KPMG

Responding to an evolving landscape

Asset management review 2021

Trends shaping the industry in Saudi Arabia

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Contents

Foreword

The COVID-19 outbreak instigated a set of unique and broad-spectrum issues that governments around the world had to grapple with, ranging from health and safety to severe economic impact as a result of the lockdowns and movement restrictions. The global asset management industry has experienced a dynamic shift in asset allocation, while the industry is underpinning global economic recovery through unprecedented investor gains in certain segments. We believe the asset management industry in Saudi Arabia is well-poised and playing a vital role to do just the same.

2020 was a year of diverse challenges amid the pandemic, global economic slowdown, low interest rate environment and enhanced credit and market risks. As we have started 2021, the domestic asset management industry can still look back to a year of resilience and modest growth, due to the perseverance of institutional investors and added liquidity injected by retail investors.

In our first edition of the Asset management review, we have analysed the industry's financial performance through the lens of 12 large asset management firms regulated by the Capital Market Authority (CMA) in Saudi Arabia for identification of key contributors to their results, providing a directional view on the wider industry.[1] In addition, we have detailed our thoughts on the dynamic shift in investment strategies and business plans amid the COVID-19 crisis and how varied investor behaviors have evolved in recent times. This is also complemented by insights from leading industry executives, reflecting revised market perspectives.

We hope that you will find our first edition of the Asset management review 2021 insightful and we look forward to your feedback.

Khalil Ibrahim Al Sedais
Office Managing Partner- Riyadh
KPMG in Saudi Arabia

Ovais Shahab
Head of Financial Services
KPMG in Saudi Arabia

[1]In our selection of the asset management firms for the purposes of our analysis in this report, we have relied upon each firm's audited 2019 financial statements and used the total assets figures as the basis.

Executive summary

The asset management industry in Saudi Arabia reported favorable results over the past twelve months amid continued bullish trend on the Tadawul, the Saudi stock exchange, and a domestic focus of affluent investors. The inclusion of Saudi Arabian equities in global indices such as MSCI and FTSE in mid-2019, coupled with the mega Saudi Aramco IPO listing on Tadawul in Q4 2019, had a profound impact on both global and local investor sentiments. As a result, there was an increased inflow of capital, enhancing the liquidity of the market and in turn driving the overall stock market performance and investor returns. Whilst the global markets have been disrupted in 2020 due to the pandemic, the asset management sector in Saudi Arabia has weathered the COVID-19 storm well, owing largely to the strong affluent client base which could absorb price volatilities and not be impacted by liquidity constraints.

As we emerge from the strict lockdowns and travel restrictions that were imposed by the government to successfully curtail the COVID-19 outbreak to date; it is evident that the asset management industry is prepared to play a pivotal role in terms of providing the necessary impetus to the overall economic recovery.

We anticipate an uptake in the deployment of necessary capital to start-ups and entrepreneurs through venture capital (VC) or private equity (PE) type investments arising from imminent privatizations and the presence of distressed assets as a result of the pandemic. We also expect fund managers, in line with the global trend, to offer a diversified investment suite to potential investors as the risk/reward appetite evolves in the market and fund managers shift their investment strategies accordingly. With the launch of the novel exchange traded derivative by Tadawul in 2020 and the noticeable growth being witnessed in commodity exchange traded funds coupled with increasing demand for environment, social and governance-oriented (ESG) investing for example, we believe there are ample opportunities for the asset management industry to continue to flourish in the coming years.

> A resilient asset management industry has withstood the two-fold challenges posed by the decline in oil prices and the COVID-19 pandemic, whereby investor redemptions have been limited and asset prices have either been stable or have rebound.

The asset management industry will be aware that, whilst Saudi Arabia has managed to control the COVID-19 outbreak well due to the unprecedented yet effective measures taken by the government, the pandemic still persists and is likely to continue to disrupt global markets.

With the onset of second waves in many global jurisdictions and the emergence of new variants of the coronavirus that are deemed to be far more infectious, fund managers in Saudi Arabia will need to remain vigilant around portfolio risk management and ensure business continuity plans are robust to withstand any potential shocks.

The asset management industry in Saudi Arabia has reason to be cautiously optimistic about the growth prospects ahead, especially in light of the recent development and deployment of preventive vaccines, despite the macroeconomic challenges that arose in 2020. A continued focus on digitalization and offering tailored solutions to investors will prove to be decisive. Asset managers that excel in these areas are expected to do well in a market that is experiencing increased competition. Furthermore, the continued capital market reforms and astute regulatory initiatives being taken by CMA will continue to enhance the transparency, robustness and resilience of the asset management industry in Saudi Arabia.

