DUFAS-PWC WEBINAR REPORT

The need for analyzing the impact of COVID-19 on the business

"It is time for making impact analyses." During this joint Dufas-Pwc webinar, experts from PwC shared insights and learnings on how to remain resilient amidst the effects of the global pandemic. Patrick Heisen, Jesse IJspeert and Manoël de Goeij took a deep dive in the impact of COVID-19 on markets, finance and the sourcing strategy. The webinar was hosted by Iris van de Looij, director Dufas, and Patrick Heisen, Leader Asset & Wealth management PwC Netherlands.

Key take-aways

The current crisis requires the need for analyzing the impact of COVID-19 on the business

Resilience in the current situation is going beyond successful crisis management – strategize and capitalize on arising opportunities

Stay in control during all the stages of the pandemic by using scenarios to understand implications for markets, finance, operations and workforce – and develop plans and responses

Having an integrated view on strategy, finance and risk is key

In the early stages of the COVID-19 outbreak, the asset & wealth management sector was very much focused on responding to the crisis and stabilizing the business. Patrick Heisen: "Now we've reached a point to navigate the landscape of risks and opportunities. In order to do so, we need to have more insights in where the crisis will hit the sector. Obviously, looking at one's own context is leading and may differ depending on whether you are a captive insurance asset manager, captive pension manager or global multi-client asset manager. As we do not know what will happen, making use of relevant scenarios is vital, depending on the context or the largest risks or opportunities that asset managers may face."

How are insurance companies dealing with the COVID-19 crisis?

Initially, default and rating pressures led to jumps in risk premiums for fixed income portfolios and loan/mortgage portfolios. The volatility adjustment (VA) spread on liabilities reached all-time highs in March 2020, due to increasing spreads in corporate and government bonds, leading to capital relief. 'What if' the VA relief remains this high? All depends on credit ratings, future defaults, and what's going to happen with the risk-free rate, Patrick says. "In their analysis phase, insurers will look at scenarios to consider their possibilities. For asset managers this could have an effect on asset allocation run by insurers and also influence choosing certain asset classes, such as selecting more alternatives or ESG investments."

Pension funds have taken a bigger hit

For pension funds, market developments resulted in risk premiums for fixed income portfolio (including loans/mortgages), falling equity markets and declining interest rates which resulted in a sharp decrease in pension funds' funding ratios. Pension funds are faced with a breach of risk limits (allocation, cash, concentration) resulting in reconsidering rebalancing. Patrick: "They will go through a phase of analysis and will look at their current financial position and consider possibilities for rerisking or derisking. Why is this important for asset managers? It could have effects on asset allocation, certain types of investment structures that pension funds will choose and possibly on the contingency of pension funds themselves."

How are retail investors coping?

As global investors are dealing with wholesale clients it is key to know and understand how retail investors are behaving. Investment funds suffered redemptions in March due to COVID-19, with bond funds showing higher outflows than equity funds. Despite the challenges posed by COVID-19, fund flows have continued in some instances as investors are increasingly using digital channels. Retail investors will also go through analysis from a personal finance context (illness, loss of income, decrease in value of investments), which means KYC information needs to be updated. Scenario analysis can be used to answer questions around portfolio rebalancing, potential shifts in asset allocation, and positioning portfolios. Asset managers who are in the know can support this segment."

Consequences for asset managers

COVID-19 could affect the asset manager's client base, volatility, pressure on fees, changes in investor preferences or have effects on the decision making in the asset mix. Asset managers themselves need to have insights in risks and opportunities to take measures and adapt to the new situation: There can be pressure on asset managers themselves in terms of operation, business continuity or third party risk. Patrick: "Be clear on your purpose. What is your strategy, what type of asset manager are you? Once the situation has gone back to normal, investors will look for diversification. How can we innovate in order to diverse our portfolio and mitigate the new risk that we now see? Digitization will become more important than ever, and will accelerate after the crisis, also in client servicing and client reporting (see also box below).

Understanding the investor perspectives Asset managers need to have insights in risks and opportunities to take measures:

Customers

- Possible changes of client base due to consolidating market
- Change of investor preferences
    - Asset mix (re-risking, derisking)
    - Investment strategy (value for money)
    - Asset manager (investor perspectives)
- Be clear on your purpose in a consolidating buyers' market

Products

- Search for attractive (direct) investment opportunities
- Robustness of the investment product portfolio
- A need for appropriate diversification of the investment portfolio driven by product innovation.

