



**The Italian asset management industry and
the trends impacting its future**

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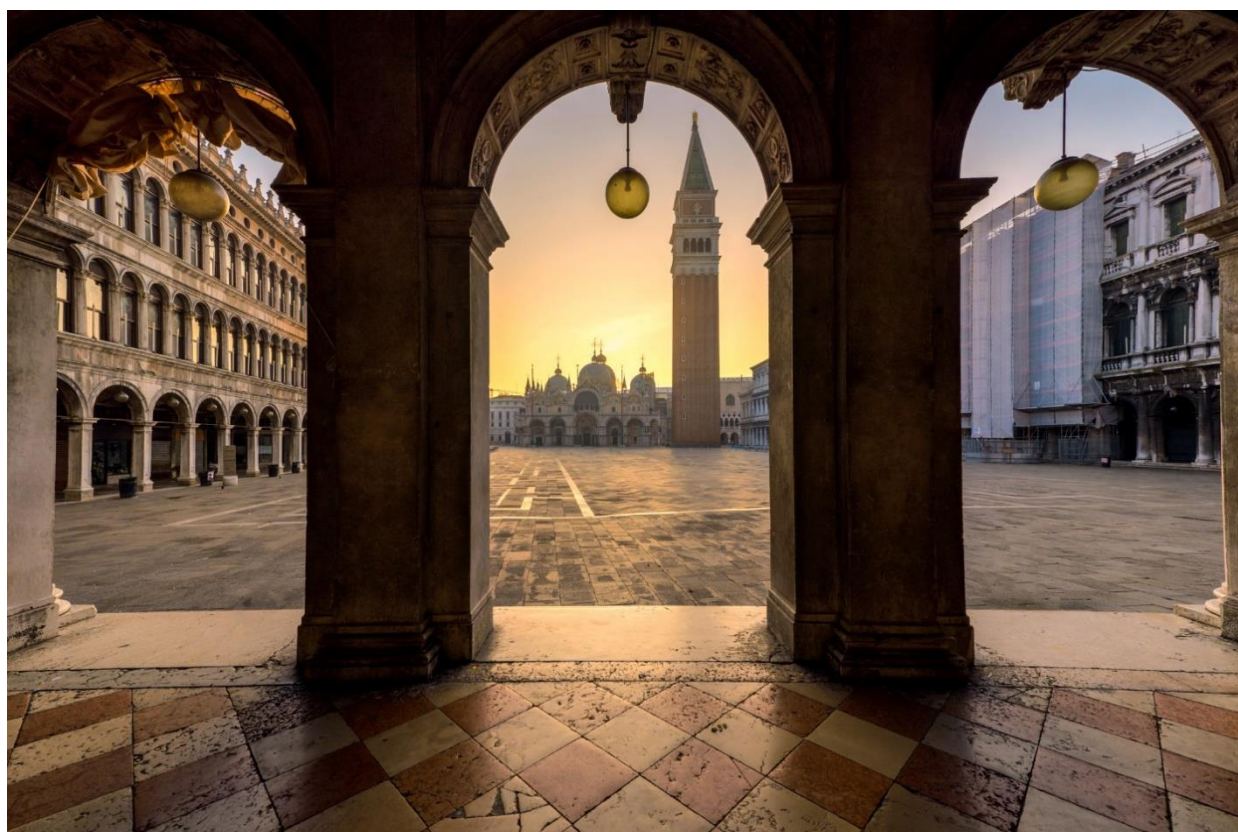
Chapter one: Introduction

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The Italian macroeconomic and political environment: Current political situation

Italy has always been characterized by internal political instability—also deriving from a historical heritage of extremely fragmented medieval kingdoms, formally unified in 1861. This constantly changing political environment, which has seen 65 different governments since the end of World War II and the constitution of the Republic, is what still outlines the political situation in the present day. Recently, Italy has been heavily impacted by the international financial crisis and the sovereign-debt crisis that affected many European countries. These global economic crises did not help the internal political situation that was swinging back and forth between political-based governments and technical governments. The medium-term consequence of this instability on the Italian

economy is a widespread feeling of uncertainty regarding the economy itself. This long-lasting instability can find its roots both in the political situation—the aforementioned internal tension, as well as diplomatic uncertainties with the European Union and even single European states—and in the economic precariousness. Italy's fast-changing governments have failed so far to implement structural reforms to actively support and boost the economy. The lack of decisive economic initiatives causes low productivity to spread across all sectors, further damaging international competitiveness both in Europe and worldwide. This convoluted situation, along with the slowdown that has been occurring in the world economy, has resulted in the economic recession that Italy has been facing in the first part of 2019.



The macroeconomic situation: current and forward-looking indicators

Italy is the fourth largest economy in Europe, accounting for 11.2 percent of the total European GDP¹, and the ninth in the world, with a gross domestic product amounting to €1,756 billion² in 2018³. Industrial activity is concentrated in the northern part of the country and much of the Italian industry is comprised of small and medium-sized family businesses, which in 2017 generated value added of 67.1 percent of Italian GDP (against an EU average of 56.8 percent), as well as 78.5 percent of employment (against the EU average of 66.4 percent)⁴. The Italian economic structure strongly relies on services and manufacturing, representing respectively 66.3 percent and 21.4 percent of total GDP⁵. In absolute terms, the GDP from the service sector did not suffer enormously from the financial crisis. By contrast, the manufacturing industry was severely hit, still lagging far behind the pre-crisis levels. The country was severely affected by the global financial crisis and only managed to recover in 2015⁶. Since then, there has been constant growth, in particular in 2017, when GDP grew by 1.5 percent. However, the positive momentum did not last long and already in 2018, Italy started facing an economic slowdown due to a decrease in domestic demand, only partially counterbalanced by the rise in foreign demand (export)⁷. Furthermore, in 2018, industrial production recorded the worst contraction in close to six years (-5.5 percent on an annual basis)⁸ and the Purchasing Managers Index (PMI) fell from 58 to 49 during the same period, signaling a negative outlook. This adverse domestic scenario, worsened by the unexpected contraction suffered by other major European countries such as Germany and France, resulted in Italy's economy

falling into recession in the third quarter of 2018 for the first time since 2013⁹.

It is worth noting the prediction made by the OECD, which forecasts negative growth in 2019, with GDP expected to drop by 0.2 percent¹⁰. By contrast, according to the European Commission, Italy is going to experience a rise of 0.2 percent in GDP¹¹. Nevertheless, this would still be the slowest growth among EU countries.

Despite a slight contraction of public debt measured in the last semester of 2018, which decreased to 132.2 percent from 133.5 percent, the situation is still worrying¹². Even though the country's primary budget has remained constantly positive at more than 1 percent over the years¹³, the cost of debt results in budget deficits, forecast at 2.5 percent of GDP in 2019¹⁴. On the other hand, unemployment is still one of the most severe problems faced by Italy. While the unemployment rate is currently almost three percentage points lower than the peak reached in 2014, it is still the third highest in Europe after Greece and Spain, at 10.3 percent.

This happened despite the number of employed people rising by 206,000 units on an annual basis in 2017¹⁵. In particular, youth unemployment remains high at 31.9 percent¹⁶.

"Italy is the fourth largest economy in Europe, accounting for 11.2 percent of the total European GDP, and the ninth in the world, with a gross domestic product amounting to €1,756 billion in 2018"

¹ Eurostat

² Hereinafter "billion" will be abbreviated as "B"