Strong financial position

Based on our analysis of most recent available financial information of 12 large asset management firms in Saudi Arabia, it is evident that 2020 has been a growth year in terms of revenue, profitability and assets under management (AUM). It is important to highlight that even 2019 was a strong financial year when firms reported a growth of 33% in their cumulative net income, largely on account of 13% growth in asset management fees. This trend of growing brokerage income, along with asset management fees on equity-based funds, continued in 2020. The growth can be attributed to both an increase in assets under management as well as strong performance of invested funds (i.e. net asset values).

By the end of September 2020, the asset management firms in Saudi Arabia that were evaluated for the purpose of this report, were managing in aggregate SAR 471 billion of AUMs, a growth of 14% since 31 December 2019. This growth is largely testament to the inclusion of Saudi equities in global indices such as MSCI and FTSE, attracting USD18 billion by the end of August 2019, according to the Institute of International Finance (IIF). This inclusion was subsequently complemented by the IPO of Aramco, the world's largest IPO, during December 2019.

As a result of these momentous events, the Tadawul market capitalization increased by 385% in 2019, thereby reaching SAR9,025 billion by the end of 2019.[2] This market capitalization was further accentuated in 2020 by main market IPOs such as Dr. Sulaiman Al Habib Medical Services Group, Amlak International for Real Estate Finance Company and Bin Dawood Holding Co, which resulted in market capitalization reaching SAR 9,101 billion by 31 December 2020. Furthermore, the foreign ownership holding value in particular witnessed an increase of 128% in 2019 and further 5% in 2020.[3] The increased inflow from both local and foreign investors – both individual and institutional- have played an integral role in enhancing the overall liquidity of the market and driving the stock market performance whereby the Tadawul All Share Index (TASI) increased by 7.19% at the end of 2019 and 3.59% at the end of 2020.

> The trend of growth in brokerage income, that started in 2019, continued in 2020, along with asset management fees on equity-based funds.

[2] Tadawul annual statistical report for 2019
[3] CMA website

Industry voices

What is the sector observing during and in the post-pandemic world?

Diversification

Recently we have been witnessing a growing demand for alternative investment products (Real Estate, PE, VC, Securitization… etc.) especially with the new low interest rate environment during and post Covid19 which effected the returns of Money Market & Fixed Income assets. Given this fact and with the new changes in consumption trends in the economy, we believe that alternative investments will be a newly added asset class for local investors.

Raed G. Al-Barakati
Deputy Chief Executive Officer
Riyad Capital

Evolving risk and reward profile

We have witnessed an increase in the clients' awareness about the necessity of having a diversified portfolio of asset classes. The shift and focus of investors we see is more toward risk/return profile of any investment instead of solely focusing on the return. We believe this shift will make multi-assets solutions more attractive.

Abdullah Salman Al-Salman
Head of Asset Management
HSBC Saudi Arabia

Competition

The level of competition in the industry is definitely increasing with the number of licensed asset managers approaching 80, benefiting from lower establishment requirements by CMA. The competition is twofold: competition on financial and human capital. While the former is a huge market that is growing rapidly, the human capital is relatively small and limited, which results in stiff competition for top talent.

Zaid Almufarih
Chief Executive Officer
Albilad Capital

Institutional participation

We are seeing more active institutional participation in the market. The weight of QFI has been structurally increasing and is now at 12.9% of free float and there is further potential for the same. As a result, the market is getting more efficient and hence requires more active participation by fund managers to spot the opportunities.

Ahmed Al Mohsen
Chief Financial Officer
Al Rajhi Capital

Valuation

Uncertainty around the future impact of Covid-19 along with a turbulent stock market provided multiple challenges to fund managers in valuation of alternative and private equity venture. There was however consensus that whatever impact businesses are having are temporary and valuations will rebound fairly quickly as soon as vaccination or medications are available to masses. However, the biggest challenge was to access the reliable information as no one had visibility when this pandemic will be over. Therefore, as fund manager we relied on our existing valuation model and principles with slight adjustments in input based on available information.

Wisam Fasihaldin
Chief Financial Officer
NCB Capital

Emerging themes and outlook ahead

Emerging themes

- Shifting investment strategy
- Assets under management
- Liquidity management
- Diversification
- Digitalization
- Competition

Shifting investment strategy

Since the COVID-19 pandemic emerged in the beginning of 2020, a noticeable shift in investment strategy can be seen where investment flows have gravitated towards asset classes such as fixed income in the form of government bonds, sukuks and murabaha placements. These inflows are buoyed by two fundamental aspects. Firstly, the government of Saudi Arabia has been very active in the local debt market, whereby there have been ample supply of government sukuks in the market. With a sound sovereign credit rating coupled with attractive yields, the Saudi government sukuks present a viable option for fund managers catering towards risk averse investors. Secondly, the global equity markets due to its volatility and the alternative asset market due to its liquidity concerns, have proven to be riskier and thus less appealing investments comparatively for fund managers in the current uncertain pandemic environment.