Services

- A need for appropriate diversification of the investment portfolio driven by product innovation.
    - Ask for more transparency
    - Digitization integrated in client servicing and reporting

Channels

- Digital customer journey integrated in the distribution strategy
- Including investor preferences in re-evaluating the quality of distribution platforms and partners

Pressure on profitability

Jesse IJspeert, Auditing Partner Asset & Wealth management, PwC Netherlands, elaborated on revenues, operational expenses, balance sheet management and reporting as multiple sides of the same coin.

It is likely that there will be a declining performance due to lower asset prices and therefore lower fees. Price pressure will accelerate, also towards safe havens such as alternatives, as the AuM pie temporarily gets smaller. Jesse: "There will be many changes and this in itself presents opportunities. What we already noticed was that asset managers have been experimenting with other fee structures, such as performance- linked structures, whereas we tend to see fixed fee structures in the Dutch landscape."

Operational expenses and balance sheet management
As for operational expenses, increased regulatory scrutiny on asset managers continues to result in extra compliance related expenses. The new 1.5 meter working environment requires additional investments from employers. As far as balance sheet management is concerned, increased operational risk will lead to extra required capital. Increasingly more, regulators are challenging the ICAAP (Internal Capital Adequacy Assessment Process) of asset managers. Additional capital requirements are expected to follow. What's more, the search for yield and capital requirements might result in asset reallocation. The valuation of illiquid assets has become more challenging.

Reporting area
Jesse: "In the reporting area, there will be a potential need for additional reporting towards investors to keep them informed, not in terms of financial statements, but in regular reporting, also marketing-wise, and keep them assured that their money is in safe hands. I expect there will also be additional disclosures in the annual report, e.g. in the directors' report, going concern paragraph and subsequent events."

Make, buy or ally?
Manoël de Goeij, Partner Valuation, PwC Netherlands, gave an update on outsourcing and securing the future through right-sourcing strategies

COVID-19 has really put the light on business continuity and clients have been asking questions about this. "This is a good moment to have a hard look at your third-party risk management framework. Is it up to speed, is it capable of dealing with situations facing your outsourcing partners in terms of business continuity? Another element is increased pressure on profitability and saving cost, so this is a good moment to have a look at your outsourcing strategy to make, buy or ally-decisions, also from the point of view of changing customer needs. Customers want more digital, more ESG, and possibly other assets. In other words, are your outsourcing partners ready to help address your changing customer needs?"

Manoël underlined the importance of remaining in control over all the operational processes and managing client expectations. When assessing the impact of COVID-19 on your outsourcing strategy there are three main considerations:

1. Determine which core activities are considered strategic and what can be outsourced? "Think of outsourcing back office, fund accounting, custody, transfer agency or securities lending. Anything that is related to touchpoints with clients must not be outsourced."

2. Unlock operational efficiencies and reduce the cost base.

3. Leverage large scale benefits

As for partnerships and M&A, market leaders have already started to position themselves by acquiring vertically, horizontally or both. Asset managers should definitely have a look at their distribution strategy. Success factors in the strategic considerations are e.g. 'what is your claim to fame?' What are our core competencies and what do we need for our claim to fame? Are we going to partner up or make an acquisition to acquire new skills or gain access to new distribution channels? When partnering up, it is wise to consider the following success factors:

Success factors in partnering

- Take the customers' lens when designing and prioritizing new value propositions
- Build ecosystem deal capability, consistently scan for opportunities and diligently screen partners against clear criteria
- Develop an integration strategy and planning
- Develop a thorough financial plan
- Clear and timely communication with all the relevant stakeholders

Concluding note

Patrick: "First, make an impact analysis stating what are the biggest risks and opportunities. Based on the outcome, make your scenarios. Is the focus on finance, then the scenario will be an economic-related scenario. Is it market-related, the scenario will address the client portfolio. Is it operations-related, the scenario will relate to sourcing. In this way you will have insights and it will also give you time to implement these scenarios. That's why we reached out to the industry to underline the importance of making impact analyses."

Links for further reading:

- PwC's COVID-19 Navigator
- Dufas website