran through their agenda, which focussed not only on economic growth, but also on the fragility of our environment and the inequalities within today's fractured societies.

This groundbreaking G7 meeting was a manifestation of a trend we're seeing around the world. Many people no longer believe that institutions and corporations understand, let alone act in, their interests. This mistrust breeds uncertainty and instability, which are reflected in everything from electoral shocks and protesters on the streets to the rapid reversal in what once seemed like the inexorable rise of globalisation and open borders. Businesses and governments alike are reeling from this upheaval.

In asset and wealth management (AWM), investors are now thinking in new ways about how their capital is handled. They're embracing digital technology, changing the way they interact with AWM firms. They're more and more interested in social responsibility and other nonfinancial aspects of investing. They recognise the higher level of competitiveness in the AWM industry

and are paying attention to cost and efficiency, even scrutinising firms' operations. And social media has given them a platform from which to broadcast their opinions, including dissatisfaction about firms that fail to meet expectations.

Things are changing from asset managers' perspectives, too, especially as tension increases between appropriately exercising fiduciary duty on the one hand and providing consistent, excellent investment returns on the other — while also balancing issues of social responsibility, risk management, uncoordinated global regulation and underfunded retirement.

If you're a leader in an AWM firm, these changes require you to transform your purpose, how you operate and how you measure success. Forget about business as usual. You can't operate in a vacuum as all these changes swirl around you.

For example, you need to transform how you make key decisions and use data to inform those decisions in order to chart a course through an era of macroeconomic and political turmoil — especially as some asset managers increase their offerings in alternative investments.

You need to transform your operations to govern your business effectively and safeguard clients in areas such as cybersecurity. You need to transform your investment strategies to meet environmental, social and governance (ESG) criteria as these considerations move from the fringes to the mainstream, especially among the biggest and most powerful investors. But because transformation is expensive and disruptive, you also need to focus clearly on the factors that are most important to your investors and the capabilities that will give you the greatest opportunities for differentiation and growth.

To determine what investors care about most and how satisfied they are with asset managers' performance in these areas, we conducted a survey of 750 institutional investors and 10,000 retail investors around the world. We then created an Investor Alignment Index that measures the gap between how satisfied investors are with asset managers' performance in each area compared with how important that area is to them. In this report, we'll explain our findings and offer advice on what AWM firms can do to seize the opportunities and address the challenges identified.

Survey and Index Scoring

Our survey looks at investor priorities and satisfaction in six key areas:

- Risk-return
- Fees
- ESG
- Relationships
- Operational strength
- Macroeconomic and political environment

Using the survey responses, we rated on a scale of 1 to 10 how important each of these factors is to investors and how satisfied they are with AWM firms' performance in these areas.

For the Investor Alignment Index, we used a scale of -9 to 9 to measure the gap between how satisfied investors are with asset managers' performance in each area and how important that area is to them. A negative score denotes that investors' needs are not being met, zero means there is no gap and a positive score means that expectations are being exceeded.

The index can provide a baseline against which future progress can be measured and priorities for further action identified.

Ample scope to win more business



In earlier papers in our *Asset and Wealth Management Revolution series*, we explored both the unparalleled opportunities for growth we were seeing in the market and the challenges that the intensifying squeeze on operating costs, fees and value for money were presenting.

Our new research underlines the extent to which performance is no longer just about financial returns in isolation from other factors. The investors we surveyed are, as a general group, most focussed on the macroeconomic and political environment, ahead of risk-return. This would suggest that investors see managing the impact of the former to be absolutely critical in optimising the latter. Our survey shows that the macroeconomic and political environment is especially important for retail investors, who are generally the most vulnerable to a downturn.

Retail investors in our survey also place high priority on relationships. A key element of why this is important to them is likely that they need communication and explanation to be reassured that managers are on top of the risks in the difficult market conditions ahead.

Operational strength is the number one priority for the institutional investors we surveyed. Operations refers to more than just systems and processes; it includes data quality, reporting, investment operations (e.g., trading) and operational risk management. Possible reasons that institutional investors prioritise operations are that they've moved towards more operations-intensive alternative investments and that they are more sensitive to operational issues owing to recent scandals. Investors are also concerned about the long-term performance of smaller and midsized asset managers, which pushes focus towards operational strength.

ESG has become a top priority for the industry in recent years. It ranks third in importance among investors surveyed, as a whole group, and it outranks fees. We've found in our day-to-day work that just as corporations' ESG records are being scrutinised by analysts and rating agencies, ESG is now a fundamental priority for sophisticated investors across the globe. They're examining AWM firms' ESG performance: they're questioning corporate pay, they're poring over labour and procurement policies, and they're thinking about how their investments affect climate change.

