

Asset management in Italy: a snapshot in an evolutive context

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Investing in Italy history in a nutshell

Investing in Italy: history in a nutshell



After the difficulties experienced during the Great Recession, the Italian asset management industry has recently seen an unprecedented growth triggered by the macroeconomic scenario, reaching at the end of 2016 111% of GDP in terms of assets under management. Nowadays, the plethora of innovation brought by technology and the increasing regulatory requirements are transforming the industry, creating room for new players and hampering traditional business models. Before undertaking a deeper analysis of the trends and events that are currently shaping the industry, we find it worthwhile to dwell on the most relevant stages of its historical evolution, thereby framing the social and economic background which underpins the Italian investment scenario.

In the aftermath of the Second World War in Italy the progressive welfare growth led to an increase in households' savings which were mainly allocated in deposits and postal savings accounts. In the Seventies, inflation caused negative real returns both on deposits and on government bonds, shifting investors' attention towards alternative solutions among which real estate dominated. The average Italian was and still is a virtuous saver, with a saving rate that in those years was equal to 24% of income, compared with the 12% average of other main European countries, but was never as virtuous in the vest of investor.

At the beginning of the Eighties the desire for secure products was still the foremost driver of investors' choices, but a tendency towards a greater equilibrium between risk and returns appeared. To meet this need, the long awaited recognition of mutual funds within the Italian jurisdiction was brought by the well-known law 77/1983 in March 1983.

Since their first introduction, Italian-based funds had achieved resounding success among investors, marking an important turning point for the industry which, until then dominated by bank deposits and public bonds, saw the rise of new investment products. In 1983, the Italian Securities and Exchange Commission CONSOB was given new supervisory competencies over the Italian asset management market and, one year later, Assogestioni was created with the aim to coordinate the newly appeared asset management companies.

The development of investment management marked one of the most important changes for the Italian financial system and, more generally, for all the industrialized countries.

It has modified the role of markets and financial intermediaries in the process of resource allocation, it induced changes in the competitive structure of the industry and determined an enlargement of the range of products offered. Yet, despite all these numerous developments, there are still few constants that have always characterized the Italian asset management industry: risk-averse investors consistently drawn towards fixed income and (apparently) safer products; an often unfitted regulatory framework and the dominance of banking institutions in the distribution setting.

Evidence of the first constant can be found already in 1984 when regulatory restrictions on foreign funds were partially lifted while, a year later, the stock market reached new peaks; as a result the industry registered an important increase in equity fund inflows. However, the enthusiasm for riskier investments proved to be only temporary as a few years later, in 1987, a negative performance of the equity market caused investor to sail away from their stock allocations towards short term CD, government bonds and bank deposits; the

average Italian investor was still seeking risk-free returns.

In the same years, banks were able to leverage their strong presence on the territory by developing economies of scale, which put them in an advantaged position, compared to other distributors. When new products came out, they always managed to exploit their position and capture big portions of the market mostly made of medium income, limitedly financially educated investors.

After many years of growth, in 1990, with the stock market slump, many investors decided to direct their money in short-term securities, such as BOT, or in bank deposits. The funds, which had just been established with great success a few years before, were already facing serious difficulties.

Among other pivotal events in the history of Italian Asset Management, we must point at the advent of SIM (*Società di Intermediazione Mobiliare*), a legal entity specifically thought for financial investments introduced in 1991, along with the introduction of SGR (*Società di Gestione del Risparmio*) and private pension funds in 1998. These indicate how relatively new the Italian context is when compared to other European countries with a much longer financial history, as the United Kingdom. Following the introduction of the mentioned legal entities, a remarkable growth was registered from 1996 to 1998, when the size of assets under management more than doubled.

The driving factors for this boom were numerous. Among them, the drop of interest rates imposed by the incoming third phase of the European Monetary Union brought extra-resources away from public debt investments towards the asset management industry.

Furthermore, the significant weakening of the public pension system gradually brought citizens to search for alternative ways to ensure economic flows, once they reached retirement age. Finally, Italian banks started looking for new solutions, in this case fund placement, that would generate fee-based income on top of the revenues coming from the traditional core banking business.

The first part of 2000s was characterised by a strong growth of market dimensions, with AuM that went from € 880 billion in 2003 to € 1,131 billion in 2007. This growth was also favored by the introduction of new investment products, such as Hedge Funds (1999) and Exchange-Traded Funds (2002).

The global financial crisis of 2008 caused a reversion of the trend with a severe contraction of the market, that caused the AuM to fall to € 841 billion in only one year, due to the massive outflows from the industry and to the loss in value of securities held in funds and portfolios. The following period was characterised by the introduction of several regulatory provisions aimed at increasing transparency of financial markets and at preventing a similar crisis in the future.

After few years, the market volume rose again to the pre-crisis level, marking a rebirth of the asset management industry.

As mentioned above, the industry is currently facing challenges brought by regulation and new tech solutions. Along with challenges, opportunities are always coming up. Although only time can tell who will be doomed by the former and who will instead take advantage of the latter, our research aims to depict both sides, providing a comprehensive overview of the industry and its foremost trends.

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Executive Summary

The Italian asset management industry is experiencing a long period of growth and is now one of the largest and most dynamic across Europe.

Over the last four years, funds and portfolio mandates have, with very few exceptions, recorded positive monthly flows, marking a truly flourishing period for asset managers and distributors. Low interest rates have for the first time forced Italian savers and institutions to look beyond the easy returns that in the past were guaranteed by Government bonds, bringing favourable news to asset managers. Nonetheless, the pace of change has dramatically intensified, triggering challenges and opportunities for incumbent and new players.

In this paper, we first provide an overview of the Italian asset management market, highlighting the recent evolution of investment solutions and the main features of the Italian fund and life insurance distribution. Then, we look at the demand side, i.e. what are the peculiarities of Italian savers and how they are evolving.

Finally, we go through the challenges brought up by the impending regulatory wave, with MiFID II about to become a reality, and the opportunities fostered by the adoption of modern technologies, such as robo-advisory, artificial intelligence, RegTech, Blockchain and social media.

Italians are great savers. Despite their conservative financial habits, they have been forced to consider other investments than government bonds and deposits.

Market overview

Funds are becoming more and more popular across investors thanks to the diversification that they allow and to the professional competence of financial operators. Multi-asset products have overtaken traditional equity and bond funds, with the rise in the most recent years of balanced and flexible funds. Now, asset managers tend to provide solutions with a *goal-based approach* rather than merely offer investment instruments. In this context, the recently introduced *Piani Individuali di Risparmio* (PIR) are gaining momentum and, in addition to foster a new financing wave to Italian companies, are deemed to blow fresh air into the industry.

Furthermore, after a decade of negative flows, Italian-domiciled funds have regained their popularity over the last four years despite their costs, generally higher than those for their European counterparts.

The current distribution model is dominated by banks, who are leaders in both fund and life insurance distribution. The relationship between the asset manager and the distributor is mainly captive, but several changes are expected for the future, triggered by the incoming regulation and by the tech innovations. Costs for compliance as well as competition will likely increase, thus triggering a consolidation wave to remain profitable over the medium-term.

The demand side

Italians are great savers. Despite their conservative financial habits, they have been forced to consider other investments than government bonds and deposits. It is of crucial importance to dig deep into their specific investment needs: low risk seekers and poorly financially educated, Italians need to have a personal relationship with their advisor. Baby boomers, who owns the largest share of the Italian financial wealth, are the foremost target of the industry.

Finally, the reader will gain insights on the Italian household's portfolio, deeply affected by the recent crisis.

It is worth to notice that one third of Italians' wealth is still parked in deposits and cash, representing an untapped potential for the asset management industry, that in the future will need to move these resources within its boundaries.

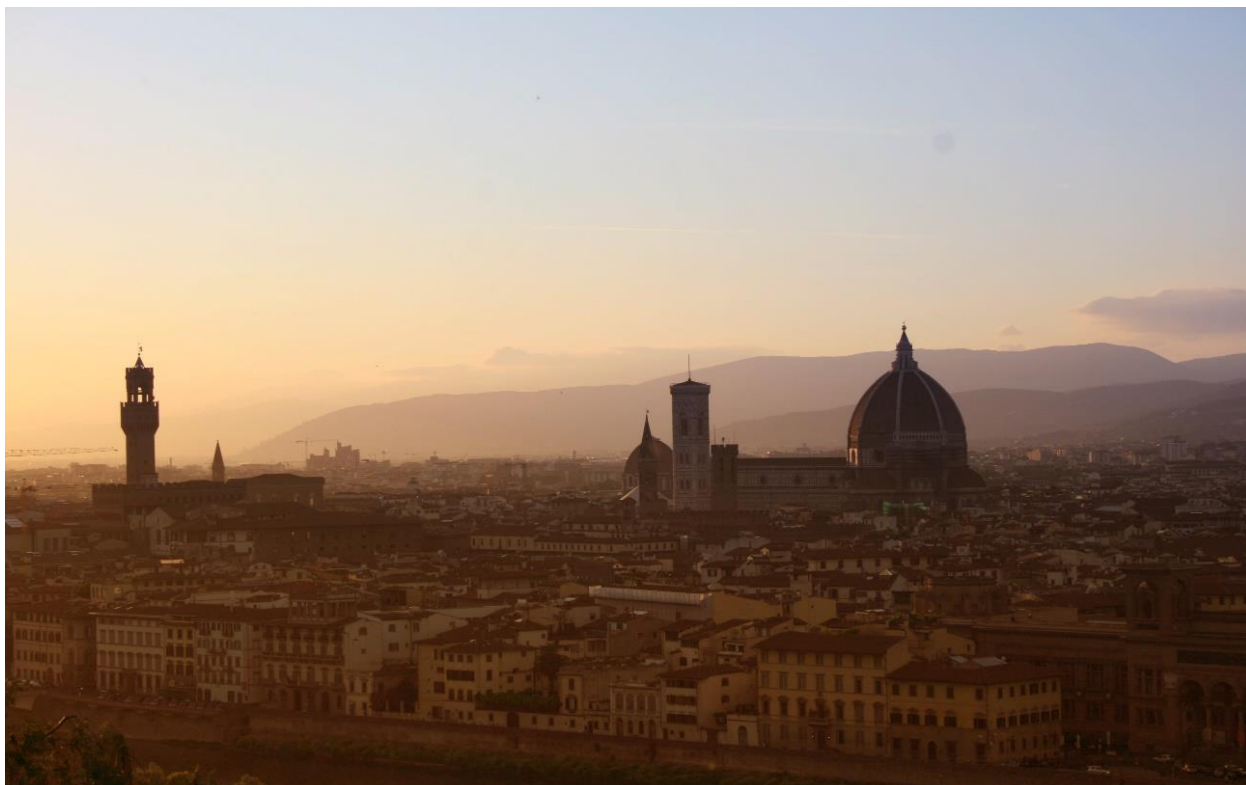
Regulatory challenges

In the past few years, regulatory compliance has constantly been at the top of asset manager's agenda. Currently, the most debated regulation is the upcoming Market in Financial Instruments Directive (MiFID II), as it covers many areas of the industry and brings relevant challenges to the table.

The Directive sets two main objectives: making the system more transparent and improving service quality.

To meet the first goal, along with other provisions, regulators have imposed costs and retrocessions disclosure requirements and banned inducements in case of independent advisory.

To achieve the second objective, they introduced standards on product governance and imposed minimum qualifications to agents operating as financial advisors. Most operators deem to be sufficiently ready to implement the aforementioned changes however, this does not mean that there will not be unexpected consequences ahead for some players, especially for the smallest, who will find handling compliance somewhat burdensome.



Technology in asset management

Technology developments are revamping asset management in many ways. To meet investors' new demands, financial institutions need now to reach their customers through a wide variety of channel, enabling them to carry out transaction in every moment and from any place. In this context, robo-advisory can be a key instrument both in the hands of investors - with a *Direct-to-Consumer* model - and of advisors - with *Robo4Advice* platforms. The range of products is wide and goes from ETFs to traditional stocks and bonds.

Together with the rise of new opportunities of accessing new markets, automatising processes and taking advantages from economies of scale, players face the risks of cannibalisation and to suffer from a downward pressure on fees.

Robo-advisory is only one element of a larger wave of technological innovation. Artificial Intelligence, for example, opens a handful of implementable services in the asset management industry, from chatbots that answer customers' demands in real time, to complex risk management models to implement better strategies.

Not only software for CRM and financial modelling, but also social media are having an increasingly important impact in asset management due to the fundamental role they play in the modern investment community.

Artificial Intelligence has begun to spread across traditional asset managers and has also created potential room for new FinTechs. Even though the possible applications are almost unlimited, Artificial Intelligence will unlikely completely replace humans, but will rather be a strong ally to make sounder investment decisions.

Not only software for CRM and financial modelling, but also social media are having an increasingly important impact in asset management due to the fundamental role they play in the modern investment community. Almost all asset managers have already appeared on social media, although only a few employ this technology to actively communicate with their customers.

New players, like Google, could enter the market enjoying a sustainable competitive advantage.

Finally, Blockchain will likely improve the back-end thanks to the distributed ledger which will allow fewer transaction costs, more data security and a reduced need of human intervention in data management.





Asset Management in Italy

1. Asset Management in Italy

Introduction

For most industries, doing business in Italy after the Great Recession has become harder and harder. Data published quarterly by national agencies and daily articles on newspapers relive the same topics: the economy has been showing signals that the crisis is gone and that the recovery will soon become a reality. Yet, with a 12% unemployment and a less-than-1% GDP growth lagging behind the other European countries, it appears that the Italian economy is still sailing out of sight of land.

However, the Asset Management industry, able to seize favourable opportunities within an attractive environment, has shown positive growth and returns and it is now preparing for facing new challenges.

Accounting for about 111% of GDP, for the first time in 2016 the total Asset under Management (AuM) has breached the GDP threshold, up from the far lower 57% of 2011.

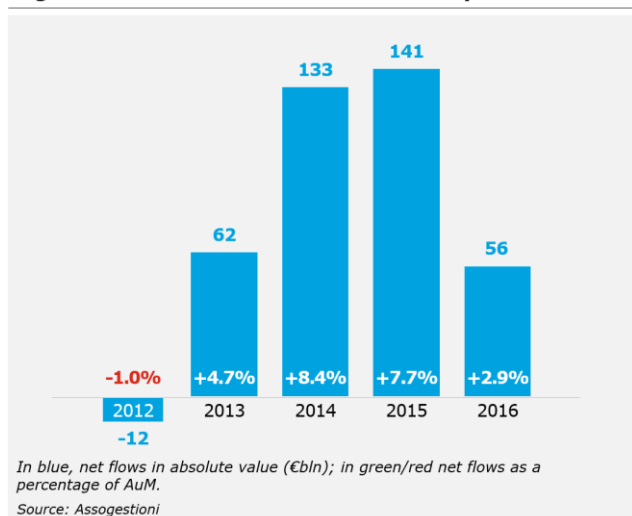
And this is not only the result of the good performance of assets underlying investment products distributed in Italy.

...the economy has been showing signals that the crisis is gone and that the recovery will soon become a reality



As figure 1.1 shows, in the last five years net flows have fueled the asset side of portfolio managers, creating at the same time a favourable environment for distributors - namely banks and financial advisors. In particular, 2014 and 2015 were two exceptional years and the net flows surged to around 8% of the current volume of managed assets. As it will be investigated in this paper, such positive flows are indeed proof of a general climate of trust towards the industry by Italian retail and institutional investors.

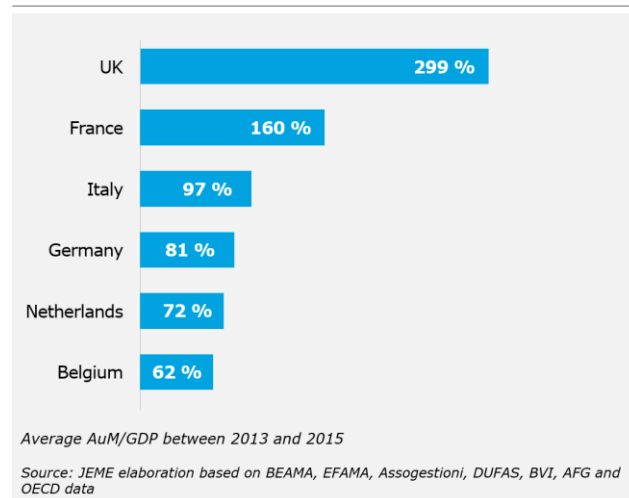
Figure 1.1 – Net Flows in the AM industry



As far as the European asset management industry is concerned, we see that Italian market is quite active if compared to a pool which includes the other main countries. Considering AuM/GDP as a proxy for the activity of the industry, and excluding the United Kingdom, which has historically been the most advanced place with regards to asset and wealth management, Italy is positioned behind only France (see figure 1.2).

Indeed, when reading figures that relate to different markets, we must take numbers with extreme care: for example, in France, money market funds (MMFs) represent a significant portion of the fund industry, whereas in Italy most of liquid assets are tracked in bank accounts and thus are outside the asset management perimeter.

