



The Middle East

Challenges and opportunities for global and local asset managers

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The Middle East economies have grown strongly in the past few years

The region has bounced back strongly from the crisis in 2008, and nations have increased their efforts to diversify their economies.

Middle East growth has picked up strongly following the financial crisis of 2008-2009, driven to a large extent by growth in the Gulf Cooperation Council countries (GCC)—composed of Saudi Arabia, the United Arab Emirates (UAE), Qatar, Kuwait, Oman, and Bahrain. The GCC region's real GDP growth rate averaged 5.2% from 2010 to 2014, thus outperforming most developed countries throughout the period¹.

Most GCC countries have benefited from high oil prices over the past decade, which contributed to significant wealth creation, for both institutional and private investors. Oil revenue still represents the majority of the region's GDP, but the countries are making efforts to diversify their economies. The UAE and other countries in the region have launched development plans (e.g., Abu Dhabi Vision 2030, Qatar National Vision 2030, UAE Vision 2021) to develop other sectors such as aviation, tourism, transportation, and financial services.

Oil revenues have allowed the countries in the region to invest heavily in infrastructure projects that today form a solid base for the development of a more diversified economy. However, the recent fall in oil prices could challenge near-term growth and investments, but long-term perspectives remain favorable in terms of oil and non-oil development.

The Middle East asset management industry is gaining in maturity and is no longer a purely institutional business

The total wealth pool in the region today amounts to approximately US\$5.2 trillion and local Sovereign Wealth Funds (SWFs) represent almost 50 percent of this wealth. The remaining wealth is split between other institutional investors such as local pension funds, as well as mass affluent investors and (U)HNWI investors in the non-professional segment. The growth in local wealth results from global capital markets growth as well as the strong growth of GDPs in the region. Local wealth growth outpaces the growth observed in most other regions.

¹ Source: Institute of International Finance

International as well as local asset managers have recognized the importance of the region in terms of potential asset collection, and have started to increase their local activities over the past decade. Historically, asset management activities in the Middle East have focused on SWFs and other institutional investors. Recently, however, we have seen asset managers increase their range of investment funds in the region that are addressed to private investors. In particular in anticipation of the opening of the Saudi Arabian stock market to foreign investors, there has been an increase of almost 10 percent in the number of investment funds operated in Saudi Arabia in 2014. There is also increased interest in the distribution of UCITS structures into the Middle East region, reflected in the increasing number of UCITS approved for distribution in the various countries.

The mass affluent segment shows one of the strongest relative growth rates in private wealth

The mass affluent segment shows the strongest growth in wealth from 2009 to 2013, with a CAGR exceeding 15 percent. This segment is composed of Western, Asian, and other expatriates who tend to keep their home banking services providers and asset managers when moving into the region and tend not to invest large portions of their wealth in the region. While historically this segment may have suffered from a home market bias in terms of asset management choices, the length of expatriates' stay in the region is increasing, and is expected to encourage local investment choices². The mass affluent segment also recorded an increase in the number of households over the past five years, indicating the creation of a financially stable middle class in the region, which supports the long-term economic development of the region in general.

The (U)HNWI investor segment is undergoing a generational shift impacting investment behaviors and needs

HNWI and UHNWI investors represent the largest segment of non-professional investors in the region in

terms of wealth, and have shown continued growth over the past few years. The majority of investors in this segment are GCC nationals. The generational shift in this segment raises questions of how to align the traditional values of the current generation with the new, more modern perspectives of the younger generation, and the impact on their investment behavior.

The current generation's investments are characterized by highly liquid, low risk assets with emphasis on capital protection. On the other hand, the younger generation has a more aggressive investment approach with higher expected returns, shorter time horizons, and seeks wealth generation rather than wealth preservation. This new generation of investors also shows an increased interest in professionalizing their private portfolios in terms of asset allocation and diversification. This creates opportunities for asset managers to provide professional solutions to those investors. Furthermore, GCC investors tend to appreciate tangible assets such as real estate - "*Property gets sick but it never dies*" is a commonly used proverb to explain the lure of such assets for local investors.³

Most assets in the (U)HNWI segment are held offshore, in part due to the lack of actively managed investment opportunities with a good track record in the region. We observe a low penetration of private wealth by professional asset management products. In 2012, roughly US\$56 billion of the total US\$2.2 trillion wealth pool in the region was captured by professional asset management products locally (i.e. investment funds and/or discretionary mandates). This is also due to the fact that many wealthy families have their own wealth advisor to ensure discretion and are not linked to professional advisors. However, both professional and non-professional investors have shown increased interest in Sharia-compliant structures as well as regional investment products, but the demand significantly outpaces the supply of such products, indicating the strong growth potential for asset managers.