³ Istat

⁴ European Commission. 2018 SBA Fact Sheet

⁵ Statista

⁶ Trading Economics

⁷ Istat

⁸ Trading Economics

⁹ Forbes

¹⁰ OECD

¹¹ Spring Economics Forecast 2019 - European Commission

¹² European Commission

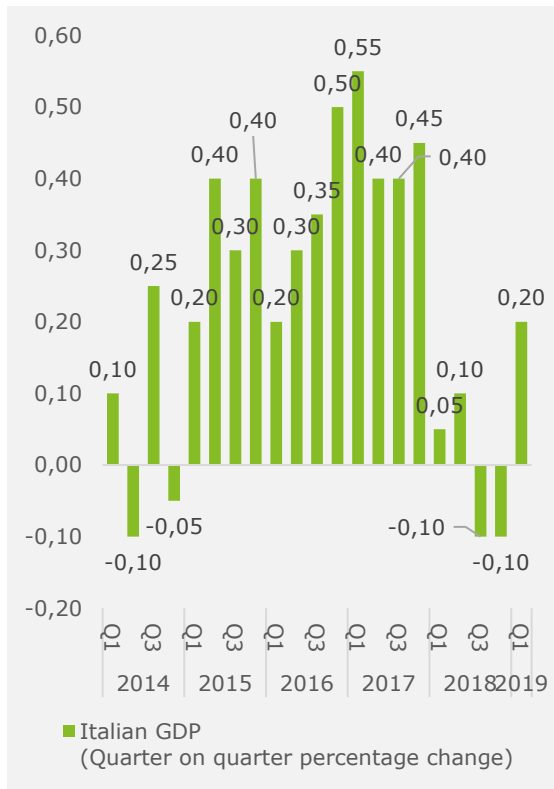
¹³ European Central Bank

¹⁴ Spring Economic Forecast 2019 - European Commission

¹⁵ Trading Economics

¹⁶ Trading Economics

1.1. Graph: GDP Italy



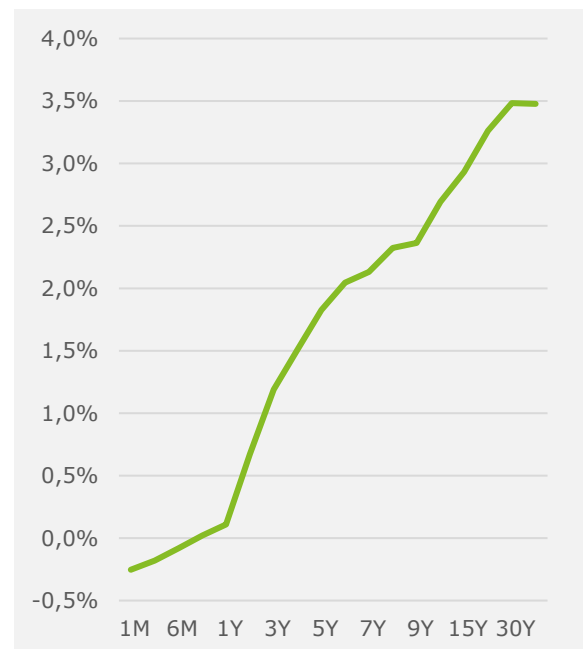
Since the end of 2018, the consumer confidence index¹⁷ has taken a turn for the worse, constantly decreasing from 116.4 points in October 2018 to 110.5 points in April 2019¹⁸. Business confidence has followed an even more worrying path, declining throughout the whole of 2018 and continuing to plunge in 2019, from 110.3 points in February 2018 to 100.6 in April 2019¹⁹. Over the same period, other leading indicators such as the number of industrial new orders and the economic sentiment indicator (ESI) showed a sharp fall²⁰, suggesting a further worsening of the Italian economic cycle.

However, the favorable condition of the banking sector mitigates the unpromising economic data. According to the OECD, Italian banks are well capitalized, and the stock of non-performing loans (NPL) is declining under the oversight of the European Central Bank.

Even if NPLs have been reducing, the rising sovereign bond yields risk is threatening

banks' balance sheets. Since the end of 2017, the health of banks and the state of public finances has started to move significantly, further in the same direction. The share of Italian sovereign bonds in banks' total assets has increased by one percentage point, namely from 9 to 10 percent.

1.2. Graph: Current Italian yield curve



The Italian investor

It is now necessary to understand the peculiarities of the typical Italian investor to refer to the asset management sector. The first and foremost characteristic that needs to be analyzed is the Italians' attitude toward saving. A recent survey conducted by Ipsos revealed that in 2018, the Italians' propensity to save—which here is intended as the desire of a typical Italian to keep a certain amount of money as a reserve—was the same as in 2017, namely 86 percent, but actually the percentage of households consuming all of their income decreased from

¹⁷ This consumer confidence indicator provides an indication of future developments in household consumption and savings

¹⁸ Trading Economics

¹⁹ Trading Economics

²⁰ Trading Economics

41 percent in 2017 to 37 percent²¹ in 2018. At the same time, a slightly higher increase in the number of families with negative savings imbalance was observed, rising from 21 percent in 2017 to 22 percent in 2018. Similarly, a significant increase in households' gross savings has been registered (+18 percent compared to 2017). However, Italians' reluctance toward investment has to be emphasized:

nowadays a third of Italians' income is kept in a bank account, un-invested.

The main reason for this is undoubtedly the Italians' lack of trust in the financial market and the economic uncertainty: a report²² revealed that this aspect is still relevant for 6 Italians out of 10. In particular, more than 40 percent of Italians are afraid to lose their job, to not have enough money to live on, and to not accrue or even to lose their pension.

Overall, the Italian panorama appears the most critical in this sense compared with those of other European countries. Uncertainty mainly affects young savers: 9 out of 10 people believe there is no social mobility and 60 percent of the Italians between the ages of 18 and 34 interviewed feel that their social and economic position will be worse than their parents'.

Concerning the household portfolio, half of the financial savings are invested in assets, which have exposure to market risk (public and private sector bonds, shares, mutual funds, pension funds, and some insurance products). During the second half of 2018, the poor market performance led to a decrease in household wealth of around 1.5 percent. It is noteworthy that the Italian government and Italian bank bonds in June 2018 accounted respectively for only 2.8 percent and 1.8 percent of the whole household portfolio, far below the 5.0 percent and 9.8 percent levels of 2012²³. At the same time, investors are spending more on investment funds and insurance policies. Data suggests that in 2018, both assets increased in investors' portfolio composition in comparison with the records of 2012. In particular, the former shifted from 7.6 percent to 12 percent, while the latter rose from 13.2 percent to 17.3 percent.



²¹ Trading Economics

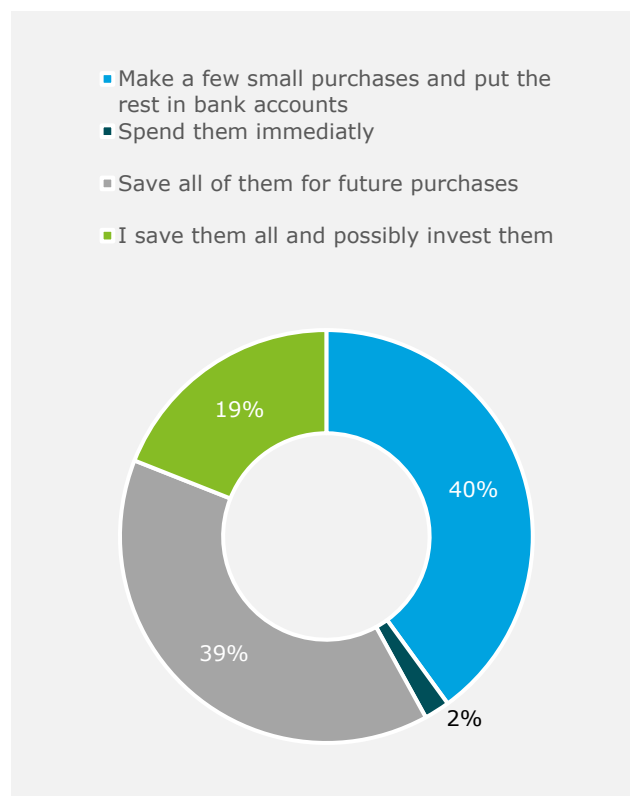
²² Ipsos

²³ Bank of Italy

Another important feature characterizing the typical Italian investor is the scarce level of financial literacy. In the OECD-INFE framework²⁴ for the evaluation of financial literacy worldwide, Italian adults scored 3.5 out of a maximum of 7 points on average, compared with a G20 average of 4.3. The percentage of respondents who achieved a minimum target score (5 or more, according to the OECD methodology) is slightly above 30 percent, versus the G20 average of 48 percent. Furthermore, Italians are broadly unaware of the benefits of portfolio diversification: only 37 percent of respondents understand that risks can be reduced by buying a wide range of securities. Besides, less than half of the respondents can calculate a simple interest rate, while only 23 percent can both calculate simple interest and recognize the added benefit of compounding over five years²⁵.

Additionally, all the above-mentioned traits emerged from a survey conducted on a sample of over 3,000 people by Oval Money and JEME Bocconi Studenti. The study highlighted the widespread propensity to save but not to invest²⁶: to the question "if you won €10,000, how would you manage it?" 19 percent would invest the whole amount, around 40 percent of the interviewees declared they would make a few small purchases and put the rest in a bank account, 39 percent stated instead they would save²⁷ the entire amount for a future purchase, while 2 percent of respondents would spend it immediately. Among the various possible reasons behind these numbers, the lack of financial knowledge and education and the above-featured risk-aversion, delineate the main characteristics of the Italian investor.²⁸

1.3. Graph: Saving propensity: "If you won €10,000, what would you do with it?"



Moreover, it has to be noted that the traditional Italian investor has extreme interrelation needs: Italians need to rely on a trusted, expert advisor to make appropriate investment choices. In an interview conducted by CONSOB²⁹, half of participants were unable to define what constitutes a consultancy service in the matter of investment, and the same percentage of people was not willing to pay for that service. In addition to that, the lack of confidence in the banking system that emerged after the recent financial crisis represents another crucial factor that holds back the Italian saver from investing. The widespread lack of trust in the banking system is also further confirmed by the fact that 38.5 percent of the people interviewed preferred to invest directly without the help of an external

²⁴ Bank of Italy

²⁵ Bank of Italy

²⁶ Sole 24 Ore: "Italiani popolo di risparmiatori ma con poca propensione a investire" (31 Ottobre 2018)

²⁷ "save" in this sentence means to deposit in the bank account

²⁸ Repubblica: "Consob, l'investitore italiano non ha cultura finanziaria e non capisce i mercati" (13 Settembre 2016)

²⁹ Consob: "La digitalizzazione della consulenza in materia di investimenti finanziari" (3 Gennaio 2019)

consultant. The demand for asset management³⁰ services is affected by the various traits of the Italian investor outlined above, and this impacts the supply chain of AM services in the country.