Key regulatory developments

1

EU

- Framework to facilitate sustainable investments
- Creation of new category of carbon benchmarks
- Shareholder Rights Directive II

2

UK

- Financial Conduct Authority Climate Change and Green Finance
- Department of Work and Pensions clarifying and strengthening trustees' investment duties

3

US

- Department of Labor ESG investment consideration guidance
- Securities and Exchange Commission guidance on climate disclosure, petitions for additional rulemaking on ESG disclosure

4

Hong Kong

- Securities and Futures Commission Strategic Framework for Green Finance

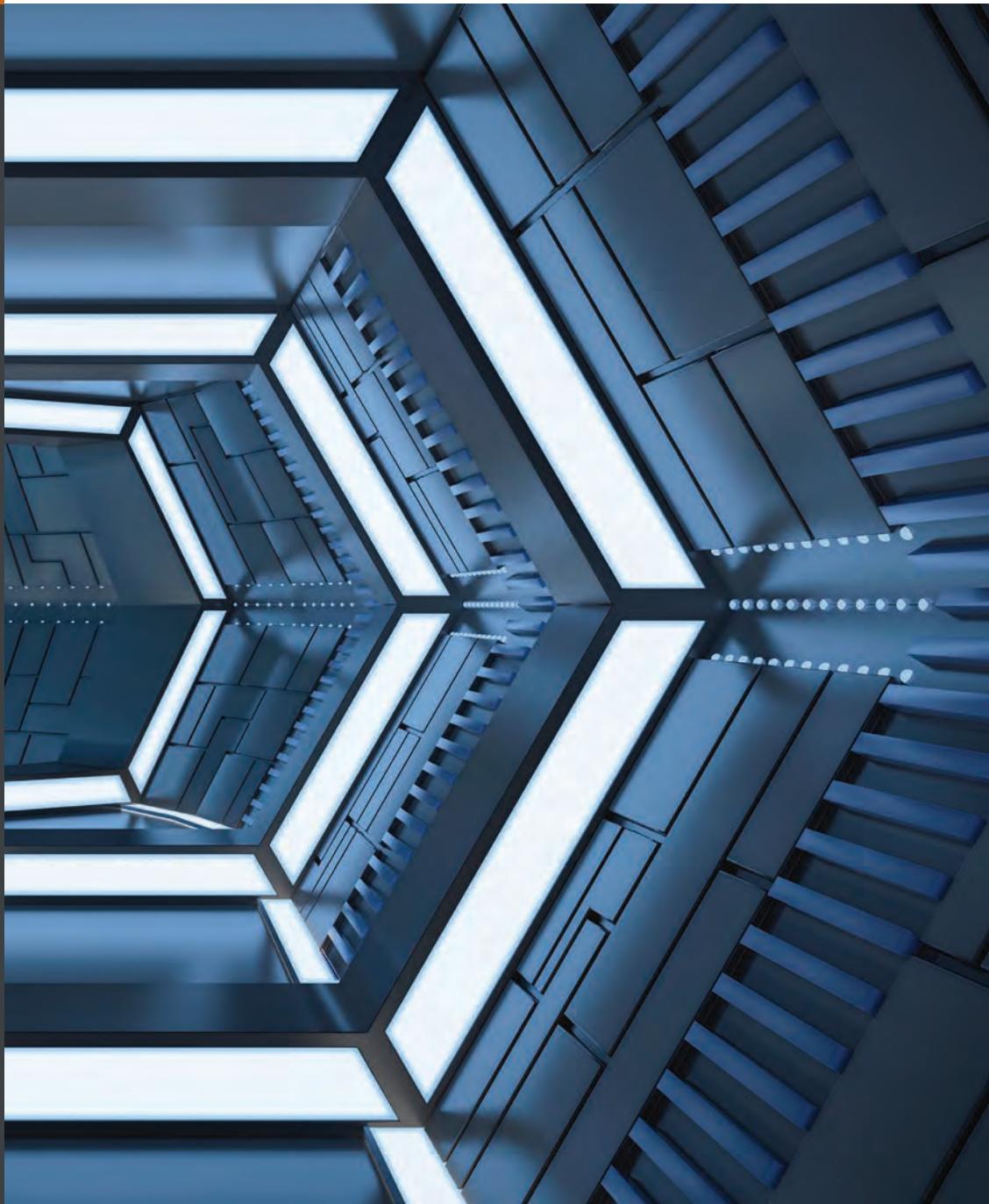
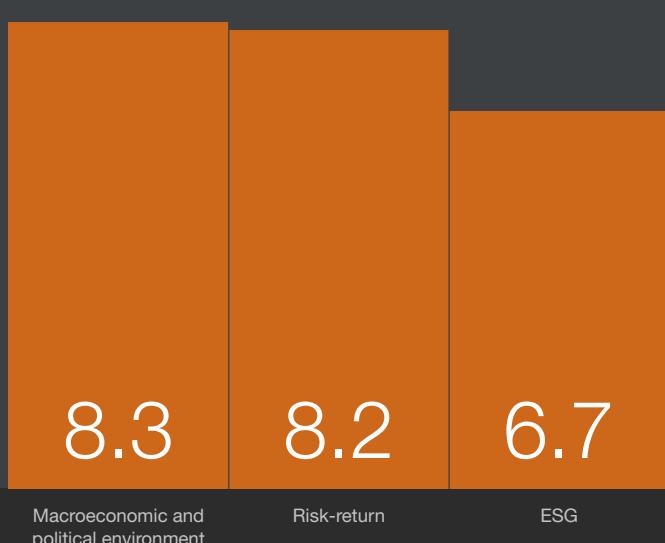


