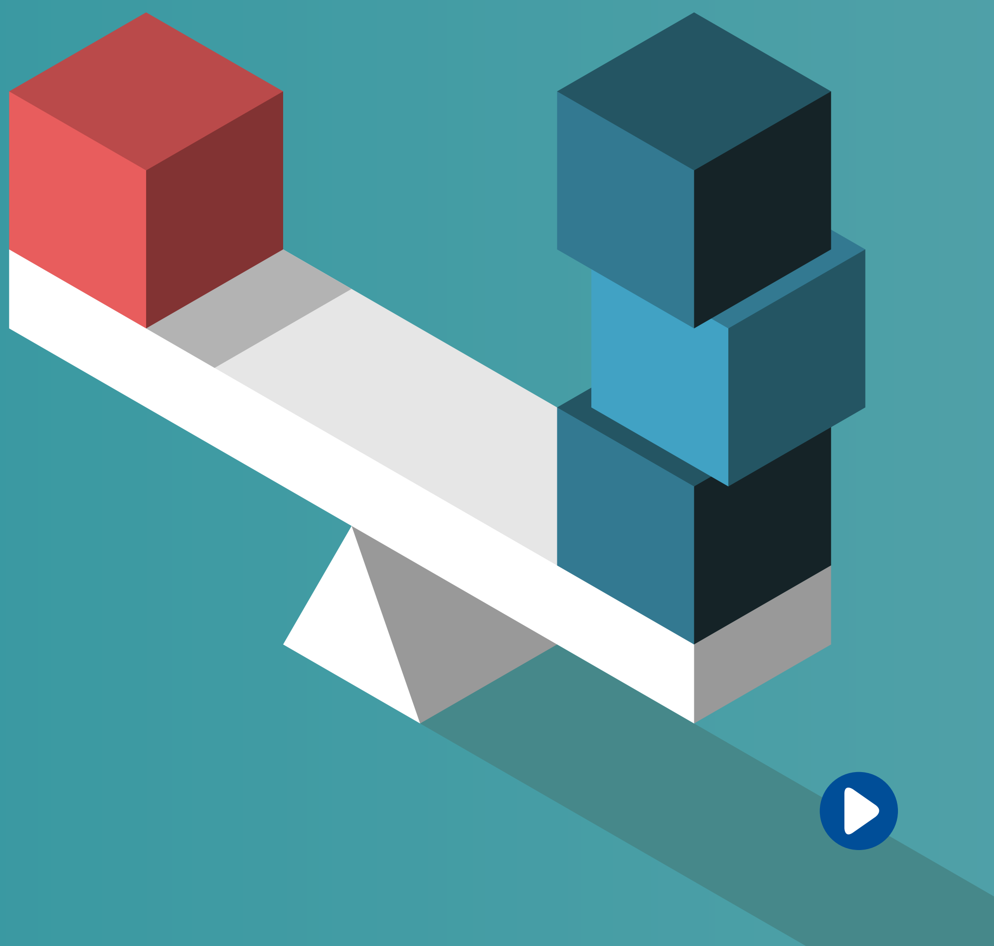
Canadian asset management industry opportunities & risks report



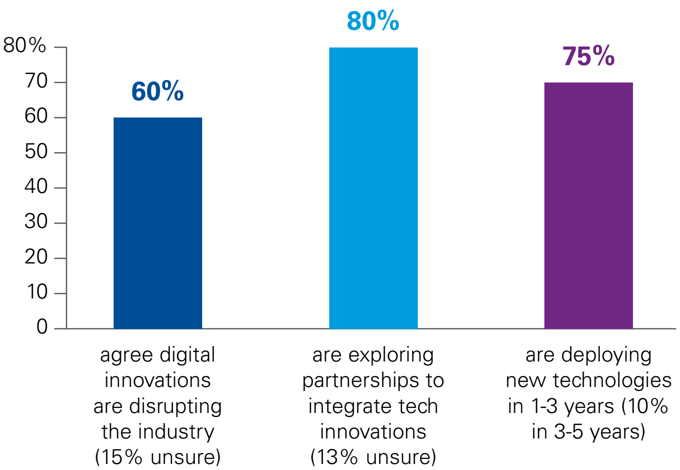
September 2018

kpmg.ca/assetmanagement

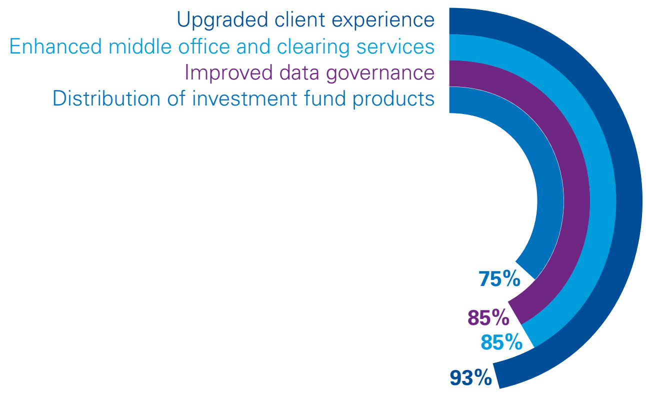
Canadian asset management industry opportunities & risks overview

It's a balancing act in asset management. The pull of new technologies, ideas, and customer opportunities is being countered by the weight of mounting regulations, technological and cyber security risks, and the rising costs of innovation. And in the middle of it all, Canadian industry players are assembling their resources and talents to tip the scales in their favour.

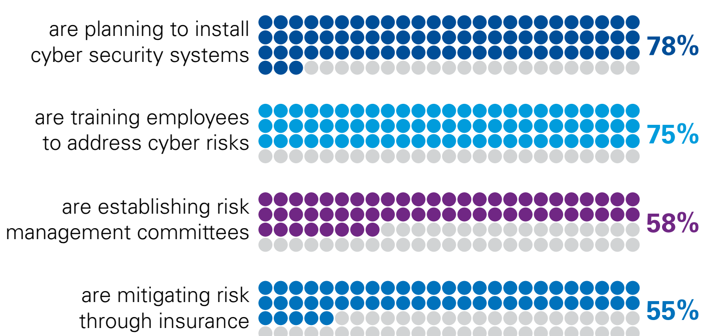
Disruption on the asset management agenda