The Italian asset manager

The asset manager, the starting point of the supply chain, represents a strategic asset of crucial importance for any reality in the financial world. This figure is essential in this specific sector, which is strongly supply-driven, although the significance of demand should not be underestimated. In this particular market structure, in which supply exercises a very strong control over the financial products placed on the market, the asset manager plays a vital role as a rendezvous point between demand and supply. The decisive role of distribution also

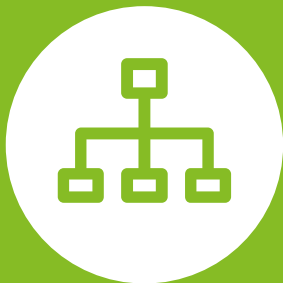
needs to be considered: asset managers need to make their best effort to reach investors on the broadest possible scale, and in most cases, third-party distribution partners are essential to fulfill this ambition.

On the other hand, as distributors' relevance increases in the market, they start owning the client relationship and the balance of power changes. In this sense, asset managers and distributors must build a partnership in which, to best serve their clients, their end-purpose reflects their work activity. Not only do third-party distributors in Italy hold a tiny share of the market, since their role is almost entirely covered by the financial advisors of the banks themselves, but also their position in the coming decades is threatened by the increasingly prominent role that Millennials³¹ will play in the AM market, as will be thoroughly described in the following chapters.



³⁰ Hereinafter the term "asset management" can be abbreviated in "AM"

³¹ People born between the early Eighties and the late Nineties



Chapter two: Empirical overview of the market

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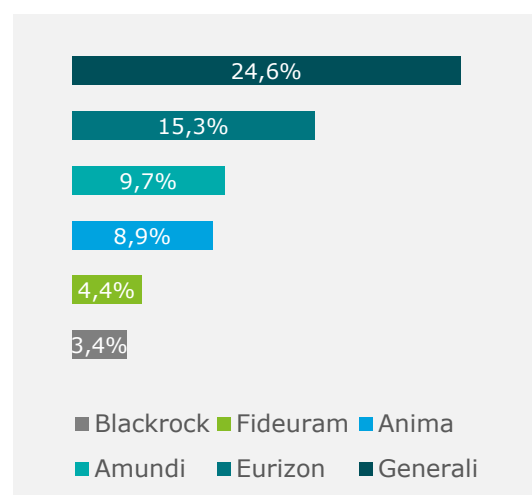
The bigger picture

The Great Recession of 2008 dealt a serious blow to the Italian asset management industry, which recorded a 19 percent fall in AuM in that year alone. From 2009 onward, thanks to a positive outlook for macroeconomic growth, this negative trend reverted. It is interesting to highlight that over this decade the industry had its best overall performance between 2012 and 2017 when it scored a compound annual growth rate of 17.39 percent and average net inflows of €12.823 B. In 2016, most of the AuM were concentrated in open funds, 46.37 percent, in discretionary mandates, 35.25 percent, and the rest was evenly spread among the other categories. Italian investors have shown a preference for either Bond or Balanced funds, which respectively accounted for 29.1 percent and 29.5 percent. These numbers can be partly explained by the long-lasting tradition of the Italian 10y BTP, which historically marked Italians' inclination towards bonds rather than equities. The remaining €805 B was allocated uniformly between stocks, flexible and non-classified funds. Even though in 2018 the pattern was almost the same, the development of new investment opportunities and the poor performance of the financial markets led to a shift in the allocation of AuM in favor of flexible and non-classifiable funds. This extremely positive period for the Italian asset management industry, which reached its peak in 2017 at 121 percent of GDP, began to show signs of distress in 2018. These indicators are mainly related to the market correction that occurred in Q4 2018 and to the negative economic outlook of the real Italian economy. These effects are visible in the spread between the AuM of funds such as stocks, bonds, flexible and balanced during the past two years. The fixed-income funds were the hardest hit due to the volatility of the Italian market, which was amplified by the appointment of the new government in

May 2018. This fund class lost 16.62 percent of assets under management with -€19.545 B in asset value (of which -€8.764 B in net outflows). Real estate and monetary funds did not seem to follow the overall trend, showing increases of +10.66 percent and +6.51 percent, respectively. However, due to their marginal role in the total assets managed (2.66 percent and 1.83 percent), such instruments were unable to counterbalance the net loss of the bond funds (which alone accounted for 25.38 percent of total AuM).

Overall, 2018 was a turbulent year for the asset management industry, during which it lost more than €68 B in asset value and recorded net outflows of €3.9 B. Moreover, the prediction made by the OECD on GDP stagnation and the overall fragile economic situation hints at the possibility of an imminent market contraction.

2.1. Graph: Major players in Italy – AuM 2018



The overall slowdown in net inflows coincided with significant political and economic events in the Italian scenario. The first factor was the appointment on 1 June 2018 of Prime

Minister Giuseppe Conte, the leader of a populist government designated after more than three months of political instability due to the negotiating process. Then, the last and more recent slowdown in net inflows can be linked to the general worsening of the domestic scenario that, as mentioned before, saw the country enter recession for the first time since 2013. This led investors to reduce their exposure to funds, confirming the general behavioral theory that investors tend to be more risk-averse when the economy is slowing down. In particular, in November 2018, the Italian panorama was subject to an additional wave of political uncertainty, which started with the publication of the Update of the Economic and Financial Document dated 4 October, followed by an adverse reaction from the European Commission concerning the high level of deficit targeted by the government. This climate of uncertainty then escalated with the submission of the Draft Budgetary Plan on 15 October and its rejection by the European Commission, and the announcement by the latter of a disciplinary proceeding against Italy on 21 November.



This turbulent climate had a deep impact on the Milan stock exchange, which plummeted from the extremely positive performances it had recorded before the government's formation (from +11.2 percent in January 2018 and +1.7 percent in the Eurostoxx 50 to -15 percent between the formation of the new executive and the end of August, and -3.2 percent in the Eurostoxx 50). This climate lasted until 19 December, when the Italian government and the European Commission reached an agreement over a 2 percent target budget deficit. Up until this point, this situation may have undermined investor confidence and been one of the causes of the net outflows of the 4th quarter of 2018. Also, the recent announcement by the President of the European Central Bank of a gradual run-down of quantitative easing measures, despite not having a strong negative impact on the industry, could have played a role in the weakening of the Italian asset management panorama besides undermining the sustainability of Italian public debt. (It should be noted that in 2019, approximately €300 B in Italian government bonds fall due). However, the interest rate is likely to remain low until the end of 2019, thus making investment funds more appealing compared with other products, namely bonds and additional deposits³².

Despite the alarming data, the net inflows calculated up to 2018 remained positive, amounting to €9.871 B³³. However, this result cannot avoid confirming the negative outlook for 2019, especially if the data is compared to the net inflows in 2017, which were almost ten times larger, namely €97.439 B.

A European perspective

Keeping a broader focus, an analysis of the main trends in the European asset management industry has a deep and propaedeutic significance, first of all to determine whether certain trends are particular to the Italian market or the consequence of a general tendency in the

³² The Law Reviews - The Asset Management Review, Edition 7, Italy

³³ JEME Analysis of Assogestioni Dataset

continental market, secondly to provide a benchmark on the Italian industry's performance.

In order to improve data readability, the European scenario of Assets under Management is broken down into investment funds and discretionary mandates³⁴. At the end of 2016, the asset management market was almost equally split between discretionary mandates (48.1 percent) and investment funds (51.9 percent)³⁵. Data for 2017 showed a similar ratio and, given the stability of this trend, it can be assumed that 2018 has maintained an analogous outlook. What differs is mainly the composition of clients accessing the two types of services, since discretionary mandates are mostly offered to institutional clients, such as insurance companies and pension funds, while investment funds are mainly bought by retail clients.