² Invesco Middle East Asset Management Study 2013

³ *Ibid.*



Regional financial centers continue to emerge with the ambition to enter the top tier of global financial centers

The financial industry in the Middle East has seen strong growth over the past decade. Today, four Middle Eastern financial centers appear in the top 35 following the Global Financial Centers Index 2015, namely Qatar (26th), Dubai (29th), Riyadh (31st), and Abu Dhabi (32nd). In consequence, global banks and asset managers have constantly increased their presence in the region and local banks have been expanding into non-interest income activities such as asset management to reduce their exposure to the highly competitive core banking activities.

Despite this increased activity, we still observe certain areas for improvement in the financial centers, which limit the ability of industry players to commit to on-the-ground investments and increased activity. These areas for improvement include capital markets liquidity and the development of robust regulatory and legal frameworks.

The revenues from oil sales have allowed the countries in the region to invest heavily in infrastructure projects that today form a solid base for the development of a more diversified economy

While still small, the local capital markets are showing progressively more sophistication and liquidity

The market capitalization of GCC stock markets was about US\$1 trillion in December 2014, with Saudi Arabia accounting for almost 50 percent with US\$480 billion. While market capitalization has increased steadily over the past decade, regional markets are still limited in terms of asset classes and investor groups such as pension funds, insurance companies, and large investment companies. These are important elements of a sound financial system that eventually support the development and growth of the overall economy.

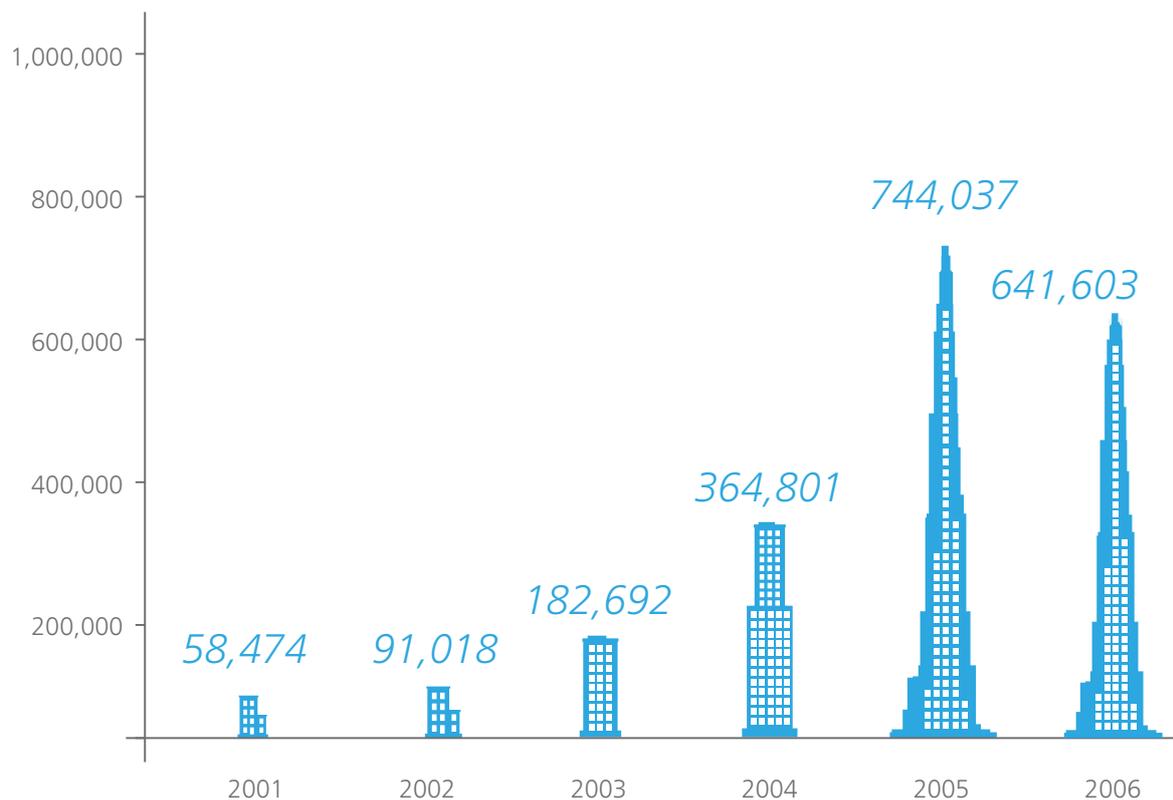
Some of the local capital markets have been closed to foreign direct investments and are now slowly being opened to foreign investors, which will ultimately increase liquidity. Especially, the opening of the Saudi

Arabian stock market to qualified foreign investors, planned for the first half of 2015, is widely considered a milestone in the development of the regional stock markets and likely to increase the liquidity in the Tadawul, the Saudi Arabian stock index. Also, the increased presence of GCC indices in global emerging market indices (e.g. Qatar's increased weight in the MSCI Emerging Markets index) is expected to have a positive impact on the capital markets' liquidity in the region⁴.

