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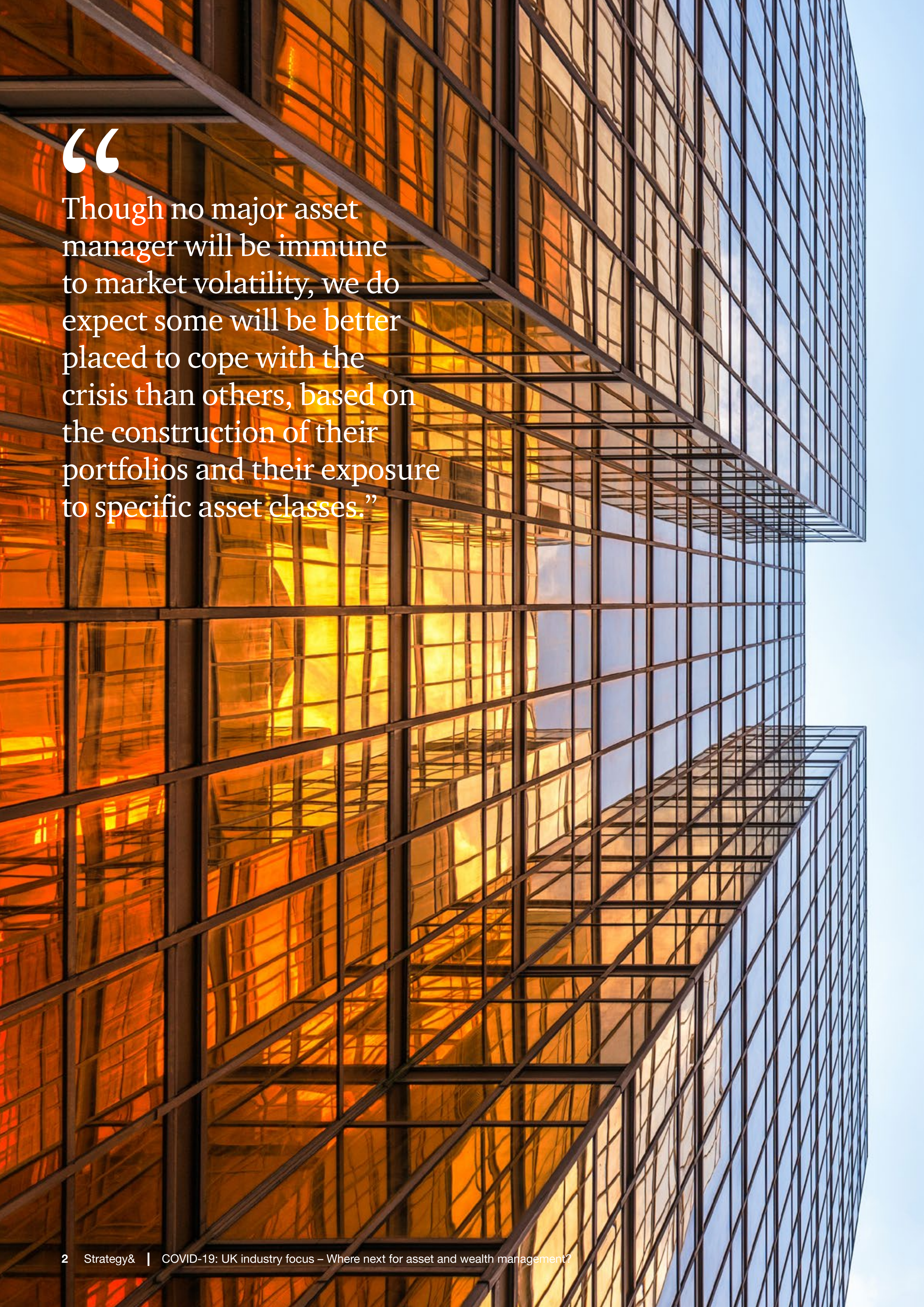
COVID-19: UK industry focus

Where next for asset and wealth management?



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Where we are today

The health and performance of the asset and wealth management industry* is inextricably linked to that of the broader economy. As such, it is already evident that the impact of COVID-19 will be protracted and severe.