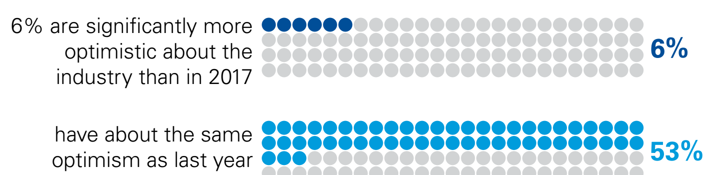
Top tech opportunities



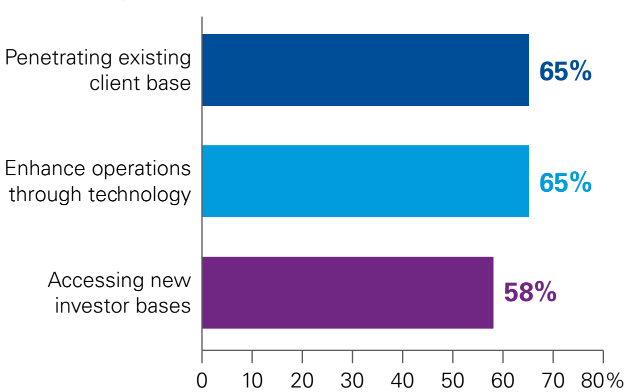
On the cyber defensive



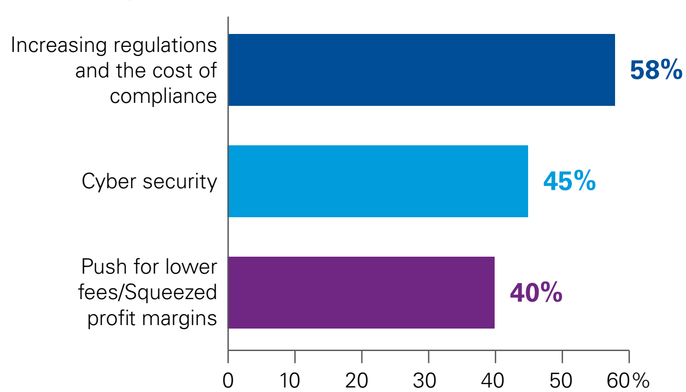
Reserved predictions



Top organizational opportunities in 2018

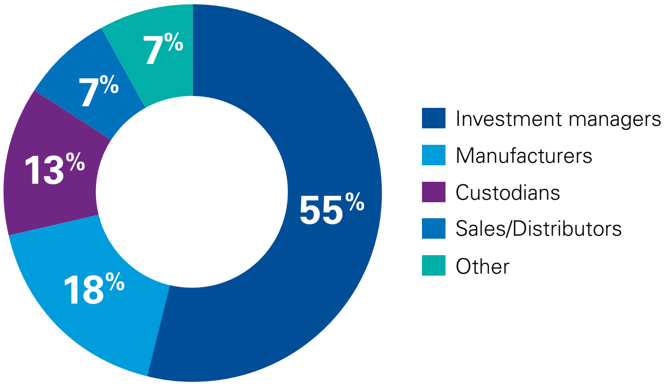


Top organizational risks in 2018

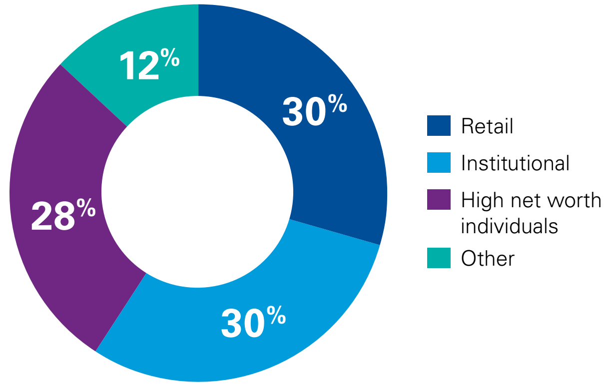


Respondent breakdown

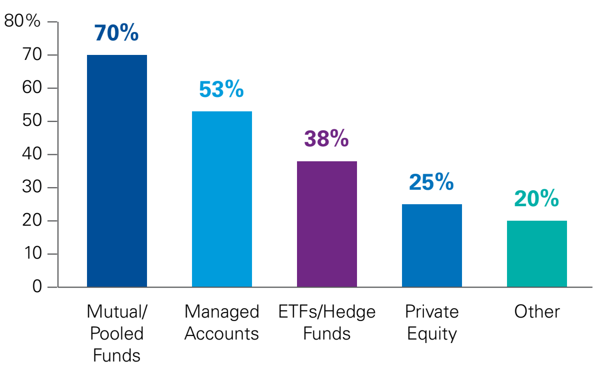
Sector profile



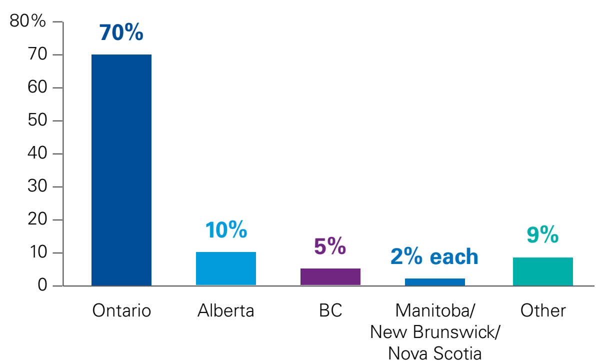
Investor base



Product types



Headquarter locations



83%

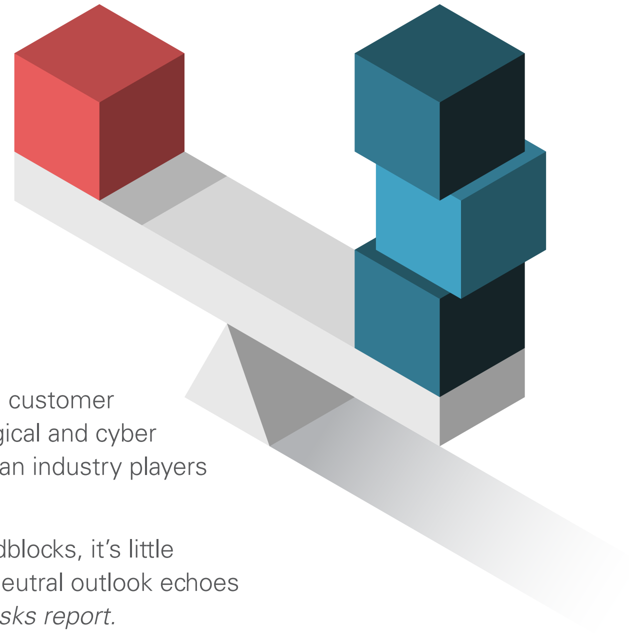
cite Canada as their investor domicile (2% US, 15% other)

84%

have over $1 billion AUM (assets under management) (43% over $20 billion)

#LetsDoThis

Learn more at **kpmg.ca/assetmanagement**



Welcome

It's a balancing act in asset management. The pull of new technologies, ideas, and customer opportunities is being countered by the weight of mounting regulations, technological and cyber security risks, and the rising costs of innovation. And in the middle of it all, Canadian industry players are assembling their resources and talents to tip the scales in their favour.

With all the exciting opportunities tempered by cost pressures and regulatory roadblocks, it's little wonder why Canada's asset managers are pragmatic about their prospects. This neutral outlook echoes throughout KPMG's *2018 Canadian asset management industry opportunities & risks report.*

Now in its third year, this report collected insights and perspectives from industry stakeholders across the country regarding the accelerators and disruptors impacting their organizations and the asset management industry as a whole. It also tapped into KPMG's network of asset management partners and professionals to better understand how organizations are getting ready for transformation and where the industry is heading.

Keeping the status quo

It's a familiar story with a few new twists to the plot. Mirroring themes from KPMG's *2017 Canadian asset management industry opportunities & risks report,* this year's survey results depict the Canadian asset management sector as a cautiously optimistic community. Leaders are both eager to adopt new methods and tools to strengthen customer ties, yet restless as ever about tightening market conditions, cyber risks, and the always-looming possibility of being out-innovated by their competitors.

What makes this year's story different, however, is a greater emphasis on strengthening consumer relationships. While there is a drive to expand markets and attract new clients, the narrative in 2018 appears centered around existing customers and investing in technologies, channels, and trust-building measures to keep them loyal and engaged.

This ambition is challenged by heightened competition and a seemingly endless supply of industry disruptors. On the other hand, it's also being driven by back- and front-end advancements, inventive strategies, and a drive to keep pace with customer expectations. Indeed, it's been said that a customer's great experience anywhere becomes their expectation everywhere.

There's more to the story. Read on for how Canada's asset managers are attempting to strike that fine balance, and let's do this.

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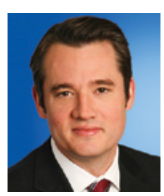

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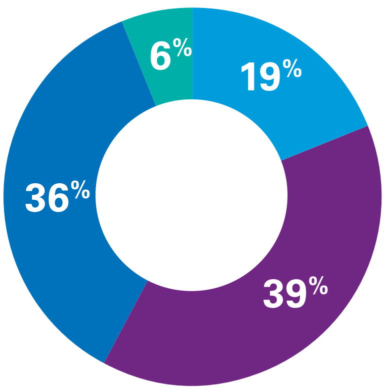
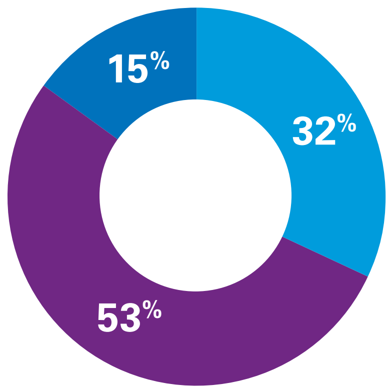
Neutral, with a chance of optimism

My outlook for my organization compared to this time last year is:



Somewhat more pessimistic
About the same
Somewhat more optimistic
Significantly more optimistic

My outlook for the Canadian asset management industry as a whole compared to this time last year is:



Somewhat more pessimistic
About the same
Somewhat more optimistic

Outlooks for Canada's asset management industry reflect the "cautiously optimistic" attitudes from our 2017 report. A third of asset managers are slightly more optimistic for their organization than they were one year prior. This outlook can be attributed to the fact they likely have made greater peace with market disruptions over the last twelve months and had more time to plan accordingly.

The industry's relationship with technology has also brightened, even if familiar uncertainties linger. That is, while organizations are becoming more confident and adept in adopting the likes of blockchain, bots, data analytics, and artificial intelligence (AI), reservations persist as to how these resources will pay back their investments and how organizations can mitigate their potential risks. And considering there's always a new competitor willing to look beyond these reservations, organizations are feeling the pressure to make a decision or fall behind.

"Asset management continues to be a growth industry, and with demographic trends signaling a big wealth transfer on the horizon, it's going to be a growth sector for a very long time," predicts Peter Hayes, National Leader for Alternative Investments, KPMG in Canada, adding, "but, there will still be a lot of uncertainty on how that growth plays out, and that's why it really is a balancing act, requiring agility from asset managers."

The pressure to disrupt or be disrupted is intensifying. So too, however, are the pressures felt by domestic and international regulatory shifts, the rising cost of compliance, the relentless push for lower fees, and the potentially game-ending risks of becoming the next headline victim of cyber-attacks.