Legal and regulatory regimes are gradually evolving toward global standards

The stability of the regulatory and legal environments is a requirement for the development of the asset management industry. Regulatory frameworks are evolving in the different regions (e.g. DIFC, ADGM, QFC) to ensure clearly recognized and enforced

GCC market capitalisation evolution (in current US\$ million)

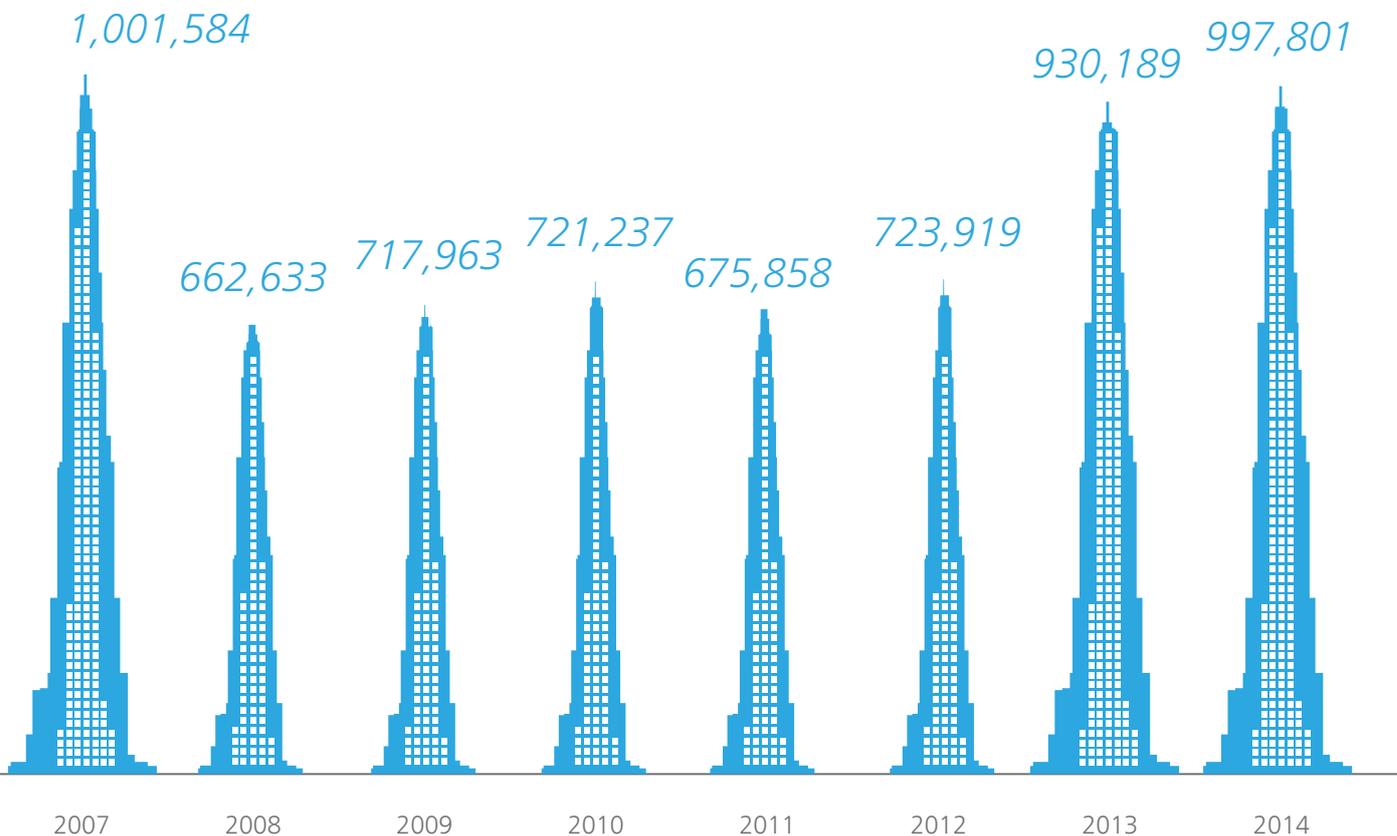


⁴ http://www.khaleejtimes.com/biz/inside.asp?xfile=/data/uaebusiness/2014/September/uaebusiness_September177.xml§ion=uaebusiness

operating standards, upon which financial services providers can build their strategy and operations. Even though the GCC countries are considered relatively safe havens compared to other jurisdictions in the Middle East and North Africa, local regulators are still defining and setting up the regulatory regimes.