The European Union, which has been very actively regulating the types of collective investments, delivered the Directive on undertakings for collective investment in transferable securities (UCITS), the main European framework covering collective investment schemes, and the alternative investment fund managers (AIFM) Directive, which covers managers of alternative investment schemes designed for professional investors. As will be later highlighted, the UCITS category of investment funds accounts for the majority of collective investment funds in Europe. Alternative Investment Funds (AIFs) are not regulated at EU level by the UCITS directive: they include hedge funds, private equity funds, real estate funds, and a wide range of other types of institutional funds³⁶. The total value of AuM reached a record high of €25.2 trillion of total value in 2017, which marked an increase from 2016 of €2.3 T. In the same period, net assets of UCITS and AIF

reached €15.2 T³⁷. The growth achieved by the European Industry in 2015 and 2016, showing a clear signal of recovery from the Great Recession, therefore peaked in 2017, an exceptional year for the European investment fund industry. Net sales of UCITS and AIF reached their highest level (€948 B), breaking the prior record set in 2015 (€756 B)³⁸. The following year did not mirror the trend of the previous ones, 2018 being a tricky period for the industry. The promising start of the first quarter of 2018, a period in which UCITS and AIFs attracted €223 B, was followed by a steep decline in the subsequent quarters, to which the Italian market was aligned. In the European scenario, during the last three quarters of 2018, considerably lower results were scored, amounting respectively to €30 B, €40 B and -€47 B in net sales. When looking at the situation in terms of assets under management, the growth recorded during the first three quarters of 2018 was completely wiped out by the fall in worldwide stock markets in the last quarter, producing a final loss of €468 B over the year, the worst result ever achieved since 2011³⁹. The rationale behind these movements is to be found in investor caution in the face of a slowdown, together with trade tensions, political uncertainty, stock market volatility and reduced monetary policy stimulus⁴⁰. Among all the countries where the funds are domiciled, only a few of them managed to close 2018's net sales balance with a positive sign. Luxembourg gained €95 B in net sales during the whole year, however the country lost 2.28 percent in total value of net AuM over 2018 due to market performance⁴¹.

"In order to improve data readability, the European scenario of Assets under Management is broken down into investment funds and discretionary mandates."

³⁴ *the former being a type of investment formed by regulated funds that combine the wealth of investors with similar goals, whereas the latter is a specific investment "mandate" offered by an asset manager to a particular client that has at its disposal a considerable amount of wealth, requiring a tailor-made service based on precise investment goals*

³⁵ EFAMA - Asset Management in Europe 2018

³⁶ European Commission

³⁷ EFAMA - The European Fund and Asset Management Association

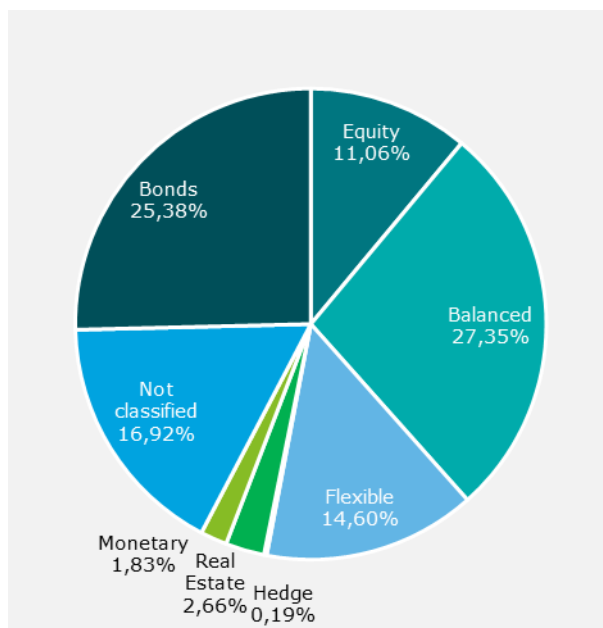
³⁸ Ibidem

³⁹ Ibidem

⁴⁰ Ibidem

⁴¹ Association of the Luxembourg Fund Industry | Statista

2.2. Graph: Composition of total AuM in 2018

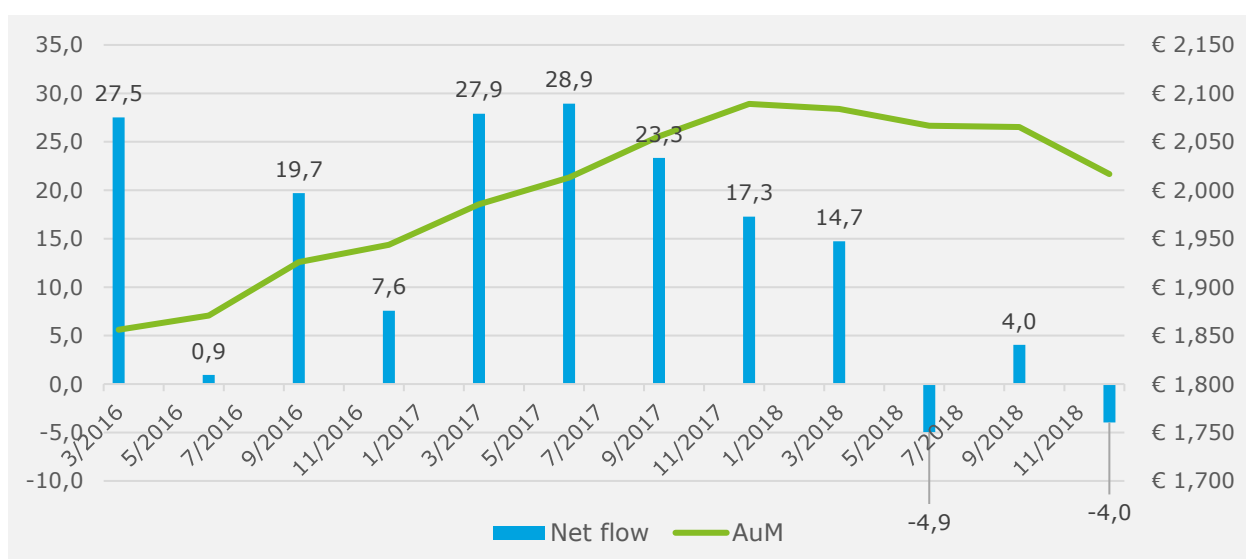


In the Global Financial Centers Index, Luxembourg was ranked as having the third most competitive financial center in Europe in terms of business environment, human capital, infrastructure, financial sector development, and reputation. In addition to this, Luxembourg holds the highest share of the market, managing 26.8 percent of all European UCITS and AIF, followed by Ireland, Germany, France and

the UK, whose shares range from 16 percent to almost 10 percent⁴².

Almost every country followed the general trend, losing a part of their net assets. The few exceptions were Bulgaria, Croatia, Cyprus, Malta, and Slovakia, which improved their balance while remaining, however, small players in the European scenario, and the UK, which lost 9.4 percent of its industry's total value (€154.3 B of net assets), very likely a natural consequence of the uncertain climate surrounding Brexit⁴³. Currently, Italy is a marginal player, managing only 2 percent of the total assets invested in UCITS and AIFs at the end of 2018, with the total industry value reaching €302.5 B. The European investment fund market at the end of 2018 was represented by 33,359 UCITS funds (53.8 percent of the market share in terms of number of funds) and 28,635 AIFs (46.2 percent). The distribution of the two types of funds in the European countries is noteworthy: in some countries such as Norway, Greece, Bulgaria, and the Czech Republic, AIFs are extremely limited in numbers, if not completely absent like in Norway, where all the funds are UCITS. In the Netherlands, Hungary, and Cyprus, the situation is quite the opposite. Many other countries, among which Italy, present a more balanced distribution between UCITS and AIFs.