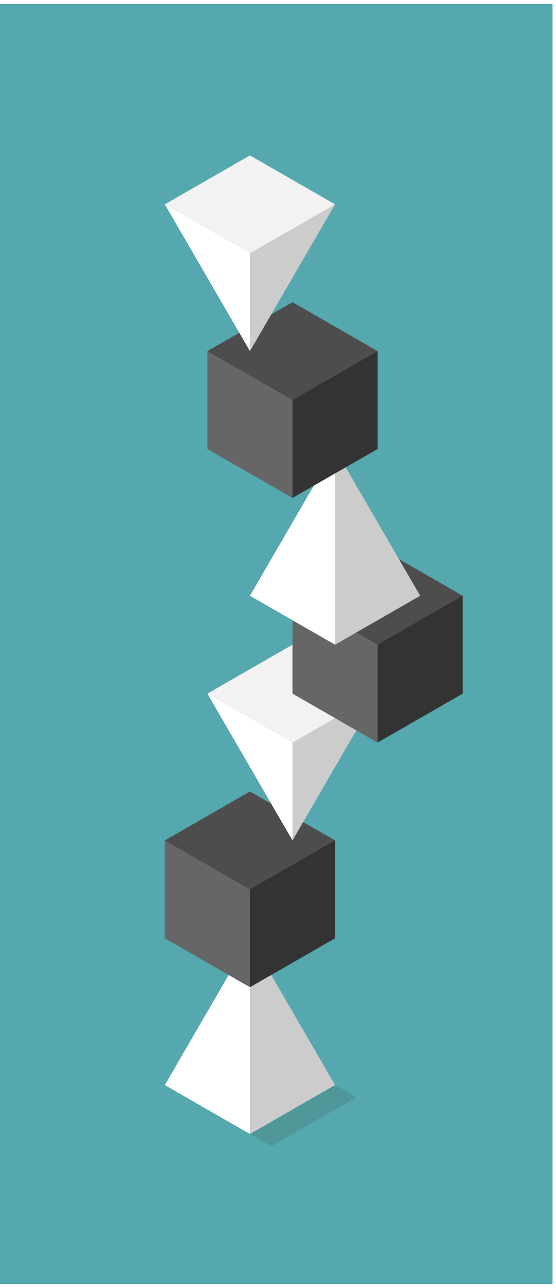
It makes sense, then, that nearly a third of asset managers have a slightly more pessimistic outlook for the industry as a whole. Given the increased competition and the possibility of more prominent market entrants in Canada, it's likely that the eagerness to innovate is taking a back-seat to fears of making the wrong moves and causing irreparable cracks in established foundations.

Shared reservations

Unsurprisingly, this year's mix of bullish ambitions and pragmatic mindsets appears throughout Canada's industries.

In *KPMG's 2018 Global CEO Outlook*, just over half of CEOs expect mild growth over the next few years, while only a third believe their headcount will grow beyond 6% in the same time-frame.

Source: 2018 Global CEO Outlook, KPMG International



"We're coming out of a long period of artificially low interest rates, which have contributed to outsized market returns, and have helped the rise of passives. As interest rates go up, and as equity returns moderate, it's going to be a more challenging performance environment, and one in which we'll likely see a fair bit of money move around."

Peter Hayes
National Leader for Alternative Investments, KPMG in Canada

Global perspective

Canadian organizations are feeling the ripple effects of international activity. Overseas, European players are contending with a tighter, direr regulatory environment. In addition to pursuing stronger regulations around customer privacy and protection with the introduction of the General Data Protection Regulation (GDPR), both European countries and countries like Asia are taking on board the outputs of IOSCO[8] and are pursuing regional and domestic regulatory initiatives.

It's a different story in the United States. More and more, President Donald Trump is repealing legislation to make it easier for players in the south to do business. In October 2017, the US Treasury issued a potentially game-changing report, which argued for fewer barriers in asset management and related sectors.

"The US made it clear that the US asset management sector should no longer be part of the domestic and global regulatory edifice that has been built since 2008," reads KPMG International's 2018 analysis, *Parting of the ways? Evolving Asset Management Regulations report.* "The principal goals are to remove the suggestion that asset management is systemically risky, and to reduce the burden of regulation and compliance on investment firms."

Still, Peter Hayes believes common growing pains are felt among all industry players: "Everyone is facing the same obstacles when it comes to fee pressures, the risks of adopting technology, or trying to find new and innovative products and services to sell their existing customer base. No one is really immune."

"We've had a historic bull run in equities for a number of years, but we're starting to see a lot more volatility. That can be worrisome for traditional asset managers when it comes to maintaining returns and AUM levels."

James Loewen
National Sector Leader for Asset Management, KPMG in Canada

"We absolutely need a more supportive provincial and federal framework with policy support to help the industry remain competitive, since other jurisdictions are responding to either maintain or grow their market share in the global asset management industry. It's one of the ways to tip the scales in the industry's and its customers' favour."

Joseph Micallef
National Tax Leader, Financial Services, KPMG in Canada

Top 5 organizational opportunities

2018

65% Increased penetration of existing client base (retail, institutional, fund of fund, and/or private wealth platform)

65% Enhanced operational processes and use of technology

58% Accessing new inventory base either within and/or outside existing market

43% Cost reduction initiatives

38% Demand for solutions and specialties (Outcome-oriented investing and multi-assets) / Launching new product types/ services (managed accounts, sub-advisory, new fund strategies, insurance-related products, and/or alternatives)

3 to 5 years

65% Enhanced operational processes and use of technology

63% Accessing new investor base either within and/outside existing market

55% Increased penetration of existing client base (retail, institutional, fund of fund, and/or private wealth platform)

43% Launching new product types/services (managed accounts, sub-advisory, new fund strategies, insurance-related products, and/or alternatives)

38% Data analytics to enhance product design, marketing, and pricing

Top 5 opportunities for the asset management industry

2018		3 to 5 years	
50%	Enhanced operational processes and use of technology	**53%**	Launching new product types/services (managed accounts, sub-advisory, new fund strategies, insurance-related products, and/or alternatives) | Enhanced operational processes and use of technology
48%	Cost reduction initiatives | Launching new product types/services (managed accounts, sub-advisory, new fund strategies, insurance-related products, and/or alternatives)	**48%**	Cost reduction initiatives
43%	Customer preferences for direct and digital channels | Mergers and acquisitions to enhance market position	**43%**	Customer preferences for direct and digital channels
40%	Data analytics to enhance product design, marketing, and pricing	**38%**	Accessing new investor base either within and/outside existing market | Mergers and acquisitions to enhance market position
35%	Accessing new investor base either within and/or outside existing market	**30%**	Increased penetration of existing client base | Data analytics to enhance product design, marketing, and pricing | Improved management of risk and use of capital

55% of CEOs have aligned middle- and back- office processes to reflect a more customer-centered approach.

Source: 2018 Global CEO Outlook, KPMG International

Moving forward

Existing customers come first for a majority of Canada's asset managers. Over two-thirds (65%) of 2018's survey respondents believe the surest route to success is building loyalty among their established client base. The desire to access new investors intensifies over a longer timeline, yet the more immediate agenda among asset managers appears to be centered around learning more about their base clients and catering to their evolving expectations and needs.

"Organizations are turning their attention to how they can secure a greater share of wallet from existing customers," agrees John Armstrong, National Industry Leader, Financial Services, KPMG in Canada. "This may be an easier path to walk than trying to secure new investors which, as we see, also continues to be a priority moving forward."

"Customers, including end-clients and advisors, expect to have options. That being said, there are organizations that try to cater to those expectations and offer a broad suite of products, resulting in stretching their investment teams and back office too thin. It's a fine line that you have to balance because you may end up with various products on the shelf that have very small dollars attached to them."

Reema Ibrahim
Partner, Risk Consulting, KPMG in Canada

This emphasis on existing clients has persisted for the last few years – and for good reason. According to Joseph Micallef, National Tax Leader, Financial Services, KPMG in Canada: "If you don't take care of your foundation, it cracks. And the more you build on that weak foundation, the worse it gets. So if you aren't really paying attention to that foundation and optimizing it, how do you grow your market? You need to have that strong base, and that's why there's so much internal focus with asset managers on learning who their customers are and taking care of them."

This inclination to "strengthen the foundation" is stronger than it was in 2017 when "increasing the penetration of existing client base" was also identified as a top opportunity (albeit, with less certainty at 52%). It's likely that the steady influx of new competitors and investing alternatives over the last year has motivated organizations to double down on strategies and experiential offerings that will keep their current clients happy, and prevent them from taking their business across the street.

"There has never been a time like today when the customer is calling all the shots and directing how the industry transforms," says Joseph Micallef.