Assets under management

Volatility has been the hallmark of 2020 for majority of the global markets. For Saudi Arabia, the volatility has been driven not just by the COVID-19 outbreak, but also the simultaneous drop in oil prices back in March 2020.
The majority of the client base in Saudi Arabia for fund managers have revenues tied directly or indirectly to oil. Thus, there was a contagion effect whereby a decline in oil revenues translated to reduced inflows to AUMs until oil prices recovered from the lows of March 2020. This phenomenon was clearly visible in the industry's AUM data which as of Q1 2020 had dropped to SAR481 billion from SAR500 billion at year end 2019 but then recovered emphatically to SAR515 billion as of Q2 2020.[4]
Fortunately for fund managers in Saudi Arabia, the brief decline in AUMs was manageable. Funds tended to be sticky and the affluent and ultra high net worth individuals (UHNWI) client base continued to have a higher risk appetite to withstand market volatilities.

With the onset of second waves in many global jurisdictions and the emergence of new variants of the coronavirus that are deemed to be far more infectious, the governments around the world are re-imposing lockdowns as a result of it thereby causing continued strains on economic activity. However the recent development and deployment of the first vaccines with high levels of efficacy, is expected to bring much respite in the near term and heightened optimism about the economic growth prospects ahead. As the vaccines are manufactured, distributed and administered to populations around the world, including in Saudi Arabia, we believe it will take some time before the full positive effects are realised. We therefore expect elements of market volatility to persist globally and thus the UHNWI client base for fund managers in Saudi Arabia will continue to be decisive in maintaining stable AUMs.

[4] CMA website

Liquidity management

A significant portion of the AUMs managed by the fund managers in Saudi Arabia are routed through open-ended fund vehicles which allows investors flexibility in terms of redeeming and subscribing units.

Despite this flexibility, fund managers have not had to grapple with liquidity challenges in Saudi Arabia during the pandemic largely owing to the following reasons:

- Our understanding is that majority of the portfolios managed by the fund managers in Saudi Arabia continue to be concentrated in equities. Positions in equity investments can be swiftly closed out to cover any redemptions when needed.
- Fund managers in Saudi Arabia are well capitalised and can offer short term funding to the mutual funds should they require to cover any sudden liquidity needs. Furthermore, regulations allow fund managers to temporarily suspend unit redemptions too if needed.

Whilst the market has been volatile in 2020, it has not prompted investors to *dash for cash* – owing largely to the fact that majority of the client base for Saudi fund managers can be ascribed as affluent who did not need to liquidate their positions during the temporary drop in the market.

Diversification

The product/solution offering suite by the fund mangers in Saudi Arabia has broadly stayed consistent over the years. Saudi Arabia has however the largest number of UHNWI in the region, a base that continues to grow and become more sophisticated to demand asset managers to become more solution specific and customer focused. Furthermore, with the advent of foreign institutional money flowing into the market as result of the MSCI and FTSE inclusions, we believe the general investor sophistication will evolve and fund managers would need to innovate to cater to the changing needs. We see this happening already in the market, of which the following examples are most vivid:

Growth in Exchange Traded Funds (ETFs)

During 2020, we have seen the launch of new ETF funds by fund managers in Saudi Arabia. Whilst the concept of ETF is not new to the Kingdom, fund managers are now seeking to expand their horizon in terms of the underlying assets in an ETF. Where predominantly the underlying securities used to be equities, we are seeing diversification towards sukuk and commodities to cater towards the evolving market conditions and investor demand.

Green investments

We are observing globally an uptake in environment, social and governance (ESG) investing and we believe that it is only a matter of time before ESG becomes a top of the agenda item for both investors and fund managers in Saudi Arabia. We have recently seen the first ever ESG compliant debt security (i.e. green sukuks) issued in Saudi Arabia by a large utility company and we expect more of such issuances in the near future.

Derivatives

The Saudi stock market in 2020 launched an index futures product that would allow investors to gain index exposure to Saudi equities included in the MSCI. This is the beginning of an exchange-traded derivatives market in Saudi Arabia being established and will present ample opportunities for fund managers in Saudi Arabia to supplement and diversify their portfolios with derivatives.

Alternative investments

Real estate continues to be the primary form of alternative investment in Saudi Arabia. We expect the real estate market, in terms of valuations to be relatively stable. As Saudi Arabia emerges from the countrywide lockdowns and travel restrictions it imposed to curtail the COVID-19 outbreak, we anticipate the real estate sector to be boosted by the resumption in construction work with contractors also able to deploy human resources that may have been hindered by the travel restrictions in place previously. With rental income being relatively stable in 2020, we believe there will be plenty of opportunities for fund managers to deploy capital to seek both capital gains and income streams.