Figure 1.2 – AuM/GDP for European Countries



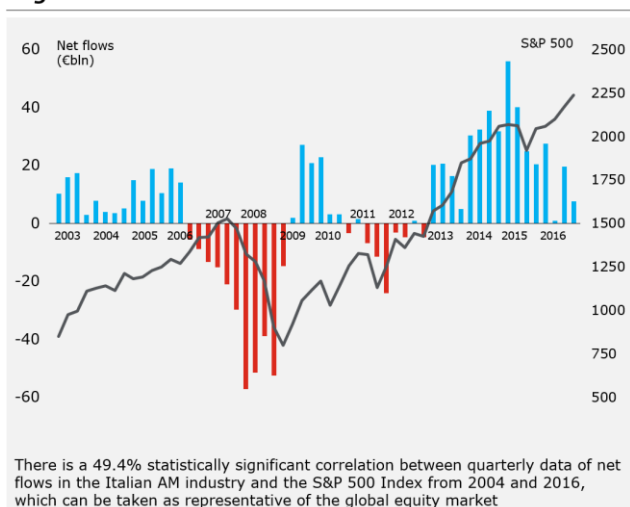
Characteristics of the industry

Showing an exceptional compounded annual growth rate of 15.7% over the past five years, assets under management in Italy have reached €1,943€ billion at the end of 2016. This amount is almost equally divided in funds (mostly open-ended funds) and discretionary mandates, which are targeted either to high net worth individuals or to institutional clients, such as pension funds and insurance companies.

Italian savers are well-known in the international environment for their risk-aversion and their preference for safer financial instruments, such as deposits, government bonds and real estate. Yet, the macroeconomic environment, characterized by low - or negative - interest rates on traditional securities has proven to be the major catalyst for the asset management industry in the last few years.

Diversification, technical competence and a relationship with the distributor based on trust are pushing households to lean towards the asset management industry, abandoning the traditional investment forms.

Figure 1.3 – Net Flows and S&P 500 Index



Behavioural finance explains why people tend to ride positive market waves and to close their positions when harsh times come.

Also in Italy investments follow the market cycles: so far, we have seen positive net flows in bullish periods. Likewise, during recessions, investors took out their savings from the industry in favor of less risky investments such as treasury bonds and bank accounts.

As shown in Figure 1.3, most marked outflows from the industry occurred during the financial crisis, between 2007 and 2008. If we look at the S&P 500 index, which can be considered a proxy of the global financial market, we clearly see the correlation between the market performance and the flows of the industry.

Funds

Over the last decades, the fund industry, hit in Italy by many shocks and recoveries, has evolved and is still undergoing a complex transformation process.

According to Assogestioni, total AuM within funds was €950 billion at the end of 2016, most of which invested in open-ended funds. In general terms, funds in Italy have proven to be quite resilient to adverse shocks by virtue of the safety that investors felt towards professional asset managers, as it might be seen in the turmoil of the first years of the 21st century.

Nonetheless, the fierce effects of the latest financial crisis left their footprint on the fund industry, which saw outflows equals to about one third of the Asset under Management in only one year (2008). Recent developments, mostly low economic interest rates and favourable regulations, have fostered the renaissance of the industry.

Asset class: data and trends

In Italy, bond funds have always been dominant among all the fund categories. In particular, after a severe decline - which hit equity funds as well - due to the uncertainty among investors triggered by the subprime crisis and its consequences, bond funds regained momentum in the subsequent years. Their share surged during the sovereign debt crisis, hitting a peak of almost half (46.4%) of the total AuM invested in funds in 2012. Unsurprisingly, funds whose principal investment is on either short-term or long-term government bonds issued by European countries have become less and less popular, with the formers suffering the most, as confirmed by data on the net flows and on total AuM. If at the end of 2004 such fund categories accounted respectively for 17.4% and 11.2% of total AuM collectively managed, twelve years later these shares resulted to be as low as 2.8% and 3.7%.

This negative trend, on top of the lowering yields of government bonds, can be explained by the fact that asset managers are increasingly preferring to create financial instruments less constrained to particular investment categories, as confirmed by the increase in the share of mixed funds¹.

An interesting trend that began in 2011 is the Italian investors' inclination towards target-date (*fondi a scadenza*) bond funds.

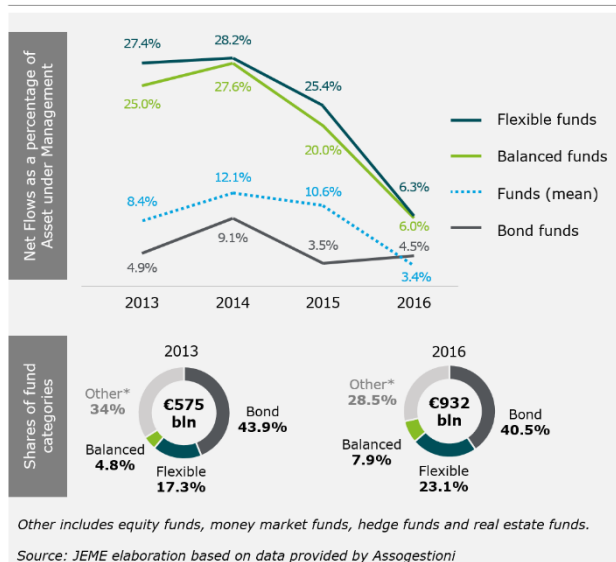
These are funds characterized by a fixed time horizon (usually 3 to 5 years) and (generally) by periodic coupon detachments. Furthermore, target-date funds are allowed to adopt distribution fees (*commissioni di collocamento*) rather than the entrance fees, which might explain why they are very attractive for distributors.

¹ Here, we refer to mixed funds as "bond funds" whose unique constraint is the maximum investment in equity fixed at 20%

The latest news from the industry shows that, in 2016, 78% of new Italian funds charged distribution fees. In more recent years, Italians have preferred fixed-term coupon funds investing not only in bonds but in a more heterogeneous blend of securities. According to Morningstar, in 2016 funds of this kind domiciled in Italy collected €4.6 billion, more than every other fund category.

This phenomenon is part of a broader trend: especially after 2012, the net sales of bond funds have slowed down. Although between 2013 and 2016 bond funds saw positive net flows for around €91 billion, we see that, in relative terms, flexible and balanced funds have been able to capture most of the money that flowed into funds (€171 billion of the total net flows, equal to €255 billion). Those products allow investors to enjoy acceptable returns in an environment of low interest rates while keeping a less risky position than they would face with equity funds. To give some numbers, funds were fueled with fresh money for an amount equal to 8.4%, 12.6% and 10.6% of their value in, respectively, 2013, 2014 and 2015. As shown in figure 1.4, over the same period of time, flexible and balanced funds grew more than twice as rapidly as the industry average. This trend has been confirmed also in 2016, but substantially with lower growth rates (in 2016, funds received net flows for only 3.4% of their value), due to the economic uncertainty triggered by headline events, such as the Brexit and the US President elections.

Figure 1.4 – The growth of flexible and balanced funds



The unfavourable macroeconomic conditions have also hampered the flows towards MMFs (money market funds), which in the last nine years have shown positive streams only once (in 2015). The underpinning reason of this decline is obvious: low yields - often negative - that characterize short-term asset instruments have made this investment unattractive or not economically viable.

Finally, equity funds have shown different patterns throughout the years. On the one hand, the volume of these funds has almost doubled in the last five years, from a little less than €100 billion at the end of 2012 to more than €180 billion in December 2016, consistently with the average growth of AuM within the industry. Yet, the same thing does not hold with regards to net flows as they have continually underperformed the other categories, highlighting that the volume growth of equity funds has mainly been due to market effects.

However, in the foreseeable future equity funds should gain momentum among Italian investors thanks to the diffusion of PIR (*Piani individuali di risparmio*).

Introduced with the Budget Law issued in December 2016, PIR are solutions aimed at funding Italian companies and SMEs through a five-year investment plan that can enjoy attractive fiscal benefits, since they are exempted from the payment of both the capital gain and the inheritance tax.

Without going into details, at least 70% of the invested amount must be addressed to businesses which have a considerable stake in Italy. Further, with the goal of sustaining the funding of SMEs, the law provides that 30% of such an amount must be associated with securities issued by companies not listed in the Ftse Mib. However, the regulator has not completely clarified which bonds and shares could be included in these saving plans and new provisions are expected in the next few months. From our field research it emerges that **experts are confident that several billions of new flows to the industry will be generated through PIR in the next five years.**

Latest data available on the net flows generated in the first months of 2017 through PIR confirm this general optimism. For example, Eurizon Capital has been able to gather around €100 million through PIR in the first two weeks after their release, which took place at the end of February. Despite the risk of cannibalization vis-à-vis other funds, PIR will contribute to further expand the volume of Italian AuM. In fact, PIR not only are expected to increase the participation share of current investors in the industry, but they also will finally attract to asset management solutions part of the customers who have so far taken refuge in bonds, stock and bank accounts. This is due to the influence of fiscal benefits on Italians' investment choices, proven in recent years also by the growth of the insurance market.

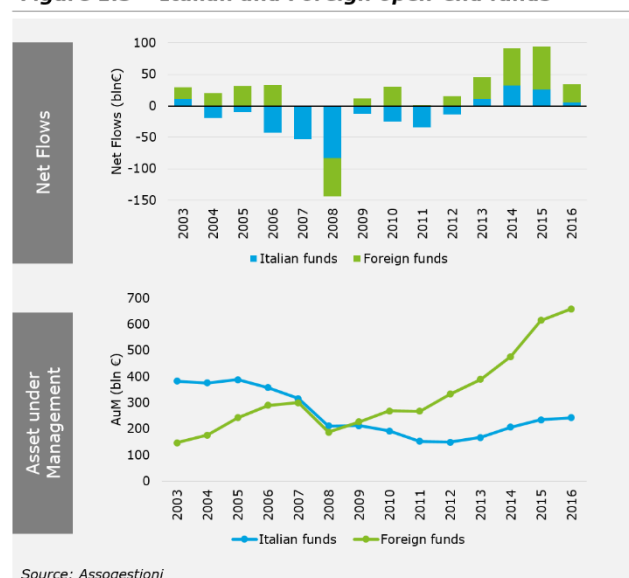
A controversial phenomenon that has affected the asset management industry until 2012 is a sort of competition in the distribution through bank branches between funds and other investment products, such as bonds and life insurance products containing financial instruments. This competition, fostered by different factors throughout the decade, was one of the determinants of the negative flows that affected funds domiciled in Italy in the same period. First, before the enactment of the Savings Act (2005), insurance products and bonds could enjoy a less regulated environment that eventually made them more appealing for banks. Second, during the financial crisis, banks, facing severe liquidity issues, promoted a direct fund-raising by a massive issuance of bank bonds, diverting money that were invested in funds. To give a picture of the entity of the issue, **banks raised around €31 billion during the second and third quarter of 2008 placing bonds to retail people.**

Third, from 2009 on, Italian funds were penalized because banks sensibly started to opt for life insurance that were both profitable for them and popular among people, who perceived these products as safe investments in a financially unstable environment. **In 2009 and 2010 banks sold life insurance for, respectively, €28 billion and €27.5 billion.**

This trend, which was interestingly possible given the highly integrated structure of the Italian players, came to an end after the ECB started injecting liquidity in the Eurozone, making banks no more constrained to retail funding. This resulted, at least since 2013, to retail bank bonds facing negative flows and funds collecting a great amount of fresh money.

This phenomenon is strongly linked to another peculiarity that has shaped the Italian fund industry until 2013: the increasing relevance assumed by foreign funds at the expense of national funds (see Figure 1.5).

Figure 1.5 – Italian and Foreign open-end funds



There are actually two interesting interpretations of this evidence. On the one hand, the opening of the market in the 2000s to foreign players was deemed beneficial to Italian asset managers since it fostered competition across the industry, resulting in a general improvement of Italian players, who were forced to react given the threat of a more competitive arena. On the other hand, the increasing inclination of national SGRs to domicile their funds abroad has been considered for long as a signal that the Italian environment was not sufficiently attractive to retain these players.

As far as destination countries are concerned, about three quarters of assets managed abroad are within the borders of Luxembourg, followed by Ireland, France and other countries with minority stakes.

Among the reasons that triggered the flows of capital across the borders, Luxembourg and Ireland were particularly appealing due to a more-friendly regulation, less constrained by red tape than in Italy, and to the presence of a developed financial industry capable of providing valuable ancillary services to asset managers. Furthermore, the fiscal regime in those countries was much more attractive for both investors and producers.

We observe that since 2013 flows towards national funds have been positive again, a circumstance fostered by the aforementioned ECB's policy effects on Italian banks as well as by a few improvements in the Italian fiscal system that incentivized the renaissance of Italian funds. Two important reforms (i) allowed funds domiciled in Italy to charge distribution fees in the same way as foreign fund were allowed to (2012) and (ii) substituted the income tax, daily charged and levying on funds, introduced in 1998, with another tax on the same income, but levying on investors and applied at the moment of disinvestment (July 2011).

This provision was particularly welcomed in the Italian system, which had experienced inefficiencies during the crisis, when, due to cumulative losses, billions of euros in tax credit were locked in funds.

As a result, after a decade of contraction, open-ended funds domiciled in Italy have increased in number (at the end of 2012 there were 740 of them, four years later 982), enjoying between 2013 and 2016 net flows for around €75 billion.

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Fees

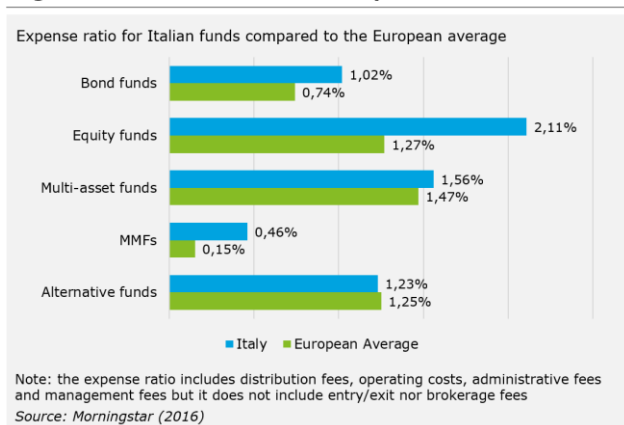
One of the key drivers of a fund's net performance is the cost that investors must bear to have the fund in their portfolio. Given the role that cost transparency will have from next January, the issue concerning the amount and the nature of fees is already of great interest, in particular because currently around two thirds of the fees paid by the investor are used to remunerate the distribution network.

Italian funds are generally more expensive than European funds.

A recent research by Morningstar pointed out that, unlike the European average, Italian funds have seen their expense ratio grow in the last four years. Considering the current expense ratio, Italian funds cost on average 1.42% of the invested amount per year, 42% more than the European average (1%).

In figure 1.6, which illustrates the expense ratio of funds for different asset classes, we see that Italian funds are less competitive than funds domiciled in other countries, especially as far as equity, bond and money market funds are concerned.

Figure 1.6 – Italian Funds are expensive



Passive vs Active management

Passive funds have assumed an increasing relevance in the asset management industry, in particular thanks to the growth in popularity of passive instruments such as Exchange-Traded Funds (ETF).

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Exchange-Traded Funds

With the exception of very few traded funds actively managed, the vast majority of ETFs is managed passively, with a strategy aimed at following the considered benchmark with ideally zero tracking error. ETFs should be widespread among investors by virtue of their flexibility and liquidity.

However, the growth registered in the past years is almost entirely due to their relevance among institutional investors rather than among retail savers.

In fact, **in Italy, the direct investment in ETFs is mostly made by the niche of financially educated investors accustomed to the usage of online platforms which offer these passive instruments.**

Traditional distribution channels rarely offer ETFs due to their lower profitability triggered by minor fees.

Institutional investors, on the other hand, use ETFs predominantly because they allow to get tactic exposures with a short-term orientation, through a simple operation at low cost.

In addition, ETFs are used by fund houses to structure the passive part present in many actively managed funds. Generally, ETFs are preferred to derivatives by these investors as they are subject to fewer constraints and are easier to manage.

In addition, the rapidity with which these instruments can be disposed, appreciated in moments of high volatility, have led 36% of institutional investor to employ ETFs for risk management or for hedging strategies, up from the 28% of the previous year.

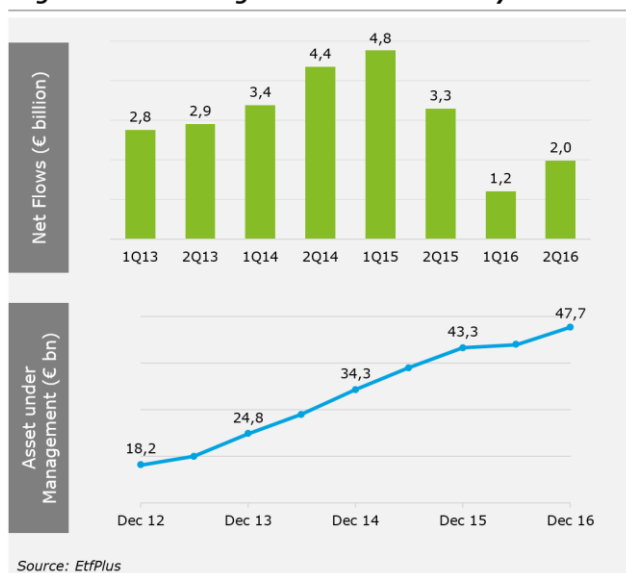
ETFs are also used to manage liquidity, especially with regards to bond allocation: in 2016, 45% of institutional investors used ETFs to manage liquidity (in 2015, 36%). Further, one institutional investor over ten predicts to use ETFs for the first time in 2017.

These advantages can help us explain the steady growth that ETFs have enjoyed in the Italian market (EtfPlus, by Borsa Italiana).

As figure 1.7 shows, in the last four years net flows have always been positive and marked a cumulative €24.6 billion flow towards the industry. In 2016, as experienced by the entire industry, flows have diminished, albeit remaining positive. With regards to AuM, the market has shown a cumulative growth of 138.7% between 2012 and 2015.

According to recent researches, in the United States ETFs account for around 16-17% of investment management; in Europe the share is limited to 7% and in Italy only to 2.3-4.8%, depending on the perimeter of the analysis. These data suggest that **there is potential room to close the gap with the European average continuing the growth trend of the last years.**

Figure 1.7 – Exchange-Traded Funds in Italy



Performance comparison

With regards to the performance of passive funds vis-à-vis their active counterparty, the long-dated debate is still open and has seen much research in favour of both positions.