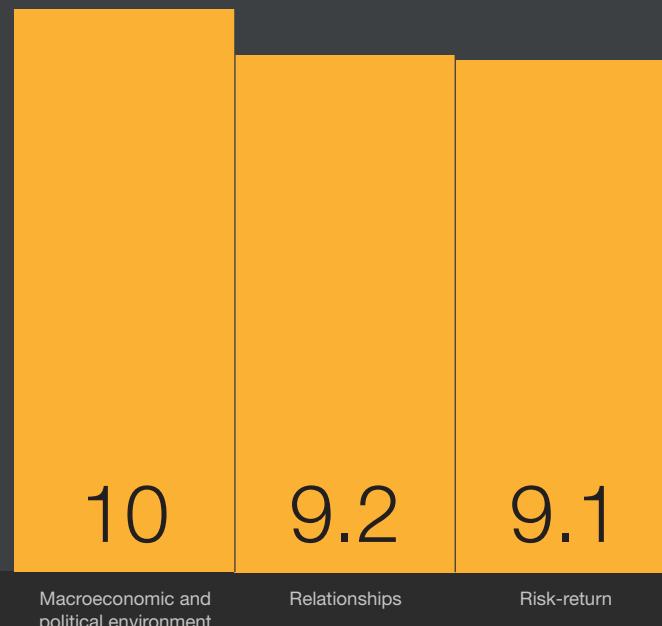
Exhibit 1: Top three priorities for investors overall

How investors, overall, rate the importance of six areas of investing, on a scale of 1-10

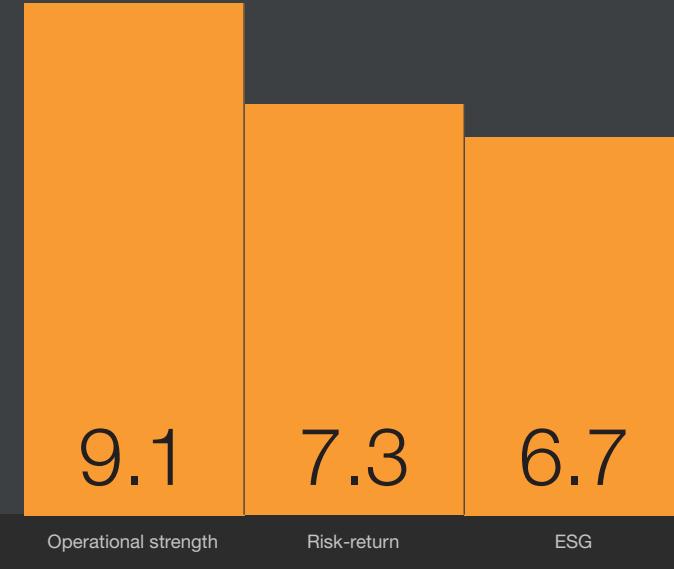
All investors



Retail investors



Institutional investors



Source: PwC

Our survey shows that most investors still see financial returns as a top priority. However, two signs that ESG is now a mainstream focus for investors are that many big pension funds have well-publicised ESG priorities and that their products cater to a wide variety of investor types. ESG and financial return aren't mutually exclusive. Many investors want ESG to be integrated into funds because they believe it can generate superior financial performance by mitigating reputational, operational and financial risks. With this in mind, we believe that overall ESG mutual

fund assets are set to grow at an 8.5% compound annual growth rate (CAGR) between 2017 and 2025, to reach US\$2.08tn, which is a stronger growth rate than that of the overall industry.