We are also now noticing in Saudi Arabia that fund managers are increasing their pursuit for venture capital (VC) investments. This is epitomised by the fact that during 2019, VC investments in Saudi Arabia amounted to $72m whereas just in the first half of 2020, VC investments reached $73m.[5] Recently we have seen a large fund manager in Saudi Arabia who partnered with a technical advisor and provided seed funding to VC start-ups. We believe these types of investments will gain prominence in Saudi Arabia as the government, in line with their Vision 2030, is indubitably creating a conducive environment in Saudi Arabia to not just attract venture capital investments but also support start-ups across a range of fields to positively disrupt the market and flourish. These start-ups will require funding and thus will present good opportunities for those investors that have a higher risk appetite to invest in this segment.

Furthermore, we expect private equity (PE) investments to pick up in the coming years too. Historically, fund managers in Saudi Arabia have had limited capital deployed in such types of investments primarily due to the risk profile of such investments combined with the lack of viable opportunities that existed in the market previously. With the advent of privatizations that are expected to occur in line with Vision 2030 coupled with both an evolving risk appetite of the investors and opportunities arising from availability of distressed assets, we believe the PE landscape will significantly evolve in Saudi Arabia.

> Technology oriented start ups, especially those within the financial (FinTech) and education (EduTech) segments are primed to attract VC and PE investments in the post pandemic world given the market opportunities that prevail for them. The continued palpable government support will enable a conducive ecosystem where both investors and investees can thrive.

[5]Pitchbook data, Capital IQ, Saudi Venture Capital Private Equity Association (SVCPEA) report, KPMG analysis.

Digitalization

Whilst the large asset management firms in Saudi Arabia had digitalization on their agenda well before 2020, the pandemic has brought about an acceleration of their plans to embrace and complete the digital journey and to further support the operational resilience of the firms. Whether that be for improving client engagement or supporting business management and support functions. We expect the asset management industry in Saudi Arabia generally to become more agile, refine their digital strategies and obtain the necessary data to create and deploy digital client experiences that can yield meaningful results. We also anticipate that significant funds will be devoted by fund managers to automate their back-office accounting functions through Robotic Process Automation (RPA) technologies as well as enhancing data analytic capabilities to support client targeting and driving sales growth. We believe digital capabilities may prove to be a key differentiator amongst the asset managers in Saudi Arabia as investors demand catered solutions.

Competition

Over the past couple of years, we have seen the CMA grant licenses to new Authorised Persons (APs) to operate in Saudi Arabia. Whilst majority of these new entrants are global names looking to establish presence in Saudi Arabia, not many have asset management licenses as yet to pool and manage capital on behalf of their clients. This is expected to evolve as Saudi Arabia continues to reform its capital markets in line with Vision 2030 to attract foreign investment. Given the number of players currently operating and competing in the market coupled with the challenges brought upon by the pandemic, we are beginning to observe that smaller players were struggling in 2020 and that there may be either some imminent exits or some form of consolidation in the near future. We believe that irrespective of the size, the asset managers that have the strongest digital systems in place, are able to offer unique products to their investors and provide stable returns will be able to continue attracting AUMs and excel as investors increasingly look for more "value" from the management fees they pay and thus will seek digitally enabled tailored solutions in line with their risk appetite.

> As competition in the market heats up and investors seek more value from their fund managers, firms will need to differentiate themselves through demonstrating cross fertilization of investment ideas to generate alpha and developing digital enablers to provide bespoke customer experience.

Regulatory reforms and evolving tax landscape

Regulatory landscape

We observed a robust role played by the CMA to ensure smooth functioning of the capital market in Saudi Arabia at the outset of the COVID-19 outbreak. CMA implemented a range of precautionary measures and undertook numerous initiatives which were invariably imbued with ensuring the health and safety of individuals involved in the capital markets and supporting the market participants as well. Some of the measures included allowing extension to prudential return filings for companies under CMA supervision and offering support to any AP, if it needed, to conduct its business.

Notwithstanding the fluidity of COVID-19 and the impact it has had on regulators globally to ensure business continuity of the capital markets broadly and market participants more specifically, the CMA has proactively motored along with its reform plans undeterred. For the asset management industry in Saudi Arabia, we believe the following key initiatives undertaken by the CMA will have a positive impact on the industry:

- The establishment of a central clearing company for derivatives, Muqassa, to support and facilitate the derivatives program launched by Tadawul. This is a key initiative developed in line with global standards that will enable efficient settlements and mitigate the risks typically associated with it for investors.
- The issuance of regulations for entities wishing to provide securities clearing services in Saudi Arabia. This will enable new entrants in the market and allow settlements to be swifter with reduced counterparty risks.
- The issuance of new Capital Markets Institutions Regulations. The new provisions around anti-money laundering (AML) and systems and policies will require fund managers to upscale their systems, controls and processes in order to comply with the regulations and enable enhanced risk assessments and mitigations.

We believe the above initiatives and continued capital market reforms in line with the Financial Sector Development Program (FSDP) will provide the impetus to enhance the robustness and resilience of the asset management industry in Saudi Arabia.