*In this article, we reference trends and insights across retail investments, wealth management and institutional asset management

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Driven by sector-based lockdowns, dramatically reduced consumer spending, curtailed business investment and considerable labour and supply chain disruption, we anticipate the greatest impact to economic growth will likely be felt during the second quarter of 2020. Overall, UK gross domestic product is likely to contract by between 12% and 16% quarter-on-quarter. That compares to a fall of just 2.1% at the height of the 2008 global financial crisis. We assume recovery will take place over six to eight quarters.

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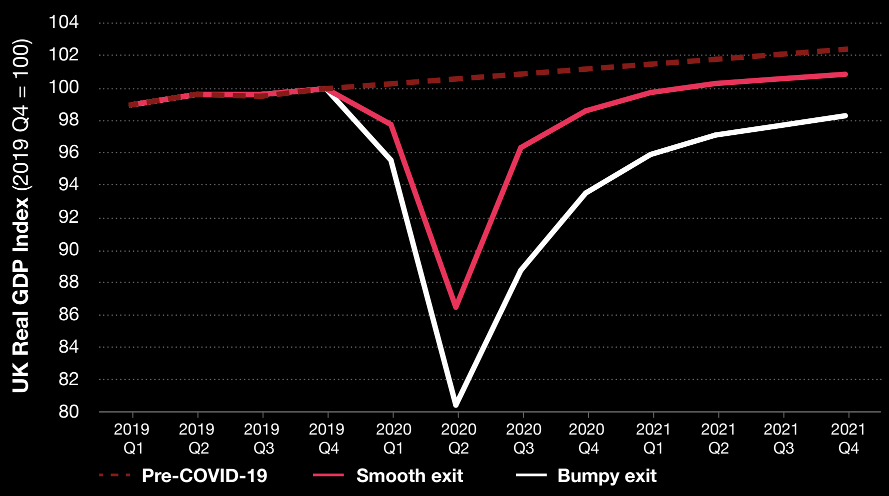
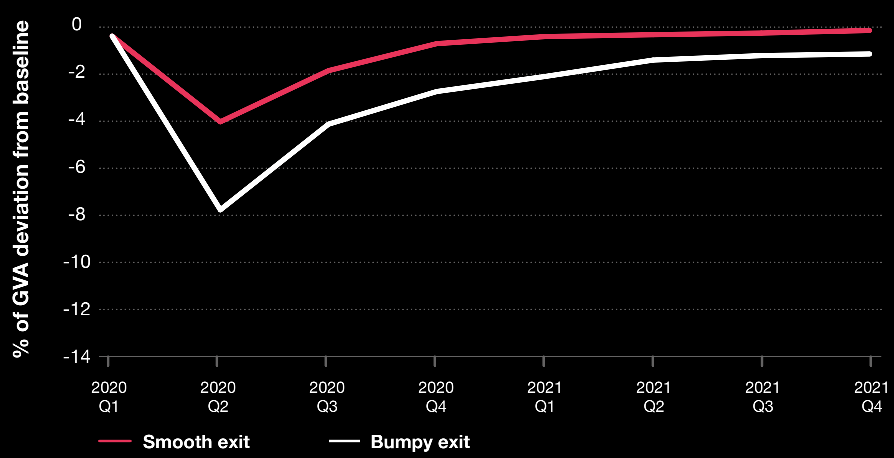
In the short term, we expect to see a pick-up in reallocation as asset and wealth managers attempt to navigate volatility, find value and avoid risk. To preserve capital reserves, any expenditure that can be put on hold will be put on hold, which is likely to lead to a slowdown in both hiring and investments in new technology, for example.

Comparison of real GDP index by scenario and pre COVID-19*



*Relative to baseline projection
Source: Strategy& UK Economic Analysis April 2020

Impact of COVID-19 on asset and wealth management (AWM) GVA by scenario



Source: Strategy& UK Economic Analysis April 2020

As volatility reduces, and market movements begin to resemble those we have seen over the last decade, asset managers need to find opportunities to differentiate themselves. Responsive and agile managers will be able to capitalise on the likely acceleration of existing disruptive forces driven by COVID-19. Further downward fee pressure driven by the crisis may add to the need for increased technological adoption, alternative offerings and outcome based investment solutions.

Technology continues to provide compelling opportunities to innovate. Customers' needs and desires are changing, so services must do so accordingly. This crisis should offer a chance to recalibrate and re-prioritise, so asset and wealth managers can emerge stronger and more resilient.