According to our survey, investors in Europe, as a general group, care more about ESG than their counterparts in North America. But for North American institutional investors, specifically, ESG is a higher priority relative to other dimensions of investing than it is for their European

counterparts. And although the overall survey results for Asia Pacific largely reflect the global picture, ESG is lower on the list of priorities for institutional investors surveyed there than in other parts of the world. ESG is a key focus for many large pension and sovereign wealth funds, and it's also increasingly important to younger generations, who will be receiving large wealth transfers from older generations over the coming years.

Exhibit 2: Top priorities for investors by region

Importance rated on a scale of 1-10



How do investor priorities and satisfaction with firms' performance line up?



The Investor Alignment Index shows that asset managers fall slightly short of the expectations of survey respondents overall (receiving a zero on a scale from -9 to 9).

Although asset managers fall slightly short of investors' expectations, they exceed investor expectations on ESG. Most importantly, in the crucial dimension of risk-return, asset managers exceed both institutional and retail investors' expectations. We believe that the demand for ESG products and services will continue to grow, and if asset managers stay on the same path, they should continue to exceed investor expectations. Institutional investors noted they are also happy with their current relationship with asset managers; however, retail investors want managers to go further. Technology can help with some, but not all, of the solution here.

In line with previous papers in the AWM Revolution series, our survey shows that alignment on fees is low. This result is mainly being driven by retail investors. A possible reason that there is no misalignment for institutional investors is that as professional investors they are in a better position to be aware of fee levels, and given their buying power, are better able to negotiate. By being more transparent and aligning retail fees with performance, AWM firms might be able to assuage retail investors' concerns.

For institutional investors, the biggest gap in importance versus satisfaction, by far, is in operations. The fact that institutional investors are more worried about operations than their retail counterparts probably reflects the extent to which they're better able to review and judge AWM firms' capabilities. Although larger managers have invested significantly in operations, this could put

particular pressure on smaller and less well-resourced firms. Clear signs of concern about operations that we've seen include the increasing prominence of operational factors in due diligence questionnaires. In the wake of governance scandals, the examination is taking an especially close look at recruitment, incentives, reporting lines and third-party controls. Granted, asset managers are dealing with increased data, governance and risk management requirements now that they're managing more alternative investments.

Regionally, investors we surveyed in North America indicated that the alignment gap is biggest when it comes to operations. This gap isn't as big for investors in other parts of the world. AWM firms in North America might believe they're ahead of the game technologically, but these findings are likely to challenge this belief and dispel any complacency.

Exhibit 3: Where investor priorities and satisfaction are most aligned

The difference between how important six areas of investing are to investors, overall, and how satisfied they are with asset managers' performance, on a scale of -9 to 9