If we look at the SPIVA Europe Scorecard (2016), which takes into account the performance of European active equity funds in relation to their respective benchmarks, we see a heterogeneous situation.

In general, however, active funds tend to be outperformed by their passive counterparts and this effect is more marked for longer time-horizons.

These results might foster the success of passively managed funds that, also by virtue of their lower costs, might guarantee higher returns to investors. Yet, the best performers among active funds when compared to the benchmark are Italian equity funds.

As the Scorecard suggests, only about 29% of actively managed funds investing in Italian equity performed worse than the benchmark (S&P Italy BMI) with a 1-year time horizon. Enlarging the observation period to five years, this percentage increases to 50%, remaining lower than for funds investing in other European equities. Industry professionals explain it because of the inefficiency of the Italian equity market, which can allow active strategies to achieve alpha more easily than in other, more efficient, markets.

The future of passive management

Broadening the scope to the global environment, many experts are confident about the future of passive management. For example, Tim Buckley, Vanguard CEO, is certain that active fund management will face serious troubles in the future due to the unsustainable costs of these products. Further, Vanguard believes that within 10-15 years passive instruments will account for almost two thirds of the investment made in Europe.

This trend is also confirmed by Bloomberg data, which show that over the last three years in Europe assets under passive management have grown by a remarkable 80%, up to €1.1 trillion.

However, it is still not clear whether passive management will achieve success in the future. Actually, **the prevailing opinion is that the market evolution will favour active management thanks to the returns that it allows.**

According to the Global Survey of Institutional Investors (2016) carried out by Natixis Global Asset Management, 75% of institutional investors, up from the 69% of the previous year, believes that the current market conditions offer more opportunities to actively managed funds. The study highlights that the surveyed investors tend to prefer active strategies thanks to the opportunities of positive alpha that can be generated as well as of the environmental, social and governance (ESG) investments that can be pursued through these strategies.

The discussion will not end up soon. Nonetheless, it will be of paramount importance for active managers to provide a clear justification of the higher fees required for their funds, stating why investors should lean towards their products, which can be either for particular investment needs (such as ESG) or for extra-returns if compared to the passive counterpart which replicates the benchmark.

In this context, **the incumbent MiFID II will likely polarize the market to the two extremes: on the one side, pure passive players and, on the other side, pure active fund managers.**

Alternative Investment Funds

Included in the category of *alternative funds* there are hedge funds, real estate funds, private equity and venture capital funds. All these typologies of funds have some common characteristics:

- low correlation with the market
- low liquidity of the fund's shares
- higher risk, volatility and potential return than ordinary funds.

On average, this handful of investment instruments has grown in importance in the last years, due to several reasons. First, starting from the crisis of 2007-2008 and the crisis of Italian sovereign debt, investors have increasingly searched for alternative investment opportunities looking for positive yields. Indeed, these instruments offer a good opportunity for diversification purposes as they allow strategies not-linked with the market.

Second, the asset management industry needed to innovate and improve its products especially after the introduction of passive management funds that allowed to reduce investment costs. Third, while in the past alternative investments were affordable only by institutional investors and high net worth individuals, today, thanks to the evolution of the distribution network, also retail clients can access these investment solutions.



A recent research carried out among Italian pension funds by an English asset management firm has highlighted a marked propensity to exploit alternative investment by long-term investors, in this case pension funds.

Specifically, 70% of respondents invested in real estate funds; among these, 57% had an investment in real estate funds greater than 10% of their total assets. Moreover, 45% owned stakes in private equity funds, 40% in private debt funds and 30% in hedge funds.

In addition, these figures are expected to grow in the next future. For example, 60% of PE investors have expressed the wish to increase their stake within two or three years. Also, 50% of hedge funds and Ucits alternative funds holders were willing to increase their investment in these alternative forms.

In 2016, Italy has seen a consolidation in the Private Equity and Venture Capital market, with the same number of investments completed in 2015 but with an increase in the total amount invested. However, **Private Equity and Venture Capital funds remain a limited phenomenon in Italy if compared to other European countries.**

Since the financial crisis, real estate funds had to face a marked downturn due to the collapse of the real estate market.

Real estate funds

Real estate funds accounts today for 46 of the €48 billion managed within closed-end funds. Roughly, €6 billion are dedicated to retail investors. They represent a minority stake in this market, which is much more suitable for behemoth institutional investors with a higher investment capacity.

Since the financial crisis, real estate funds had to face a marked downturn due to the collapse of the real estate market. For the nearby future, significant disinvestments are expected, particularly with regards to retail funds. During 2014, several funds near expiration had their duration lengthened because of the harsh conditions in which the real estate market was sailing, thus avoiding massive capital loss for retail investors deriving from the sale of real estate assets.

Many among these funds will reach the closing date within 2020.

However, there are still many opportunities of growth for the Italian market.

The European Public Real Estate Association (EPRA) shows that activities listed at the Italian Stock Exchange and backed by real estate assets account for only 0.55% of the total market capitalization, whereas the average for other European countries is 4.9%.

Hedge funds

Officially recognized in 1999, almost 50 years after their launch, hedge funds are a relatively-new entry in the Italian landscape.

Nonetheless, they gained momentum soon after the introduction of the first hedge fund in 2001, with volumes passing from €2.3 billion in 2003 to €12.4 billion in 2005.

Nowadays, in Italy, open-ended hedge funds are 61, representing a share of 1.3% of all the asset management industry. Moreover, only 0.5% of the total investments in open-ended funds in 2016 flowed into hedge funds. Among the reasons of such a low penetration in the market, we list the low returns that they have guaranteed in recent years (hedge funds are facing issues in generating alpha for their investors) and the high commission fees.

Discretionary Mandates

Retail mandates

Since 2003, GPF (*fund retail mandates*) and GPM (*securities retail mandates*) have registered very different paths.

In this time horizon, the volume of GPM almost doubled, passing from €49 billion in 2003 to €95 billion in 2016. The overall growth has shown upward and downward trends.

In particular, the most marked losses were triggered by the two crises (financial crisis in 2007-2009 and sovereign debt crisis in 2010-2012). Both declines were caused by the loss of value of securities held in funds as well as by negative net flows, determined by an increased mistrust of investors.

With respect to GPF, the trend has gone in the opposite direction: AuM within this category went from €93 billion in 2003 to as low as €34 billion in 2016. Also for GPF the two crises caused negative figures, yet in this case the decline is also due to the enactment, in 2007, of a provision by CONSOB and Bank of Italy which banned the inducements related to funds held in discretionary mandates, making more and more intermediaries switch towards more profitable products.

For the future, retail mandates are expected to grow as the general trend in favour of multi-assets products suggests.

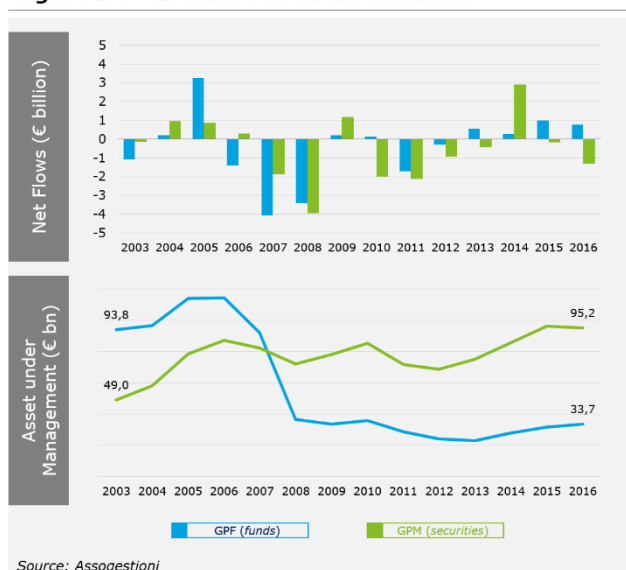
In fact, customers are less focused on the single products and require services tailored to their investment needs. Being retail mandates customized solutions by definition, it is likely that they will experience a positive trend over the next few years.

Institutional mandates

The pension fund industry in Italy is showing a positive - yet still slow - trend in volume growth. At the end of 2016, mandates of pension funds to asset managers accounted for €83 billion in AuM. This small figure finds its roots in public welfare dynamics over years. Traditionally, Italian citizens have always relied on a public pension system, characterised by mandatory payments throughout the working ages to accumulate the money needed for the retirement. With no need to seek for alternative pension forms, Italians have always been reluctant towards pension funds. This feature is peculiar of Italy, as other countries show significantly higher portion of financial assets into pension funds (in the UK, for example, pension funds account for more than 40% of the households' financial assets). Notwithstanding, recent events and market conditions are laying the foundations for a future development of pension funds. Above all, **the uncertainty about public pension schemes and the extension of the working life are pushing more and more people to adopt some forms of additional pension.**

Another remarkable trend in the Italian pension fund market regards the overall investment strategy. In fact, Italian pension fund portfolios appear significantly risk-averse by modern standards. At the end of 2015, 62.6% of second-pillar pension fund assets were invested in fixed income, 78% of which was sovereign debt. Only 16.7% was invested in equities. However, during 2016 Italian pension funds have increased their employment of alternative investment strategies (including real estate, private equity and private debt): diversified strategies is becoming the first point in the day-to-day agenda, even if funds lament a lack for domestic opportunities.

Figure 1.8 – Evolution of Retail Mandates



Source: Assogestioni

INSIGHT: The recent growth of life insurance

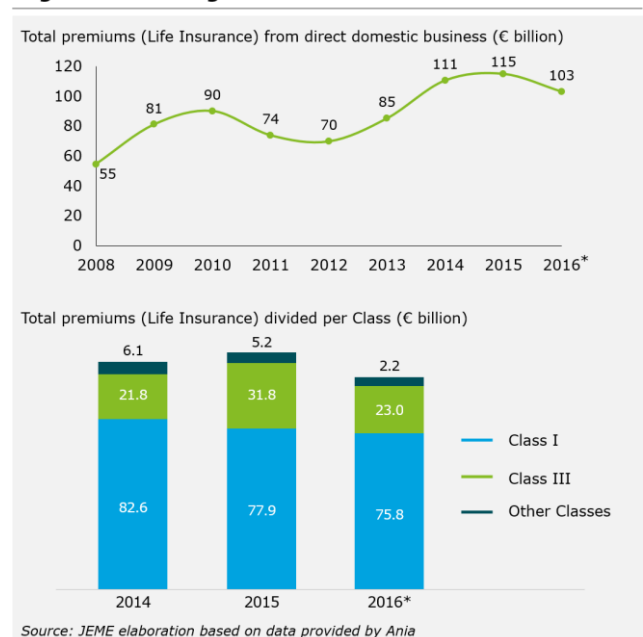
Despite the lower degree of maturity of the life insurance industry in relation to other European countries, in Italy this market has shown positive signals in the last five years, as confirmed by the steady increase in life premiums and life mathematical provisions. Unlike many other countries, such as Germany, Spain, the Netherlands and the United Kingdom, Italy has recently experienced a marked rise of the life insurance penetration index (i.e. the ratio between premiums and GDP), going from 5.3% in 2013 to 7.0% in 2015, delivering promising news for insurance companies and distributors. Subsequent to this upward trend, however, 2016 has been characterized by a general slowdown, reflected in the 12.3% yearly decrease in premiums generated by newly issued policies (see Figure 1.9).

This reduction, mainly driven by a downturn in Class I and Class III policies, is also the result of the high volatility of the equity markets and of traditional policies' less-appealing yields, which, in turn, are the product of the low interest rates environment.

In Italy, around 70% of premiums are generated through Class I policies (straight life) and almost 30% through Class III policies (linked). In particular, between 2013 and 2015 premiums of Class III policies have grown with an average 32% annual growth rate thanks to the increasing interest of banks towards these assets, most of which, unlike Class I policies, are characterized by the absence both of a financial protection and of a minimum guaranteed return. Class I policies, on the other hand, hit a peak of €83 billion in premiums in 2014 and then started to lose popularity, reaching €76 billion in 2016.

In Italy, around 70% of premiums are generated through Class I policies (straight life) and almost 30% through Class III policies (linked).

Figure 1.9 – The growth of Life Insurance business



Anyway, between 2013 and 2015 around €118 billion have flowed into the industry (net of the incurred claims), confirming that banks, agents and financial salesmen have been able to persuade investors. Indeed, the lower transparency of life insurance policies when compared to other investment solutions has allowed the operators to charge substantially higher fees, making the former an attractive product to sell. Analysing the demand side, insurance policies have met with lasting success among retail people for multiple reason.

First, the tax benefits, consisting in the waiver of stamp duties (for Class I policies), the deductibility of 19% of the premium paid in the tax records as well as other tax advantage, have contributed to the investors' propensity for insurance products.

Second, the unattachable nature of life insurance is another benefit in the eyes of investors.

Third, in the public imagination these assets are mistakenly perceived almost as safe as bonds (also, the word *assicurazione* comes from the Latin word *securitas*, which means "serenity due to the absence of dangers"). Yet, the European Directive 2016/97 (Idd) is likely to bring some change in the insurance distribution terms of transparency towards final customers.

Coming to the asset class of insurance policies, we see that, in the last fifteen years, on average more than 80% has pertained to Government securities and bonds. However, since 2008 there has been a significant divergence between the two aforementioned asset classes, with the former prevailing over the latter. In 2008, in fact, both Government securities and bonds equally made up more than 40% of life policies, whereas at the end of 2015 this percentage was, respectively, 57% and 29%.

Class III policies, for their nature, are more risky and their asset allocation has always been dominated by shares (at the end of 2015, shares made up 35% of Unit-linked policies, against the 10% average for life insurance products). Further, for the first time bonds in 2015 overtook stocks, reaching 39% of total investments in Unit-linked policies.

As far as diversification is concerned, also in the insurance market we are experiencing a steady growth of combined products. Indeed, multi-class policies (*polizze multiramo*), a combination of traditional segregated assets and unit-linked investment funds, are becoming increasingly relevant in the industry. Again, this trend is mainly driven by the need of surviving the low-interest environment through alternative financial instruments.

Further, these “insurance boxes” have been able to gather momentum across retail investors thanks to the fiscal advantage that, as already mentioned, have made insurance products particularly appealing to Italian savers. As reported by Ania, the national association of insurance companies, in a recent publication, in 2015 €22 billion of new premiums were generated through multi-class policies. On top of the relevant weight of multi-class policies in the life insurance market (in 2015 they accounted for 23.1% of the premiums gathered through newly issued life policies), the most interesting figure is their growth through the years. In fact, the number of subscribed multi-class policies doubled in only one year, from almost 350,000 in 2014 to around 710,000 in 2015. This was then reflected in the surge of the share of these policies, which went from 13.2% in 2014 to 23.1% in 2015.

Despite the slowdown of the insurance market in 2016 and the incoming Insurance Distribution Directive, professionals in the field believe that these products will nonetheless remain among the most successful investment solutions also in the following years.

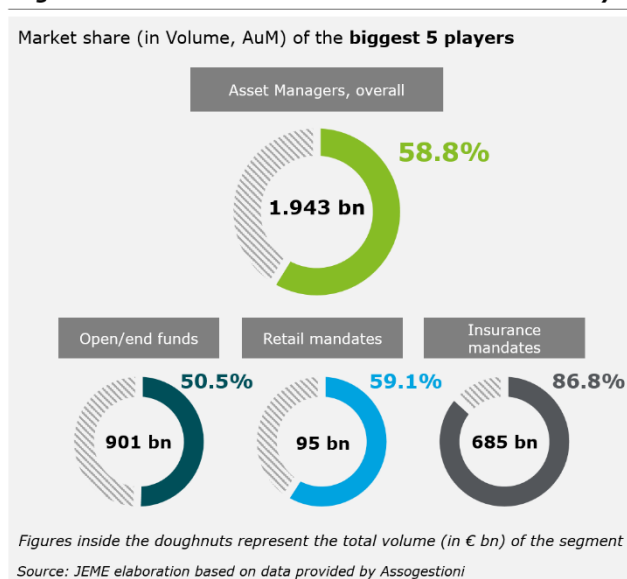


Key players in the AM industry

Achieving scale efficiency and critical-mass seems to be one of the biggest concerns for Italian asset managers.

Indeed, the battlefield is dominated by few big fighters, who share part of the arena with about 60 smaller players, both national and foreign. At the end of 2016, more than half of the AuM in the Italian industry was in the hands of the first three groups, namely (i) Generali, which achieved an undisputed position as market leader in insurance products through inside-group institutional mandates, (ii) Intesa Sanpaolo, which includes the biggest Italian fund manager, Eurizon Capital, and the private banker Fideuram, and (iii) UniCredit, with its asset manager Pioneer investment, now sold to Amundi.

Figure 1.10 – Concentration in the Italian AM industry



A fourth big group could emerge after the agreement between Anima and Poste Italiane.

The latter, which already owns around 10% of Anima's shares and is willing to broaden its scope from insurance towards funds, has reached an agreement to strengthen its position by the first half of 2017, becoming the major shareholder of the former thanks to the ownership of almost one quarter of Anima's capital.

Two emerging patterns in the industry are consolidation and further concentration.

A recent example of this phenomenon is the aforementioned agreement between Poste Italiane and Anima, as well as many other deals that are transforming the marketplace. The recent acquisition of Pioneer Investment, already the third group in Italy, by the French group Amundi is another proof of the consolidation wave. In December 2016, at the time of the operation, the combined volume managed in Italy by these two groups would have been €192 billion, or 10% of the entire industry. Beyond the strategic reasons pursued by UniCredit, the deal was aimed at strengthening the position of this future group amongst the top players. Furthermore, last January has been a hectic month for the two biggest groups on the stage: Intesa Sanpaolo attempted - but then withdrew from the deal - to take over Generali, which would have created a group managing over 40% of the assets in the market.