2.3. Graph: Net flow and AuM (2016-2018, € billion)



⁴² EFAMA - The European Fund and Asset Management Association

⁴³ Ibidem

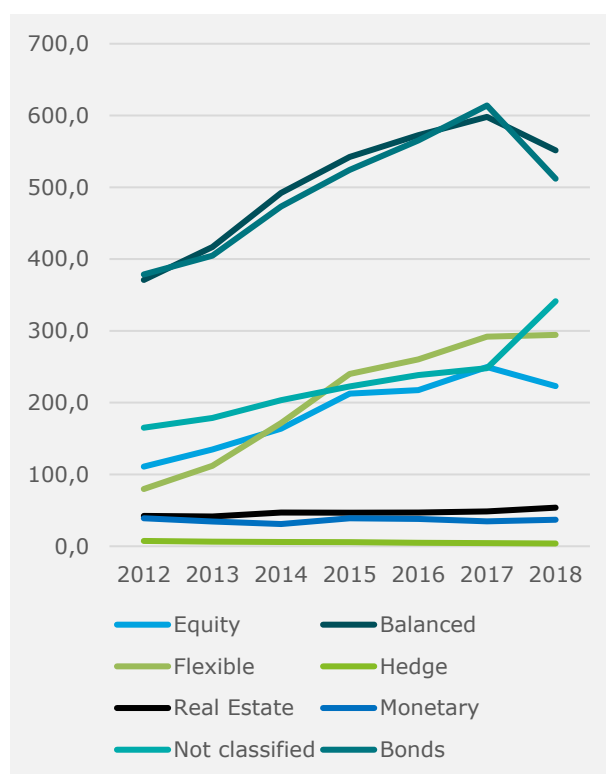
A closer look

Breaking down AuM⁴⁴

Following the European trend, assets under management in Italy at the end of 2018 were almost equally split between collective investment funds (50.2 percent) and discretionary mandates (49.8 percent). The predominant part of the former category of investment was represented by open funds, which closed the year with net inflows amounting to €671 million⁴⁵, whereas closed funds did considerably better, reaching net inflows of €4,504 M. 2018 was evidently a fairly difficult year for open funds, considering that they represented 94.4 percent of all the assets managed in collective investment funds, but accounted for only 13 percent of the inflows of the category as a whole. The main drivers of such a slowdown were open long-term bond funds, which lost over €25 B in net outflows over 2018. This type of assets, however, followed a consistently bad trend during the year, but with a marginal improvement in the last two quarters. On the contrary, the other open funds had positive net flows at the beginning of the year and, subsequently, started losing momentum, showing a negative figure in the last quarter (for equity and flexible funds) or generally achieving low net inflows (balanced and hedge funds). Over the whole year, balanced and flexible funds had the most positive outlook, with net subscriptions reaching respectively €10,093 M and €8,566 M. In line with the country's difficult political and economic situation, open funds domiciled in Italy, representing one fourth of the total amount of net Italian assets under management, lost €3,437 M in net sales over the year, whereas foreign open funds gained €4,108 M. The closing quarter of 2018 was a difficult period particularly for UCITS funds, which lost almost €10 B in net sales, while AIF funds gained almost €1 B despite representing only 5 percent of the total.

Over the year, however, the former category of funds managed to report positive, albeit low, net flows, whereas AIF funds closed with a negative sign.

2.4. Graph: Investment Funds and Discretionary Mandates (Net Assets, € billion)



On the other hand, closed-end funds followed a particularly positive path in the last semester, improving the trend of the previous one and reaching a very good overall result for 2018. The majority of these funds were closed-end real estate funds, but security funds also followed the positive trend and gained an impressive +65 percent in net assets in just one year. Net flows in discretionary mandates scored a similar overall result to investment funds, collecting a total of €4,696 M of new assets in 2018. The distribution over time of these inflows is, however, very different from what has just

⁴⁴ JEME analysis of Assogestioni Dataset and Assogestioni - IV trimester 2018 Report

⁴⁵ Hereinafter "million" will be abbreviated as "M"

been described for investment funds. Assets held in discretionary mandates had their worst moment during the second quarter, with negative flows of €5.8 B offsetting the positive figure of the first three months. In particular, management of insurance products, representing 70 percent of individual investments as a whole, and individual investments in securities, representing another 8.7 percent, dragged down the net flows of the entire category. Net sales of discretionary mandates subsequently recovered from this drop, reaching €5.48 B in the second semester of 2018. Particularly impressive was the case of insurance products, which collected €8,390 M during the second part of 2018 (and just €8,407 M over the whole year).



The investment strategy representing the largest share of the market is that of balanced investment, accounting for 27.3 percent of total assets under management at the end of 2018. Generally speaking, in 2018 this type of product did not meet investors' preference, obtaining negative net flows of €4.7 B. This result, however, has to be fully attributed to individual investments, whereas collective ones achieved a positive result, managing to gain subscriptions amounting almost to €10 B, in line with the overall trend of balanced

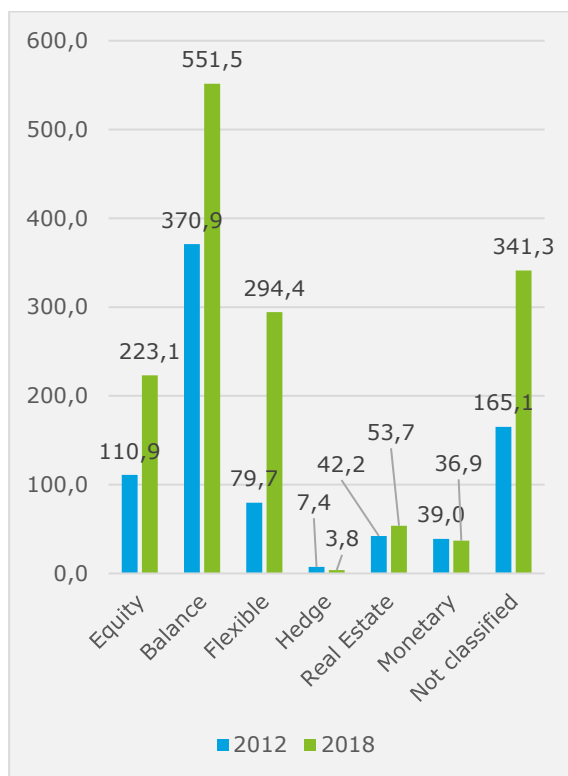
investment over the years. 2012 was the last year in which a negative sign was scored by this type of investment and over the period 2013-2017, this category scored an average amount of net inflows exceeding €16.5 B per year. Interestingly, only less than one fifth (17.8 percent) of these assets are managed as a collective investment (i.e. funds), making this type of investment strategy particularly suited to individual investments (i.e. mandates), aimed at those investors who need tailored services. Concerning collective funds, even though the number of balanced funds rose from 180 in 2012 to 345 at the end of 2018, they still represent about 10 percent of the volume of collective investments in Italy. On the other hand, balanced mandates constitute 45.1 percent of the total volume of mandates in the country.

Investments in bonds, the second type of financial investment in Italy in terms of net assets (25.4 percent of the industry), followed the same negative trend: at the end of 2018, net flows amounted to -€12.3 B. This result is even more surprising when one considers that not only was this type of asset the only one to show a positive figure in 2012, together with real estate investments, but also that the average yearly net flows from 2012 to 2017 amounted to €27.5 B. A distinction in this negative movement can also be made for bond investments between individual investments and collective ones. Collective investments lost over €24 B in net flows, whereas individual ones partially covered the loss, chalking up positive net inflows of almost €12 B. Such distinct dynamics in collective and individual investments in 2018 also represent a reversal in the trend of recent years: since 2012, the former have been growing in proportion, from making up two thirds of total bond investments to almost three fourths, increasing in number from 1,171 to 1,515.

The only type of financial investment that exceeds this number of funds is the equity asset class, with 1,613 funds in 2018. In contrast to fixed-income funds, the number of equity funds did not change markedly over time, from 1,556 funds in 2012. However, this did not prevent equity assets from gaining percentage points, rising from 9.29 percent of the industry in 2012 to 11.06 percent in 2018,

and doubling total assets of this type, from €111 B to €223 B. Looking at the results they achieved in 2018, a distinction can again be made between collective and individual investments, the former achieving €4,349 M in net sales and the latter only €144.2 M, still representing more than 11 percent of equity investments. The positive inflows recorded by equity investments are in line with previous years with respect to other types of investment, as over the period taken into consideration, they scored yearly net sales of about €5.6 B.

2.5. Graph: Trend 2012-2018, € billion

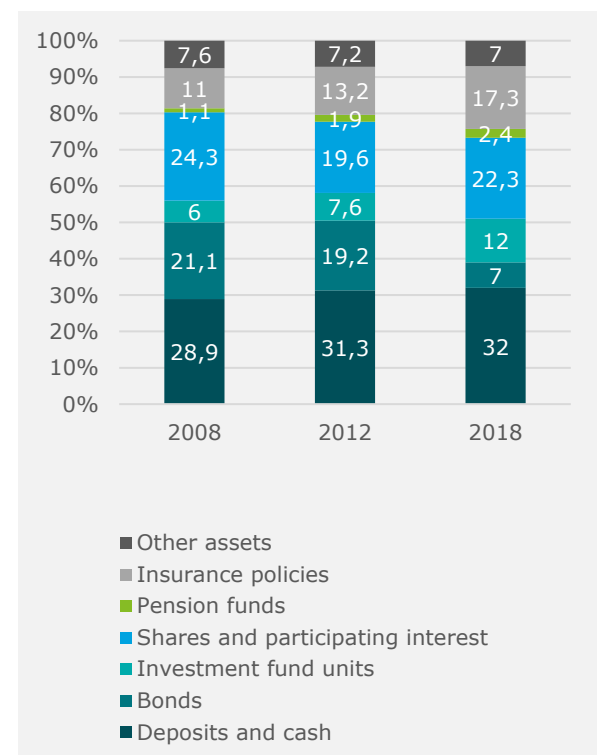


A similar net inflow to the equity assets was scored by flexible investments. Net assets for this category rose from €79.7 B in 2012 to €294.4 B in 2018, a striking increase of +269 percent, unequalled over the same period, and also achieved positive net inflows of €8.8 B in 2018, the best result in the industry for this year. Again, there is a strong discrepancy between individual investments, which closed the year with negative net sales amounting to almost -€0.3 B, and collective investments, which accounted for the whole positive result of the category. This is consistent with the trend set in previous

years, collective investments usually being the leading part of this type of asset, scoring better achievements in terms of net sales over the period 2012-2018 and representing 15.9 percent of net assets invested in flexible products. The number of funds of this type also increased, almost doubling from 2012 to 2018, rising from 678 to 1260, 15 of which are closed funds. This last investment category completes the investment options that collect more than €100 B of assets under management in Italy. Other investments worth citing are real estate investments (€53.73 B), monetary investments (€36.89 B) and hedge funds (€3.8 B).