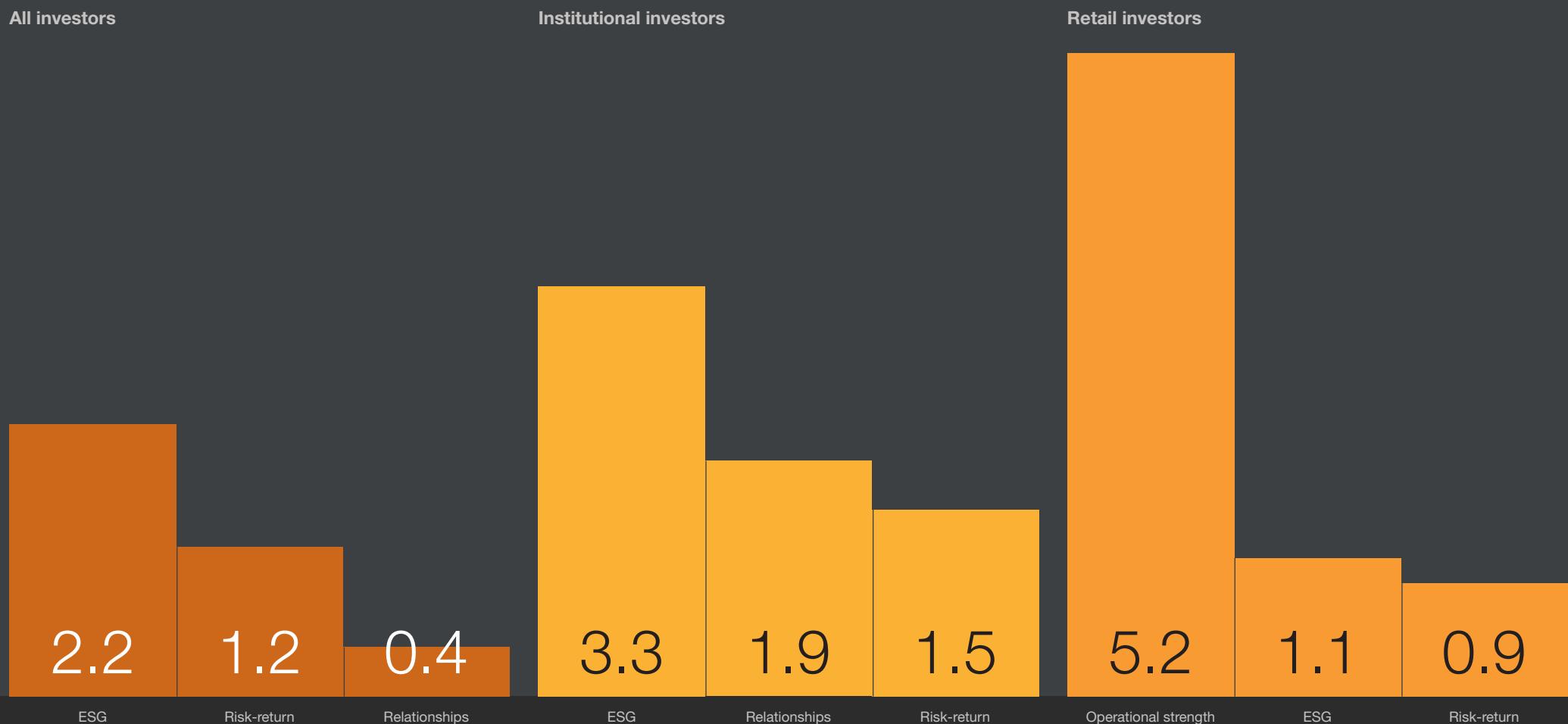
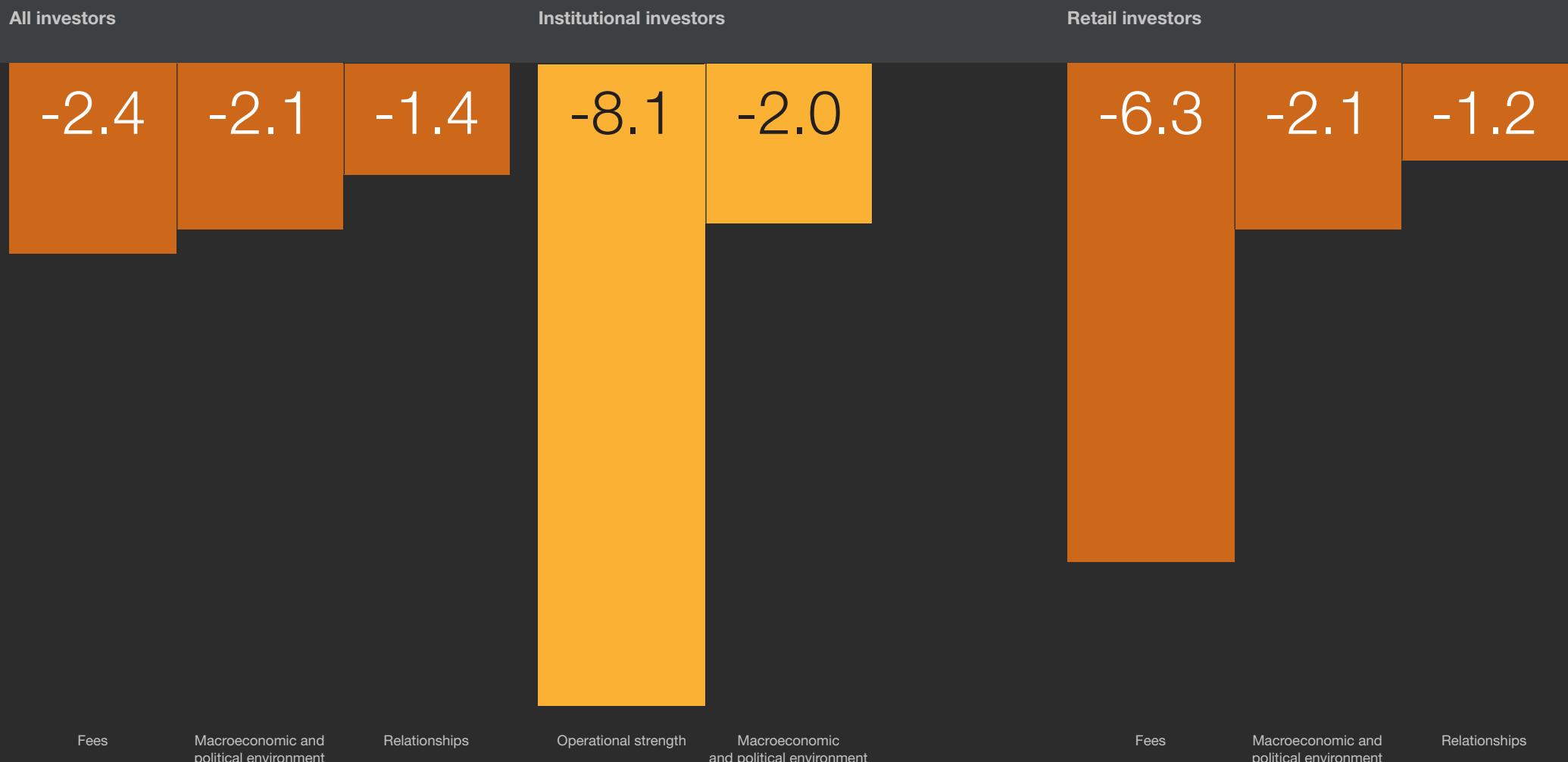