We see that the main reason for this consolidation can be found in the quest for profit generation. While the line to be considered as global players is often set at €1.000 bln in AuM, at national level the minimum dimension to be competitive is quite lower, in the tens of billion of Euros.

Companies positioning under the threshold will incur in many obstacles like the increasing competitive pressure and low economies of scale for operating and distribution costs while low rates and compliance costs will in general reduce returns.

The size also allows manufacturers to sell their products through many different distribution channels, which is considered by customers as one of the critical factors in the choice of the products, since they consider it as a sign of stability and talent.

Further, scale will be particularly important for asset managers which are not integrated with a distribution channel. Indeed, companies relying only on manufacturing will find even more difficult to find distribution channels if they don't have a strong bargaining power, which can be obtained only by managing large quantities of assets and funds.

Also, compliance to the provisions of the impending directives will likely raise issues for small, stand-alone companies because of the increasing transparency requirements and adjustment costs. Small boutiques and family offices are deemed to be able to survive and to stand out after MiFID II enforcement if they create and clearly show a higher level of service and personalization for their clients. Nonetheless, they will likely still remain a very small niche in the market.

INSIGHT: Socially Responsible Investments

Socially Responsible Investments (SRI) are becoming popular as a way to achieve both financial return and to act preserving other people and the surrounding environment. However, their diffusion among investor still needs to face some misunderstanding and biases. In Italy, this is particularly evident: at the end of 2016, SRIs accounted for less than 5% of the average Italian portfolio, a very small share when compared to the average of the other countries, usually a double-digit share.

This divergence stems from a lack of clarity on the subject, since many investors, both retail and professionals, tend to confuse SRIs with impact investments. In fact, even though the underlying goals are the same across the two categories (i.e. creating a social and environmental benefit in addition to profit), impact investing focuses more on the social and environmental sides, sometimes at the expenses of reduced returns.

SRIs, on the other hand, predominantly aim to maximize profits, albeit avoiding companies and markets considered not socially responsible. As a demonstration of their profitability, a recent research by Candriam and ETicaNews (2017) has shown that through SRIs it was possible to achieve higher returns than through traditional investments in the last five years.

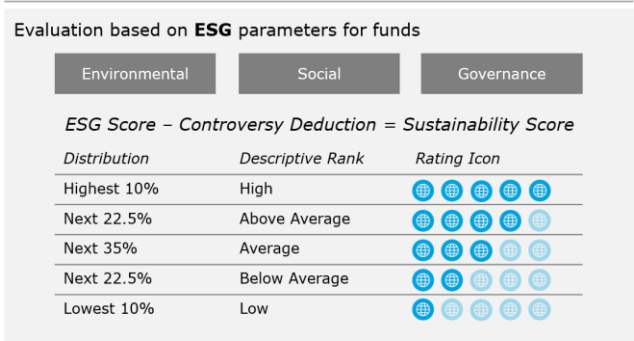
A second important issue is the absence of regulations and certifications regarding this subject. Consequently, investors willing to try SRIs must rely only on the confidence in the manufacturer goodwill or to invest by themselves following their own criteria.

This issue has already been addressed by some important market actors such as Morningstar, which now provides a *sustainability rating* for funds as a complement to the general and financial information about the fund.

The evaluation is based on environmental, social, governance (ESG) issues and on ESG-controversies in which the companies are involved.

Then, funds are sorted into five normally distributed classes, which allow a direct comparison with category peers.

Figure 1.11 – Morningstar Sustainability Evaluation



Future expectations for SRIs are very high; sustainable and responsible investing offer the opportunity to combine typical financial evaluation with more in depth analysis about companies’ governance and activities which results in more accurate evaluations, with pleasing financial consequences.

However, it is not yet clear whether SRIs are just a temporary fashion or the blue ocean of future investments. This remains an unanswered question.





Distribution in Italy

2. Distribution in Italy

In the course of time, the distribution side of the asset and wealth management value chain has grown in complexity, which is caused by many factors, such as the presence of an increasing number of actors on the field, the availability of multi-faceted investment solutions and the employment of multiple channels. The available literature and past research on this subject are partial, incomplete or outdated. Therefore, our study has been carried out with a particular focus on fund and life insurance distribution, which, as we have already outlined in the previous section, are the major components in terms of volumes in the Italian Asset Management industry.

Fund Distribution

We must be very careful when we deal with fund distribution, as it includes at least three sub-categories with different nuances based on the nature of the investor (retail vs. institutional) and on the way according to which the investor's money are managed (that is whether there is a discretionary mandate or not). In fact, **about 85% of funds are in the hands of retail investors, whereas the remaining part pertains to institutional investors**. Due to the nature of institutional investors, it is not of great interest to study how they invest the proceeds that they collect from retail people since it widely happens through the SGR belonging to their group. Focusing on funds distribution across retail investors, these people might access the fund industry through an intermediary either with or without a discretionary mandate.

About two thirds of the volume of funds are directly sold to retail people, whereas the left third belongs to investments made through a mandate (mostly traditional mandates and unit-linked insurance policies²).

Four are the peculiarities of the Italian fund distribution: the relevance of banks as the predominant channel; the concentration of the market; the substantial integration between Italian asset managers and distributors and the moderately high level of openness of the distribution architecture.

Banks and financial advisors

The first aspect worth to mention is that in Italy banks play the lion's share in the distribution of funds. To be concrete, 70% of the more than €700 billion of funds handled in retail portfolios (including mandates), are placed through bank branches. Further, this percentage has been growing year over year. Financial advisor networks are the other big distribution channel in the field, owning a 30% market share. These players are able to catch up with banks only in relation to unit-linked policies, whose distribution is almost equally divided between bank branches and advisors.

Interestingly, financial advisors play an important role in the penetration of foreign funds in the Italian market. In fact, we see that, despite their minor share (30% as already mentioned), these players are able to place around half (45%) of the foreign funds distributed in Italy.

The future evolution of the Italian distribution is still uncertain. On the one hand, the positive wave which has boosted the industry over the last four years is deemed to continue, and the available data on 2017 flows towards the industry seem to confirm this trend, fostering optimism among incumbent players. On the other hand, there is a high degree of uncertainty regarding the business model of future successful distributor.

² Unit-linked policies are constituted mainly of funds (around 94%). For the sake of simplicity, we will refer to "unit-linked policies" also in relation to "funds included in unit-linked policies".

Undoubtedly, after the enactment of MiFID II, the relationships between asset managers and distributors will become more frequent and costly, likely reducing the number of agreements across players at different stages of the value chain. With the advent of independent advisory, distributors will need to make the strategic choice whether to rethink their organization or to maintain the status quo, albeit increasing the quality of the advisory.

The scenario will likely evolve differently than in the UK, where since the enactment of Retail Distribution Review in 2012, inducements to distributors have been forbidden.

In Italy, in fact, there will still be room for the traditional distribution model. As a matter of fact, **the biggest ten banks and advisory networks, despite showing some evolution in terms of service offered and of the fee model, have not implemented the independent advisory model yet; in our opinion they will not easily make this change, at least in the near future.**

Concentration of the market

A general feature that characterises the Italian distribution is the high concentration of market share among players. As far as banks are concerned, the biggest ten players (among them we list Intesa Sanpaolo, Unicredit, Monte dei Paschi di Siena, BNL and Banco BPM) place together 75% of funds distributed in Italy.

The concentration is even higher among the networks of financial promoters: in this case, the top ten (including Azimut, Fideuram, Generali, Mediolanum and Fineco) are able to place 98% of funds among retail people.

Asset manager and distributor: captive relationship

Another interesting aspect lays in the fact that the distribution model of Italian players is generally captive. This means that players in the industry are very integrated, in the sense that most distribution agreements are made between the asset manager and a distributor who belongs to the same group (i.e. between Eurizon Capital and Intesa Sanpaolo Private Banking) or who is involved in a strategic

partnership (i.e. UniCredit and Pioneer Investment after the deal with Amundi). This is true for Italian asset managers, who distribute almost all their funds through an integrated model, whereas foreign asset managers basically rely on independent distributors for most of them do not have in place an own distribution system in Italy.

The principal downsides of this captive relationship are the low incentive of the fund house to ameliorate the internal processes and the client's misperception of the real cost of each service.

Open Architecture

Looking the market from the other side, that is from the distributor's point of view, the Italian scenario is marked by a moderately open distribution model, at least if compared to the European counterparties. We define "open" a distribution model when the actors who place the funds, namely banks and financial advisors, also opt for products not produced by an asset manager who depends on the same parent group. **We estimate that, taking everything into consideration, almost one fund over two is not managed by the group which the distributor belongs to.** If we broaden our analysis also to foreign countries, we see that, on average, in Europe two funds over three pertain to the group asset managers, meaning that European distributors are more closed than Italian ones.

Yet, these results must be read only as a summary description of the Italian scenario. Indeed, different distribution channels and different customer segments show peculiarities that depart from the average. We observe that the distribution architecture of funds directly sold to investors is not as open as the overall figure would suggest. For every euro invested, almost 50 cents pertains to funds placed through closed architectures (i.e. distributors which sell mainly products of the group fund house). Moreover, Italian funds are mainly placed in a context of closed architecture, whereas foreign funds are distributed through an open architecture. Consistently with this piece of evidence, we also see that financial advisors are generally more opened than banks.

Hence, what causes the architecture to be, on average, more open? The answer to this question lies in wealth management: funds held in private clients' portfolios, as well as retail mandates, a niche which targets wealthier investors, are in fact characterised by a high degree of openness of the architecture.

On the other hand, even though more recent studies have not been published yet, operators detect in the commercial policies of banks and advisor networks a general decrease in the openness of the distribution architecture and they forebode that it will become even more closed in the future. As we will point out in the following sections, the incumbent directives, MiFID II after all, will challenge the open-architecture model due to the growing regulatory requirements that will likely push the distributors to rationalise the offer and focus on fewer funds.

Figure 2.1 – Key features of Italian fund distribution

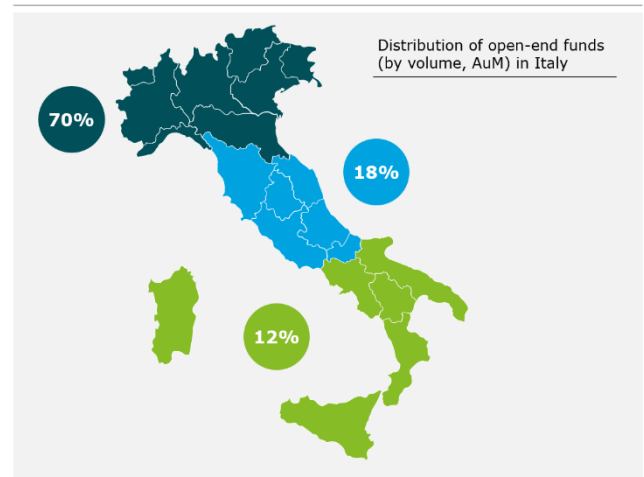


Regional Distribution

Italian distribution is very heterogeneous from a geographical perspective, and it is not the case that one-figure-fits-all, particularly with regards to how clients are scattered throughout the Italian peninsula as well as to how distribution channels differ from region to region. Consistently with the wealth distribution across the Italian territory, 70% of the assets belonging to retail clients invested in open-ended funds pertains to people living in Northern regions. On the other hand, 18% is invested in Central regions and the remaining 12% in Southern Italy. In Central and Southern Italy, only Lazio, the region where Rome lays, is comparable to Northern regions as far as the

volume of funds distributed is concerned. Furthermore, The regional difference is even more marked when taking only private clients into consideration, who are more concentrated in the North.

Figure 2.2 – Fund distribution across Italy



In terms of distribution architecture, Southern regions are characterised, albeit with some exceptions, by a more closed model, which, as we have seen, might be explained by the wider presence of private clients in the North.

Life Insurance Distribution

With more than €100 billion in premiums each year, the life insurance business has experienced a significant surge in the past, becoming one of the investments preferred by Italian savers.

Looking at the data on distribution, in Italy the largest share of premiums is collected by bank branches and post offices, followed by financial advisors and insurance agency networks.

This bank-centric distribution, also called *bank insurance model*, is not the prevailing model everywhere in the world. In Anglo-Saxon countries, like the United Kingdom or the United States, or in other European countries, like Germany, where insurance companies have traditionally had an established distribution channel, agents and brokers hold a much higher market share (*traditional insurance model*). The relevance of banks and financial advisors has characterised the Italian scenario for at least the last 15 years, though with differences across the years.

During the financial crisis, for example, banks lost a significant portion of their market share due to their urge to collect money from retail people through the placement of bonds rather than insurance policies. Yet, in more recent years, this channel has gained back its magnitude.

In fact, following the data published by Ania, the Italian Association of Insurance Companies, from 2012 to 2015 banks and post offices sharply increased their penetration in the insurance market, with a volume of written premiums that went from €33.8 billion in 2012 to €72.9 billion in 2013, that is the 63.4% of the entire market. In the same time-window, all the other channels have decreased their relative share, albeit growing in absolute terms, but at a slower rate than the average. Hence, during 2015, financial advisors were able to place 15.9% of the written premiums, whereas insurance agents had only 12.8% of the market; the remaining 7.8% was marketed through brokers and subsidiary agencies.

With regards to banks and financial advisors, the prevalent model, adopted by the biggest players, is highly integrated (*captive*), where the insurance company and the distributor belong to the same group or are strategic partners (i.e. UniCredit and its partner insurance company CNP UniCredit Vita). Further, the volume of policies distributed through captive agreements has remarkably increased over the years, accounting in 2015 for 61% of the premiums distributed.

Coming to insurance Classes, banks and post offices are leaders in both Class I (straight life) and Class III (linked). In particular, in 2015 banks significantly increased their offer of linked policies due to the higher profitability allowed by these products.

Nonetheless, financial advisors have traditionally played an important role with regards to unit-linked products and still these policies represent the largest part of their insurance offer.

In conclusion, the Italian distribution of life insurance, despite some essential peculiarities of these investment products, is not dissimilar to the distribution model of funds, with the predominance of bank branches exploiting captive relationship with the “manufacturer” companies.





The Italian
investors

3. The Italian investors

The usual overview of asset management industry is generally focused on the supply side, mostly because this market is more supply than demand-driven. To some extent, this is true for investors characterized by modest financial availabilities and less sophisticated financial education and needs. As a matter of fact, the AM market is highly polarized: the subscribers belonging to the richest 10% possess more than 50% of the total investment portfolio.

Yet, a complete picture of the Italian AM market should also include the demand side with an analysis of the needs and the peculiarities of Italian customers, especially in a moment when the Italian offer competes with foreign operators which can provide quality products with better support services. Italian operators will therefore need to understand better their customer base and the drivers of their investment decisions, in order to improve not only the development of new products, but also client-operator relations.

In the following part, the reader will gain insight on the specific savings characteristics of Italian households: how much Italians are willing to save? How does this impact the industry? What are the drivers of their investment decisions and what does the typical investor look for? What segments should be targeted and what is the future evolution of the customers of the AM industry in Italy?

The Italian savers

The first aspect to be analysed is the attitude of Italian households towards saving.

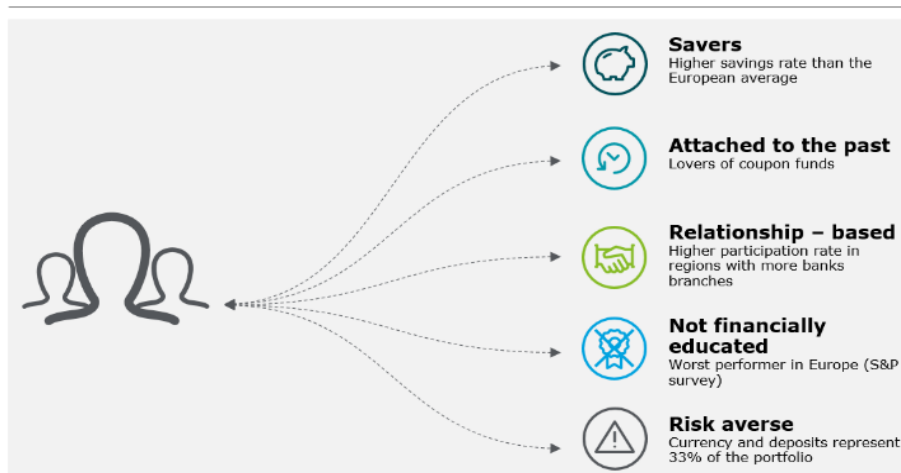
In recent years, the Italian savings rate has become higher than the European average: Italians are great savers and have low debt exposures, which makes the market very attractive for the players, who need to study the particularities of the demand to convert savings into managed investments.

Yet, the consequences of the financial crisis are still a reality in the Italian scenario, and the savings rate, equal to around 10% at the end of 2015, remains far behind the much higher historical level.

Despite saving a significant share of their earning, Italian customers, on average, are not characterised by high levels of disposable income. A study undertaken by Ipsos Public Affairs (2015) reveals that only 38% of Italians can easily support their life tenure.

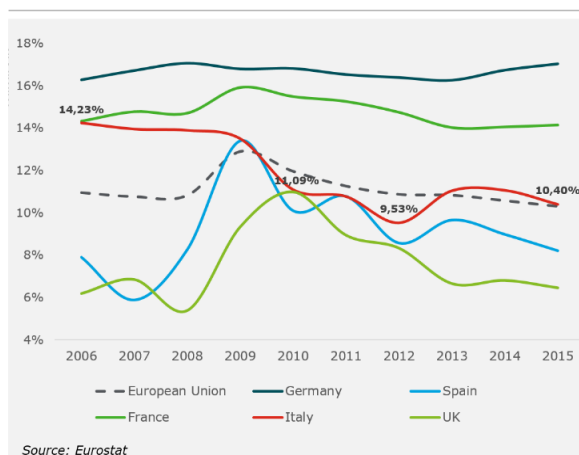
In addition, the research shows that while more Italians were able to actively save money in 2015, the percentage of people using their savings to accomplish consumption needs also increased thus creating a negative savings balance.

