Rapid change on all fronts

The EY GCC Wealth and Asset Management Report 2017
Foreword

Introduction: rapid change on all fronts

New technology: more hopes (and fears) than reality

Saudi Arabia’s reform program: the reinvention of the largest GCC economy

The imposition of sanctions against Qatar: limited impact so far

Regulations within the region: higher costs for many

The disintermediation of providers: an existential threat for some advisors
<p>| | | | | |</p>
<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>16</td>
<td>Asset management</td>
<td>D</td>
<td>18</td>
</tr>
<tr>
<td>G</td>
<td>28</td>
<td>Digital transformation in wealth and asset management</td>
<td>H</td>
<td>34</td>
</tr>
</tbody>
</table>
The EY GCC Wealth and Asset Management Report 2016 (Global forces drive regional realities) was based on the premise that it was not possible to consider the latest developments in isolation from what was happening outside the region.

Many of the disruptive factors that were emanating from outside the region last year remain in place. In no particular order, these include: new regulatory requirements in the United Kingdom (UK) and the European Union (EU); technology; and global prices for energy that are relatively low by the standards of 2011–14.

Since our last report, geopolitical risk has emerged as an additional factor emanating from outside the region that can have an impact on the asset management industry in Gulf Cooperation Council (GCC) member states. The Brexit vote in the UK and the election of Donald Trump as President of the United States have changed conventional views of “safe” countries and “unstable” countries.

As international markets remain ever strong, reaching new highs whatever geopolitical event may present itself, the industry must adjust to a period of constant change. Disruption, particularly in technology, which in multiple ways is driving the agenda, is creating global growth in capital markets and a positive effect in the GCC region. Disruption will continue, as will consolidation, and as an industry, we must be prepared for this rapid change.
Our third annual edition of the GCC wealth report talks about “rapid change on all fronts.” This recognizes four major changes that have emanated in the last year from within the region.

The largest of these changes has been the announcement in mid-2016 by the Government of Saudi Arabia of its Vision 2030 strategy — a general “road map” for the diversification of the economy away from hydrocarbons — and the National Transformation Program (NTP) — a list of specific targets to be achieved by 2020.

The second change, from June 2017, has been the imposition of sanctions against Qatar by the governments of several countries, including Egypt, Saudi Arabia, the United Arab Emirates (UAE) and Bahrain.

The third and fourth changes are less momentous in terms of the sums of money that are involved, but are unquestionably relevant to international asset management companies and international life insurance companies that are distributing their offerings across the GCC countries, along with the financial advisors with whom they work. The changes involve new rules laid down by regulators from within the region, and disengagement of clients from the financial advisors.

In short, the GCC wealth and asset management (WAM) industry faces change on a greater number of fronts than in late 2016. Collectively, the developments that have taken place over the last year suggest that the overall pace of change has increased too.

Like its two predecessors, this report has three objectives. The first is to provide a detailed “snapshot” of the (broadly defined) asset and wealth management industry in the GCC region — at a time when the rapid change is generating confusion. The second is to attempt to identify what might happen next. Finally, the report looks at where the opportunities may lie. We are constantly reminded in the region of the pace of change, driven mainly by technology, that continues to make the industry ripe for disruption.

As ever, I am most grateful to those industry leaders from the region and beyond who have taken the time to share thought leadership analysis, opinions and data. I am incredibly excited to publish the third EY GCC Wealth and Asset Management Report.
Introduction: rapid change on all fronts

In 2016, the global asset management industry faced a number of headwinds. These included interest rates and bond yields that were at very low levels by the standards of the past 20 to 50 years, as well as frequently volatile financial markets. Regulatory changes such as the EU’s second Markets in Financial Instruments Directive (MiFID II) were imposing new costs.

This was in the context of much talk about the impact on financial services in general of new technology. To the extent that they had been implemented, many of the changes had not had much impact on asset management. However, international asset managers and international life companies had been improving their digital offerings – in terms of providing information or facilitating transactions. Advisors working with clients across the region have been unclear whether to embrace automated advice, often referred to as robo-advice, as a threat or as an opportunity.

The year ending September 2017 has been a good one for world stock markets. The Morgan Stanley Capital International (MSCI) World Index, for instance, gained 15.93% in US dollar terms. Meanwhile, the MSCI Emerging Markets Index and the MSCI Frontier Markets Index have risen by 19.73% and 21.50% respectively.
Collectively, these movements indicate that the world’s investors are upbeat about the global economy and corporate profits, and their prospects. Actual and potential moves by central banks to increase official interest rates or trim their bond portfolios are not seen as problematic. Nor are global investors overly concerned about Brexit or the idiosyncrasies of President Trump’s Administration.

In short, rising official interest rates and global geopolitical risks are topics of conversation, but nothing more, for the asset management industry of GCC countries. The generally sideward movement of regional stock markets, with the MSCI GCC Countries Domestic Index up 1.57% in US dollar terms since the beginning of 2017, indicates that investors are not particularly worried about the ongoing conflicts in Syria, Iraq and Yemen.

Accordingly, this report focuses on the themes that really do matter to the asset management industry of the GCC countries.

What does the asset management industry of GCC countries include?

At the end of 2016, institutional investors based in GCC countries had combined assets under management (AUM) of around US$3,500b, according to research company Marmore.

Around US$2,900b of this was accounted for by sovereign wealth funds (SWFs) established by GCC governments as buffers to provide protection against the financial impact of lower energy prices and for other purposes.