Taxation outlook

Value Added Tax (VAT)

The impact of VAT can be felt throughout the financial services supply chain both in terms of pricing to clients and the cost of operations. As part of its approach to mitigate the impact of the COVID-19 pandemic, the General Authority for Zakat and Tax (GAZT) introduced measures to ease cashflow demands by delaying submission of tax returns and payment of taxes due. However, the standard rate of VAT was also increased to 15% with effect from 1 July 2020. This increase is beginning to impact the asset management industry. Particularly, where the unitholders/investors in investment funds will need to bear the additional VAT on management fees that are paid to the fund manager. The investors, especially if they are private individuals, VAT now has become an extra cost on their investment. Fund managers will also need to proactively assess their fee structures and consider their own liquidity and cash flow situations to manage VAT impacts effectively. Given the tax landscape generally continues to evolve in Saudi Arabia, we believe the asset management firms will need to have a robust tax risk management framework in place to actively assess and manage any emerging tax risks and expected changes in tax regimes. There can be various sources of tax risks, be it regulatory, people or process related and thus the purpose of an effective tax risk management framework would be to ensure that the organisation has a transparent tax strategy and the appropriate tools for managing the sources of tax risks.

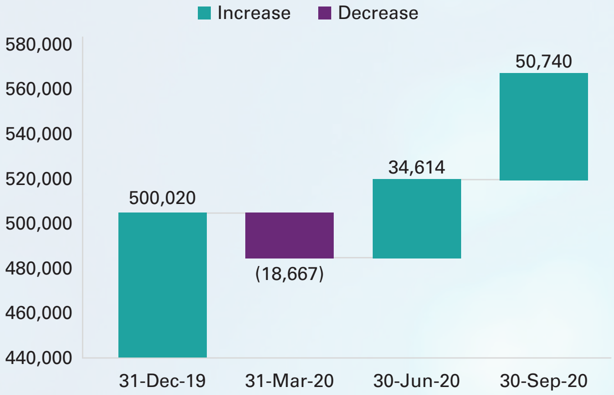
Real Estate Investment Trusts (REITs)

The zakat landscape has recently evolved in terms of REITs in particular whereby they are now being encouraged to register for zakat purposes with GAZT, and thus be liable to pay zakat. Whilst the annual zakat expense will be borne by the REIT, it will ultimately impact the returns to unitholders. Fund managers will need to be cognisant that unitholders will likely assess their returns in light of the expenses borne by investing in REITs, notwithstanding the consideration of alternative investing vehicles, and evaluate their investing and management fee strategies accordingly. We believe that REITs will continue to be an attractive investment option in the market primarily due to its liquidity benefits, stable cash dividends and providing investors exposure to diversified real estate with much less capital than what would be typically required in direct real estate investing.

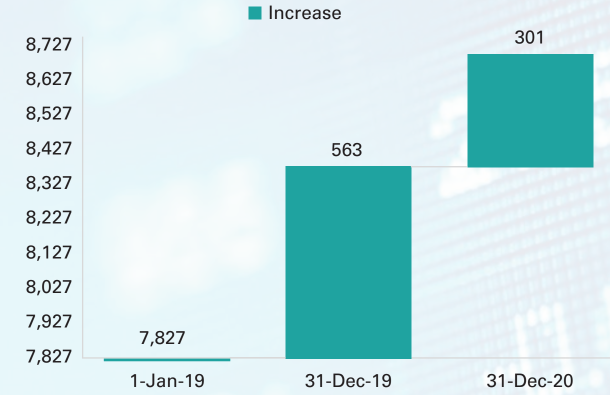
> “Fund managers will also need to proactively assess their fee structures and consider their own liquidity and cash flow situations to manage VAT impacts effectively.

Industry performance analysis

Assets under management[6]



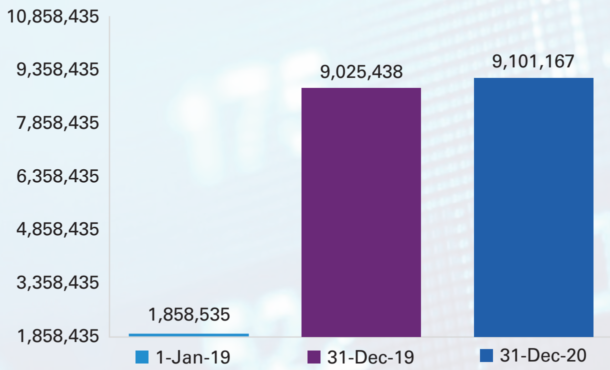
TASI performance[7]



Number of funds as at Q3 2020[6]