369,000

Current no. of sector employees

'Total number of employees' represents the total number of employees in the asset and wealth management sector (this is defined as activities auxiliary to financial services and insurance services, which includes fund management activities amongst others). These figures are deduced from ONS, specifically the Business Register and Employment Survey 2018 provisional.

Medium

Jobs at risk RAG rating

'Jobs at risk' rating reflects the analysis conducted by the International Labour Organisation. They assessed the global impacts of COVID-19 on different sectors, assessing those most likely to lay off workers due to lower cash flow.

13%

of workers normally come into physically close contact with >20 fellow workers

Physically close contact is defined as a distance of 2m. Source: PwC Research QuantiBus April 2020.

87%

of workers can work from home

The Work From Home index is based on a survey carried out by PwC Research, and is the equivalent to the % of respondents saying they can work from home.

What are we learning?

From retail investors

Lockdown and social distancing measures have already impacted retail investor behaviour. Investment platforms and managers that offer intuitive and seamless digital journeys, which can be easily accessed from home, have benefited from the recent market correction as retail investors rushed to open ISA accounts. Vanguard, for example, reported a 60% increase in account openings during March 2020 compared to the previous month. Government measures to protect employee incomes are also likely to curtail any panic withdrawals.

60%

increase in ISA account openings during March 2020 compared to the previous month

Elsewhere, we would not be surprised to see a cooling in demand for retirement income solutions (such as annuities or drawdowns) as people look to delay retirement, hopeful their pension assets will regain lost value before they leave the workforce.

Pension providers should recognise this as an opportunity. They could choose to provide customers with new, innovative retirement income solutions that offer greater security and protection against unexpected events such as a pandemic.

More broadly, for some time, regulators have been pressuring investment managers to adopt a responsible approach to customers and their financial wellbeing. The Financial Conduct Authority's (FCA) most recent annual business plan identifies "enabling customers to make effective investment decisions" as a top priority over the coming three years.

The implications of COVID-19 will intensify this pressure. Providers will be expected to design products that are fair and appropriate for consumers' needs. They will be required to adhere to high standards of governance in relation to the networks of individuals in their distribution chains. Financial education levels will have to be taken into account when marketing and selling any products, particularly to the most vulnerable customers. Regulators will keenly focus on providers who are just "ticking the boxes" when it comes to the legal small print, and those who are complying with the spirit of regulation.

> “COVID-19 has demonstrated that reliable technology will be the key to fostering strong client relationships in future, particularly if remote services become more commonplace.”

From high-net-worth individuals

High-net-worth individuals have been deeply unsettled by the pandemic and ensuing market volatility, leading to an increase in demand for customised advice and seamless communication with advisers.

Private high-net-worth clients have traditionally valued face-to-face contact, but social distancing rules have challenged traditional service models. Some providers have been more successful at swiftly transferring to technology-enabled communication methods. Some wealth managers have hosted ad hoc investor phone calls. Once again, their ability and willingness to adapt their services within these new societal constraints could have long-term repercussions for reputation and client retention, particularly as many high-net-worth individuals attribute great value to a personal and customised service.

Before the pandemic, just over half of all wealth managers believed a lack of digital capabilities was a major threat to business (Source: GlobalData). COVID-19 has demonstrated that reliable technology will be the key to fostering strong client relationships in future, particularly if remote services become more commonplace.

From institutional investors

Actively managed funds have for years been put under considerable pressure by passive funds eroding market share. But the former now have an opportunity to prove their worth. Dramatic losses in stock markets have impacted investors in passive equity funds. With the Bank of England trimming its base rate to 0.1% from 0.75% in March, good returns are hard to find in almost any asset class.

Institutional investors eager to avoid even more losses may turn their attention back to active managers, even though fees are significantly higher than for passive funds. Asset managers capable of outperforming benchmarks during this period of intense volatility could be rewarded with significant inflows.

The rise in the popularity of alternative investments, however, will come under short-term pressure. Real estate funds have already been impacted by the pandemic. Aviva, Janus Henderson and Kames Capital are just some of the providers that have suspended dealing in their UK property funds due to a high degree of uncertainty over valuations. On the other hand, infrastructure has remained fairly resilient to date, with sub-sectors such as digital infrastructure and new energy still very active.