Two other pools of assets are associated with governments. These include pension funds, which provide retirement and other social welfare benefits to GCC nationals, and government-owned enterprises (GOEs), with combined AUM of about US$530b. Insurance companies, mutual funds and private equity funds collectively had AUM of about US$120b.
Executive summary

Focus themes 2018

- New technology
- Saudi Arabia’s reform program
- The imposition of sanctions against Qatar
- Regulatory change within the region
- The disengagement of clients
**What to watch for in 2018**

**Asset management**
- Further investment by GCC SWFs in alternative “real” asset classes
- SWFs actively looking to diversify by asset class in line with international asset owners
- Greater use by asset owners of passive and replication strategies and products

**Pensions and retirement savings**
- Realization that reform of GCC state pensions is imperative
- Pressures on pensions from the lack of liquidity in domestic markets
- Growing allocation of pension capital to active management in traditional and alternative asset classes
- Greater awareness of the limitations of the end of service benefits (EOSB) regime

**Wealth management and private banking**
- Further development of wealth management value proposition offerings by local banks
- Growing focus on intergenerational transfer of wealth within wealthy families
- Ongoing marketing of private banking and related services by certain international finance centers (IFCs)
- Partnerships between international asset management companies and local banks

**Asset services**
- Fundamental reform in the provision of custody in Saudi Arabia (KSA)
- Further growth in the importance of pensions for employers and institutions
- Further development of bond markets
- Official initiatives to boost transparency and corporate governance in the markets of the GCC region
- Further newsflow in relation to large-scale IPOs in KSA

**Opportunities**

**Asset management**
- Growing AUM of some SWFs
- Further diversification of SWF portfolios
- Provision of advice in relation to “strategic” holdings of companies listed on GCC regional exchanges
- Increasing replatforming and use of technology by asset owners across business functions that work with them to reduce costs and to improve security

**Pensions and retirement savings**
- Growing AUM of pension funds
- Further diversification of pension portfolios
- Greater depth and liquidity of local stock markets
- Development by international life companies and asset managers of solutions that address the limitations of the EOSB regime
- Potential mandatory retirement savings to expatriate community

**Wealth management and private banking**
- Further entries to and departures from the GCC by private banks
- Further promotion of low-cost solutions such as exchange-traded funds (ETFs)
- Increasing offerings of Islamic asset management products

**Asset services**
- Possible partnership with a government or financial center regulator to grow asset servicing operations with a physical presence in the region
- Innovation resulting from development of new technology in other parts of the world
- Possible partnerships with local banks that play a leading role in distribution of funds and other wealth management products
New technology: more hopes (and fears) than reality

Recent research from Insight Discovery noted that 49% of financial advisors in GCC countries were upbeat about the prospects for robo-advice, even if only 35% of them saw it as an opportunity for their businesses in 2017. Meanwhile, 22% saw robo-advice as a threat to their business.

Since this report, robo-advice does not seem to have captured a significant share of the market for financial advice, let alone in relation to the distribution of more complex products, such as savings plans and policies offered by international life insurance companies. This is partly because the persistence of paperwork in the GCC region’s insurance industry means that digital transactions are a long way from the mainstream.

Advisors are keen to reduce costs for clients, and nearly 61% of advisors who used ETFs were looking to increase their allocations through 2017. There was also evidence that they were increasingly looking for cost-effective multi-asset and discretionary fund management (DFM) solutions.

Logic suggests that reduction of costs, rather than the adoption of new technology per se, is also a priority for the institutional investors that account for the overwhelming majority of AUM sourced from the GCC region. All of the institutional investors have had to contend with low interest rates and the generally lackluster performance of regional stock markets. Some have also had to cope with outflows or reduced inflows.

Last year, we noted how blockchain technology could streamline the clearing and settlement of trades within the global (and regional) asset management industry. As of late 2017, there remains limited actual usage of blockchain outside markets for cryptocurrencies. Nevertheless, it remains reasonable to suggest that blockchain will have a positive impact on the GCC region’s asset management industry over the next three to five years.

A positive wild card for the region’s asset management industry comes from the close economic ties between GCC countries and the Indian subcontinent. It could be that Indian FinTech companies develop solutions that enable the industry to develop faster than their peers in other parts of the world.

FinTech will disrupt every element of the wealth and asset management (WAM) sector’s value chain. Each element of the WAM value chain is being disrupted by new technologies, driving the sector’s transformation. The winners will be existing institutions and new players who harness the following disruptive technologies most effectively.

| Blockchain gaining traction among listed risk projects; commercial implementation requires a few more years: |
| Recognize the opportunity presented by blockchain technology to radically transform, modernize and streamline the way asset management firms handle payments, custody, clearing and settlements for most financial transactions |

| Robo-advice adoption increase among all investor communities is driven by regulatory changes: |
| Increase customer loyalty and sales conversion |
| Migrate customers to low-cost channels |
| Enhance advisor-client interaction |

| Artificial intelligence (AI) leading to iterative self-learning applications capable of mastering increasingly difficult human gaming problems: |
| Identify investment opportunities by applying social data analytics |

| Robotic process automation (RPA) to replace back-office functions and repetitive activities: |
| Reduce costs through automation and duplicative efforts |
| Improve customer experience by reducing lead times and errors |
In mid-2016, the Government of Saudi Arabia published its Vision 2030 (a strategic view of how the country and economy could be transformed) and the NTP (a list of specific targets that are to be achieved by 2020).

**Key target areas announced in Vision 2030 and the NTP:**

**Labor markets**
- Unemployment to be cut from 11.6% in 2016 to 9% by 2020 and 7% by 2030
- Women's participation rate to be lifted from 22% in 2016 to 28% by 2020 and 30% by 2030
- Creation of **450,000 new jobs** in nongovernment sector by 2020
- Reduction in civil service workforce by **20% by 2020**

**Fiscal**
- Non-oil revenue to be increased from SR163b in 2015 to SR530b in 2020 and SR1t in 2030
- Reduce wages and salaries as percentage of budget spending
- Balanced budget

**Tourism**
- Liberalization of tourist visa regime
- Plans to build world's largest Islamic museum alongside other heritage sites
- Increase in number of Umrah pilgrims from abroad from 6m per year to 15m in 2020 and 30m in 2030

**Subsidy reform**
- Subsidies to be removed: direct cash payments to be made to low- and middle-income households that rely on subsidies

**Private and SME sectors**
- Share of private sector in economy to be increased from **40% of GDP in 2016** to **65% of GDP by 2030**: SME sector contribution to be raised from **20% of GDP to 35%**