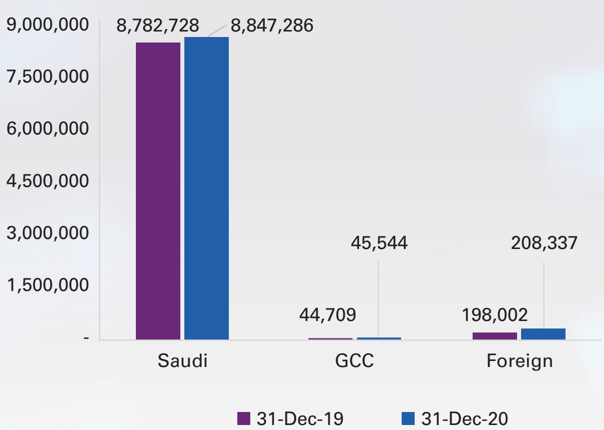
Total Public Funds	Total Private Funds
255	403
Total public funds Q4 2019 were 253.	Total private funds Q4 2019 were 354.

Market capitalization[7]

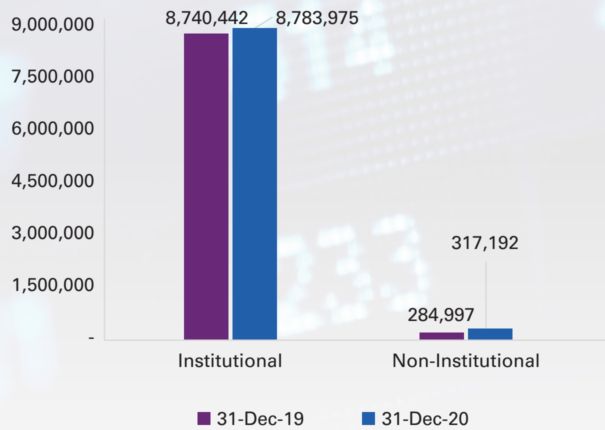


Ownership of Tadawul based on market capitalization[7]

Nationality wise



Investor type

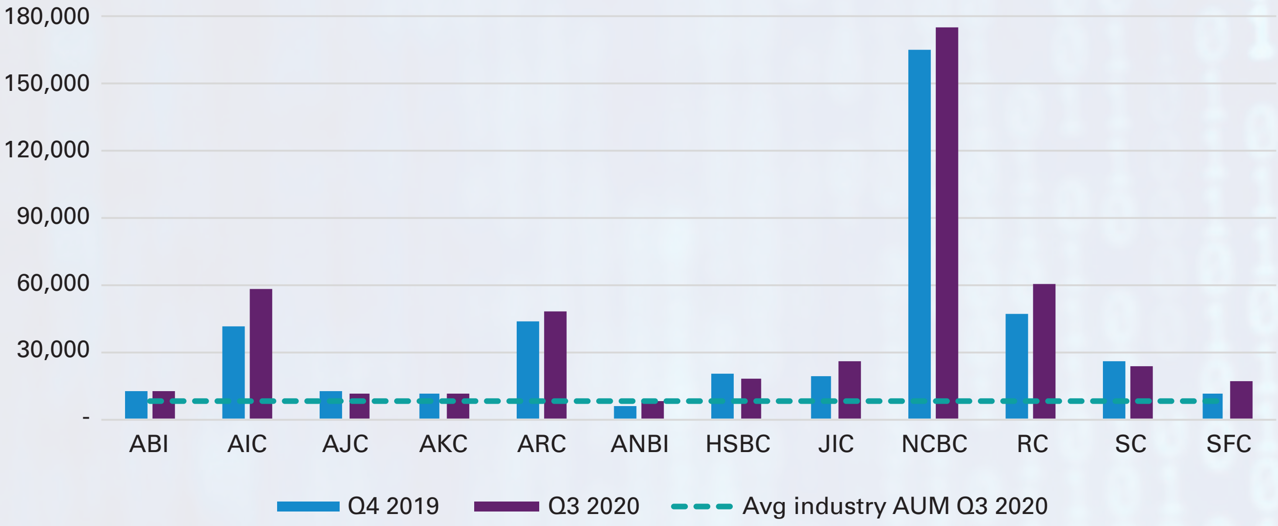


[6] CMA website.
[7] Tadawul website.