Completing the framework, there is a fraction of assets under management, representing 16.92 percent of the total, almost entirely coming from discretionary mandates that do not fall into one of the categories, which have been analyzed so far, or that are difficult to be traced back to the investment form in which they are allocated. They represent one third of individual investments in 2018, whereas in 2012 they accounted for one fourth of the total. This type of assets doubled from 2012 to 2018, reaching net assets of €341.3 B and closing last year with net sales of €7,611 M.

2.6. Graph: Average portfolio composition



Italian AM customer base composition

The Italian asset management industry serves both retail clients, usually households and high net worth individuals, and institutional clients, which are the most relevant clients of the industry. At the end of 2016, institutional investors accounted for around 65 percent of total AuM, while retail investors accounted for the remaining part. Institutional clients are dominated by insurance companies and pension funds, which amounted respectively to about 45 percent and 5 percent of total AuM⁴⁶. Their presence in the AM industry can be explained by the fact that they control large quantities of financial assets and usually outsource their management to external asset managers.

Institutional clients strongly dominate the discretionary mandate segment of the market. At the end of 2018, institutional investments accounting for 47 percent of total AuM were made through a mandate. Mandates are typically correlated with a minimum investment amount, making them less appealing or simply not available to retail investors. Furthermore, mandates can provide specific investment products according to the investors' precise requirements. Hence, in general, asset managers deliver this type of customized solutions to clients with a high level of financial assets.

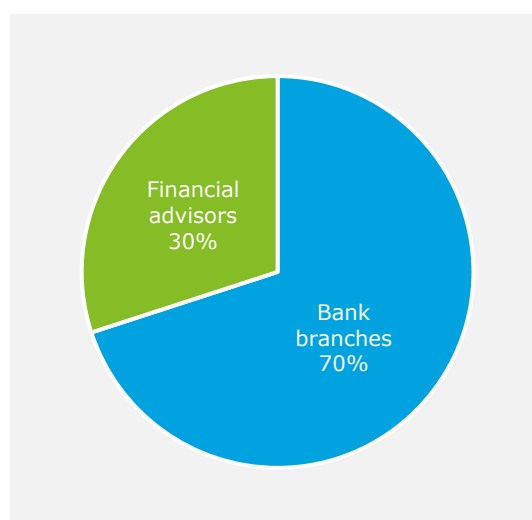
"The Italian asset management industry serves both retail clients, usually households and high net worth individuals, and institutional clients, which are the most relevant clients of the industry."

Additionally, the offer to households and retail investors has increasingly differed according to the type of client, polarizing into the private and the mass-affluent segments. While the offer in the private segment includes a wide and articulated range of products, including mainly funds managed by the major foreign investment houses, the demand of mass-affluent clients is satisfied mainly by banks using the products of the "home manager" or of the SGRs⁴⁷ with which there are partnership agreements⁴⁸. Of the total volume of funds distributed to retail investors, 70 percent was distributed to the mass-affluent segment, and the remaining 30 percent to private investors.

How funds are distributed

Distribution of asset management services is a partially fragmented activity, which has grown in complexity over time. This is mainly due to an increasing number of actors in the value chain, the availability of specific investment solutions and the use of multiple channels.

2.7. Graph: Distribution in Italy



The fund market is highly retail oriented. 54 percent⁴⁹ of the open funds' volume is directly

⁴⁶ EFAMA - Asset management in Europe - An overview of the asset management industry

⁴⁷ Società di Gestione del Risparmio: Italian acronym for asset management firm

⁴⁸ Banca d'Italia - Carmelo Barbagallo, L'industria del risparmio gestito: la crescita degli anni recenti e le sfide del futuro

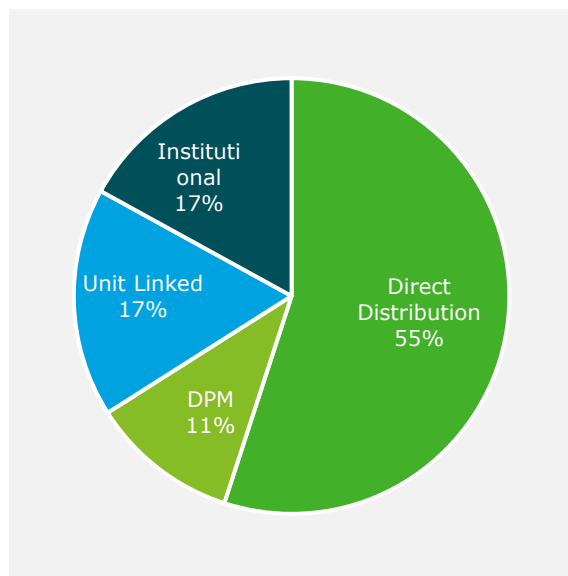
⁴⁹ Assogestioni - "The Italian Asset Management key figures". All subchapter data refers to this source

sold to retail investors, whereas 12 percent is managed through the discretionary portfolio management service and 16 percent is characterized by the use of unit-linked policies. What is left is subscribed by institutional clients, who manage these funds with the SGR belonging to their group.

It is worth noting, considering the €586 B of funds sold directly to retail investors, that banks dominate the distribution landscape. At the beginning of 2018, 70 percent of funds were placed through bank branches, a percentage which has been growing slightly year over year considering that it amounted to 68 percent in 2014. Financial advisors represent the other relevant distribution channel.

Another interesting aspect lies in the fact that Italian distribution is characterized by a high concentration of market share among the top players. Concerning banks, the ten most prominent players at the beginning of 2018 distributed 80 percent of the total fund volume. This percentage is even higher when considering the top ten financial advisors. Taken together, they placed 94 percent of the funds.

2.8. Graph: Open-end funds



From the asset manager perspective, a general feature observable in the Italian distribution market is the predominance of the captive model. This means that players in the

industry are very integrated or rather the distribution agreements are mainly made between the asset manager and a promoter that belongs to the same group. At the beginning of 2018, 73 percent of funds were distributed through an integrated model.

Interestingly, analyzing only non-captive funds, the distribution between banks and financial advisors is more homogeneous, with the former placing 52 percent of the fund volume. By contrast, considering the different segments of private and mass-affluent investors, banks still account for the distribution of 60 percent of the total volume of funds distributed to the former segment and 74 percent of the total volume distributed to the latter.

Looking at the market from the distributor point of view instead, the Italian asset management industry has been characterized for years by a modest degree of openness. In other words, banks and financial advisors, among the funds that they place, also opt for products crafted by third parties, i.e. asset managers not dependent on the same parent group. At the end of 2017, funds characterized by an openness level greater than 50 percent occupied 31 percent of funds distributed by banks and 62 percent (a total of €237 B) of those distributed by financial advisors. In general, financial advisors are more open than banks. In the next chapter, we analyze the impact of MiFID II on this aspect among others.

"The fund market is highly retail oriented. 54 percent of the open funds' volume is directly sold to retail investors, whereas 12 percent is managed through the discretionary portfolio management service and 16 percent is characterized by the use of unit-linked policies."