Figure 3.1 – The Italian investors



After describing the Italian saver, it is of crucial importance to dig deep into his specific investment needs and characteristics. The main topics that will be addressed in the following paragraphs concern financial education, relationship needs with the financial advisor and risk-aversion attitudes.

Figure 3.2 – European Savings Rate



Italians have a weak financial education

Italians' poor financial education can be well-described by a naive - yet very insightful - example. Usually, when households are to buy tangible goods, say a fridge or a washing machine, it takes hours for them to decide between two similar appliances for a 10€ difference, whereas when they must decide about the future of their savings, they entrust their capital to the bank employee without questioning whether they are making the best thing, with consequences that could go far beyond a mere 10€ note.

In order to look at this specific aspect, we considered the S&P Global Financial Literacy Survey, which analyses the financial education levels in different countries around the world. Asking people about the definition of four basic financial words, the survey highlights that only a few countries have adequate levels of financial education (a person was deemed educated if she was able to answer correctly at least three out of the four questions). Italy, in particular, was the worst performer among G7 countries.

Moreover, Italy was to some extent more similar to developing than to advanced

countries. For example, when considering the results grouped by the age of the respondent, the highest scores are achieved by middle-aged people in all developed countries but in Italy, where the youngest are the best performers, similarly to what happens in emerging countries. In addition, if we cluster the respondents on a regional basis, another study shows that some Italian regions score worse than Colombia considering financial education among the youngest slice of the population. Another important difference between Italy and Europe regards gender diversity. Usually there is a 5% difference in financial awareness between men and women, whereas this difference in Italy rises up to 15% putting Italy in one of the top positions.

Nevertheless, the recent crises had a somehow positive impact on financial literacy: the adverse outcome suffered by Italian investors triggered them to increase their financial awareness by learning from the shocks. Now, Italian savers are more willing to learn, also because of the great amount of available data and information. Sometimes, though, this overload of data might damage the relationship between demand and offer, because of the well-known problem of information asymmetry. Hence, since about one third of Italians are unsure about whether to invest or not in the next year, a possible solution to push them towards the AM industry is improving the quality of available information.

These pieces of evidence are of paramount importance because they represent a real opportunity for the AM industry.

It has come the moment to turn the potential market into a real one by making savers aware of the services they could benefit from. For this reason, a number of asset managers have recently introduced personal financial advice sections on their websites, featuring written guidance or videos that cover a wide variety of individual financial considerations for different life stage events.

There are at least three main areas where these educational programmes could be put in place: schools, workplaces and communities.

Successful real examples are videos on YouTube that address the issues raised by the S&P survey for different age clusters and geographies; online games that simulate financial situations or financial museums, like the “Museo del Risparmio” of Turin.

Personal relationships are still important

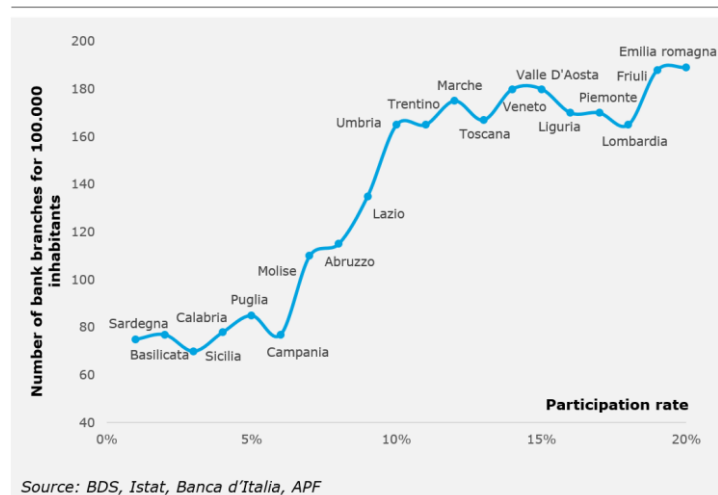
The interrelation needs of Italians are another essential aspect to be considered. This behavioural factor is well acknowledged by financial experts and advisors, who are accustomed to having a personal relationship with all their customers, especially when the market trends are negative and there is uncertainty about future returns. Financial intermediaries know that the Italian customer needs to rely upon an expert and trusted person.

The higher the amount of wealth and the lower the level of education, the more investors rely on informal advice.

To support this qualitative evidence, a recent study by Assogestioni and BDS, Banca Dati sui Sottoscrittori (which gathers data on investors holding shares of domestic funds), has shown that there is a positive relationship between the number of bank branches/financial promoters and the participation rate of the population in domestic funds, suggesting that the demand is actually driven by the offer, as we stated before.

Where there is a closer relationship with the financial promoter, savers have more developed attitudes towards investments.

Figure 3.3 – Participation rate vs. Bank Branches



If we consider how the investment decision is made, there are two different types of customers: the ones relying on informal advice and the ones seeking for formal consultation. The report on financial investments of Italian households issued by CONSOB provides an interesting insight on the matter: 24% of the interviewed decides independently, 38% follows families' and colleagues' advice (the so-called *informal advice*), 28% asks a professional and only 10% delegates the decision to an expert. The higher the amount of wealth and the lower the level of education, the more investors rely on informal advice. Moreover, people who invest independently are more sensible to the risk of loss of the initial investment. But, on the other hand, the general concern regarding the economic market trend is common to both types.

Italians are risk averse

Last but not least, risk aversion has been crucial in the most recent years, as many experts have underlined. **Customers do not seek for high returns anymore; they instead search for low risk investments with a medium/long term horizon.**

Such risk aversion derives from the fact that, even if Italy has experienced two years of growing GDP, the recovery was slower than expected: more than a quarter of households are still suffering from the economic downturn, directly or indirectly (Ipsos Public Affairs, 2015). Hence, on average, Italians are better off than 2-3 years ago, but pessimism about the future still worries them.

From a research of People Lab, the Ubi Pramerica observatory on Italian investors, what worries most the population is corruption, not terrorism nor any other international emergency, differently from what happens in other European countries. **Corruption, public debt and unemployment are the most alarming topics for the Italian families.**

Why do national events tend to overwhelm international issues?

On top of affecting people directly, this is due to the fact that Italian investors have traditionally relied on financial instruments strictly connected to the Italian economy, such as the popular-in-the-past Italian government

bonds. In addition, the market long-term trend is shaped by the economy and the national business environment, rather than by exogenous factors, which determine short-term deviances but do not affect trends. As a matter of fact, the two biggest market collapses were triggered by the burst of the dot-com and the real estate bubbles, not by terror events which, albeit having a psychological impact on the investors, brought only short-term fluctuations.

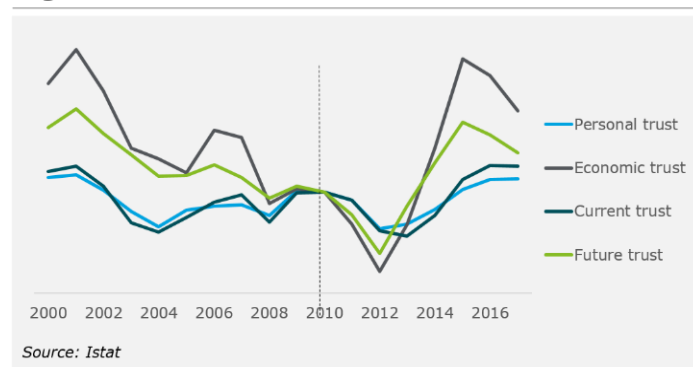
Therefore, as we can derive from figure 3.4, Italian families are more positive about the future outlook of the economy, but are still concerned. Moreover, there is negative news for the AM industry: this positive attitude about the future fades partially for Baby Boomers, the main target of the industry.

They are less enthusiastic about what-comes-next and less ready to bet on the future.

The expectations towards 2017 are characterised by substantial stability, while the savings and investment forecasts are limited.

The best target from this point of view are young and financially educated men.

Figure 3.4 – Consumers trust attitude



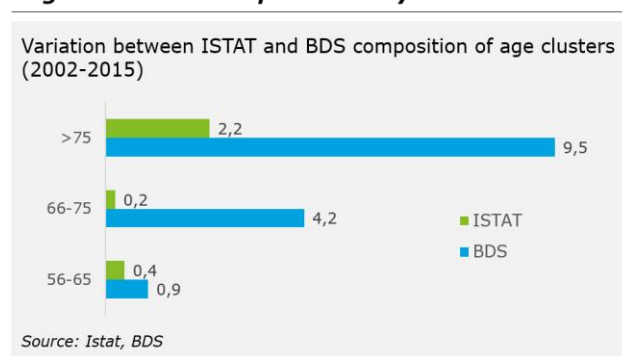
The aforementioned considerations highlight that the AM industry has a real chance to guide the evolution of the market towards a more customer-oriented value proposition, that will ultimately be beneficial for the business itself.

Baby Boomers in Italy

Baby Boomers represent the demographic group born during the post World War II, approximately between the years 1946 and 1964. This includes people who are between 53 and 71 years old in 2017.

Baby Boomers are particularly relevant for the industry: the number of subscribers of Italian funds grows faster than the number of residents for the oldest age group, i.e. the ones belonging to the Baby Boomers generation (Figure 3.5).

Figure 3.5 – The impact of Baby Boomers



The data evidence even more the importance of this age group. **The Italian senior savers belonging to Baby Boomers represent 37% of the Italian population but 60% of the clients of the Asset Management industry in Italy, owning 63% of the AuM.** Furthermore, from 2002 to 2016, the average age of investors increased from 51 to 58 years. Not only they are relevant for the share of assets that they hold, but they are also going to live longer: nowadays, life expectancy for a person aged 65 is 83.6, whereas in 2050 it is expected to increase to 86.1.

So, what are the differences in needs and attitudes between this age group and the others? The Research Institute Demia, for Assogestioni, interviewed senior savers in 2016 in order to answer this question. Most of the interviewed see savings and investments as highly correlated: they mostly save to be protected from unexpected events and to finance their retirement period (curiously, this is a more important aspect for the 45 to 55 age group rather than for those closer to the pension age). On average, seniors have a short-term investment horizon: 1 out of

4 expects to have a return within one year from the investment; while the overall average is 3.8 years.

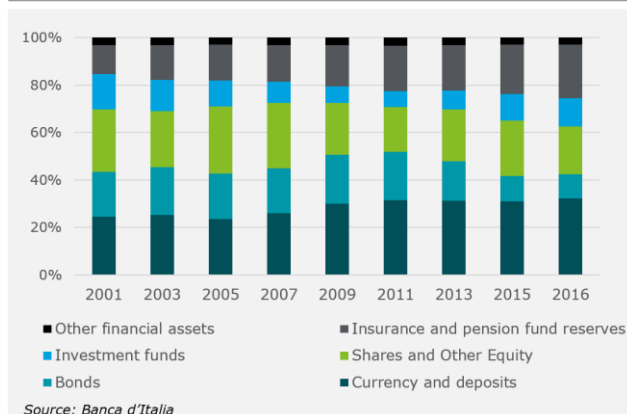
When analysing their opinion on the asset management market, seniors are conscious that products have changed over time and that the market is committed to increase transparency and easiness; but nevertheless **82% of seniors think that the market is still too complex.** They are also aware of the low degree of financial literacy. On a scale from 1 to 10, the average grade they assign to the financial competencies of their network of friends and relatives is 5. As pointed out by the experts in the sector, seniors need a stronger contact with the financial advisor and 75% of them agrees on the necessity of an educational program to enhance their investment experience.

Baby Boomers are entering retirement, bringing with them an average level of assets considerably higher than that of their parents' generation. Therefore, this generation cluster is particularly relevant for the AM industry: the subsequent question regards what-comes-next. In fact, the next generation has not fared as well. For example, median household net worth for young to middle-aged members of Generation X (the demographic cohort following the Baby Boomers) has declined significantly relative to that for households of a similar age 25 years before. Even if the importance of this category of customers is high, experts in the sector suggested that asset managers are less worried about this generational shift. The Generation X is often already investing and has similar needs to the previous one, while the Generation Y, which comes after Generation X, is still very young and will become an actual stakeholder of the market in 20 years, when their needs will be probably very different from the current ones. Therefore, even if consciousness is fundamental, it is still a long-term problem for the industry.

Household financial portfolio

All of the aforementioned factors (savings attitude, risk aversion and relationship needs) impacted the investment decisions of Italian households.

Figure 3.6 – Breakdown of household financial wealth by type of asset



Risk averse in a world of low interest rates, households have so far leaned towards liquid products and insurance policies. As a matter of fact, in 2016, one-third of household's portfolio was represented by cash and deposits.

The sharp increase registered between 2006 (23,6%) and 2010 (30,7%) continued until 2016. Nevertheless, the Italian average in cash and deposits is in line with the European trend, even if much higher than the one of France and UK.

On the other side, we have the opposite trend for equity products: from 2006 to 2016, households reduced their investments in equity by 37%. Following the low interest rates of the last 5 years, also bonds, which the Italian investors were very used to, faced a sharp decline. **Nonetheless, Italian preferences still stick to the past. In fact, the popularity of funds characterised by coupon detachments is high, a remnant of Italian treasury bonds that have been very remunerative in the past.** Financial experts see this devotion to the past as typical of the Italian tradition and culture, whereas change is seen as dangerous and risky. Even if from an accounting perspective coupon funds might be less lucrative in case of wide market fluctuations (you might pay taxes on the monthly gains even if at the end the returns are negative), Italians appreciate them and accordingly increase their demand.

While the share of investment funds held in Italian portfolios is still lower than before the financial crisis, in recent years they have experienced a sharp recovery and today they

represent 12% of Italian households' financial wealth.

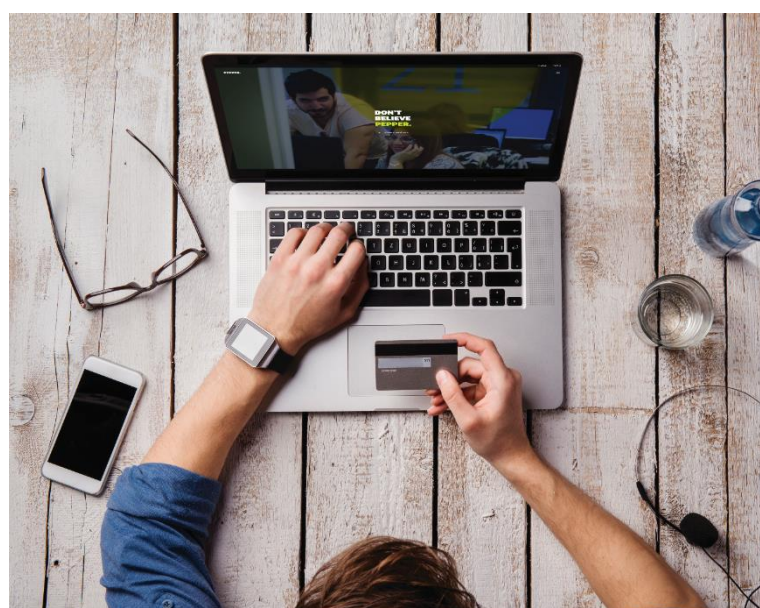
As confirmed by the aforementioned analysis, the Italian market is subject to macroeconomic environment reversals, with a volatile investment composition. During the crisis, Italian took shelter under the insurance and pension funds products, that represent almost $\frac{1}{4}$ of the total portfolio and are expected to grow even more in the following years, as confirmed by experts in the sector.

The Italian market is subject to macroeconomic environment reversals, with a volatile investment composition.

Conclusion

The recent evolution of Italian customer needs to be looked from two points of view: economic capacities and behavioral attitudes.

The potential demand increased, thanks to the wealthier customer base, that saves more and therefore seeks for investment opportunities. On the behavioral side, what emerges is a very risk-averse customer with a medium/long term outlook. Understanding their needs is fundamental in order to improve the key drivers of customer satisfaction: strong support and service, financial education and low risks.





Regulatory
challenges ahead

4. Regulatory Challenges ahead



The years following the financial crisis have been characterized by a long series of regulatory provisions which have challenged the incumbents' ability to adapt to more and more stringent rules. In addition to the measures aiming to create financial stability, legislators have felt the urge to address the competitiveness and fairness of markets.

There have been indeed several provisions on these matters, some examples of which are the following: rules regulating UCITs, first adopted in the 90s and then improved multiple times, lastly with UCITs V; RDR (Retail Distribution Review) limited to the UK and PRIIPs (Packaged Retail Investment and Insurance Products) published in 2014.

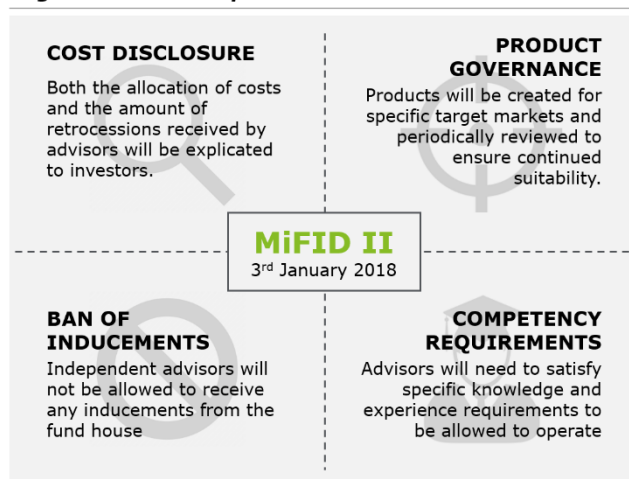
These directives address different markets and products, but there is one thing that ties them all together: the aim to protect investors through a much more transparent, safe and fair system.