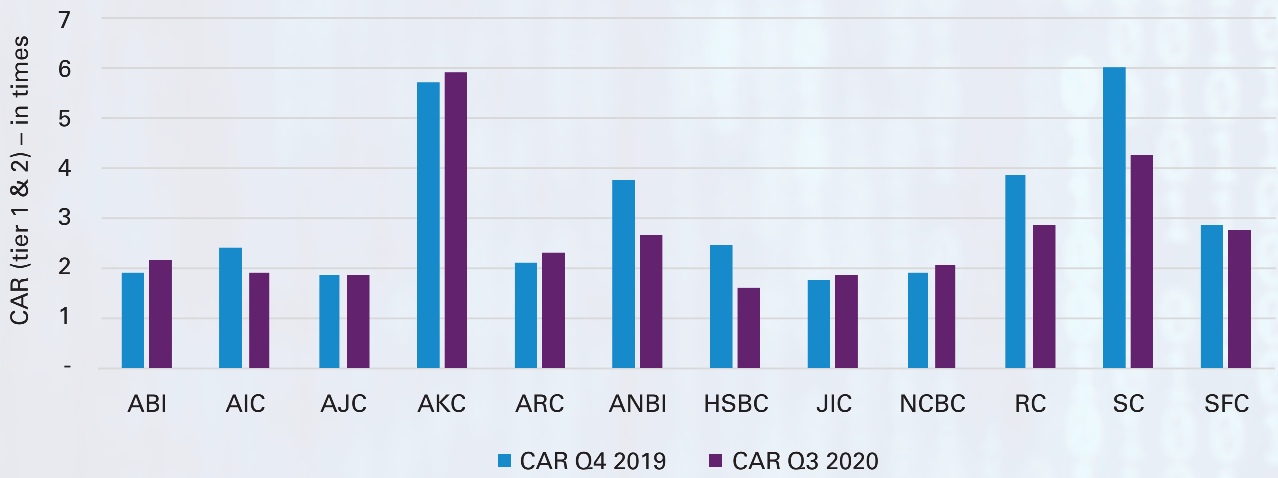
Note: All amounts in this section are presented in Saudi Arabian Riyals and are rounded off to a million unless otherwise stated.

Asset management firms' analysis

Asset under management (AUM)[8&9]



Capital adequacy[8]



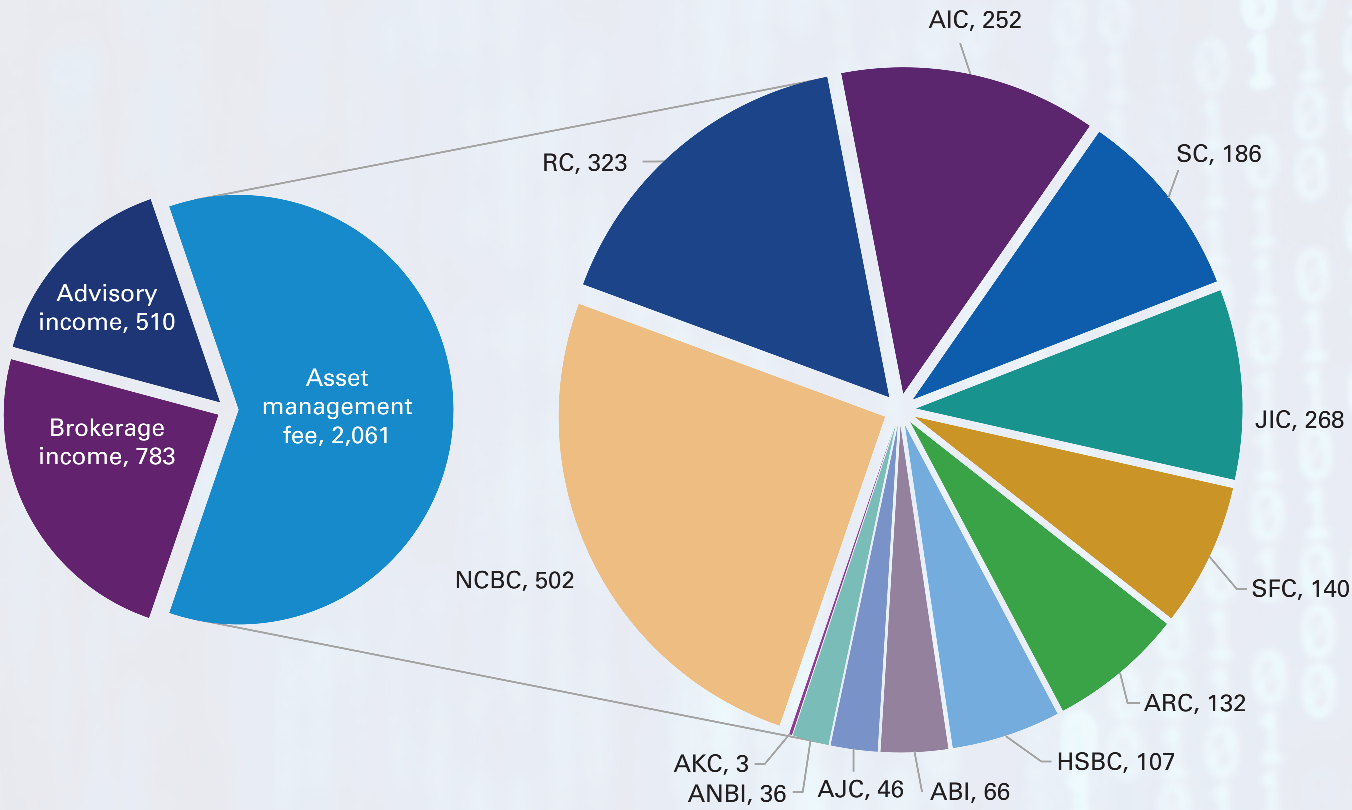
Legend

Albilad Investment	ABI	Al Rajhi Capital	ARC	NCB Capital	NCBC
Alinma Investment	AIC	Arab National Investment	ANBI	Riyad Capital	RC
AlJazira Capital	AJC	HSBC Saudi Arabia	HSBC	SAMBA Capital	SC
AlKhair Capital	AKC	Jadwa Investment	JIC	Saudi Fransi Capital	SFC