**Education**
- Modernization of curriculum: greater focus on training teachers and measuring performance

**Health care**
- Plans to increase private sector role in health care and to boost life expectancy from 74 to 80 years

**Housing**
- Focus on affordable housing: home ownership to be boosted from 47% in 2016 to 52% in 2020
- **47%** 2016
- **52%** 2020

**Foreign direct investment (FDI)**
- Increase of FDI from **3.8% of GDP in 2016** to **5.7% in 2030**

**Military**
- Military industry holding company to be created: local participation in defense production to be boosted

**Trade**
- Share of non-oil exports to rise from **16% in 2016** to **50% in 2030**
- **16%** 2016
- **50%** 2030

**Immigration**
- Green card-like program for foreign workers by 2021
- Visa exemption for expatriates working in King Abdullah Financial District (KAFD)
Aramco

IPO of up to 5% stake in equity: dual listing likely

Government estimates value of Aramco at more than US$2t

Oil and gas

Increase share of domestically owned oil and gas sector output from 40% in 2016 to 75% in 2030

Public Investment Fund (PIF)

SWF to be created to boost diversification away from oil: assets to be increased from SR600b in 2016 to SR7t in 2030


Since then, much commentary has focused on the IPO of a 5% stake in Saudi Aramco, the giant state-owned energy company, to raise about US$100b. If and when this transaction takes place, it will be the largest IPO ever. Current indications are that it will occur in late 2018, though, at the time of writing, there is press speculation about a private placing rather than a listing, and debate surrounds the valuation.

Several of the initiatives announced in Vision 2030 and the NTP are consistent with making Saudi Arabia a cheaper and easier place in which to do business. An example is the possible development of the KAFD in Riyadh as an international financial center that is broadly similar in concept to the Dubai International Financial Centre (DIFC).

However, these objectives need to be reconciled with the Government’s shorter-term financial needs. In July 2017, the Government imposed levies on expatriate workers and on expatriates’ dependents.

To date, Saudi Arabia’s economic reform program has had relatively little impact on the asset management industry, notwithstanding that seven international companies had registered as qualified foreign investors (QFIs). Saudi Arabia has yet to be fully included in the MSCI Emerging Markets Index. Saudi stocks have performed in a mixed fashion since the beginning of 2017.
Economic data indicates that the imposition of sanctions against Qatar in early June had a limited immediate impact on that country’s non-oil sector. However, a clearer picture should emerge when the final statistics for 3Q17 are released. Anecdotal evidence, together with proposals by Qatar’s Government to make it easier for expatriate workers to become permanent residents, suggests that a large number of expatriates may already have left the country.

The sanctions have had an adverse impact on perceptions of the prospects for Qatar’s leading listed companies. The MSCI Qatar Index, for example, fell by 18.2% in US dollar (and local currency) terms over the first nine months of 2017.

Continued sanctions will, for at least the next year or so, likely curb Qatar’s economic growth rate relative to what it would have been in the absence of the sanctions. This could retard the expansion of the country’s SWF and other asset pools. Nevertheless, the absolute AUM owned by Qatari interests will remain substantial.

With or without the sanctions, there will remain many opportunities for asset management companies, private equity and VC funds, and institutional banks to deal with Qatar-based clients through the UK, Switzerland and other international centers.

56% of GCC AMs consider geopolitical issues a threat.
A key feature of the GCC economies is that they have all developed far beyond the point at which every job created could be filled by a national. All of the economies are dependent to a high degree on expatriate workers, who can be found at all levels of the various countries’ labor markets. At the higher levels, expatriates come mainly from developed countries, the Indian subcontinent and non-GCC Arab countries.

Expatriates generally see themselves as living and working in the GCC region for a limited period of time, taking advantage of low taxation to save capital.

Expatriate residents of GCC countries have traditionally relied on financial advisors. Many of the leading financial advisor groups are part of long-established UK firms. Over the years, these companies have moved away from fee-based products to a more customer-centric offering to ensure that their operations in GCC countries meet the standards that are required by regulators in the UK. Compliance with the UK’s Retail Distribution Review (RDR) regime, for instance, was a key issue for managers of major financial advisor groups in the GCC region.

In general, greater regulation has been consistent with lower and more transparent fees for clients and higher levels of service. Over the last year or so, though, advisors have had to contend with a new wave of regulations and charges emanating from governments within the GCC region.

Some of the changes are clearly and directly going to increase the cost of doing business. Examples include the value-added tax (VAT) that will be introduced in all GCC countries in 2018, and the new levies on expatriate workers and their dependents in Saudi Arabia.

Other changes that have been announced will have a significant impact on at least some of the leading financial advisors, as well as international life insurance companies and asset managers who are hoping to do business in the region. In the UAE, for instance:

- The Securities and Commodities Authority (SCA) is introducing rules that affect unit-linked insurance policies.
- International asset management companies who want to distribute funds in the UAE are required to inform the regulator of the authorized distributors with whom they wish to work.
- The distributors (mainly local banks) will need to apply for a new “promoter’s license.”
- The Insurance Authority (IA) has introduced increased capital requirements for insurance brokers. It appears that the brokers will have to deposit AED3m with the regulator and maintain another AED3m in working capital. Industry sources suggest that the number of brokers in the UAE could roughly halve from the current 130 or so.
The disintermediation of providers: an existential threat for some advisors

The arrival of automated advice, and the development of digital offerings across asset and wealth managers, ensures easier execution for clients to bypass their advisors in implementing investments and to avoid general interaction with them. For the first time, clients are going directly to the companies that are providing the services and products that they need, without an intermediary. Disintermediation, with the development of direct-to-consumer (D2C) models, is an interesting development across the industry, and we see controlling the value chain as key.

According to Insight Discovery, 63% of advisors were pessimistic about clients’ willingness to commit to the solutions that their advisors were offering. Only 18% of advisors were optimistic.