This evolution is creating both opportunities and challenges. As industry practices become more transparent, investor confidence and operator interest will continue to grow. At the same time, the complexity and cost of ensuring compliance with tightening regulatory standards will increase, in particular considering the multiple, country-specific frameworks present in the region.

International as well as local asset managers have recognized the importance of the region in terms of potential asset collection, and have started to increase their local activity over the past decade





Considerations for asset managers

Asset managers need to continue developing propositions tailored to private client needs

The mass affluent segment is particularly interesting for asset managers. Those investors are generally well educated and might already be served with existing products from global asset managers. However, given the increase in the number of households, there is likely growth potential in this segment, as they need increasing amounts of financial advice when moving along their career paths and growing their net wealth. Despite the high cost sensitivity of this segment, which asset managers must consider in their product offering, product needs are generally basic and straightforward, and no complex asset allocation strategies are required. Moreover, the client relationship can be relatively limited and could for example be centered on digital access, thus reducing costs for the asset manager. Such “execution only” service models with limited advice costs should be considered, but require higher degrees of systems automation for asset managers to operate profitably.

Opportunities to better serve the (U)HNWI segment also exist. The generational shift offers opportunities for asset managers to establish connections with the new generation and their specific need for professional advice.

This could also be used as a foot in the door to establish a link to the current generation, by understanding their investment needs and translating them into easy-to-understand investment propositions. (U)HNWI have historically been one of the most favored client segment for asset managers due to the high margins linked to this client base. However, competition in this segment is intense and it may be difficult to convince clients with a long-term relationship with existing Single or Multi Family Offices (SFO/MFO) to enter into new wealth management relationships.

Besides the macro segmentation of the non-professional investors, asset managers should consider the demographic composition of the different countries and markets. Even though GCC nationals dominate the (U)HNWI segment, expatriates are also represented and have different investment habits that should be considered by offering specially tailored products to this sub-segment. The same rule applies to the mass affluent and retail segments, where expatriates from the Asian countries can wield increasing investment power.

The increasing wealth and thus investment potential of mass affluent investors and the new generation of (U)HNWI investors require asset managers to rethink their distribution strategies and product offerings

The changing regulatory landscape needs to be closely monitored

The increasing number of regulatory regimes in the region, that aim to define a framework for asset managers and financial services providers to operate in, creates opportunities for those players to position themselves in the market in the appropriate way. However, as those regimes are still under development and most likely subject to further amendments, asset managers need to implement regulatory watch processes to closely monitor the evolution of the regulatory regimes applicable to their entities and assess their impact on their existing business models. New or changing legal requirements may just represent additional workload (e.g. additional reporting requirements), but may also offer new business opportunities to asset managers (e.g. creation or permission of new product classes) into which they (quickly) need to tap if they want to benefit from the momentum created by such amendments or new laws.

On-the-ground sales teams are not sufficient to build long-standing relationships

Global asset managers often limit their presence to local sales teams or representative offices in order to manage the assets in the global financial centers. However, establishing relationships with wealthy investors in the region is a long-term project and such relationships are built over several years with regular face-to-face contact. We think that this is one of the reasons why global asset managers have failed to capture more of the available wealth into their asset management products.

Asset managers have to rethink both their distribution and product strategies

The increasing wealth and thus investment potential of mass affluent investors and the new generation of (U)HNWI investors require asset managers to rethink their distribution strategies and product offerings.

Digital channels have become a key selling point of a complete asset management value proposition and go beyond the provision of account statements in electronic format. The digital channel should offer a complete service with information and transaction execution features as well as advising features and a link to the relationship manager. It should also be possible to switch between interaction channels without any problems (e.g. from mobile applications to face-to-face advice in a branch).

This increased wealth also has an impact from a product point of view, as the increased re-allocation of assets in the region should be captured in local products to further boost economic development and local financial market liquidity. The success of local products (e.g. Sukuks and other Sharia-compliant structures as well as local REITs) indicates that there is a strong demand to invest in the region and to do this using local structures. If asset managers manage to successfully respond to that demand by creating innovative products, this will eventually lead to a greater diversity in asset pools, and thus allow the financial centers to increase their maturity and their contribution to overall economic development.