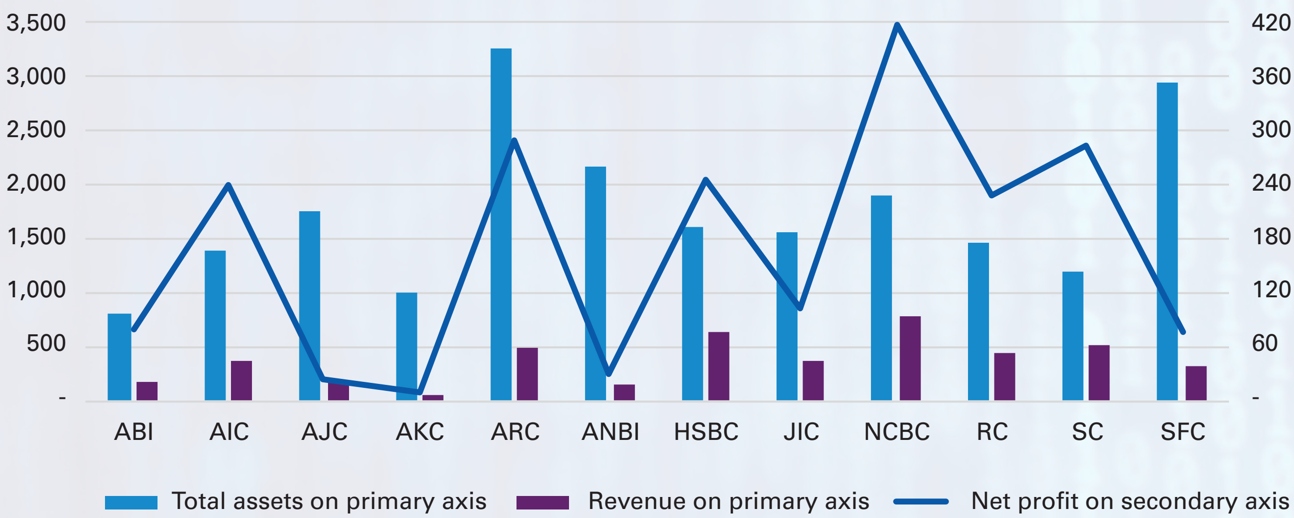
[8]Source: CMA website.
[9]There are some variances in the AUM amounts as per the Company's financial statements and the report on CMA website. For the purpose of consistency, we have used AUMs from CMA report.

Note: All amounts in this section are presented in Saudi Arabian Riyals and are rounded off to a million unless otherwise stated.

Key revenue streams for 2019[10]



Key 2019 totals analysis[10]



[10]Financial statements of the Company.

Note: All amounts in this section are presented in Saudi Arabian Riyals and are rounded off to a million unless otherwise stated.

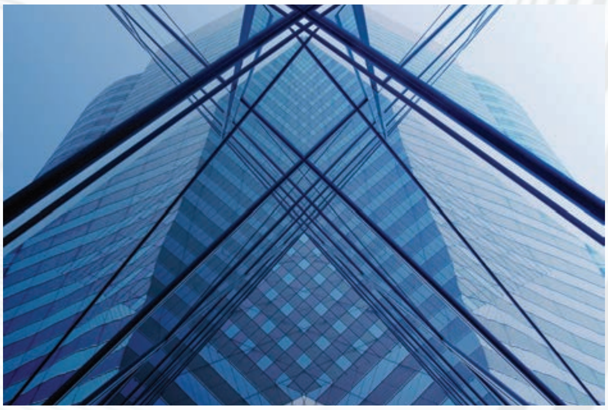
Further reading

In the spotlight

Evolving Asset Management Regulations

Tenth edition of EAMR and the beginning of a new decade

New Reality in Asset Management



Six key themes believed to be critical to the asset and wealth management industry

Frontiers in Finance

Market insights and forward-looking perspectives for financial services leaders and professionals

Venture Pulse Q3 2020

KPMG Private Enterprise quarterly global report on venture capital trends.

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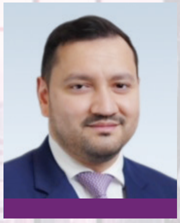

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