The most ambitious regulatory plan, however, will be implemented starting from next year and will replace the current Market in Financial Instruments Directive, MiFID I. Given the broad scope of the new Directive, its implementation has been a long process, originating in 2011 and being characterized by numerous adjustments that have kept the industry eagerly waiting for the final version.

To highlight the wide extension of MiFID II, while UCITs and AIFM were only indirectly affected by MiFID I, MiFID II will now apply directly to UCITs managers and EU AIFMs, who manage separate discretionary accounts.

The following points are the key aspects of MiFID II, which will affect the investment management industry and investors in a more significant way.

Figure 4.1 – The impact of MiFID II



Italians are very peculiar, as they can dispose of a considerable amount of financial resources but show a poor level of financial education.

Price transparency

Price transparency will be absolutely imperative in the post-MiFID II environment.

Ideally, after the implementation of the Directive, customers will be perfectly aware of the nature of the fees they will incur for their investment. In fact, a picture of the entire cost structure of investments will be available to them and will also include inducements received by distributors; a crucial point, considering that most investors despite being aware of the mechanism of retrocessions are currently not able to quantify them.

Everybody agrees that cost transparency is a fundamental right of all investors. Yet, players in the industry seem a little concerned about this requirement. A possible explanation is that the asset management sector has been experiencing extremely high returns in the years also due to investors' illiteracy on cost allocation. Italians are very peculiar, as they can dispose of a considerable amount of financial resources but show a poor level of financial education.

These characteristics have generally guaranteed higher margins in the Italian asset management industry compared to the rest of Europe. Now investors are gaining a greater understanding, making the issue of justifying the costs of paramount importance. What worries industry representatives is that greater transparency could undermine their margins, since they could be considered too high.

This is expected to have a significant impact on the industry. The quality - real or perceived - of the advisory service will likely increase in order to justify the premium charged to investors. Greater quality will not necessarily translate into higher returns, but it will more likely mean tighter relations between clients and advisors, who will be required to devote more time to their customer, providing them with a tailored service. More time and resources will be needed, hence calling for greater productivity. In this context, it is easy to understand the potential role of tech innovations to streamline and automate standard processes.

Product Governance

Another crucial point concerns the relationship between manufacturers and distributors, which will require more frequent contacts between the two parties and larger exchanges of information. For the first time manufacturers will be obliged to clearly identify a target market for their products and then provide distributors with detailed information about it. Distributors, in turn, will have to identify target markets themselves in a more detailed way, while keeping in mind the recommendations provided by the manufacturers.

Furthermore, both parties will constantly need to exchange information in order to ensure that products still suit the identified markets, which will require constant communication also between distributors and the final client.

This provision casts a shadow on smaller firms; the continuous exchange of information will indeed yield high costs for both distributors and manufacturers. **Faced with tighter margins, many will find it more convenient to deal with a reduced number of counterparts,** therefore cutting on minor providers.

A study by Quinlan & Associates predicts a decline of 25-30 percent in global research expenditures by 2020.

Investment research

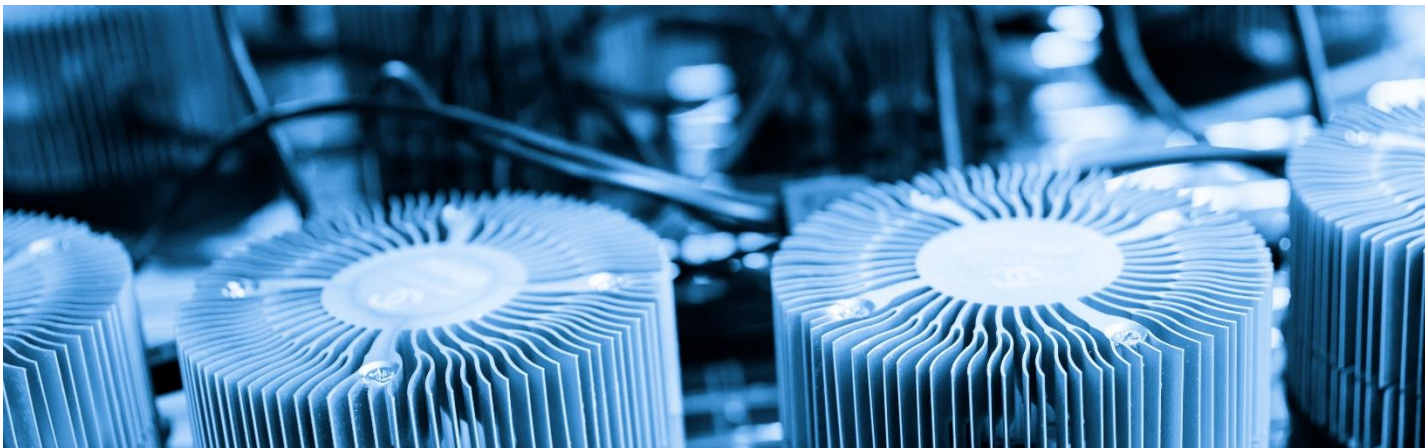
Under current provisions, European investment managers can pay for investment researches from brokers by charging fees directly out of clients' portfolios. This will not be allowed anymore, thus investment management firms will have to choose between (i) paying for researches out of their P&L, (ii) instituting a research division themselves and, expected for smaller firms, (iii) agreeing on a designated research budget with the client.

This is an extremely worrisome measure for incumbents since a large share of commissions paid by investors worldwide comes from research. While some big fund managers will probably absorb those costs themselves, some will keep charging them to customers who will have to be appropriately informed.

Since the requirements are the same regardless of the firm's size, smaller players will clearly suffer the most due to their limited resources available to internalize research.

Smaller firms not only will suffer from the burden of high research expenditures, they will also likely find it more difficult to find a broker to serve them. Employers at numerous brokerage houses reported that asset managers were offering more limited budgets for research. A study by Quinlan & Associates predicts a decline of 25-30 percent in global research expenditures by 2020.

The more limited payments for research could push brokers to serve only larger businesses, creating a further challenge to small scale firms.



Knowledge and Competency

With the aim of protecting investors, competency requirements for financial advisors will have to be fulfilled by January 2018. The Directive provides that operators will have to satisfy two types of requirements: they will have to hold eligible qualifications as well as demonstrate an adequate experience in the field to be able to exercise investment advisory services. **On this point, Italian industry representatives do not seem to be concerned as they believe that the model already in place is compliant with the Directive.** Indeed, Italy could be taken as an example by other European countries for its *financial advisor register*, which, according to the European Security and Market Authority, guarantees a qualification in line with the Directive. However, this is different for bank tellers: many of them do not meet any of the MiFID II requirements.

For this reason, financial institutions will have to quickly find a way to fill the gap and make their advisors compliant. There are around 200,000 bank tellers in Italy; most of them shall obtain certification by the enactment of the Directive in order to be allowed to operate.

Independent vs. non-independent

MiFID II sets a clear distinction between independent and non-independent advisors and allows only the latter to receive inducements from the manufacturer for the products offered. Indeed, advisors who will decide to be classified as independent will not be allowed to receive any type of monetary or non-monetary payment by product manufacturers, with the exception of some "minor non-monetary compensation" described by the Directive.

To be classified as independent, advisors will have to satisfy a series of specific requirements such as the obligation to offer a handful of financial instruments (by type, manufacturer or issuer) and to consider all the relevant aspects when comparing products, ensuring an unbiased selection of instruments and recommendations.

Different scenarios could emerge in the coming years on this matter.

Most likely, the majority of advisors will simply take the non-independent pathway in order to avoid the negative consequences of the ban, thus continuing to offer their current range of products. Although it will probably be a minor phenomenon, since we do not predict a shift away from the current model, some new opportunities of independent advisory could still arise for a specific segment of investors willing to pay directly for advice. However, the size of this segment will represent only a minor stake in the market.

Even though the United Kingdom has different features if compared to the Italian market, it is still relevant to look at the consequences brought by their passage from a commission-based system to a completely fee-based model, under the much-debated British regulation RDR. Given the tighter margins that the industry faced following the directive, providers decided to serve only clients investing an amount of assets above a certain level, therefore leaving a significant part of the population unable to access any professional advisory service (*advisory gap*). Keeping this in mind, the idea of maintaining the current non-independent model does not seem to bring any negative consequence to investors that could still gain by having more options in a more transparent setting.

In the case of Italy, where the figure of the independent advisor is still uncommon, it seems to be hard to change the remuneration model of the distribution network. Leaders and experts interviewed by our team have proven to be very confident about the Italian case.

In particular, most of them believe that no revolutionary changes on this matter will be brought by MiFID II apart from an infusion of trust in the market. They often stress the fact that the quality of advisory, not the remuneration model in place, will be the key determinant for a company to achieve success

Complex vs. non-complex

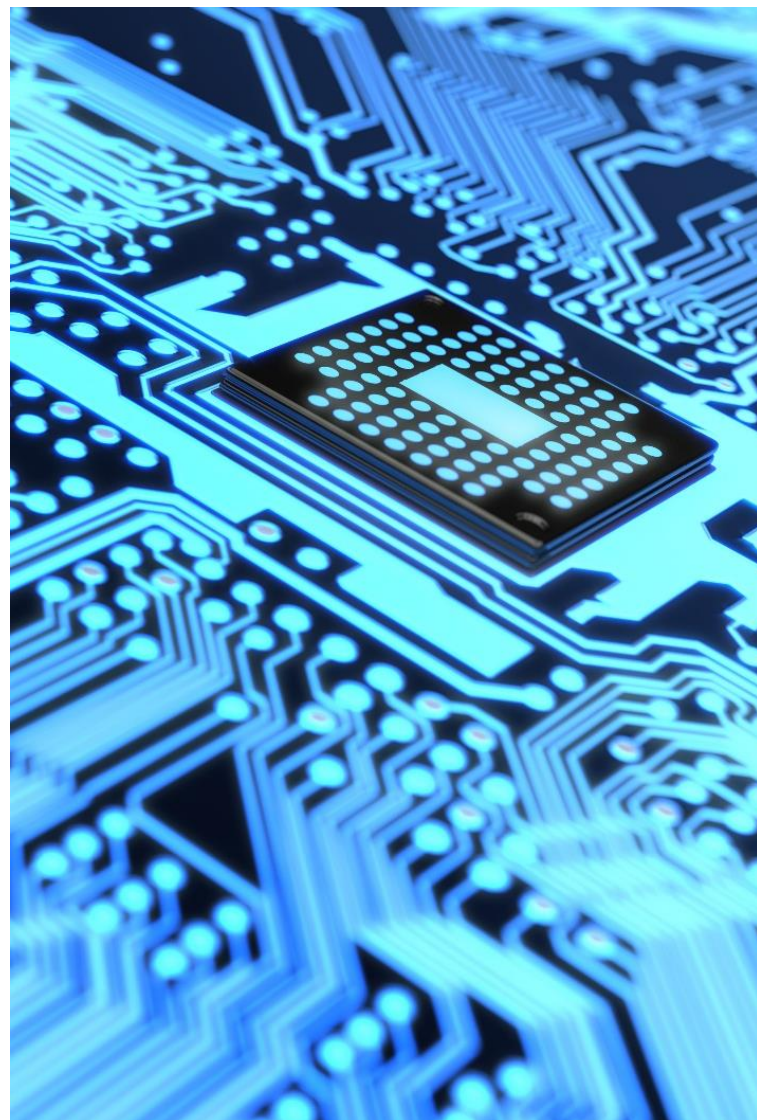
Investors will still be allowed to invest by themselves. However, this option will exclusively be allowed with non-complex products. This is because the most sophisticated instruments are considered too risky for retail and professional clients. As a matter of fact, some UCITs and all AIFs have been labeled as *complex*. As a consequence, retail clients willing to allocate savings to these products must first seek professional advice and accept the cost that this might entail. This could cause a decline in popularity of complex products at least among investors who are accustomed to self-investing.

Conclusion

Ultimately, there is still much to be defined since we are waiting to see how the Directive will be transposed into national law. Given the current frame, two trends have emerged. Firstly, we will see a more concentrated industry across Europe, with big firms increasing their share and smaller companies being driven out from the market. Secondly, being able to meet investors' needs effectively will be the determinant for the success. Customers will have better tools at their disposal to assess the operators' performance and the actual value created.

As many industry representatives keep remarking, regulation has raised the bar.

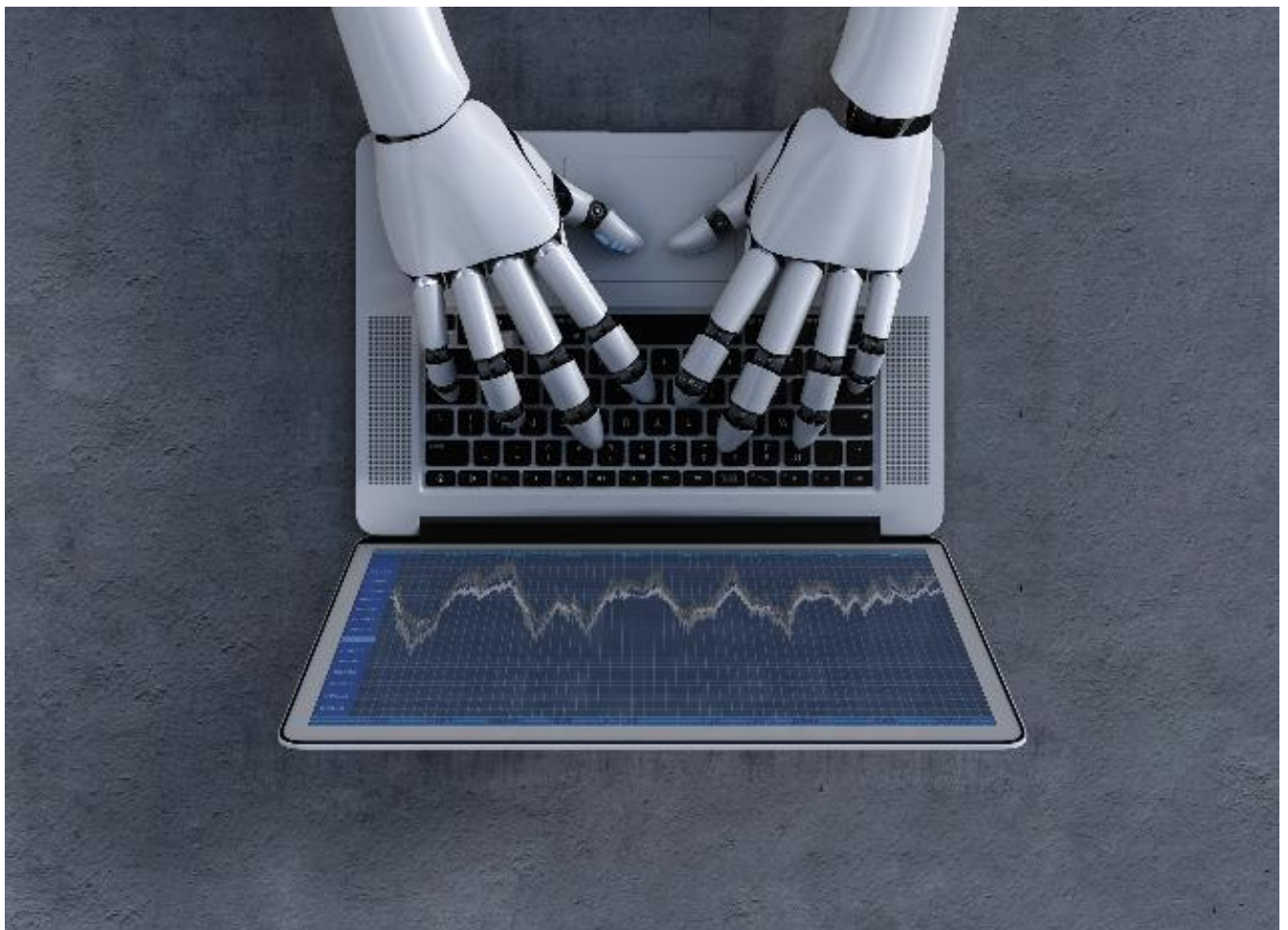
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Digital (r)evolution in Asset Management and Fund Distribution

5. Digital (r)evolution in Asset Management and Fund Distribution



IT technologies are now strongly impacting the asset management industry; we are experiencing a turmoil for incumbents and new opportunities for unconventional players; xxxTech is the prevailing word across innovative companies. What is this upheaval made of?

What are the implications for asset managers and distributors? What are the features that will allow companies to survive this revolution? In this section, we deal with the most relevant technologies and their applications which asset managers should be aware of, namely RegTech, robo-advisory, artificial intelligence, social media and Blockchain.

RegTech: the opportunity brought by compliance

What is RegTech?

RegTech, acronym for Regulatory Technology, stands out as a state-of-the-art opportunity in the financial service industry, allowing a new way to address regulatory challenges through innovative technology. RegTech is the answer to the big wave of legislative innovations which address the issue of the increased reliance on customer data especially among the new FinTechs. The rules on data privacy usage are becoming more demanding and stricter. In addition, when these rules are amended, companies who use traditional methods must go through long and costly upgrades of their in-house software. As a direct consequence, asset management operators - but not only them - recognize that one of their short-term goals is automating back-office processes, as regulatory compliance is a complex and time-consuming practice for their business.

How does it work?

Regtech operates in various spheres of the financial and regulatory worlds. Examples of everyday activities that RegTech automates include employee surveillance, compliance data management, fraud prevention, and audit trail capabilities. RegTech often relies on automation and information management technologies, delivered as Software-as-a-Service (SaaS) or on a cloud-based model, which decrease fixed costs of infrastructure requirements and increase effectiveness of client data vetting.