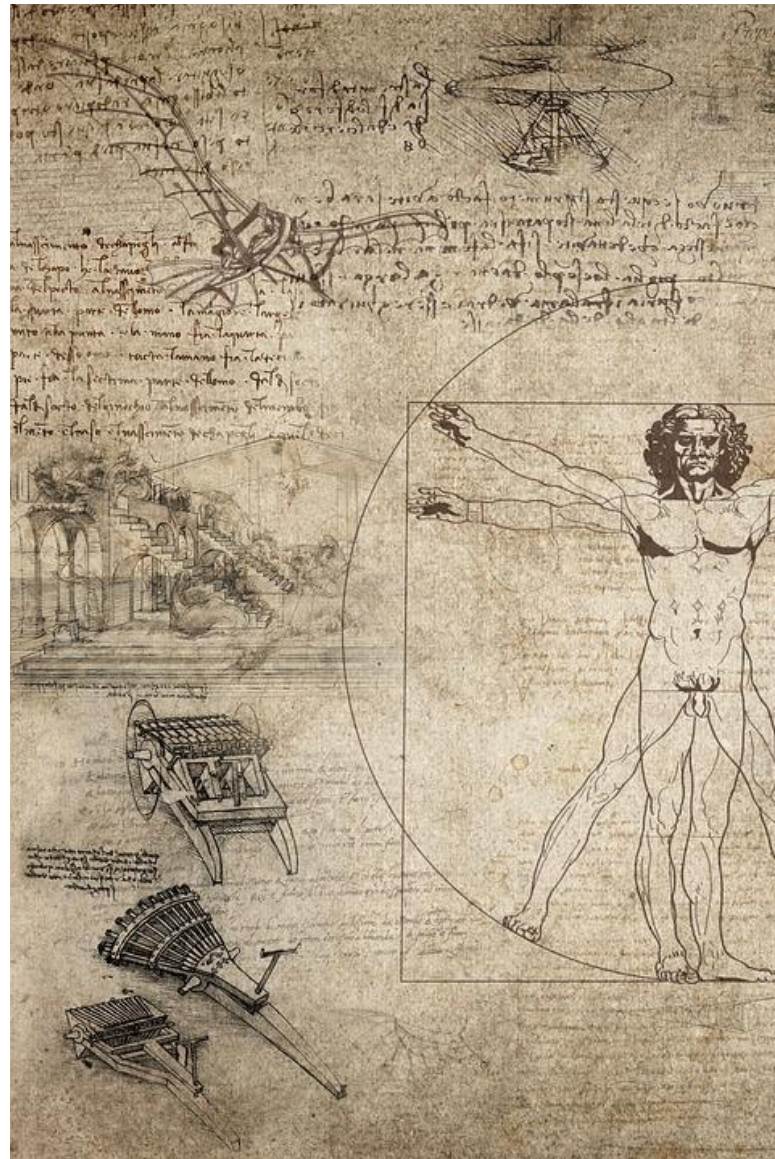
Chapter three: trends impacting the industry

Chapter 3: Trends impacting the industry

Brief definition of “trend”

Although AuM are growing, it is undeniable that the asset management industry is now facing a turning point. The future is likely to become extremely chaotic and uncertain for all the incumbents who neglect the structural changes happening in the market. These structural changes are being driven by a number of major trends, including sea changes in the social, demographic, environmental and technological fields that are reshaping not only the asset management industry, but all sectors worldwide. A trend implies a series of changes that influences society and the daily life of each of us on a social, political and economic level, in terms of consumer behavior, often with important technological implications.

Trends have the potential to significantly impact and alter the financial system and, in particular, the asset management industry. With regard to investors' portfolios, these trends can offer support to returns, as in the long-run they deeply influence the performance of companies best positioned to benefit from them. Furthermore, securities supported by long-term trends may be less subject to short-term volatility due to their high potential. Finally, it is worth noting that these trends have positive consequences for numerous economic areas. Investment strategies focusing on these trends therefore provide the possibility of maintaining broad diversification within the portfolios.



Demography

Economic scholars have always been interested in finding out the impact that demographic trends have on economy. Nowadays, demographics still remains one of the strongest forces that have an impact on our society. In particular, in the near future, a shift in demographics is set to shape almost every sector of our society, from healthcare and welfare to the labor market and saving habits. As a consequence, international organizations, national governments and financial institutions are trying to understand its specific impacts. The most relevant trend that is already affecting and that will further impact the 21st century is population aging. More specifically, the fundamental determinants of this process are, on the one hand, fertility contraction and, on the other, lengthening lifespans, which derive from a general improvement in living standards as well as from medical advancements. In particular, the global population aged more than 60 reached 962 million in 2017, almost three times more than in 1980. This number is expected to double again by 2050, reaching nearly 2.1 billion⁵⁰. By the same year, older people are expected to account for 35 percent of the European population, 28 percent in Northern America, 25 percent in Latin America, 24 percent in Asia, 23 percent in Oceania and 9 percent in Africa. Focusing on Italy, according to the demographic forecasts conducted by ISTAT, in twenty years from now the percentage of people over 64 will shift from the current 22 percent to 31 percent⁵¹. This means an absolute increase of 4.8 million people in this age group, accompanied by a decrease of almost 6 percent in terms of total population that by 2040 is forecast to decrease to 56.8 million⁵². By 2065, life expectancy will rise, reaching an expected age of respectively 86.1 years for men and 90.2 years for women⁵³.

From an economic point of view, there are several consequences to this demographic trend. First of all, there will be repercussions on the labor supply, manifested in companies facing worker shortages with negative effects on economic growth. In order to prevent this risk, a number of strategic actions should be implemented, such as an increase in the retirement age, a number of investments to foster productivity and more flexible immigration policies. Secondly, the aging population might shift its demand from durable goods toward services, such as healthcare. In addition to this, there will be changes in terms of savings decisions: as a matter of fact, older people tend to save more, with consequently lower levels of interest rates and inflation, making it harder for central banks to use traditional tools to support economic growth. Finally, the generational imbalances described previously will require a greater amount of resources to be allocated to social spending by governments. Governments will therefore be faced with budgetary difficulties due to pension and healthcare expenses and, in order to mitigate the impact of these dynamics, it will be necessary to implement appropriate policies, for instance supplementary pension instruments.

Impacts on social welfare, healthcare system and eventually effects on the asset management industry

The overview presented in the opening of this chapter highlights the effect of population aging on different branches of the asset management industry, which is due mainly to the direct impact of a potential slowdown of the economy and to the role the AM industry will play in the future of the welfare state. In order to assess the potential magnitude and relevance of this trend on the aforementioned industry, a two-step analysis was carried out. The first part describes the effects of demographic shifts on the real

⁵⁰ United Nations - World Population Aging

⁵¹ Prometeia

⁵² World Population Review

⁵³ Istat

economy. The second focuses on the correlation between Italian GDP and AuM. The latter will be used to make inferences on the impact of demography on the asset management industry.

Literature shows that a worker's productivity is correlated with their stage of life, due to factors such as "accumulation of experience over time, depreciation of knowledge and age-related trends in physical and mental capabilities"⁵⁴. It has been proven that such a factor determines a bell-shaped productivity curve, which is upward sloping for the 25-40 age group, and then downward sloping due to the incidence of physical and skills impairment of older people compared with younger ones. In this perspective, the aging trend will have a major impact on the country's output per worker ratio. Demographic trends are estimated to impose a substantial burden on European GDP by decreasing it, on average, by 0.2 percentage points per year. The situation is forecast to be worse for countries like Italy, which are more exposed to the phenomenon of population aging⁵⁵. The IMF Working paper proposes, as a strategy to reduce the magnitude of this trend's impact, an increase in investments (in R&D) related to the healthcare industry. These will contribute to minimizing the physical impairment due to "workforce aging". Such policies should be implemented by each State, especially considering that, on the one hand, the slowing pace of the real economy is shrinking the GDP per capital figure, reducing the future wealth of the population, and on the other hand, the growing debt-to-GDP ratio is burdening younger generations to an unprecedented level. A request for aid, to ameliorate the situation, is addressed to the private sector.

In this sense, the asset management industry is trying to grasp and tackle all the aforementioned determinants of the future consumption patterns of financial services to

provide concrete solutions. Some experts believe that there are potential benefits to be exploited by adapting the investment strategies to this changing environment. In an article of a relevant economic Italian newspaper, a financial manager outlined that investing in themes related to longevity is currently outpacing the market in terms of growing potential, which will be further enhanced in the next 20 to 25 years.

Over this period, the effects of an aging population will be more visible and extremely relevant. Another key fact is the investment approach developed by the asset management firm. The focal points of the strategy are the long-term perspective and the diversification feature. The former aims at reducing the risk related to the cyclicity of the industries. The need for long-term perspective requires patience and determination from the investor, who could otherwise be influenced to disinvest due to short-term market fluctuations. It is also important to keep in mind that long-term investments can leverage factors such as increasing innovation in the personal services industry, the importance of medical research and new consumption patterns.

Another key trend that helps in understanding the future of the asset management industry is the increasing migration flow, which is characterizing the global scene in the early 21st century. In this sense, it is important to outline the two major directions of such movements: one is national, characterized by increased urbanization, and the other is international, involving migration from emerging countries to developed nations. The combination of such patterns is forecast to increase the share of urban population from 3.9 B in 2014 to 6.9 B in 2050⁵⁶. The aforementioned facts unveil major potentials for many markets, the most evident being the industrial and real estate sectors. The migration flows that will likely characterize mostly developing countries are opening up new, major challenges related to the planification and construction of megalopolises. The structure

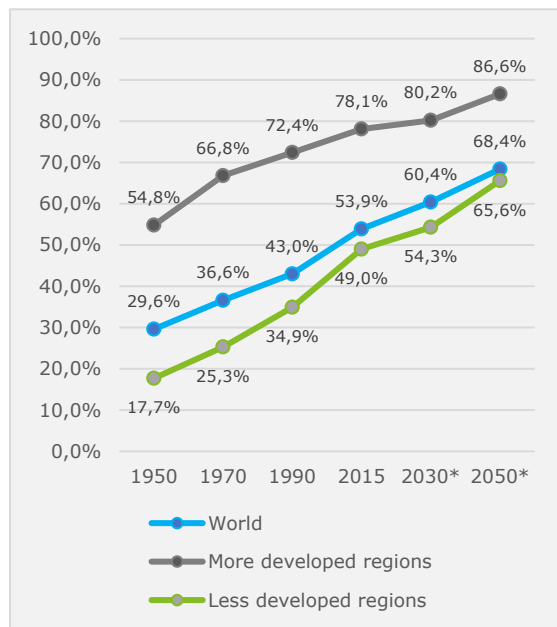
⁵⁴ International Monetary Foundation

⁵⁵ Sole 24 ore

⁵⁶ Forecasts of the United Nations Department of Economic and Social Affairs

of these cities will have to comply with the increased necessities and higher standards – above all health and waste management. As an example, the importance of these new trends for the AM industry is further outlined by UBS's decision to include these types of industry in its long-term trends portfolio.