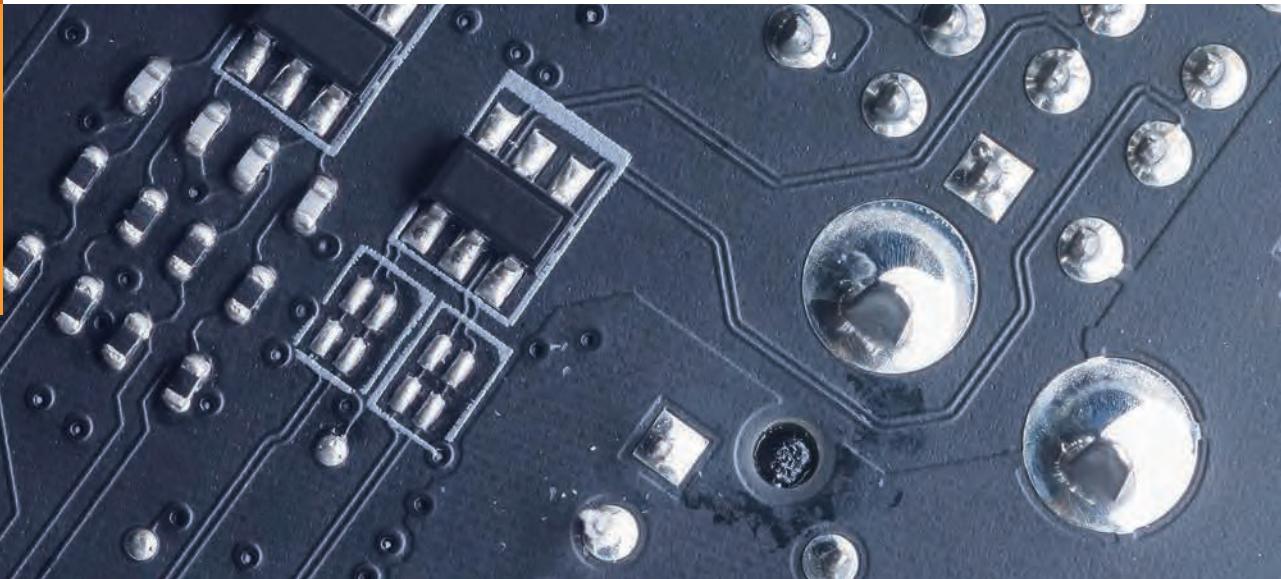
Exhibit 4: Where investor priorities and satisfaction are least aligned



Note: There was misalignment for institutional investors on only two dimensions.

Source: PwC analysis

More investment in technology required



Asset and wealth management firms need to transform their operations. Few firms have invested significantly in their operations, and the pervasive siloed approach to tech modernisation fails to recognise the interdependence among efficiency, investor experience and investment performance and the resulting need to create platforms that can work across the enterprise.

Operational weakness opens the door to the big tech and fintech entrants that might seek to partner with AWM firms or make direct plays. And as technologies such as artificial intelligence (AI) and the Internet of Things (IoT) reshape investors' expectations, [these possibilities will only increase](#). If you're an asset manager, targeted strategic alliances can help you quickly acquire the talent and tech capabilities you need to deliver on investors' expectations. Fintech firms have more to offer you, too, than just a quick, easy and cost-efficient path to digital enablement. Companies like these can assist you with a tech transformation, helping you develop intuitive customer relationships, manage the downside risks in the economy and respond to changing client demands with greater precision and agility.