As of late 2017, it appears that client disengagement has had less of an impact on financial advisors than was feared by many of the pessimists. Nevertheless, the possibility of loss of clients, the probability of having to adapt to new regulations and the associated higher costs mean that conditions will likely remain challenging for finance advisors across the GCC. Conditions will also be challenging for some of the wealth managers and asset managers that are dealing with the advisors.
Asset management

As has long been the case, the largest opportunity by far for asset managers who are looking to do business with clients based in the GCC region will rest with SWFs, whose collective AUM amounted to around US$2,900b in late 2016.
Estimated AUM of SWFs, end 2016 (US$b)

<table>
<thead>
<tr>
<th>Country</th>
<th>2016</th>
<th>2021 (Estimated)</th>
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<tbody>
<tr>
<td>UAE</td>
<td>1,253</td>
<td>1,790</td>
</tr>
<tr>
<td>KSA</td>
<td>489</td>
<td>907</td>
</tr>
<tr>
<td>Qatar</td>
<td>479</td>
<td>596</td>
</tr>
<tr>
<td>Oman</td>
<td>343</td>
<td>538</td>
</tr>
<tr>
<td>Kuwait</td>
<td>19</td>
<td>11</td>
</tr>
<tr>
<td>Bahrain</td>
<td>19</td>
<td>15</td>
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</table>

Source: SWF Institute; Marmore Research.
Note: SWF assets at end 2016 are our estimates and may differ slightly from actuals.

Traditionally, GCC countries have had excess savings. Massive revenues from exports of oil and gas have underpinned structural current account surpluses, which have had to be invested outside the region.

Nevertheless, some SWFs have investments in companies that are listed on GCC stock exchanges that are large in absolute terms, large in relation to the company in question and, sometimes, in relation to the SWF itself.

The dynamics of SWFs vary quite widely, in part because of differing aims and objectives. Taking into account current (late 2016) government debt levels and likely trajectories and funding of budgets, research company Marmore expects that the AUM of the SWFs of Oman and Saudi Arabia will fall consistently over the five years to 2021. Over that period, Saudi SWF assets are expected to contract by around US$107b. Conversely, Kuwaiti SWF assets should grow by more than US$60b, and Qatari SWF assets by slightly less (although the impact of subsequent sanctions have affected these projections).

Of the major themes that we have identified, the most important are Saudi Arabia’s reform program and the imposition of sanctions against Qatar. In both cases, the exact developments that take place could have a significant impact on public finances and the trajectory of the AUM of the countries’ SWFs.

In terms of AUM, the SWFs fall into two broad groups. A number of enormous institutions each have AUM of (significantly) more than US$100b. The remainder typically have AUM of US$20b or less.

What to watch for in 2018
- Further investment by GCC SWFs in alternative asset classes, in line with established trends
- A gradual increase in the number of asset classes used by SWFs, in accordance with trends
- Use of technology by SWFs and the asset managers that work with them to reduce costs and improve security
- Greater use by SWFs of ETFs and other low-cost solutions and products
- Continuing trend of in-house front-office investment operations

Opportunities
- Growing AUM of some SWFs
- Further diversification of SWF portfolios
- Provision of advice in relation to “strategic” holdings of companies listed on GCC regional exchanges

Artificial intelligence

One of China’s biggest e-commerce companies has continually reinvented itself using live market insights and feedback, not only to develop new products but also new business models. Its progress mimics that of AI, where iterative self-learning has allowed programs to master increasingly difficult human gaming problems.

These capabilities hold significant commercial opportunities for asset management, which depends on quality data and deep analytics to drive insights and decisions. Today, traditional managers looking after a Chinese retail fund are likely to base investment decisions on lag indicators such as occasional executive interactions, news and financial statements.

In future, those managing the retail index fund could have all of this information, plus additional insight into 50% of the online retail market in China – providing real-time knowledge of which products from which companies are trending by village and client segment. Already, early solutions are applying social data analytics to identify investment opportunities based on what’s trending on social media, and free-text comments. The industry needs to harness similar innovative analytics and emerging decision support solutions to improve performance.
Pensions and retirement savings

As of late 2016, state-sponsored pensions of the GCC countries represented the second-largest pool of assets in the region, with AUM of a little more than US$400b. Saudi Arabia’s pension system accounted for about 70% of this total.
Kuwait’s pension fund remains well positioned due to its lower population

<table>
<thead>
<tr>
<th>Country</th>
<th>Real GDP, 2016, US$b</th>
<th>Pension assets as % of GDP</th>
<th>Native population (m)</th>
<th>Income per capita (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>KSA</td>
<td>697</td>
<td>40%</td>
<td>21.2</td>
<td>13,169</td>
</tr>
<tr>
<td>Kuwait</td>
<td>134</td>
<td>50%</td>
<td>1.2</td>
<td>56,136</td>
</tr>
<tr>
<td>UAE</td>
<td>365</td>
<td>7%</td>
<td>1.1</td>
<td>24,578</td>
</tr>
<tr>
<td>Qatar</td>
<td>215</td>
<td>7%</td>
<td>0.3</td>
<td>45,349</td>
</tr>
<tr>
<td>Oman</td>
<td>72</td>
<td>17%</td>
<td>2.5</td>
<td>4,940</td>
</tr>
<tr>
<td>Bahrain</td>
<td>65</td>
<td>18%</td>
<td>0.7</td>
<td>17,229</td>
</tr>
<tr>
<td>Total</td>
<td>1547</td>
<td>27%</td>
<td>27</td>
<td>25,380</td>
</tr>
</tbody>
</table>

Source: Marmore Research; EY.

Kuwait’s pension system is the second largest in the region in terms of AUM, and accounted for about 15% of the total. Because of Kuwait’s superior funding position, it is well placed to meet its obligations.

The various pension systems vary quite widely in terms of the replacement ratio (a measure of the generosity of retirement incomes) and contributors per retiree. In part, this can illustrate the relative projected trajectory of each pension fund over the medium to long term.

The pension schemes of the GCC countries also vary quite markedly in terms of asset allocations. Qatar’s pension system, for instance, tends to have a greater orientation toward local fixed income markets than does its counterpart in the UAE.