The rise of technology-led frauds and hacks can be widely reduced with big data analysis and machine learning, which represent more efficient ways for banks and other intermediaries to reduce risks of illegal activities. By using automation, this technology can be more accurate than any compliance team, which will be able to focus on more complex operations. Being able to identify those potential threats earlier will also allow financial security to minimize risks.

As an example, a financial institution can use predictive analytics to combine current data analysis with information from previous

regulatory failures to predict potential risk areas where the institution can focus its attention on. **Banks that actively exploit RegTech can drastically decrease compliance costs and increase efficiency.**

Besides providing significant support to innovative companies, the adoption of RegTech solutions will constitute an important instrument for regulatory authorities because it will streamline and simplify the regular checks on the implementation process. The diffusion of RegTech will facilitate the exchange of information between regulated companies and regulators and by virtue of its flexible solutions it will provide regulators only with the most relevant information needed to verify compliance.

What are the implications for AM?

Industry agents pointed at many possible evolutions of RegTech solutions, where the most relevant for the asset management industry regard big data analytics, inbuilt compliance and risk and compliance monitoring.

Analyzing large amount of unstructured data has already been a necessity in the last few years and it will continue to be of paramount relevance also in the future.



Nowadays, one of the leading issues of compliance is the enormous amount of data available to operators in different formats and from various sources which makes it challenging to identify tangible information. RegTech is deemed to be a great opportunity on this matter as it could provide solutions able to analyze and classify large amounts of structured and unstructured data and store them in so called “data lakes”.

Inbuilt compliance refers to the codification of regulatory requirements into automated rules to be applied when relevant. A technology that could automatically apply the regulatory program code would make compliance much easier thereby reducing staff costs. Going even further, inbuilt compliance systems of artificial intelligence could be developed to automatically reassess and improve processes in reaction to input from users, eventually replacing the most complex and high-volume regulatory tasks.

Monitoring risk and compliance has become fundamental for firms in the past few years. RegTech could provide important solutions to improve efficiency on this matter as well. Through correlating multiple sources of information and using powerful calculation engines it could indeed help identify in real time risk and/or fraud. As for all other RegTech implementations, this would definitely contribute in cutting costs and time currently spent in monitoring risk and compliance in a world of ever more complex and far reaching financial regulations.

Recognizing the impact of RegTech on the asset management industry, the UK Financial Conduct Authority (FCA) and the Hong Kong Monetary Authority and Securities and Futures Commission (SFC) have issued guidelines to support financial intermediaries benefiting from such cloud technologies.

Also, SFC has announced plans for a pilot project with 20 banks to monitor and detect systemic risk using RegTech.

RegTech represents, fundamentally, the opportunity for the AM industry to take a holistic approach to compliance management.

RegTech can provide not only more elasticity by processing multiple reports at once, but also more rapidly. This will help firms reduce back-office and focus on internal practices, business development and risk mitigation.

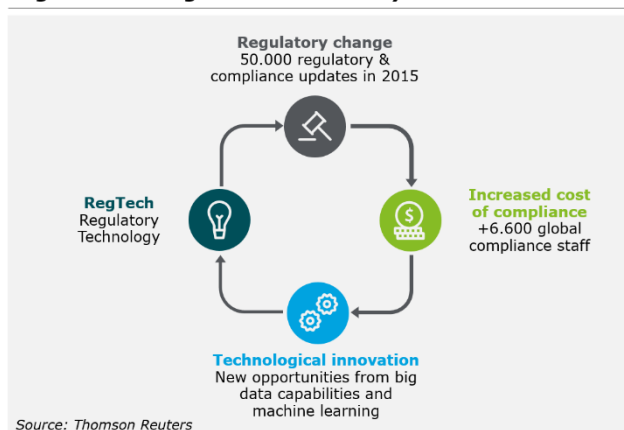
Nevertheless, some professionals are still uncertain about the exact course of action needed for the integration between regulation and technology: as a matter of fact the allocated budget to RegTech solutions varies among different institutions. From a survey conducted by Thomson Reuters, while ¼ of the interviewed lacked a budget for this new opportunity, ⅓ reported their willingness to invest even more.

Industry trends

A fundamental undertaking for any future development of RegTech solutions is the involvement of regulatory authorities in the process. Regulators need to define their expectations and potentially create a system of certifications which would increase RegTech programs’ credibility. Also more reluctant firms would start implementing and investing in these new tools.

RegTech represents also a great opportunity for new FinTech start-ups, since barriers to entry in this business are quite low. Up to now the offer spectrum consists of around 100 startups, many of which have made their debut in the past five years in UK, Ireland and US.

Figure 5.1 – RegTech is on the way



The Irish Silverfinch, led by a FS veteran, represents a successful case of a RegTech startup offering services specifically tailored for the asset management industry. Originally created to help with Solvency II compliance, the platform now provides regulatory reporting support for all the main regulations, among which PRIIPs and MIFID II dominate.

In the context of Solvency II, Silverfinch aimed at creating a bridge between asset managers and insurers through a single data platform.

The platform provides a unique site to collect portfolio data that will be later standardized in order to respond to numerous client demands in an efficient, cost effective and safe way.

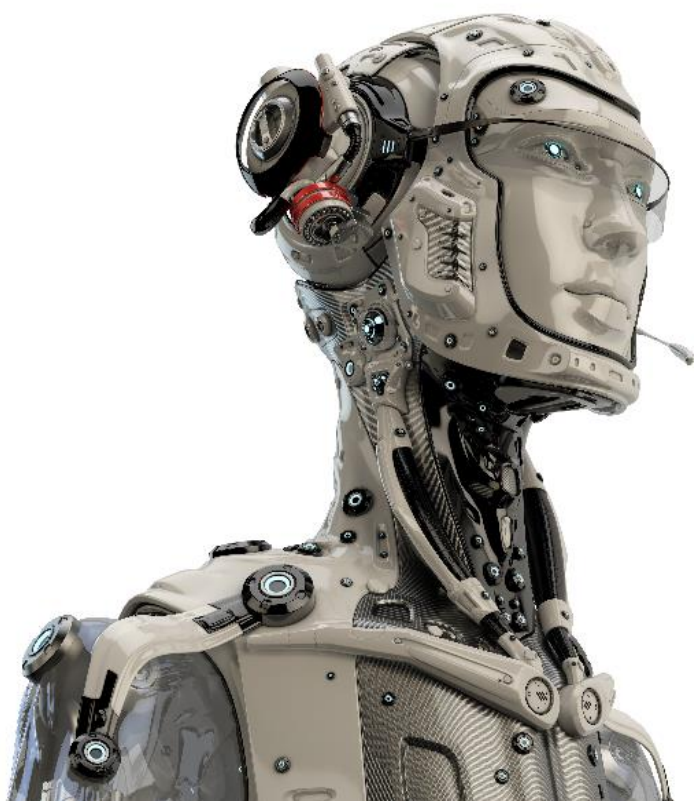
On the side of insurers, Silverfinch provides a simple, trustworthy and low cost mechanism to organise data in the way they need it to satisfy reporting and risk management. For what concerns MiFID II, the three main areas that will be addressed by Silverfinch are product governance, costs and Know-Your-Distributor.

Silverfinch mainly addresses the challenges of data exchange between different market players, which is the most relevant link among the three aforementioned areas. Indeed, without a system to serve as an intermediate for data exchange, such complex procedures will bring in further inefficiencies in an area already filled with complexity and scalability challenges.

Conclusion

RegTech solutions represent on one side a way to exploit new technological improvements for compliance operations and, on the other, a new opportunity for business development. By using RegTech, AM operators can not only economize time and costs, hence leaving managers with more room to focus on the core business but also make data exploitable for other business purposes thanks to advanced analytics and data mining tools.

Silverfinch mainly addresses the challenges of data exchange between different market players, which is the most relevant link among the three aforementioned areas.



Robo-advisory: is there enough room in Italy?

Introduction

Nowadays, investors do not simply want to invest their money. They increasingly opt for goal-based saving plans, linked to their life projects, such as money for children's university or a safety net for emergencies. In addition, **today's investors tend to be more demanding: they require having access to their portfolios whenever, wherever and however.**

Providing a multichannel approach is a key selling point both for banks and asset managers and, in this direction, one of the foremost cutting-edge technologies is robo-advisory. On the one hand, new robo-advisory companies constitute an effective access point to professional investment services for the mass affluent audience. At the same time, robo-advisors, in the guise of Robo4Advice, are an extremely valuable ally for traditional players to enhance customer relationship management.

Although still limited to certain aspects of the value chain, robo-advisory shows shy but positive growth trends. According to Morgan Stanley, it is expected to reach as much as \$6.5 trillion in AuM in the next 15-20 years worldwide. In Europe, the industry is still at the dawn. However, it may open noticeable untapped opportunities. Targeting mainly mass affluents, industry experts estimate the current addressable market at €3 trillion, around 10-15% of the total European AuM. As for today, the market is controlled by more than 60 players, of which around 20 are based in Germany. In Italy, the industry is less blooming, but it is catching up.

Overview

Robo-advisors allow companies to **streamline some of the most time consuming and mechanical operations**, making it easy for clients to invest or freeing up resources to financial advisors of HNWIIs.

At the present stage, the main services provided are:

- Client onboarding, through Know Your Client, Anti-Money Laundry and Compliance Checks
- Investment allocation among different asset classes
- Rebalancing of the weightings of portfolio assets.

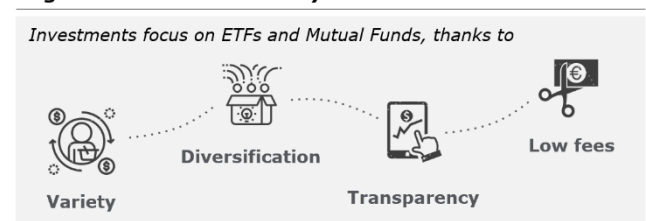
The investment process with robo-advisors works as follows. First, the software interacts with the clients to assess their investment goals and risk attitude through surveys. Then, the algorithm proposes an investment solution that matches the preferences of the clients. Accordingly, **different types of instruments are offered: stocks, bonds, indexes, ETFs and mutual funds.**

The last two are the most looked after products for a number of reasons: (i) access to a wide range of instruments; (ii) ease of diversification; (iii) high degree of transparency, because the products are listed; (iv) low management fees. In particular, with regards to this final aspect, technological platforms allow robo-advisors to offer lower fees than traditional wealth managers.

In Europe, robo-advisors' fees range between 50 and 100bps, while traditional players' fees are above 150bps. **In Italy, in particular, robo-advisors' fees are between 30 and 125bps, while traditional wealth managers ask for 150-200bps.**

Robo-advisor technology is very versatile and is able to bring contribution to the value chain of different segments of the Asset Management industry, namely mass-affluents and HNWIIs.

Figure 5.2 – Robo Advisory offer

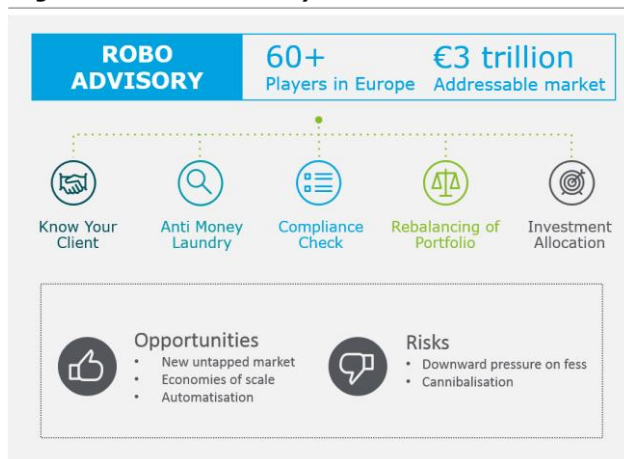


On the mass-affluent side, robo-advisors give access to professional asset management services to a larger plethora of individuals.

This objective is pursued by trying to reach consumers with *Direct-to-Consumer (D2C)* user-friendly platforms, which allow robo-advisors to streamline intermediate phases and hence to decrease costs and management fees.

On the wealth management side, little is expected to change. The service will likely be more of the kind of *Robo4Advice*, a service used by financial advisors as a tool to improve client relationship management. In the HNWIs segment, in fact, the side services (e.g. loans on unique collateral, trusts, set up of charitable funds, and "concierge" services, like notary, going to closings on behalf of clients, insurance paperwork) offered by financial advisors are a major driver of the demand and are hard or impossible to replicate by robo-advisors.

Figure 5.3 – Robo Advisory

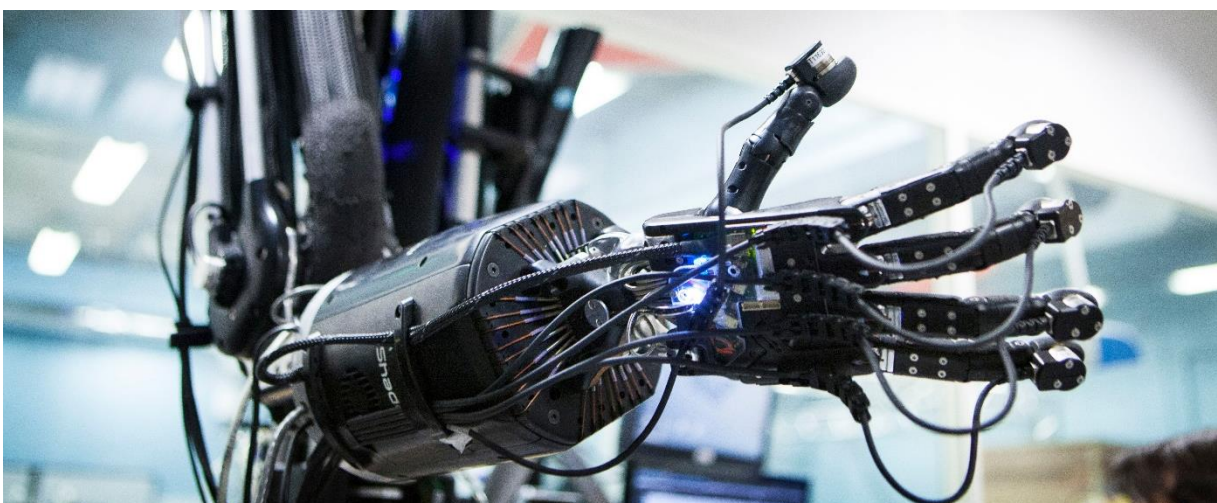


Where does Italy stand?

In Italy, wealth is more consolidated and originated from past activities rather than new entrepreneurial ventures. As a result, older individuals hold most of wealth and make most of the investment decisions, while young people still struggle to find jobs and save money for investments.

Assets managed by robo-advisors are only in the order of the hundreds of millions of euros. Even though still far from the development of US or UK players, in Italy some notable robo-advisor companies are rising. One of the most successful examples is MoneyFarm. Among the first to enter the market, MoneyFarm now represents the biggest independent player in the country and operates also in the UK. Incumbents are reacting in different ways to the innovation: for example, CheBanca!, in partnership with AdviseOnly, developed its in-house robo-advisor, Yellow Advice, directed mainly to mass-affluents.

The Italian market shows potentiality for the sector. According to our research, a substantial share of potential investors would like to use digital solutions to improve their performance. At the moment, the great majority of clients consists of individuals in their 40s-50s coming from the North. Millennials are still a minority, because older individuals hold most of the wealth.



Currently, apart from MoneyFarm, players operate mainly locally and they focus more on advisory solutions rather than on portfolio management services. Peculiarly to Italy, emphasis is more on client relationship than on practices like tax loss harvesting or auto-rebalancing, as in the US.

Two main models arise: on one hand pure robo-advisory platforms, on the other hand hybrid advisory model.

This latter model is believed will be more successful in the future: 71% of experts think the hybrid models will be a Blue Ocean, while only 10% of people in the field are so confident about pure robo-advisory models.

Robo-advisors of the first kind tend to offer mainly pre-packaged solutions, based on investment objectives and are usually in partnership with an execution platform. Those of the second type emphasise the human interaction - virtual or real. This is the case of YellowAdvice by CheBanca!. The robo-advice is assisted by human interaction, achieved through online instruments, such as video/web chat, file sharing, desktop sharing. However, clients may also choose to meet a CheBanca! advisor in a physical branch.

As in other countries, Italian robo-advisors target both mass affluent and HNWIs. As for the first category, competition is on price, but fees are generally 40bps higher than those offered by US players. Regarding HNWIs, robo-advisors are mainly Robo4Advice and assist private bankers in their activity.

Overall, in the near future, few changes are expected in the HNWIs segment and robo-advisors will more likely continue to be used as tools to enhance the relationship with clients. On the other hand, the mass-affluent market may be split between those who have a good financial and digital literacy - still a minority - who may opt for a D2C service, and those who have less financial and digital literacy - currently the majority - who may tend to more hybrid human assisted solutions.

More substantial changes might be expected in a wider time horizon with Millennials coming to obtain more control over wealth. Regarding the mass-affluent segment, these people might

end up preferring pure robo-advisors or D2C platforms.

In relation to Private Banking, Millennials will likely be more in the position to make decision about their family wealth and to be more at ease with more automatised digital services even in this now conservative segment.

Possible scenarios: incumbents, risks and opportunities

With the introduction of the innovation, both new robo-advisors companies and incumbents will potentially enjoy huge opportunities but will also face significant risks. Winners and losers are hard to spot at the moment, what is sure is that no one cannot stand by.