What are those strategies to strengthen the foundation? Forty-three percent of survey respondents are investing in the means (e.g., data analytics, market research, stronger client interactions) to better understand their customers' preferences regarding new products, services, and service channels.

"There's certainly a focus inwards on enhancing the client experience, and most are doing it through technology," observes Peter Hayes, National Leader for Alternative Investments, KPMG in Canada. "There's a real push to give clients more transparent and flexible access, be it through new online channels, point-and-click services, or automated functions. Companies see these as opportunities to keep their clients happy and stop them from switching. Whether or not they think they can do so better than their competitors is debatable."

Six pillars of customer experience

Organizations from all industries are united in their efforts to build a better customer experience. KPMG International's Six Pillars of Customer Experience were created to help our member firms gain insight into the psychology of experience and better tailor our service offerings to meet our clients needs. The pillars are:

1. **Personalization:** Using individualized attention to drive an emotional connection;
2. **Integrity:** Being trustworthy and engendering trust;
3. **Expectations:** Managing, meeting, and exceeding customer expectations;
4. **Time and effort:** Minimizing customer effort and creating frictionless processes;
5. **Resolution:** Turning a poor experience into a great one;
6. **Empathy:** Achieving an understanding of the customer's circumstances to drive deep rapport.

Learn more about the Six Pillars at KPMG's Refocus on the customer: How customer experience is shaping the future of wealth management.

"The very best brands for customer experience excellence are now starting to think of their customers as assets that should be protected, nurtured, and invested in. They view their customers' loyalty as a form of equity in the company. To cultivate true loyalty and trust with tomorrow's customers, today's companies need to look beyond the traditional demographic and segmentation approaches to understand each customer as an individual. They need to then use these insights to engage intelligently."

Julio J. Hernandez

Head of Global Customer Centre of Excellence US Customer Advisory Lead, KPMG in the US

Source: KPMG Global Customer Experience Excellence report, 2018

Technology at top-of-mind

Technology plays a critical role in understanding what makes today's investors tick. Moreover, the desire to use data mining, AI, and automation to gain the market edge has never been stronger.

As is the case in many industries, however, asset managers are developing a more visible awareness as to both the risks these tools create and the risks of failing to act.

The good news is that Canadian organizations are more assured in their ability to leverage technology to their advantage and, in some cases, lead the pack. Sixty-five percent of asset managers are confident technology will enhance their operational processes in 2018 and beyond (up from 48% in 2017), while half (50%) believe technology can unlock the same operational enhancements for the industry as a whole (up nearly double from 27% in 2017).

It's not all talk, either. Four out of five asset managers plan to invest in/or explore partnerships to integrate technology into their business models or strategies. Those numbers are up considerably from the one-in-five who revealed the same intentions in our previous study.

As for which technologies are top-of-mind for asset managers, Peter Hayes, National Leader for Alternative Investments, KPMG in Canada, offers: "Investments in technology have more recently been centered on the customer experience and the front office. We'll continue to see investments in the middle- and back-office to try and make the process more efficient and squeeze costs out of the system, but for a large number of organizations, the investments are about enhancing the client experience through more user-friendly portals, innovative channels, and more transparent and flexible reporting."

Canadian organizations are more comfortable with disruption than they were one year ago. The fog of mystery around blockchain, digital ledgers, deep thinking, and RPA has begun to lift as asset managers invest in the skills and resources to learn more about the options before them.

Moreover, many organizations have dedicated internal resources toward better qualifying the value of these technologies and exploring ways to integrate them into their processes. They've watched these blockchain technologies, robo-advisors, and digital channels evolve, engaged their peers and experts, and dipped their feet in the water through internal development or strategic partnering.

Surely, says Joseph Micallef, National Tax Leader, Financial Services, KPMG in Canada, as the race to innovate speeds up, "A lot of organizations have realized that if they don't understand these technologies and where they can be utilized in their respective business models, they're going to end up being behind the proverbial 8-ball."

The "buzz" around these technologies is also building. Fintechs have made a big noise about digital ledgers, extreme automation, and AI, in recent years and a growing number of third-party vendors have also come out with more advanced and secure solutions in regards to cloud-based services, Internet of Things (IoT) tools, and on-demand platforms. What's more, the trade headlines have been rife with news of large financial institutions who are either making investments in these spaces or engaging in M&A activity to bring them to market faster, and credible alliances between government and security regulators have begun to form around such disruptors. These moves have added further legitimacy to technologies that were once thought too risky to pursue.

"We're seeing increased awareness and optimism about new technologies because, while people have been aware of them over the past few years, now they have seen a number of success stories and how they can affect the asset management industry," says James Loewen, National Sector Leader for Asset Management, KPMG in Canada, adding, "People are now starting to believe the hype."

"There are a number of changes on the horizon in regards to transaction transparency, fees, and reporting that are going to put an increased burden on players in the asset management space. It's no surprise that there is a stronger focus on using technology to enhance operations and overcome that burden while at the same time meet the demand for a stronger, more digital experience for both customers and intermediaries."

John Armstrong

National Industry Leader, Financial Services, KPMG in Canada

Rise of the Robo-Advisors

According to KPMG International's *Refocus on the Customer* report 2018, the Assets Under Management (AUM) for automated investment platforms was estimated at over $200 billion in aggregate worldwide and continues to grow at pace.

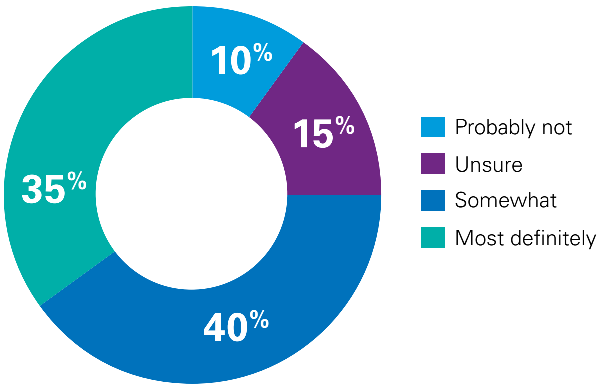
Certainly, it argues, the robo-advisors are picking up momentum among asset and wealth managers, and its impacts are not going unnoticed.

Yet as much as human-free interactions are being targeted toward Millennials and tech-savvy groups, Reema Ibrahim, Partner, Risk Consulting, KPMG in Canada, indicates that intelligent, automated systems are a technology embraced by all: "There's a misconception that innovations like robo-advisors are there to attract Millennials, when the reality is that technologies like this are embraced by wealthy investors who want a sophisticated yet simple experience.

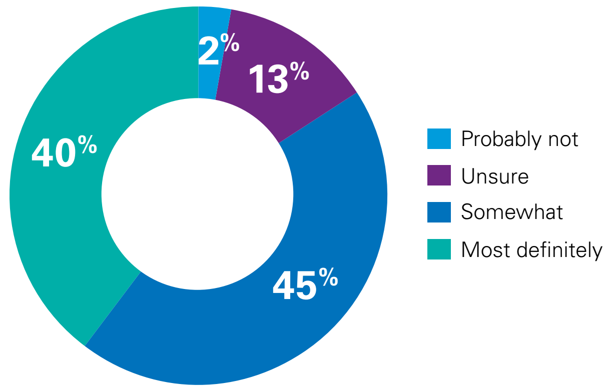
The good news is that there is an opportunity for the industry to explore customer segmentation and preferences across each generation, not just one."

Technology innovation potential

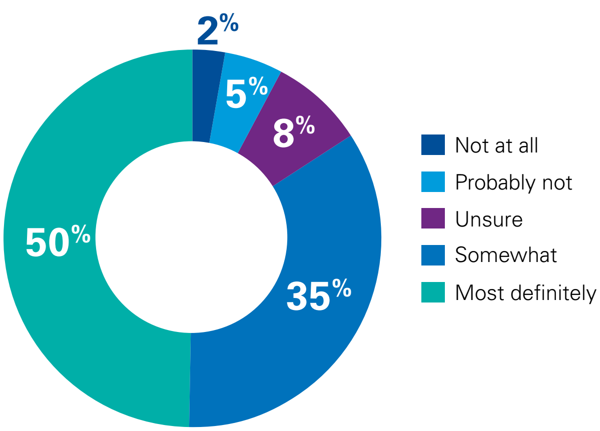
Distribution of investment fund products



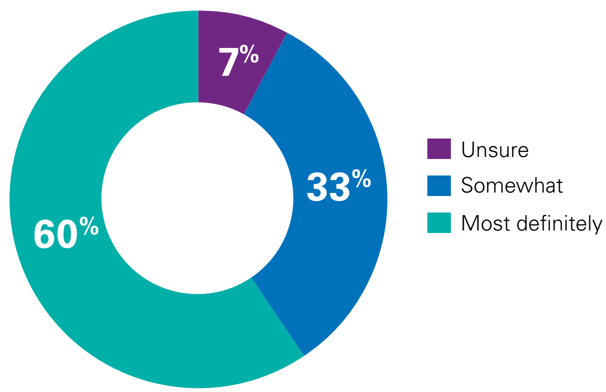
Improved data governance



Middle office and clearing services (DLT-enabled platforms are elevating middle-office functions from cost centres to profit enablers)



Client experience



Costs under pressure

Reducing costs remains seen as a topmost opportunity for asset managers. It is driven by regulatory pressures, the desire to retain customers, and the entrance of new ETF products that are continuing to drive capital accumulation from the more traditional mutual funds and similar products.