### Differences in asset mix of GCC pension funds

<table>
<thead>
<tr>
<th>Asset class</th>
<th>UAE</th>
<th>Qatar</th>
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</thead>
<tbody>
<tr>
<td>Cash</td>
<td>0%-10%</td>
<td>0%-5%</td>
</tr>
<tr>
<td>Local fixed income</td>
<td>0%-10%</td>
<td>20%-30%</td>
</tr>
<tr>
<td>International fixed income</td>
<td>15%-35%</td>
<td>5%-10%</td>
</tr>
</tbody>
</table>

Source: Abu Dhabi Pension & Benefits Fund; Marmore Research; latest available data.

<table>
<thead>
<tr>
<th>Asset class</th>
<th>UAE</th>
<th>Qatar</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local equity</td>
<td>0%-20%</td>
<td>30%-50%</td>
</tr>
<tr>
<td>International equity</td>
<td>30%-50%</td>
<td>10%-20%</td>
</tr>
<tr>
<td>Alternatives</td>
<td>10%-30%</td>
<td>0%-5%</td>
</tr>
</tbody>
</table>

Note: AUM for each country.
Like some of the SWFs, a number of the pension funds have significant exposures to stock markets. As of late 2016, GOSI held slightly more than half of its AUM in local stocks, according to research company Marmore. For Saudi Arabia’s PPA, the corresponding figure was almost 21%. The demographics of the GCC countries are positive for pension systems, in that working age populations are growing and participation rates are increasing. According to Marmore, the AUM of Saudi Arabia’s pension system could more than double to exceed US$600b by 2025.

Of the major themes that we have identified, the most important is Saudi Arabia’s reform program. How the program is implemented in practice will have an impact on growth in the workforce and in contributions to the pensions system.

Retirement benefits for expatriate workers are typically paid by the employer as a lump sum – the EOSB. There is growing awareness of the shortcomings of the EOSB regime (such as the possibility that the employee will receive nothing in the event that the employer has financial problems).

**What to watch for in 2018**

- Realization that reform of GCC state pensions is imperative
- Potential mandatory retirement savings for the expatriate community
- Pressures on pension systems from the lack of liquidity in domestic financial markets
- Growing involvement of pension systems in foreign and alternative asset classes
- Greater awareness of the limitations of the EOSB regime

**Opportunities**

- Growing AUM of pension systems
- Further diversification of pension systems’ portfolios
- Greater depth and liquidity of local stock markets
- Development by international life companies and asset managers of solutions that address the limitations of the EOSB regime
Wealth management and private banking

85%

estimated increase of household investable assets in the GCC by 2020.

The GCC region is a highly prospective market for private banks and other providers of wealth management solutions. Thomson Reuters estimates that the investable assets held by the region’s households should rise from around US$60b in 2016 to US$111b in 2020. In absolute terms, the increases should be greatest in Saudi Arabia (with estimated investable assets growing from US$29b to US$51b) and the UAE (from US$6b to US$19b).

In practice, there are a number of challenges. Established finance advisors face increasing costs, rising regulation, greater demand for transparency of fees and charges, and downward pressure on incomes. It
is no coincidence that wealth managers have become more imaginative in the ways in which they maintain contact with their clients. More than two-thirds of the GCC region’s advisors have a social media engagement strategy.

The nature of the GCC economies means that the two main groups of clients who have investable assets are unusual:

- GCC nationals enjoy benefits from their governments’ social security systems that are among the most generous of any in the world. They are under relatively little pressure to provide actively for their own futures.
- High-income expatriates do not necessarily see themselves as living and working in the GCC region for the long term.

However, a third group is emerging that is attractive to wealth managers and private banks: the affluent segment of upwardly mobile millennials who want to transact business in a different way and communicate with advisors in a different way. The development of digital banks is testament to this in the region.

The implication of this is that assumptions that hold for private banks and wealth management businesses in developed markets do not necessarily apply in the GCC region and may diminish over time. Further, HNW and UHNW clients tend to come from just three communities: long-established local (i.e., GCC national) families; expatriates in senior executive roles; and expatriates from the Indian subcontinent who are owners of substantial businesses or senior executives.

These unusual aspects of the wealth management industry in the GCC region mean that the private banking community is difficult to define and constantly shifting. Research by Insight Discovery in 2013–14 found that around 60 private banks had a physical presence in the GCC countries. This number had been changing, as private banks were opening and closing operations in the region. The private banks differed widely in terms of the number of people employed and the clients that they were targeting.

Crucially, the number of private bankers on the ground in the GCC region is a subset of private bankers working with GCC-based clients. Traditionally, a number of the region’s wealthiest clients prefer to work with private bankers, or other trusted advisors, in other parts of the world: typically the UK, Switzerland and the Channel Islands.

Islamic asset management, and the perennial (but positive) wild card

According to Thomson Reuters and the DIFC, the total AUM of the global Islamic asset management industry rose from US$53b by the end of 2012 to US$59b by the end of 2016. The AUM of funds domiciled in this period in Saudi Arabia and Malaysia were US$20.6b and US$19.6b respectively. The number of investment funds rose from 683 to 937.

Employer-sponsored pension funds that are run according to Islamic principles have been growing rapidly from a very small base. The number of such pension funds has almost doubled between the end of 2012 and 2016, from 32 to 60. Their aggregate AUM, on the other hand, has increased almost tenfold in the same period, from US$37.7m at the end of 2012 to US$305.3m at the end of 2016.

The advantages of Islamic financial services are well known. In no particular order, they include: enablement of faith-based investing; the additional security that comes from products and services being approved by Sharia boards; the very strong support of the governments of Saudi Arabia and Malaysia; and the potential for huge growth, given the increasing size of Muslim communities globally.

The challenges are also well known. In no particular order, these include: a lack of understanding of Islamic financial services by potential clients; a shortage of scholars who are suitably qualified to sit on Sharia boards; the underdevelopment of Sharia-compliant capital markets; and the general underdevelopment of financial services in several of the countries that have the largest Muslim populations.