For instance, what regulators, the media and the public expect from ESG is constantly evolving. Firms need an agile, proactive response and stringent management and oversight to avoid problems that might damage their reputation. Firms that can transform their operations in these ways will intensify pressure on the '[squeezed middle](#)' in the AWM industry. Tech-transformed front-runners could even succeed over scale players.

Major shift needed



If you're a leader in an AWM firm, transforming your purpose, performance and operations to keep pace with investor expectations demands a major effort. But where do you begin? We think there are two key foundations for reorientating your business: redefining your purpose and determining what capabilities you need.

Redefine your purpose. An investor comes to you one day asking about carbon-neutral investment portfolios. "Great," you say, and point them to one of your funds. An hour later, another investor rings up wanting to switch their weighting towards tobacco or oil. "No problem," you say — the different funds are segmented, so you can satisfy both clients. Will tomorrow's investors accept

this 'something for everyone' approach? We're seeing that distinctions between sustainable and mainstream investment are already beginning to disappear, and as our survey points out, many investors see ESG as a core part of the mandate. It isn't just investors who are driving change, either. What do your employees think? What does society expect?

Asset managers can no longer sit on the fence given the issues confronting our world. Controlling what we estimate to be some US\$100tn in assets worldwide, asset managers can — and we believe should — be part of the solution. This is a fundamental question of how firms should think about their purpose. Redefining that purpose and living by those values need to be C-suite imperatives and built into the strategy and underlying mission of the business.

The sceptical, even cynical, times we live in heighten the pressure for a shift in objectives. Any whiff of corporate doublespeak, greenwashing or other failures to live up to society's ever more exacting — and expanding — expectations can quickly spark a brand-destructive social media storm. And as wealth is transferred from baby boomers to socially and environmentally conscious younger generations who also want to work for organisations that share their values, businesses will struggle to attract and retain both clients and employees if they don't take action.

The AWM industry has already begun to tackle some of these issues through the development and promotion of impact investing funds, investments that specifically prioritise creating a positive impact on society over financial returns. These funds reached US\$239bn in 2018,

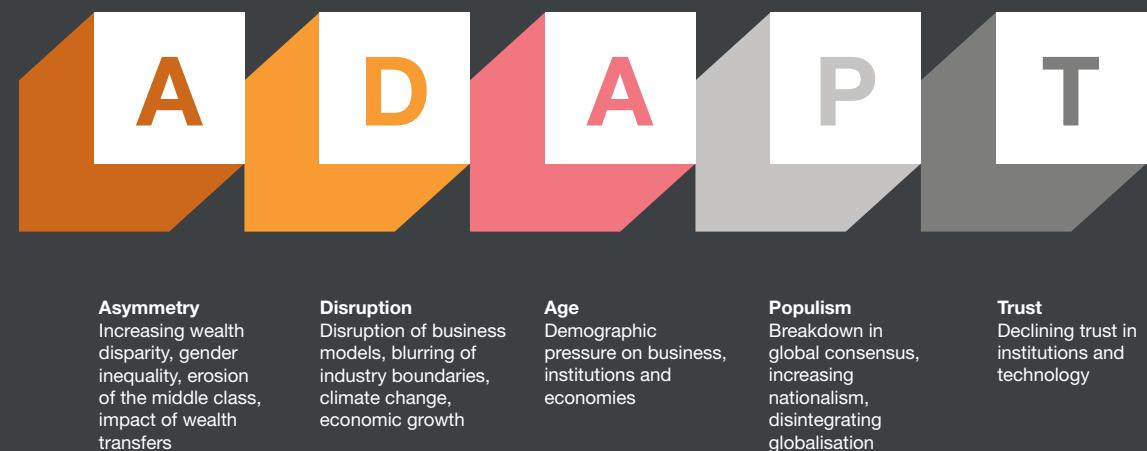
according to the Global Impact Investing Network. Many impact investors believe this will drive broader shifts in investment practice. This includes changing mind-sets about the fundamental purpose of finance in society and integrating impact considerations as the 'new normal.'

Every organisation has different values and business models. And investors vary, too. Ideas about responsible investing might differ by region or culture. But it's important to understand the forces shaping investor expectations, especially as success depends not only on addressing them now, but also on anticipating and responding to what's coming down the line. PwC's ADAPT framework can provide a starting point for this evaluation. It looks not only at the direct impact of forces such as the widening wealth gap, environmental havoc, populism, shifting demographics and declining trust, but also at how these strands coalesce and collide in the reshaping of investor and wider societal expectations.