"The need to remain competitive has certainly turned a boardroom spotlight on how and what firms are going to do to manage not only regulatory compliance, which is extremely overwhelming and costly, but also remain profitable in light of all these compressions and headwinds that are impacting their business," says Joseph Micallef, National Tax Leader, Financial Services, KPMG in Canada.

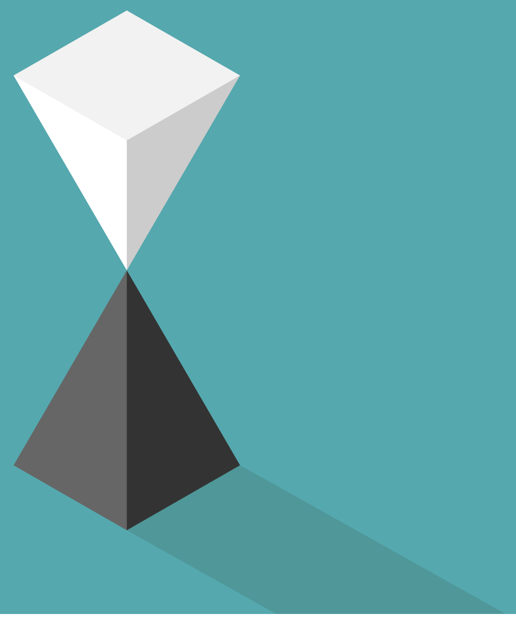
Top 5 organizational risks

2018		3 to 5 years	
58%	Increasing complexity of regulation and cost of compliance	**53%**	Increasing complexity of regulation and cost of compliance
45%	Cyber security risks	**45%**	Cyber security risks | Failure to adopt new technologies successfully | Intensified competition and consolidation
40%	Push for a lower management fee environment | Cost challenges and squeezed profit margin	**43%**	Failure to adapt to changing customer preferences
35%	Failure to adapt to changing customer preferences | Failure to adopt new technologies successfully | Intensified competition and consolidation	**40%**	Push for a lower management fee environment | Cost challenges and squeezed profit margins
33%	Tax changes	**38%**	Technological advancement

Top 5 risks to the asset management industry

2018		3-5 years	
55%	Cyber security risks | Cost challenges and squeezed profit margins	**58%**	Cyber security risks
53%	Push for a lower management fee environment	**53%**	Increasing complexity of regulation and cost of compliance
45%	Intensified competition and consolidation	**50%**	Push for a lower management fee environment
43%	Increasing complexity of regulation and cost of compliance	**43%**	Cost challenges and squeezed profit margins
38%	Failure to adopt new technologies successfully	**40%**	Intensified competition and consolidation

The stress of compliance



"We're going to see regulations that place more of a burden on intermediaries in terms of better understanding their products and customers. That, in turn, is going to put more pressure on manufacturers to help advisors become smarter about all the funds they're offering, which may mean some of those products are going to be left out in the end."

John Armstrong
National Industry Leader, Financial Services, KPMG in Canada

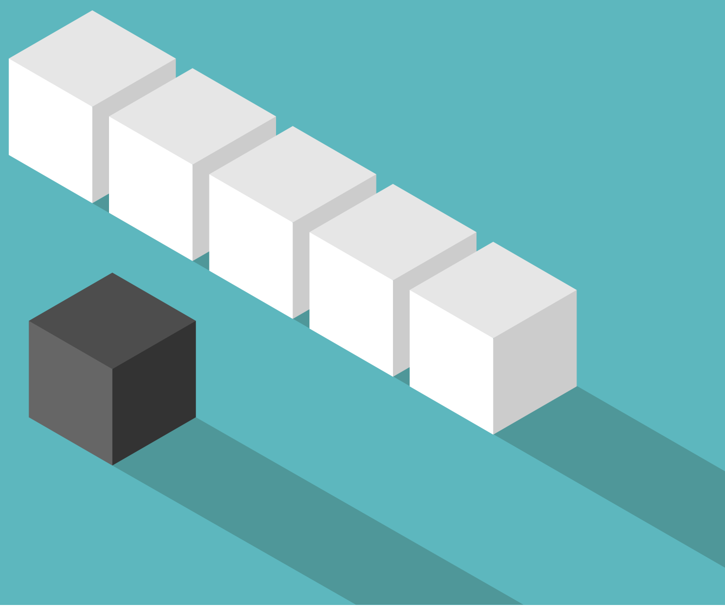
The asset management industry has always been under consistent regulatory pressure and current times are no exception. The resulting tension is felt among a majority of this year's survey participants who listed the increasing complexity of the regulatory environment as the number one risk facing their organizations both now (58%) and into the years ahead (53%).

At the time of the survey, both the Best Interest Standard and discussions of Embedded Commissions loomed heavy. And while both have seemingly been shelved since, it's likely that elements of it will exist in various incoming rules.

These domestic concerns aside, asset managers are also contending with regulation-shifts outside of Canada. The new General Data Privacy Regulation (GDPR) initiative in Europe, for example, imposes significant obligations on those with a large EU footprint.

Overall, says Georges Pigeon, Partner, Deal Advisory, KPMG in Canada, "There have been a lot of demands from regulators, which has created more complex reporting, more complex products, and greater complexities around reporting. Regulators are requiring increasingly more from asset managers, whether product or information compliance. Asset managers are now addressing a community of investors and potential investors who want specialized products and more information. This has led to more complex products and more substantial reporting. Increasingly, asset managers will weigh the cost vs. benefits, and solutions will be required, so changes can be expected to level the playing field."

Enemies at the (virtual) gate



It's no surprise cyber security tops the list of challenges keeping the asset management industry awake. Despite increasing awareness and stronger cyber postures across the board, the media continues to stoke fears with constant headlines of large-scale data breaches, cyber theft, or other high-profile incidents here in Canada and around the globe.

Those fears and anxieties are justifiable. Cyber breaches can expose organizations to penalties from regulators, and even the slightest incident can land companies in the headlines, exposing them to potentially game-ending reputational damage and loss of consumer confidence.

"The cyber threat is very much alive as asset management organizations have seen enough profile breaches around the world," says James Loewen, National Sector Leader for Asset Management, KPMG in Canada. "There's this permeating sense that no one is safe and anyone with sensitive data is a target; which, in the asset management world, means sensitive client data."

It may be that the threats are more sophisticated than before. Or it may be that the risks of becoming a victim more severe. Either way, organizations are continuing to invest in the means and expertise to shore up their virtual defenses either through partnerships with third-party security firms or internal skills development.

"Whether or not the risk is new or more prolific, it doesn't matter," adds Joseph Micallef, National Tax Leader, Financial Services, KPMG in Canada. "If you can't protect client data, you are going to lose the trust of your clients, and ultimately, their business. As soon as there's any breach whatsoever of a particular manager or wealth advisor's information – which is the customer's information – that trust and loyalty you've built up through the years can all go away, instantly."