It remains to be seen if distribution of this asset class will gain critical mass in the GCC region or elsewhere, and a major institution achieves considerable success in selling Sharia-compliant products to non-Muslims. This could well provide the key catalyst for the next burst of growth in Islamic asset management.
Automated advisors

Robotics solutions are poised to revolutionize the wealth management front, middle and back offices. Overlaid across legacy systems, robotic automation comes with compelling benefits. Robots work faster and more accurately than a human being, 24 hours a day, 7 days a week, without complaint or breaks – and at a significant discount. They do not require the traditional complex, costly and time-consuming legacy systems integration required of other transformative solutions, making the business case extremely compelling. A robot works at one-tenth the cost of an onshore full-time equivalent (FTE) and one-third that of an offshore FTE. We anticipate the rapid uptake of robotics will likely lead to significant middle- and back-office redundancies in the industry.

Automated advisor platforms are becoming more prevalent, with global AUM estimated to exceed US$2t by 2020:

- In 2016, there were circa 40 standalone robo-advisors that collectively managed around US$55b, including the Vanguard and Schwab platforms.
- Forecast AUM growth is estimated to be 68% CAGR for automated advice through 2020, exceeding US$2t, half from non-invested assets.

Established WAM firms have launched their competing robo-advisory offerings to undercut existing robo-advisors:

- Some firms have launched their own robo-advisors, while others have partnered with external providers, and still others have bought formerly independent players or have just provided small equity financing.
- Analysis of 24 WAM firms revealed that around 60% launched their offering via partnerships or built their own robo-advisory platforms.

The B2B and B2B2C robo-advice model has begun to emerge as a preferred mode of robo-advisory

- Many B2C and D2C robo-advisors have struggled to acquire customers or achieve profitability. Nutmeg, the largest D2C robo-advisor in the UK, with an estimated €650m in AUM, has posted three straight years of losses, with pre-tax losses rising to €10m for 2015, despite increased revenues.
- White labeling is expected to expand in 2017. Automated advisors are likely to make the transition from the B2C or D2C model to the B2B and B2B2C market. Collaborations will empower advisor networks with digitally automated solutions to achieve scale, retain clients and remain profitable.
- Going forward, we can expect to see a large number of asset managers and independent advisors partnering with skilled technology firms that are able to optimize robo-advisor technology much more efficiently than they could do in-house.
Robots are a virtual workforce controlled by the business operations teams. They are tools that emulate human execution of tasks via existing user interfaces. Robots sit alongside existing infrastructure, governed and controlled by IT.

Automated solution can work 24/7/365
One-third of the cost of offshore FTE
Double-digit reduction in error rates

Robots work with existing IT landscape
Robots can be trained by business users
Cuts data entry costs by up to 70%

- An effective deployment plays to both robotic and human strengths.
- Robots deliver repetitive, deterministic, high-volume tasks efficiently.
- People build relationships, provide subjective judgment, deliver low-frequency and exception tasks, and manage change and improvement.
- RPA is unique among the automation spectrum for its rapid benefit delivery.
As of late 2017, the environment for providers of asset services (e.g., custody, transfer agency, cash management and fund administration) to clients in the GCC region is mixed. Among the SWFs, collectively the largest pool of assets, some institutions are likely to grow; meanwhile, others are likely to contract. Conversely, demographics mean that pension systems across the region are expected to expand. It is therefore possible to identify both tailwinds and headwinds for asset managers and providers of wealth management solutions that are active across the region.

All this is in the context of a world where all service providers remain under pressure to cut fees and costs. As ever, asset service providers need to invest heavily in technology, in part to keep up with new demands by regulators.

The general trends are positive. The reforms announced by the Government of Saudi Arabia in Vision 2030 and the NTP are consistent with a greater number of IPOs, improved liquidity and increased participation by foreign investors in equity markets.

According to EY, the norm is for three to four equity IPOs to take place across the Middle East and North Africa (MENA) region each quarter, raising a total of around US$300m. However, the size of the proposed IPO of a 5% stake in Saudi Aramco means that it is a landmark transaction in global terms.
What to watch for in 2018

- Further newsflow in relation to large-scale IPOs in Saudi Arabia
- Further growth in relative importance of pension systems as institutional clients
- Further development of bond markets
- Official initiatives to boost transparency and corporate governance in the markets of the GCC region

Opportunities

- Possible partnerships with governments or financial center regulators to grow asset servicing operations with a physical presence in the region
- Innovation resulting from development of new technology in other parts of the world
- Possible partnerships with local banks that play a leading role in distribution of funds and other wealth management products

Blockchain

At the back end of the value chain, blockchain is set to make asset servicing radically more efficient, with the potential to make not only humans, but entire organizations, redundant. Blockchain is an emerging technology that can disintermediate the WAM ecosystem. Blockchain facilitates transaction interactions without the intermediaries currently needed for execution, clearing, settlement, depository and custody. Blockchain replaces all the separate central ledgers with a system of distributed ledgers — a unique copy of the truth held in many places at the same time. This means we can now settle cash or securities in close to real time — rather than two to three days after the trade occurs.

According to EY’s *With blockchain, what comes first, opportunity or threat?*, blockchain technology is high on the asset servicing industry leadership agenda. Though still in the early stages of development, it is becoming one of the hottest topics in financial services, with the potential to streamline and accelerate business processes, protect data integrity and transform the asset servicers’ business.

Distributed ledger technology (DLT)

**Distributed infrastructure**

The network becomes intermediary

From master ledgers, e.g., clearing houses and banks

To distributed ledgers with no intermediaries

**Blockchain in action:**

Stocks have already been issued, derivatives created, instant cross-border money transfer executed, IPOs floated and land rights registered, all without an intermediary.

Nasdaq was the first global stock exchange to publicly launch a blockchain platform for its private market clients. In December 2015, Chain was the first of six inaugural clients to use this Nasdaq Linq blockchain platform to transfer shares. Also in December 2015, the SEC approved a plan from an online retailer, to issue company stock via the internet using its blockchain technology. Now, leading global financial institutions are backing R3, a blockchain consortium. By 2022, blockchain is expected to save US$20b in securities transaction costs.