As an asset manager, when [redefining your purpose](#), ask yourself:

- What does our business stand for?
- What marks us out?
- Does our purpose reflect what our stakeholders — employees, regulators and investors — expect from us?

Exhibit 5: ADAPT: A framework for understanding today's most pressing challenges



Source: PwC

Your board should take the lead in addressing these questions and ensuring that your guiding purpose is reflected in your strategy, objectives and incentives. Then, you have to regularly assess how stakeholder expectations are changing and whether your company's values are still aligned. Without this board-level direction, stakeholders will not believe there is an appropriate tone at the top.

Determine what capabilities you need. Successful AWM firms have a good data strategy and client experience and scalable operations. As market pressure increases, these capabilities are going to be even more critical.

If you're an asset and wealth manager, focussing on these operational aspects of your business can help you deliver more for less. For example, having a cost-efficient common infrastructure for reporting that takes care of routine disclosures lets you focus on customised communication. Even bigger possibilities are coming up as emerging technologies help create a customised and differentiated experience and investment planning at a lower cost than if you tried to deliver those services without technology.

Is your workforce equipped to deliver? Radical changes are needed in an industry that, some leading firms aside, has been slow to recognise, let alone keep pace with, how technology is transforming stakeholder expectations. You most likely will need to upskill your people, not just to improve their technical abilities but also to make them more expert in areas such as sustainable and impact investing.

Getting up to speed starts with a move towards single or integrated infrastructures and centralised data management systems in order to provide investors with a seamless experience and improve investment decisions. In-house development might be an option, but it requires considerable scale and investment. And by the time your systems are ready to go, the market might have moved on. That's why outsourcing is emerging as a viable solution. Beyond being less expensive than in-house development, servicers have the scale and resources to update their technology constantly. But instead of wholesale outsourcing, we're seeing a move towards a more modular approach that matches specific elements of the target operating model with best-in-class providers.

It's important to remember, too, that business success will continue to be talent-led. A recent PwC research report, [*The productivity agenda: Moving beyond cost-cutting in financial services*](#), reveals that AWM firms and other financial institutions said the biggest barrier to digitisation isn't technology, process or data, but people. That's why leading asset managers are creating a workforce that is more diverse, tech-conversant and geared for innovation. Purpose is a key part of this by helping to attract people who might not have considered a job in asset management before.

Digital transformation is both empowering and disorientating for the workforce, so it's important to set out a clear vision for the future, provide incentives for [upskilling](#) and bring innovation out from the fringes and into the centre of the business. Employees might need training in data analytics and coding, but they'll also need to learn design thinking, empathy mapping and the ability to turn data into insights.

Business not as usual



The overriding message from our research and analysis is that investors expect more than most AWM businesses are currently offering. And without urgent attention, the gap between expectations and satisfaction will get wider and wider. The bull market of recent years has made it hard to dissect performance, with firms racing to the bottom on cost and fees. But AWM firms will have an opportunity to distinguish themselves in the difficult environment ahead if they embrace a transformation that focusses on redefining their purpose and strengthening their capabilities to better align with investors' priorities.

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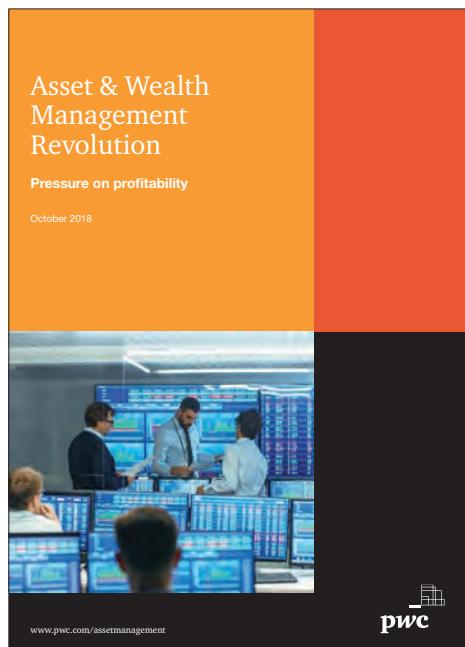
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Further reading



Asset & Wealth Management Revolution: Pressure on profitability
<https://www.pwc.com/gx/en/industries/financial-services/publications/pressure-on-profitability.html>



Asset & Wealth Management Revolution: Embracing Exponential Change
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ADAPT: Five urgent global issues and implications
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The productivity agenda: moving beyond cost reduction in financial services
<https://www.pwc.com/gx/en/financial-services/pdf/pwc-productivity-agenda.pdf>

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