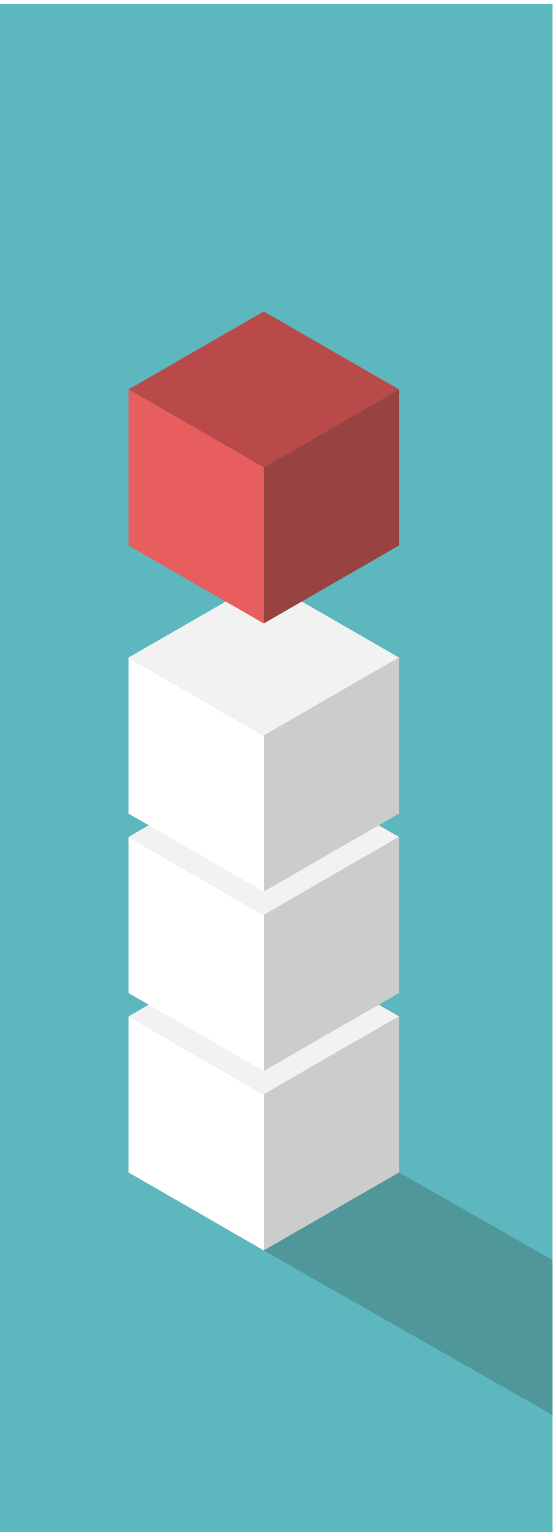
Tighter cyber security regulations have also put cyber security in the spotlight. The EU's newly introduced General Data Privacy Regulation (GDPR), for example, holds those with overseas business accountable for tighter controls over consumer data, while Canada's own mandatory breach disclosure

Global cyber perspectives

Few, if any, business leaders are sleeping easy when it comes to cyber security. Half of the respondents to *KPMG's 2018 Canadian CEO Outlook* believe becoming a victim of a cyber-attack is a case of "when" not "if", and six-in-10 think protecting customers' data is one of their most important responsibilities as they look to build customer trust.

As such, 55% believe a robust cyber strategy is critical to secure key stakeholders' trust.

Source: Growing pains: 2018 Canadian CEO Outlook



"Cyber will likely remain high on the list of concerns for the next several years as we move toward an open banking system, and as more and more smaller fintechs are introduced into the ecosystem who might not have as mature a cyber defense as larger entities would. As those partnerships take shape, and as data-sharing increases, concerns over cyber security will precipitate and the boards, regulators, and financial backers are going to be asking these very same questions because it is a very, very, big deal to the health of the business."

Joseph Micallef
National Tax Leader, Financial Services, KPMG in Canada

laws mean companies must be more diligent in their communications of an event. Add in rising insurance costs and the consumer push for stronger data security, and it's no surprise that cyber-crime is top of mind.

"Cyber security should be top of mind," suggests Reema Ibrahim, Partner, Risk Consulting, KPMG in Canada. "In today's online investing and banking era, organizations will be held to a very high standard of data privacy and protection."

Into the breach

Organizations are not standing idle in the face of cyber threats. In 2018, 78% say they plan to install systems to detect and/or prevent cyber-incursions, while over half (58%) aim to establish a risk management committee to address cyber security and 55% intend to purchase insurance to protect themselves against such incidents. Interestingly, while three out of four asset managers say internal training is still a priority, this is fewer than in years past. This speaks to a trend toward outsourcing the challenge of cyber security – which is also reflected by over a third of respondents (35%) who say they intend to transfer the risk to a vendor.

"When cyber first came up as an issue, it was more about do we have governance control procedures in place. It went from there to making sure you had insurance and were training your employees on what to look for," explains Joseph Micallef, National Tax Leader, Financial Services, KPMG in Canada. "Now, as regulators become even more sophisticated, and the base work has been done, companies are getting more serious about it and they're shifting to hiring third-party consultants to protect their systems, conducting ethical hacking, and making sure they have the right controls and procedures in place."

Tech anxieties

There are many reasons why over a third of asset managers feel less-than-confident about their ability to adopt new technologies. Aforementioned cyber security concerns are certainly among them; however, they are joined by fears of being late to market with an innovation, overshadowed by a more nimble tech-savvy competitor, or simply being unable to make the most of a new tech investment.

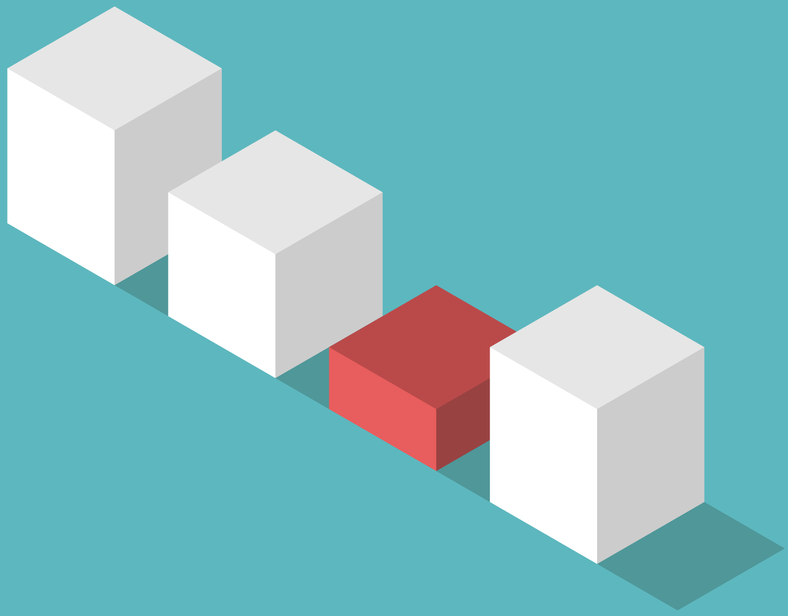
The size of an organization can also be a factor. It's one thing for more nimble niche managers to experiment with online solutions, but another altogether for those dealing with AUMs in the billions of dollars. At the end of the day, it comes down again to what clients are asking for, which again points to the reason why many organizations are using the time now to pinpoint what exactly their clients want before pulling the trigger on technology investments.

According to Joseph Micallef, National Tax Leader, Financial Services, KPMG in Canada, these factors can make organizations take a more cautious wait-and-see approach: "I don't believe a lot of players out there want to be the leaders in these technologies. Instead, they prefer to do their due diligence, kick the tires, and sit back and see who is leading to see what they're doing and how it's working. They're picking and choosing what they want to be a leader in and follower with, which doesn't necessarily make them a late adopter, but means they're taking a more cautious approach."

"Our industry is made up of many mid-sized organizations that just don't have the type of infrastructure to be able to keep up with all of these emerging technologies – especially in a world where so much of the operations are outsourced."

James Loewen
National Sector Leader for Asset Management, KPMG in Canada

How low can you go?



The pressure remains on organizations to lower fees to clients. This speaks again to an underpinning theme towards building customer loyalty and staying a viable competitor in an increasingly crowded space.

Interestingly, that risk isn't rising. The percentage of those who cited the push for a lower fee management as an organizational risk remains the same as those from 2017 (40% each), while the number of those who believe it to be a risk for the industry itself in 2018 (53%) is less than one year ago (64%).

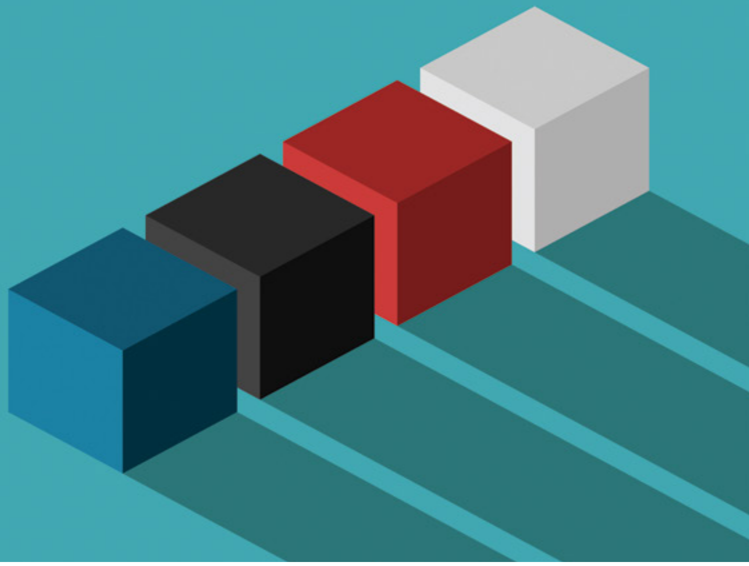
Peter Hayes, National Leader for Alternative Investments, KPMG in Canada, offers one take on why this risk is less prominent on an industry scale: "Lowering fees appears to become less of a concern in 2018, but that's likely a symptom of the simple fact that many may feel they have gone as low as the industry can bear."