“More than half of ethical investment funds have outperformed the wider global stock index due to the lower exposure to the oil and energy sector.”

How do we respond?

COVID-19 has stress tested and shone a light on areas of the industry where change needs to happen. The latest business plans from the FCA and Prudential Regulation Authority (PRA) highlight the importance of change management practices and technology risk management, and how these manifest themselves in operational and cyber resilience strategies. But the current crisis certainly intensifies this pressure and could spark opportunities for a variety of players across asset and wealth management.

An opportunity to prove that personal service does not have to be delivered in person

The wealth management industry is built on strong client relationships which have historically been established and fostered face-to-face. Clients, whether retail, high-net-worth or institutional, value a personalised service. But the restrictions and limitations introduced by COVID-19 could introduce a sector-wide cultural shift. Even if meetings are forced to become virtual, customers will continue to expect at least the same level of attention, quality of advice and conversation, if not more. Investing in and implementing the appropriate technology to easily facilitate these remote interactions will be key even as we emerge from the pandemic.

To retain the trust of their client base, wealth managers will have to pay particularly close attention to the less digitally literate and those who are less accustomed to using technology daily. To differentiate themselves, investment platforms and wealth managers will need to tailor their communications strategy to meet the specific needs of their customers, particularly as technology-enabled client relations become more prevalent even after the pandemic subsides.

Regardless of the nature of the customer, effective communication will be imperative to operational success, and systems must be in place to keep all stakeholders informed of business continuity plans. This pandemic has demonstrated the importance of reassuring clients, in order to prevent panic-induced outflows. Managers would be wise to remember this in the face of future challenges.

An opportunity to prove the true value of traditional investments

Amongst other consequences, this crisis could uncover undervalued assets with strong fundamentals. COVID-19 should prove the value of active managers, as skilled investors adjust portfolios not just to weather the storm but also to take advantage of the altered economic and social landscape that is likely to follow. By design, passive funds are at the mercy of market movements.

Protection against market crashes can be pursued through following the foresight of rock star investment managers, but it can also be created through less inspiring means. Structured products, previously shunned by advisers and investment managers alike, due to the cases of mis-selling by distributors with misaligned incentives, could be on the verge of a resurgence. With market volatility at an all-time high, exemplified by the WTI oil price turning negative in April, and base rates hitting the floor, investors will be looking for products that provide some degree of security with a reasonable return. Investments that boast capital guarantees with the potential benefit of market exposure could be well suited to the current economic environment. Furthermore, the FCA's enhanced focus on positive customer outcomes could ensure that they are sold appropriately this time.

An opportunity to supercharge appetite for ESG investments

As governments have enforced lockdowns of varying severity across the globe, citizens have been forced to act in a way that benefits society as a whole. A new found importance of community has been fostered through the isolation indirectly imposed by the pandemic. Positive Environmental, Social and Governance (ESG) focussed investments have already experienced a significant growth trajectory over recent years but this collective change in mindset is likely to steepen the curve.

More than half of ethical investment funds have outperformed the wider global stock index due to the lower exposure to the oil and energy sector. This could further raise the status of such funds and pique the interest of previously uninterested investors. Managers that are able to harness these positive winds of change by gearing towards purpose driven investments are likely to have a greater chance of surviving through the crisis and beyond.

> "COVID-19 and the resultant disruption should also accelerate the overdue adoption of new technology, enabling the creation of richer customer relationships, fit for the digital age."

A catalyst for positive change

As is the case in other sectors, COVID-19 is unlikely to fundamentally change business models beyond recognition. But beyond addressing short-term disruption and volatility, the resulting challenges and changes in asset and wealth management can certainly provide a catalyst for positive, long-term evolution.

The industry must find ways to balance the demand for flexibility and security, and innovate new tailored and customisable products that reflect changing customer needs and attitudes shaped by the ways that COVID-19 has impacted people's finances and life plans.

The experience of encountering COVID-19 and the resultant disruption should also accelerate the overdue adoption of new technology, enabling the creation of richer customer relationships fit for the digital age and less dependent on face-to-face interaction. It should encourage managers to re-examine their cyber defences and operational agility and, as such, should help shape a more resilient industry, better equipped for future challenges.

Who to talk to

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