Smart contracts

**Attractive features:**

- Blockchain’s single most characteristic feature allows parties to share a “golden record” of data and records, in a trusted format, with no intermediary.
- In addition, the peer-to-peer nature of DLT makes it inherently resistant to certain types of directed cyber attacks, and the use of many nodes, each with a copy of the blockchain, guards against data corruption.
Digital transformation in wealth and asset management
In recent years, technology has revolutionized industries all over the world, and the WAM industry is no exception. Global wealth managers face the challenge of adapting to a rapidly evolving market environment. Client needs, shareholder expectations, stricter regulation and milestone developments in technology are driving future business models and shaping their requirements. Strong client preference for digital channels and the pressure to grow revenue mean wealth and asset managers must rethink their strategies, operations and technologies; and adapting early to the new reality will open the door to profitable future growth opportunities.

According to a recent study Wealth Management Outlook — 2017 by EY, digital wealth managers will dramatically increase their market share over the next few years and control roughly a third of the global wealth management industry in 2025. The report says that wealth managers with a “new digitalized, holistic business model” will drive traditional wealth managers out of the market by 2025. It predicts these “holistic wealth managers” (which provide digitalized investment advice that is driven by life events and that generates true added value for clients) will see their share of the market jump from close to zero currently to between 20% and 30% by then. Software-based tools enable these wealth managers to collect vast sums of data from different information sources and providers. Implementing a successful hybrid model requires deep understanding of clients and the ability to deliver the services they need through the channels they prefer.

The report further predicts that the global wealth management market for clients with more than US$1m (€850,000) to invest will grow by around a quarter from more than US$55.4t now to US$69.6t by 2021, representing an annual increase of around 4.7%. Therefore, it becomes imperative for wealth managers to anticipate this growth and adjust their business models to wealthy clients’ needs, which are changing more fundamentally than ever before.

Digitization is here and, while it may be unevenly distributed and the WAM industry is really just beginning, the time to act is now, as digital is set to become one of the leading CEO agenda items in the years to come. The explosion of data and ideas enabled by digitization is creating more complexity than many organizations can handle or their stakeholders can easily grasp. Swimming well in digital waters is imperative for a bright future, and it is more important than ever that firms make goals, strategies and methods transparent and simple to understand.

If digital transformation refers to the application of technologies and processes changes to improve aspects of the business, today’s executives must act quickly to formulate strategy and align capital investment to concentrate on the following critical areas for long-term growth and profitability:

- **Improve client experience**

- **Reinventing the wheel**

- **Revamping business models**

- **Convergence**

  The convergence of technologies and industries is increasingly ingrained in our daily lives. EY’s recent Convergence Lab in San Francisco identified investment and financial advice as one of four global hotspots for convergence. The lab highlighted that there is a huge potential for firms to transform themselves through collaboration. In a converging world, partnering with companies from other sectors – and even with rivals – in the search for simplicity can help wealth and asset managers succeed.

- **Improving the client experience**

  Today’s clients are impatient. Digitization can deliver the speed they’re looking for. The virtual world is slowly but steadily spreading its wings, with the help of digital channels. Wealth and asset managers will have to focus on new investments in digital technologies that can help them engage more effectively with digital clients at every touchpoint in the client experience life cycle. Therefore, it will be imperative to move investments into:

  - **Advisor tools** – to enable them to develop relationships with clients and understand the health of the relationship at a glance. The role of the advisor will most likely shift toward the profit of a requirements engineer and client supporter serving as a contact backed by digital tools. The future business model focuses on the wealth manager’s technology and digital infrastructure, and is increasingly independent of the advisor. Added value is generated by technology infrastructure, which enables a holistic perspective on the private wealth situation and advice relating to it. Consequently, infrastructure and technology-driven capabilities will be fundamental to a wealth manager’s activity in the future.
Data analytics — to deliver enhanced real-time access to portfolio information, reporting and virtual portfolios in a fluid visual and intuitive way via secure online channels.

Smart devices — to provide access to a deep array of anywhere, anytime online and mobile transactions. Clients want a high level of technology sophistication from their financial advisors.

Transforming operations or reinventing the wheel

With increased cost pressure combined with the threat from digital entrants and the crushing cost of regulatory compliance, many wealth and asset managers are strengthening their operational improvement agendas. Wealth and asset managers can use digitization to re-engineer their existing processes and increase efficiencies.

Revamping the business models

Most profound for the industry is the potential for digital to help wealth and asset managers fundamentally revisit the way in which their businesses are conducted. There is a tidal wave of focus on the mass affluent segment, whether by traditional private banks or new entrants. Digital is providing a potential means to reach this rapidly growing segment successfully, and service this low-AUM group profitably, by enabling a lower cost-to-serve platform. Wealth and asset managers can use digitization to re-engineer their existing processes and increase efficiencies.

Cybersecurity in wealth and asset management

Cybersecurity continues to be “top of mind” for wealth and asset managers as the number of high-profile cyber attacks continues to increase. The dynamic nature of the sector provides a unique set of challenges in the management of cyber risks.

Over the past few years, firms have begun to establish their strategic priorities and enhance their adaptability to an interconnected global economy. This includes expanding business in high-growth markets, as well as leveraging enterprise intelligence and data analytics as competitive advantages, all of which expose WAM to new cyber risks compounded by an ever-evolving threat and regulatory landscape. It has been estimated that up to 35 million attacks occur for large organizations every year. Typically, it takes an organization 200 days to detect an attack. Firms also continue to struggle to keep pace with threat vectors, with limited resources and budgets.