It's a concern nonetheless – particularly in a time where Canada's fees are comparatively higher than its global peers and more cost-effective products and passive products like ETFs continue to gain market share. Peter Hayes adds, "As interest rates start to increase and people have to work harder for returns, those passive beta returns might not be as easy to get. Perhaps people are expecting there will be more demand for more sophisticated products that do have higher fees."

Georges Pigeon, Partner, Deal Advisory, KPMG in Canada, believes it could also be a matter of accumulating expenses: "If you're taking 2% out every year, the compounding impact is very significant over time relative to, say, a management fee of 1.9% or 1.8%."

As returns are becoming increasingly difficult to achieve in excess of market, he adds, "Lowering management fees would help to some extent."

Strength in numbers



While 2018's data suggests mergers and acquisitions (M&A) aren't considered as risky as they were in 2016/17, M&A remains a hot topic among asset managers. Some factors are driving smaller businesses to seek buyers as a means of survival and, reversely, larger firms are eyeing partnerships with smaller market players as a means to obtain the technologies, capacity, or innovations they need to keep on track.

"We're seeing an increase in mergers and acquisitions due to continued pressure on fees and increased operational costs. Organizations are reducing management fees to remain competitive due to customer sensitivity to pricing. Moreover, organizations are in need to invest in new technologies to redefine customer experience and manage operational cost, on top of spending to meet continuously evolving reporting requirements" says Reema Ibrahim, Partner, Risk Consulting, KPMG in Canada.

Larger firms may be more equipped to handle that pressure; and certainly, many have invested in incubators to develop those tools from within. Still, says Joseph Micallef, National Tax Leader, Financial Services, KPMG in Canada, "Any time there's already somebody out there making an impact in the market, it's a lot easier to partner or acquire them than to develop those same skills or technologies organically – which is what we see a lot of large banks and financial institutions doing. Going it alone comes with the risk that, at the end of the day, offers nothing new and doesn't justify the development expense."

"This industry has recognized it can't go it alone on some of these technologies, and so the idea of partnering has gained momentum."

James Loewen
National Sector Leader for Asset Management, KPMG in Canada

Distribution channels

One of the more notable changes between 2017 and 2018 was a drop in perceived opportunities around developing distributor channels. Trends indicate that more players are trying to level the playing field with respect to more "Business to Customer" approaches as opposed to distribution channels.

"There are a lot of products and very few distributors, so they're all in high demand, and they all have a lot of power in the channel," offers James Loewen, National Sector Leader for Asset Management, KPMG in Canada.

That's always been true to some degree, he continues, but adds, "It's more so today. You now have some very large financial services companies that have been buying up asset managers, and now have a lot of product to provide to their own distribution channels."

Convergence or divergence?

The question moving forward for some is whether or not Canada's asset management landscape will be one of convergence or divergence.

From his perspective, James Loewen, National Sector Leader for Asset Management, KPMG in Canada offers: "Are a few managers going to offer lots of different types of products, or are you going to have many managers that are going to play in niche areas right? You've got a few people that do ETFs and a few that do private equity and so on, and what we're seeing is that more and more people are going to try and offer different products for their entire customer base."

"If you're really good at fixed income, but you know your clients are also interested in equities or balanced for example, then you're going to try and do that too," he adds.

Whether this activity is a risk or an opportunity is a matter of which side of the see-saw one sits. One perspective is that this activity is giving smaller players in the space the chance to pick up clients who don't want to be folded into a larger organization. Others may also view this activity as an opportunity to move into spaces once occupied by smaller, niche players who have now been acquired.

No matter the motivation, M&A activity appears to be a sticking trend. It is also one shared with CEOs across all industries, as more than a quarter of CEOs in *KPMG's 2018 Global CEO Outlook* cited a high appetite for M&A activity over the next three years, and a third expressed a similar desire to form strategic alliances with third parties.

As Christoph Zinke, KPMG's Asia Pacific Head of Global Strategy Group, noted in the report, "Strategic alliances are driven by the capabilities you need to succeed in the future. Take a look at the automotive industry, which is now focused on mobility and not just producing cars. It's a totally new ecosystem that redefines the value chain. Alliances also offer flexibility if you need to add new partners or get rid of certain partners you aren't happy with."

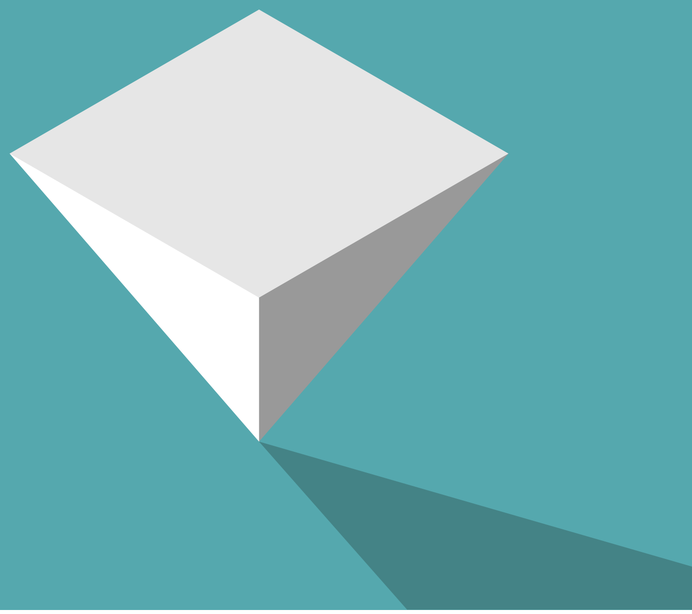
"To be competitive, small- and medium-size asset managers will likely seek, or be forced, to consolidate within the industry. However, that is the natural order of things so that managers can attract and maintain their investor base, while at the same time reduce costs and be regulatory compliant.

That being said, I am fearful that with so much focus on cost and regulation, many small and emerging managers will be unable to grow or be entrepreneurial in this space. Therefore, if the government does not become more engaged with the industry to ensure we have the right balance between regulation and creating a competitive environment, we will only have a few large players dominating the industry, which will result in a loss of entrepreneurial talent as they seek opportunities outside of Canada."

Joseph Micallef

National Tax Leader, Financial Services, KPMG in Canada

The tipping point



The landscape is shifting and the headwinds are strong. If the perspectives from this year's survey are any indication, asset managers are well aware of the obstacles ahead of them and aware that survival means pushing forward regardless.

It's not a dire outlook. Regulatory pressures and cyber concerns may loom heavy over boardroom conversations, yet there remains a strong desire to invest in the skills and technologies to strengthen customer bases (e.g., data analytics) and enhance their overall service experience (e.g., on-demand platforms, robo-advisors, and mobile innovations).

Transformation won't come easy. It rarely does. Staying in line (or ahead) of this increasingly-crowded market will mean costly IT infrastructure investments, stronger cyber security postures, more measures to remain compliant, and a willingness to experiment with the latest technologies or business models – either by way of internal development or industry partnerships.

"Transformation through disruption is fundamental. It's healthy," says Joseph Micallef, National Tax Leader, Financial Services, KPMG in Canada. "That doesn't mean it isn't stressful. A lot of people are a bit nervous about what it will take to stay in the game, and that explains why their outlook remains as cautiously optimistic as it has been over the past several years."

There's pressure to choose those right paths and make those right decisions, he continues, "Because failure at the end of the day could cost them a significant market share, and it's not clear yet if everyone will have the ability to weather that storm."

It's true there will be winners and losers. Such is the law of the land. With a wealth of new tools, ideas, and opportunities for collaboration at our doorstep, however, the biggest risk of all may be standing on the sidelines.