In continental Europe, the financial advice industry is dominated by banks, which have high pricing power and are less likely to be overthrown by FinTechs. Most traditional players in Europe and US have reacted to the phenomenon mainly in two ways: either by establishing strategic partnership with FinTech companies (like UBS and Santander with SigFig) or by developing their own technology in-house (like Deutsche Bank and Credit Suisse). It is reasonable to expect a similar trend of partnerships, acquisitions and in-house development of robo-advisory services as well in Italy.

Opportunities

The latest developments open a handful of opportunities for both asset managers and clients. Both new FinTech companies and traditional asset managers shall consider them in order not to lag behind.

In terms of revenues, **robo-advisors could help traditional asset managers to enter a new market.** This is the case, for example, of Schwab with its completely automated platform Schwab Intelligent Portfolios and Vanguard with its hybrid, human assisted Vanguard Personal Advisor Services.

It is likely that the new technology will **improve productivity, by making economies of scale easier to manage, and by automatising some operations**, such as "Know your Client", "Anti Money Laundry" compliance and reporting.

In Europe, some structural features could make the industry bloom in the near future.

On the regulatory side, the banning of inducement for independent advisors and discretionary portfolio managers by MIFID 2 will likely favour robo-advisory. Some societal changes could also benefit the industry: people are more and more comfortable with digital channels to make purchases, even though in Southern European countries, like Italy, they are a bit more resilient to innovation.

Risks

Traditional players might no longer be the masters of the universe of asset management.

Downward pressure on fees and cannibalisation are the big threats posed by robo-advisors, mostly in the retail segment. Those who deal mainly with high-end clients (such as UBS and Credit Suisse) face fewer risks of this kind.

Regarding fees, as part of the value chain is automatised, competition will increase, especially among retail investors, for whom low management costs are a foremost driver of demand. In fact, as it is currently happening, robo-advice favours portfolios of ETFs and mutual funds, which require lower management fees, at the detriment of traditional funds. As a result, all players may end up lowering the industry fees.

As traditional players adopt robo-advice services to reach retail customers, they increasingly face the risk of cannibalisation. This could be the case of Schwab, which has moved many clients to new online platforms, such as Schwab Intelligent Portfolios. According to people in the sector, cannibalising existing retail clients and making less money on the same assets is *short-term pain, long-term gain*. Since they do not require face-to-face interaction like HNWIs, automated channels for the mass affluent category will in fact ultimately help rationalise the firm's sales structure.

Conclusion

Robo-advisory represents a great opportunity, but it is too early to have a clear idea of what the industry will look like in the near future. Robo-advisory has still to find and define better solutions to the replacement of human interaction, rising concerns about data protection and privacy and scalability of the business model.

What is sure is that robo-advisory and FinTech innovations more in general have started a revolution in the dusty Asset Management business model. New ideas are putting into question every single aspect of the industry. Where all this boost of innovation will drive the industry is still unclear, both newborn FinTechs and incumbents shall watch out and take action in order to stay in the market. The game has just started.



Artificial Intelligence

Artificial intelligence (AI) encompasses a wide range of software which can be used to automatise certain processes of financial companies. It is hard to give a complete list of all the functions performed by AI, yet some of the most relevant are: **chatbots, virtual personal assistants and robo-advisors on the CRM side; machine learning, cognitive intelligence or collective intelligence on the operational side.**

Like IBM's Watson can support a flesh-and-blood pilot in flying passengers to their destinations, so Artificial Intelligence can side asset managers to achieve their investors' financial goals. Artificial Intelligence will hardly replace human beings, but will rather constitute a valuable supplement for financial advisors to enhance stock picking, asset allocation and risk management strategies, by analysing market complexity in a fast and precise way.

With industry newspapers' headlines like *Goldman Sachs wants to become the Google of Wall Street*, it is clear that AI is becoming a big thing in the financial system and that established players are taking concrete steps to take advantage of it. Asset managers and hedge funds are significantly investing in technology and data management, hiring computer scientists to build IT systems that perform better than human advisors. Acquisitions have also played a major role to bridge the gap of established players with the new technology, especially over the last three years: for example, financial analytics firm Kensho was acquired by Goldman Sachs, FutureAdvisor by BlackRock and AI advisory platform Jemstep by Invesco.

Each sector of the financial industry applies AI in different ways, either to improve internal management or to enhance customer relationship.

Some firms use natural language processing and graph processing software. It is the case of *Data Lake* by Goldman Sachs, a database built using APIs.

In this case, bytes of data on transactions, markets, and investment research, as well as insights from emails, voice calls, and instant messages are all conveyed to machine learning

software, which then makes the collection of data available and usable to internal and external users.

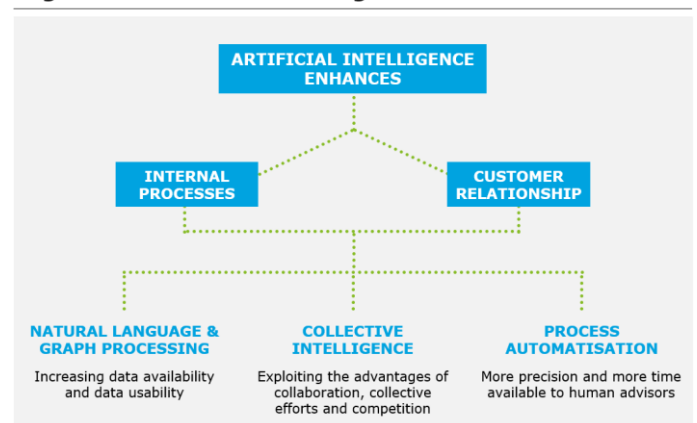
Some firms use AI to frame scenarios.

It is the case of Aladdin by Blackrock, which relies on Collective Intelligence emerging from collaboration, collective efforts and competition of many individuals. The system is meant to be used by investment managers that want to connect the information, people and technology needed to manage money in real time.

The platform gives access to a combination of risk analytics and portfolio management, trading and operations tools, which allow managers to make better decisions.

Other companies use AI to increase efficiency, automatising standardised side services. This is the case of JPMorgan's COIN. Based on Contract Intelligence, COIN employs machines to interpret commercial-loan agreements. To have an idea of the scale, **the job done in seconds by the new machines required around 360,000 hours of work each year by lawyers and loan officers.**

Figure 5.4 – Artificial Intelligence



The field is not dominated only by incumbents, but there is also room for innovative start-ups, like the Italian Euklid, an asset management fund which uses over thirty types of algorithms, like Adaptive Learning and Swarm Intelligence, to frame investment strategies.

The peculiarity of Euklid is that - along the lines of the Facebook motto - it wants to make asset management *free, and forever*, by adopting a zero management fees policy.

The possible benefits in terms of efficiency are unlimited. On the one hand, it is undeniable that AI may subtract some tasks from employees, on the other hand, by automatising certain process it frees human resources that could be employed differently.

Asset managers could, for example, consult more with clients and improve the overall quality of offered services and, eventually, the customer experience.

Given the recentness of Artificial Intelligence, it is hard to make exact predictions on the development and application of the new technology. However, most experts agree that AI will radically change the industry and that the current trend will grow exponentially in the next years. Who will be the protagonists and how they will reshape the industry are still unanswered questions that however find a lot interests both among asset managers and computer and data scientists.

Social media and New Players

When analysing the drivers of success in the asset management industry, besides the investment decisions taken by the fund manager and the ever-present luck, we should also look at communication: the way an asset manager diffuses the brand and values of his firm (or simply how he is able to communicate the results to his clients) can make a stark difference.

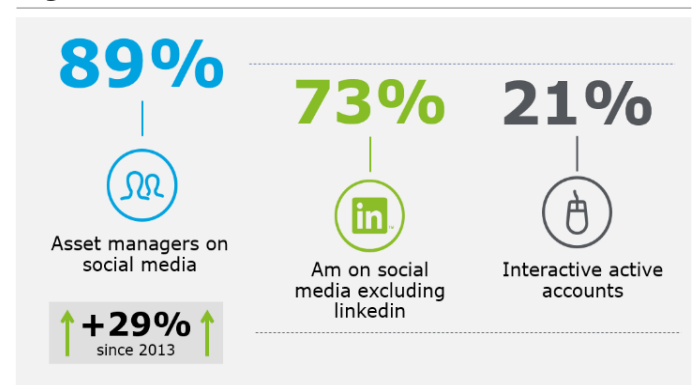
It is then easy to understand the importance of social media, the ever-growing channel of communication of our century, in this relational aspect in the asset manager's role.

Social media in Asset Management

Following a recent study, in 2016 the share of asset managers present on social media was 89%, share that falls to 73% when we exclude LinkedIn. To remark the increasing importance of this aspect, it is useful to note that this percentage went up from the 60% registered in 2013. However, the rise in the assets managers' activity on social media is still oriented to the standard usage of these means, i.e. Product/Market Information (44% of respondents) and Investor Education (34% of respondents).

The Asset Management industry has been quite conservative regarding the social media approach, considering that only 21% of active account dedicated to asset management are interactive, offering direct ways through which the public can communicate and interact with the asset manager, whereas the great majority prefer to use the account for a unilateral transmission of contents.

Figure 5.5 – AM and Social Media Involvement



In the Italian market, financial institutions use the social networks mainly to provide market information and commercial communication adopting the above mentioned unilateral approach.

Yet in Italy, the social network penetration has surprisingly proved to be impressive considering the cultural background of the country and the general skepticism of people towards technology.

The 2017 edition of the famous research "We Are Social", developed by the homonymous website, shows that 52% of Italians are active on social medias, with a remarkable growth of 11% from the previous year.

Figure 5.6 – Social Media in Italy



These figures highlight the potential impact on customer relationship that social networks could have if asset managers and distributors were able to exploit them. The time spent on average by users (more than 2 hours per day), together with the confidence that these channels seem to inspire on the average Italian user, gives us an insight on the importance that social media have in the Italian modern society.

Thus, social media will no longer be only an additional channel that corporations can use to communicate but they will also represent a pool that might provide significant information. In particular, in the Italian context, social media is considered one of the preferred means to discover opinions, products and companies, not only among millennials. As a consequence, mining social channels, along with the use of sophisticated analytical tools, could represent a valuable tool for asset managers, which would be able to change their product development strategies listening to the continuously changing customers' needs.

Where we are today

These technologies are already a reality: while relatively small at this stage, there are a number of emerging models leveraging a combination of technology, data, social networks and communities to bring fresh propositions to the market

which play to the evolving megatrends and could have the potential to cause some waves in the industry. Dataminr, for example, is a real-time social media analytics company able to pick up more than 340 million tweets each day, which are then used to predict events on behalf of clients in the financial sector.

The company represents an entirely new category of social media analysis and has the potential to provide one of the earliest warning systems on the market.

Another company that aims to exploit the potential of social media in the asset management industry is Motinvesting, an ideas-based stock investing business which gained the backing of Goldman Sachs as part of a US\$25 million financing round in April 2013. The company allows customers to invest online in theme-based portfolios and offers a social platform which allows customers to tap into and share ideas with other investors, and it is now claiming to have made investing *social*.

Hence, it is clear that social media are a source of valuable information and that they might become a new distribution channel for asset managers who wants to provide retail investors with an alternative, easier way of subscribing funds. And given the very high cost of customer acquisition in this sector, this could be a valuable option for cutting-edge players. The potential effects of such a new distribution strategy are twofold: fund managers and distributors will be able to enjoy eventual new-fund related revenues as well as a broader customer base.

Furthermore, the increased speed and simplicity of the online services which were brought by the new tech firms like Google and Amazon have set a new standard also in the financial sector. Now customers expect the same level of speed and user-friendliness when dealing with financial services. Hence, creating social media accounts dedicated to customer service, as well as corporate social accounts for employees that directly deal with clients, could highly enhance the customer experience.

New players?

However, also the other side of the coin must be taken into account. Even if new technologies and social media represent a great opportunity for asset managers, they are also seen as a threat brought on by those players who can best exploit the new context considering the technological advantages and the ability to deal with data coming from social media.

Google has been known to be a potential new entry in the investment industry. The true potential competitive advantage of Google lies in the volume of its keyword search that could be leveraged to predict not only macroeconomics and regional trends but also company trends. These insights could trigger the development of investment strategies both over the medium and the very short term. To feel the power of the data that can be accessed and elaborated by Page and Brin's famous search engine, we might look at Google Trends, a tool designed with the aim of aggregating search volume for specific words or phrases. It is not a big surprise that Google Trend is used by institutions to get insights about the population. For example, the American Department of Labor is able to accurately forecast unemployment claims, a key indicator for the status of the American economy.

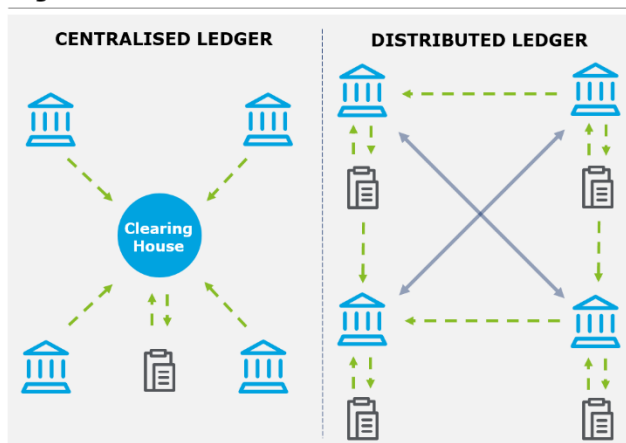
Yet, several barriers, such as the absence of specific regulation, are still keeping Google and other companies outside the investment management industry. Another restraint is, as reported by an Italian FinTech expert, the conflict of interest that Google would have considering that among its top clients there are many financial institutions that would then clash with the Mountain View-based company. Therefore, considering the specific characteristics of the Italian context, Google and other similar tech firms will not be disruptive in the next three years. However, the situation is extremely dynamic and these companies could play a more significant role in the medium term.

Now customers expect the same level of speed and user-friendliness when dealing with financial services. Hence, creating social media accounts dedicated to customer service, as well as corporate social accounts for employees that directly deal with clients, could highly enhance the customer experience.

The disruption of Blockchain

The asset management industry will be significantly transformed by blockchain technology. Since its processing is mainly based on fund registries, transfer agents and fund administration, it would highly benefit from the introduction of the new technology. Blockchain is able to automatically, quickly and transparently record transactions in digital ledgers and to perform smart contracts, self-executing and self-enforcing protocols that facilitate, verify and guarantee the fulfillment of obligations. It is based on a distributed digital ledger that automatically validates, authorizes and records transactions in a transparent and secure environment that does not require any trust authority to validate operations.

Figure 5.7 – Blockchain



It represents an opportunity for asset managers to replace the centralized system of records in order to cut costs, reduce delays, provide timely and accurate information and improve reporting accuracy.

The asset management industry provides its services through a complex distribution net, making a great use of trusted companies that act as intermediaries between them and clearing and settlement counterparties.

For this reason, the distribution process is characterized by high costs and lengthy procedures. The Blockchain thus carries a tremendous potential for streamlining and innovating the asset management industry that will lead to huge costs reduction and result in lower charges for investors.

Any kind of intermediation (trade and cash settlement, transfer agents, fund distribution and custody, fund accounting) that carries out activities related to registering, recording or executing of transactions between parties might be not needed anymore and replaced by blockchain.

Impact on Asset Management

The deployment of the blockchain technology in the asset management industry will lead to significant benefits. First, the blockchain could be used to share and communicate data. Creating a common data set allows parties to enhance information sharing by eliminating duplications of documents, reducing risk of tampering with data and working parallelly in common digitalized ledgers.

Second, the combination of digital and distributed ledger with the potentialities of smart contracts could enable asset managers to keep track of their investments on a real-time basis and have up-to-date reporting on risk and performances of the invested capital. The Blockchain technology could thus create an efficient environment to store and manipulate data in order to provide clients with better and more timely solutions. Virtually, investors could be able to directly access to the information through the distributed ledger or indirectly through vendor-interfaces, creating a self-service reporting.

Third, the Blockchain is able to create a full track record of asset ownership on a shared ledger that could reduce reconciliation costs and eliminate errors in terms of potential mismatching and failed trades.

The clearing and settlement of security transactions will be automatically executed by blockchain-based infrastructure, shrinking the timeline of operations processes and increasing the efficiency of the overall security settlement ecosystem. Instantaneous settlement could slash costs in allocation and matching services for custodians and broker dealers.

Moreover, real time settlement could reduce counterparty risk and liquidity risk, making it easier for asset managers to deal with redemption requests.

Fifth, the blockchain technology could enable new investment products, such as new tradable, digitised fund unit; additionally, asset management strategies are likely to be affected thanks to the reduction in counterparty risk and liquidity risk.

Cost saving will be applicable to many departments. The main areas that are likely to be affected are operations, finance, IT and portfolio management.

The final beneficiary will be the end investor. Increased efficiency and cost savings in asset management are likely to be passed along to investor that will be offered lower fees. Additionally, client services might bring more added value thanks to more accurate and timely reporting that will enable end investor to access to real time risk and performances.

Use cases

Its application to the asset management industry might have the effect of disintermediating many processes, reducing costs, improving speed of execution while increasing resilience in the business. Figure 5.8 shows some use cases of the blockchain technology.

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Figure 5.8 – Blockchain use cases



Challenges

As a recent innovative technology, blockchain presents different challenges to overcome in order to experience benefits. The main aspects to be considered are the following:

- Technical understanding of how blockchain works falls out of the traditional IT skills and may represent an obstacle to the implementation and practical usage of the technology;
- Technology and cultural acceptance may require long time and the implementation of technology is likely to be executed gradually as the confidence rises;
- Since the ledger is distributed and shared with many users, data privacy and confidentiality represents one of the most serious concerns perceived by the industry;
- There is a lack of a standardized regulatory framework that disciplines the characteristics and execution of the technology, especially with regard to smart contracts.

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