Cyber risks should not be viewed only as a technology issue, but as a pervasive business and operational risk with the potential for a significant negative impact on assets, revenues, reputation and profitability. An organization’s cyber program should be focused on holistically managing cyber risk and protecting people, processes and technology, as well as protecting investor and other stakeholder value. Wealth managers need to think through the full range of cyber exposures and examine all contributing sources of cyber risk when designing this integral component of the organization’s enterprise risk management process. It is therefore no surprise that regulators around the world are increasing scrutiny on cybersecurity risk management.
Cybersecurity threats continue to evolve as attackers become more sophisticated, patient and persistent. Due to the relative ease of access via IP addresses, digital systems are often targets for cyber criminals and should be included in an organization’s approach to improving cyber maturity. Attack surfaces also continue to expand beyond technology targets: increasingly, the human element is exploited by attackers to gain access to sensitive business data. Typical points of weakness include the following:

1. Smart devices and services can deliver unintended consequences and exposes mass data to risk.
2. Social media is “always on” and shares information widely, without a full appreciation of privacy and security.
3. Information is increasingly stored in the cloud or with third parties, resulting in less control, increased risk and a more complex cybersecurity ecosystem.
4. Human behaviors are changing.
5. New legislation and regulations are forcing changes in processes that can open up new vulnerabilities and widen the attack surface of an organization.
6. Reliance on third-party outsourcing and cloud service providers creates additional pathways into an organization.

EY conducts an annual Global Information Security Survey to identify industry trends in security program maturity, security investment prioritization, and preparedness against attacks and data breaches. In 2015, 1,755 respondents representing all key sectors in 67 countries participated in the survey.

According to the survey results, respondents from the asset management sector did not feel confident of their ability to detect attacks and meet increasing cybersecurity demands, as indicated by the statistics on the right.

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
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<tbody>
<tr>
<td>25%</td>
<td>25% of respondents listed “end-user awareness” as the primary control failure that led to the most significant cyber events of the previous year.</td>
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<tr>
<td>60%</td>
<td>60% of respondents said a lack of skilled resources was a key challenge for managing IT security.</td>
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<tr>
<td>49%</td>
<td>49% of respondents did not have a threat intelligence program.</td>
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<tr>
<td>33%</td>
<td>33% of respondents felt their organization was unlikely to detect a sophisticated attack.</td>
</tr>
<tr>
<td>47%</td>
<td>47% of respondents did not have a Security Operations Center (SOC) that is responsible for the identification and resolution of security events.</td>
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Increased regulatory requirements – overview

Conventionally, wealth and asset managers have invested heavily in remediating operational risks that maximize returns. As the number of security incidents and attacks intensify, managers need to adopt a proactive approach and familiarize themselves with the relevant regulations. Firms should reassess their operating models and cybersecurity ecosystem, and evaluate whether new policies, standards and procedures need to be implemented to strengthen the security controls and overall governance structure, and comply with relevant global regulations. In view of the recent developments in regulatory landscape, the traditional approach of confining regulatory challenges to a compliance office needs to change. An environment where cybersecurity controls and leading practices are operationalized throughout the organizational structure should be encouraged.

Government mandates and regulatory rules may also increase to combat cyber threat actors in the rapidly evolving digital world, which will add to the burden of organizational security management. Organizations need to be aware of the various cybersecurity regulatory requirements as guidance, as well as the differences in requirements among the various countries they have a presence in. Continued oversight by senior management, and proactive measures taken across the organizational structure to adhere with the regulatory standards and security controls, will help reduce this burden and maintain stakeholder confidence. In addition, organizations must maintain documentation that demonstrates their compliance with their countries’ applicable cybersecurity regulations.

Ten-point action plan

The following are 10 considerations that wealth and asset managers should include when creating and updating their organization's cybersecurity program:

1. Understand the business ecosystem, including internal and external stakeholders that impact business strategy and operations, threat actors across the ecosystem, and how cybersecurity impacts strategy and business relationships
2. Identify the most critical assets (crown jewels), threat scenarios and the potential impact to the bottom line if compromised
3. Prepare and assist the board of directors and organization to mitigate operational, economic and reputational risks in response to a breach
4. Define the firm’s cyber risk appetite and develop a cybersecurity strategy to help achieve the firm’s vision while maintaining agility and resilience
5. Improve cybersecurity awareness and focus on creating a security-minded workforce
6. Embed cybersecurity into the firm’s operating model, business architecture and operations through digital and cybersecurity transformation
7. Extend the cybersecurity framework, with more detection mechanisms, and incorporate cyber threat intelligence
8. Test the firm’s cyber incident response plan
9. Optimize the firm’s resilience strategy
10. Evaluate cyber insurance packages to cover the firm properly in the event of a breach
To help manage cybersecurity threats, WAM executives need a cybersecurity lens on all aspects of the business: strategy, finance, operations and regulatory. Digital touches every part of the WAM business, and cybersecurity should as well. Firms should work to develop a prudent cybersecurity risk management framework that can adapt to any threat that emerges. Wealth and asset managers must remain steadfast in supporting a well-developed cybersecurity program and continue to adapt to the changing environment.

Sources:

FinTech
3. 2017 WAM T&D Deck

Cybersecurity
2. Global Information Security Survey 2016/17 results (EMEIA FSO Advisory Webcast Learning)

Digital
Afterword

Last year, we noted how various changes that are taking place in the GCC region’s asset management industry need to be considered in the context of three trends:

- The importance of client experience – especially for the millennial generation, who are at early stages in their working lives
- The impact of greater regulatory requirements, thanks to official decisions that are made within the GCC region and elsewhere
- The potential for disruption of businesses from digital technology and automated technologies

It is a fair bet that all three trends will remain important in 2018. By that stage, there should be more clarity over the ramifications of Saudi Arabia’s NTP. Perceptions of Qatar’s geopolitical situation will almost certainly be different from those of today.

It is significant that the NTP sets out specific objectives for 2020. That will be the year of Expo 2020 Dubai, the first world exposition to take place in the Middle East and an event that has provided the catalyst for a new wave of infrastructure investment in Dubai.

It may well be that 2020 is the year that the asset management industry of GCC countries is seen properly as an entity in its own right, rather than as an offshoot of the part of the global industry that focuses on the broadly defined Europe Middle East and Africa (EMEA) region.
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