Appendix: Opportunities & risks

Top 5 organizational opportunities for 2018

2018

65% Increased penetration of existing client base (retail, institutional, fund of fund, and/or private wealth platform)

65% Enhanced operational processes and use of technology

58% Accessing new inventory base either within and/or outside existing market

43% Cost reduction initiatives

38% Demand for solutions and specialties (Outcome-oriented investing and multi-assets) | Launching new product types/services (managed accounts, sub-advisory, new fund strategies, insurance-related products, and/or alternatives)

3 to 5 years

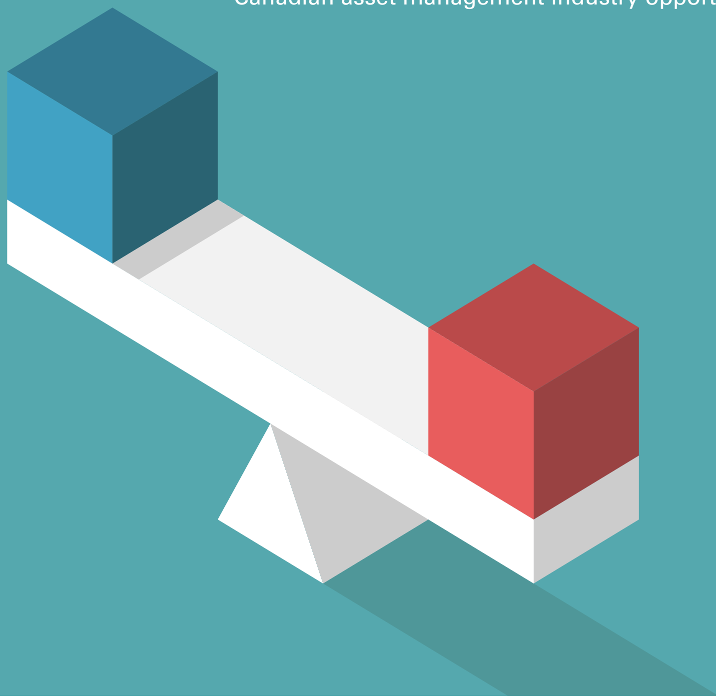
65% Enhanced operational processes and use of technology

63% Accessing new investor base either within and/outside existing market

55% Increased penetration of existing client base (retail, institutional, fund of fund, and/or private wealth platform)

43% Launching new product types/services (managed accounts, sub-advisory, new fund strategies, insurance-related products, and/or alternatives)

38% Data analytics to enhance product design, marketing, and pricing



Top 5 organizational opportunities for 2017

Next year

70% Focusing on distribution channel and their client needs

55% Enhanced operational processes and use of technology

52% Launching new product types/services (managed accounts, sub-advisory, new fund strategies, insurance-related products, and/or alternatives)

52% Increased penetration of existing client base (retail, institutional, fund of fund, and/or private wealth platform)

52% Accessing new investor base either within and/or outside existing market

3 to 5 years

55% Accessing new investor base either within and/or outside existing market

55% Focusing on distribution channel and their client needs

48% Launching new product types/services (managed accounts, sub-advisory, new fund strategies, insurance-related products, and/or alternatives)

48% Enhanced operational processes and use of technology

45% Mergers and acquisitions to enhance market position

Top 5 organizational risks for 2018

2018		3 to 5 years	
58%	Increasing complexity of regulation and cost of compliance	53%	Increasing complexity of regulation and cost of compliance
45%	Cyber security risks	45%	Cyber security risks | Failure to adopt new technologies successfully | Intensified competition and consolidation
40%	Push for a lower management fee environment | Cost challenges and squeezed profit margin	43%	Failure to adapt to changing customer preferences
35%	Failure to adapt to changing customer preferences | Failure to adopt new technologies successfully | Intensified competition and consolidation	40%	Push for a lower management fee environment | Cost challenges and squeezed profit margins
33%	Tax changes	38%	Technological advancement

Top 5 organizational risks for 2017

Next year		3 to 5 years	
64%	Intensified competition and consolidation	58%	Increasing complexity of regulation and the cost of compliance
58%	Increasing complexity of regulation and the cost of compliance	58%	Cyber security risks
52%	Cyber security risks	55%	Intensified competition and consolidation
39%	Push for a lower management fee environment	42%	Cost challenges and squeezed profit margins
39%	Product differentiation	42%	Push for a lower management fee environment

Top 5 asset management industry opportunities for 2018

2018		3 to 5 years	
50%	Enhanced operational processes and use of technology	53%	Launching new product types/services (managed accounts, sub-advisory, new fund strategies, insurance-related products, and/or alternatives) | Enhanced operational processes and use of technology
48%	Cost reduction initiatives | Launching new product types/services (managed accounts, sub-advisory, new fund strategies, insurance-related products, and/or alternatives)	48%	Cost reduction initiatives
43%	Customer preferences for direct and digital channels | Mergers and acquisitions to enhance market position	43%	Customer preferences for direct and digital channels
40%	Data analytics to enhance product design, marketing, and pricing	38%	Accessing new investor base either within and/outside existing market | Mergers and acquisitions to enhance market position
35%	Accessing new investor base either within and/or outside existing market	30%	Increased penetration of existing client base | Data analytics to enhance product design, marketing, and pricing | Improved management of risk and use of capital

Top 5 asset management industry opportunities for 2017

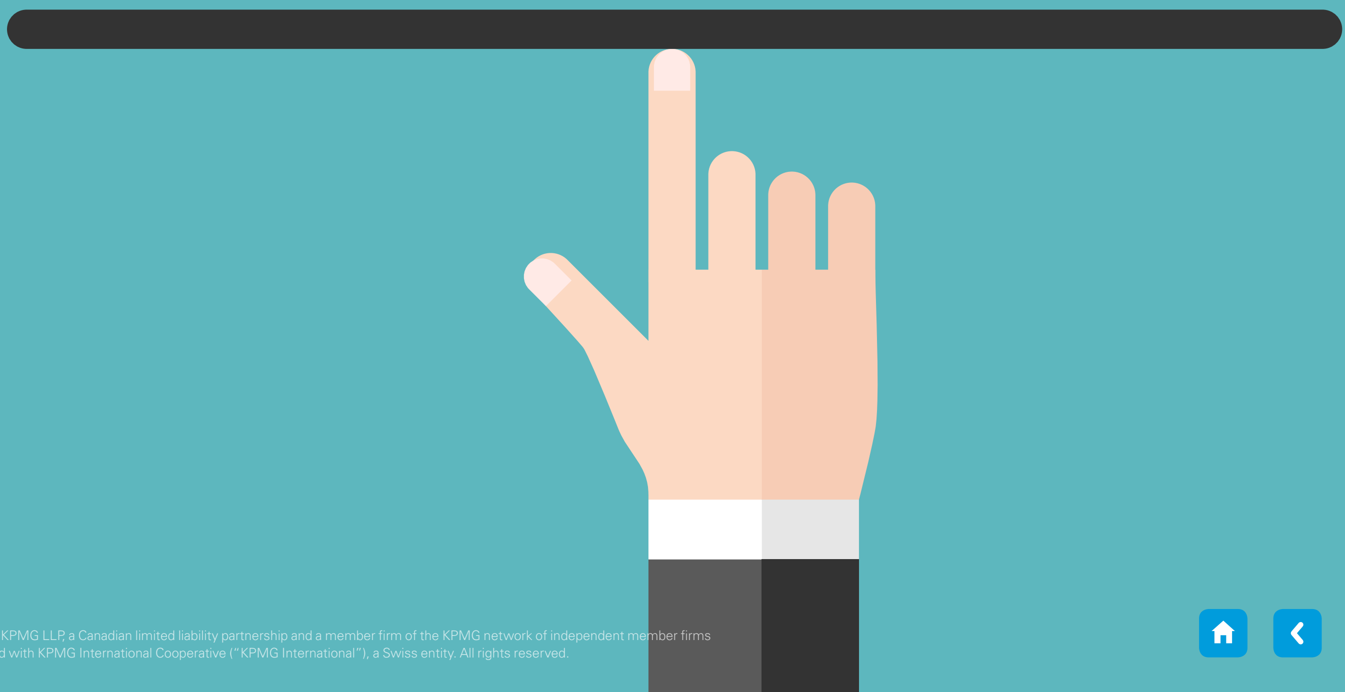
Next year		3 to 5 years	
58%	Increased penetration of existing client base (retail, institutional, fund of fund, and/or private wealth platform)	52%	Enhanced operational processes and use of technology client needs
48%	Focusing on distribution client needs	48%	Data analytics to enhance product design, marketing, and pricing
45%	Mergers and acquisitions to enhance market position	48%	Mergers and acquisitions to enhance market position
42%	Data analytics to enhance product design, marketing, and pricing	42%	Launching new product types/services (managed accounts, sub-advisory, new fund strategies, insurance-related products, and/or alternatives)
42%	Demand for solutions and specialties (outcome-oriented investing and multi-assets)	36%	Focusing on distribution channel and their client needs

Top 5 asset management industry risks for 2018

2018		3 to 5 years	
55%	Cyber security risks | Cost challenges and squeezed profit margins	58%	Cyber security risks
53%	Push for a lower management fee environment	53%	Increasing complexity of regulation and cost of compliance
45%	Intensified competition and consolidation	50%	Push for a lower management fee environment
43%	Increasing complexity of regulation and cost of compliance	43%	Cost challenges and squeezed profit margins
38%	Failure to adopt new technologies successfully	40%	Intensified competition and consolidations

Top 5 asset management industry risks for 2017

Next year		3 to 5 years	
64%	Push for a lower management fee environment	70%	Push for a lower management fee environment
64%	Cost challenges and squeezed profit margins	55%	Intensified competition and consolidation
61%	Intensified competition and consolidation	55%	Cost challenges and squeezed profit margin
52%	Increasing complexity of regulation and the cost of compliance	52%	Increasing complexity of regulation and the cost of compliance
48%	Product differentiation	33%	Failure to adapt to changing customer preferences



If you have questions about the contents of this report or would like support in navigating any of the opportunities and risks described, please contact us.

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