3.1. Graph: Percentage of population living in urban areas worldwide from 1950 to 2050, by regional development



In 2020, 45 percent⁵⁷ of the global workforce will be composed of Millennials. It is important to bear in mind that, in terms of sheer size - with its 2.3 B people - this is the biggest generation ever. In this sense, it is crucial to outline the impact on the industry that is due to the profound difference of the Millennial generation with previous generations and to its weight on the current and future global population.

Understanding the consumption and desire patterns of this new generation is and will be crucial to the investment management industry. Their low salaries, and therefore their lack of resources to be invested in their future consumption, their need to constantly be able to monitor their financial situation and their proclivity for online assistance platforms have already begun to create a

whole new industry. Since the last decade, with the development of FinTech services, the world has seen the birth of a new, flourishing industry that is taking the role played by PayPal a step forward.

The aforementioned aging population, together with an increase in the average years spent in education before entering the job market, are leading to a marked increase in the average age of investors. Not only do young people start working later than their parents, but they also start saving later as their first wages are lower. The average yearly earnings per family when the main earning person is up to 35 years old decreased by €911 from 2003 to 2016, whereas for people aged 65 and older, the average family yearly wage increased by an astonishing 30.5 percent, or €7,247⁵⁸.

3.2. Graph: Annual earnings by age clusters: below 35 vs above 65



As it can be seen in the graph, the former category of people started earning less on average than the latter in 2003. It is very likely that this trend, which showed consistency in the last two years, will also be valid in the near future due to the lack of

⁵⁷ Article: Siete pronti per i millennials? Asset management - Francesco D'Arco

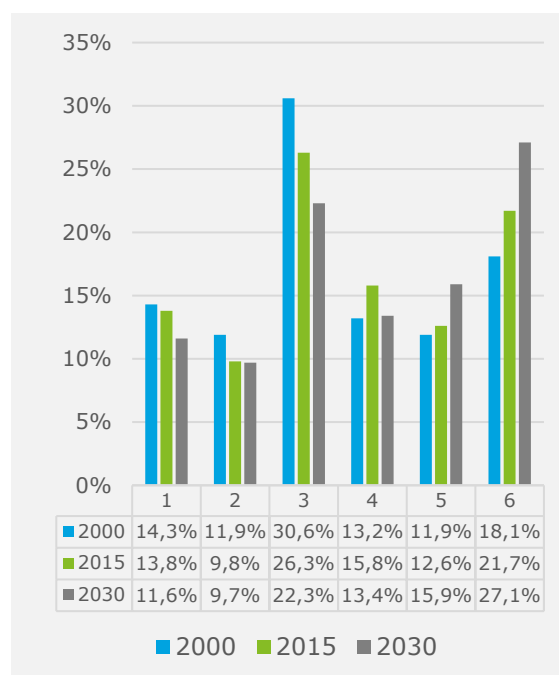
⁵⁸ ISTAT elaboration, data from i.Stat database

policies aimed at facilitating young people's access to the job market.

As a consequence of these factors, the asset management industry has to adapt to the shift in the average age of its clients, tailoring the services offered to the needs of the older clientele. The consolidated belief in literature is that, as a person gets older, their investments should decrease in volatility, and hence in risk, promoting a safer position against the opportunity of gaining higher returns; the reasoning is that a person who is expected to work for many years can face a higher degree of risk because, even in the case of a substantial loss, they can still recover the lost amount thanks to the future years of work. However, many believe that this rule is no longer valid given the increasing expected length of working life for each individual. Moreover, some experts believe that the tendency of older people to invest directly or indirectly in bonds and domestic markets, both perceived as safer, will be reverted in order to allow investors to earn more consistent returns, up to a target of a nominal average yearly return of at least 7 percent, which would allow people to maintain a constant standard of living⁵⁹. In order to do so, new financial products will have to be designed and delivered.

"In 2020, 45 percent of the global workforce will be composed of Millennials. It is important to bear in mind that, in terms of sheer size - with its 2.3 B people - this is the biggest generation ever."

3.3. Graph: Age distribution of the population in Italy in 2000 and 2015, with a forecast for 2030



1 = 0-14 years old; 2 = 15-24; 3 = 25-44; 4 = 45-54; 5 = 55-64; 6 = 65+

Given the demographic situation outlined, the Italian public provision plan will be subject to increasing pressure, with many economists doubting that it will turn out to be sustainable in the long-run: this is the reason why complementary provision plans are also going to play a very important role in the near future. This claim is also justified by the fact that, as of 2019, only 9.5 percent of retirees in Italy could afford a full-time in-home nurse using only the pension they receive, and for almost one half of seniors, the maximum they could afford was five hours per week. Furthermore, more than 70 percent of Italian seniors earn less than €20,000 per year in total, which means less than €14,600 available to be spent each year⁶⁰.

Pension funds in Italy manage assets worth 10 percent of the Italian GDP, very far behind other European countries such as Finland, the United Kingdom and Switzerland, in which they are valued

⁵⁹ Pictet

⁶⁰ Sole 24 Ore

between 80 percent and 120 percent of the domestic GDP, and the Netherlands, where they reach a remarkable value of 200 percent of GDP⁶¹. Even the number of adhesions is low: as of September 2017, only 8.1 million workers, less than one third of Italian workers, were enrolled in a complementary provision plan. The IORP II Directive was recently introduced in order to regulate the governance and transparency of pension funds; Italian players are trying to take the directive as an opportunity to evolve toward a lighter structure that could potentially attract more savers. The aim is to increase the dimension of the funds by reducing the total number through mergers, thus gaining more weight and therefore being able to play a more relevant role in the European scenario⁶².

However, population aging is not only a relevant trend for seniors, as young people must also take into account the fact that they will work and live longer. People entering the job market now are realizing that they will face harder conditions than their parents, with greater difficulties finding stable working positions and a growing need to change and adapt midway to the evolving job market. This, of course, translates into the need of accurate planning of the saving and investing horizon, in order to cope with unexpected events. Since only approximately one fifth of young workers are enrolled in a complementary provision plan, pension funds are evolving in order to be more attractive for this category of workers. For example, the aforementioned directive encourages fund transparency by requiring an implementation of websites, both as sources of useful information and as a communication channel between the fund and its subscribers. However, the great level of political uncertainty and the high degree of public debt complicate the scenario. In 2017, the Italian public debt was valued around €2,358 B and the annual cost of servicing the debt was €65.6 B; this means that each Italian citizen owned a portion of debt of almost €38 thousand. However, this portion

of debt is not equally distributed among the different age groups. Considering the amount of debt produced in each year, and assuming that the debt will stabilize in the future, it is possible to compute the debt burden for each individual: a newborn starts his or her life with something more than €60 thousand in debt, versus €56 thousand for people born in 2004 and €45 thousand for those born in 1963. If the interests to pay are included in the calculations, the numbers become even more impressive, as for each euro upon a person born in 1946, respectively two, four, eight and sixteen euros are shouldered by people born in 1986, 1994, 2009 and 2014⁶³.

These computations aim at demonstrating the high degree of uncertainty regarding the sustainability of public provision plans currently implemented in Italy, which in turn contributes to the widespread feeling that a person's working life is getting longer and longer. Another fact worth considering is that, since people feel that they will have to work longer, they might worry less about the savings destined for their retirement as they see it as very distant in time and prefer to focus on the shorter term; they will therefore concentrate their saving strategy in a form of investment that is more liquid than a pension fund.

Finally, Italian pension funds are typically characterized by high annual percentage rates of charge: some instruments, such as the PIPs⁶⁴, have a surplus compared with negotiated pension funds' average annual percentage rate of charge that ranges from 142 to 233 basis points. The effects on the long run are rather heavy for workers, considering that a surplus of 2 percent instead of 1 percent potentially decreases the accumulated capital by 18 percent over 35 years. Many see the solution to this problem as the introduction of Pan-European pension products (PEPP), but these are not likely to be available in the market before two years⁶⁵.

⁶¹ Corriera della Sera - Economia

⁶² Storie della Sera

⁶³ Sole 24 Ore

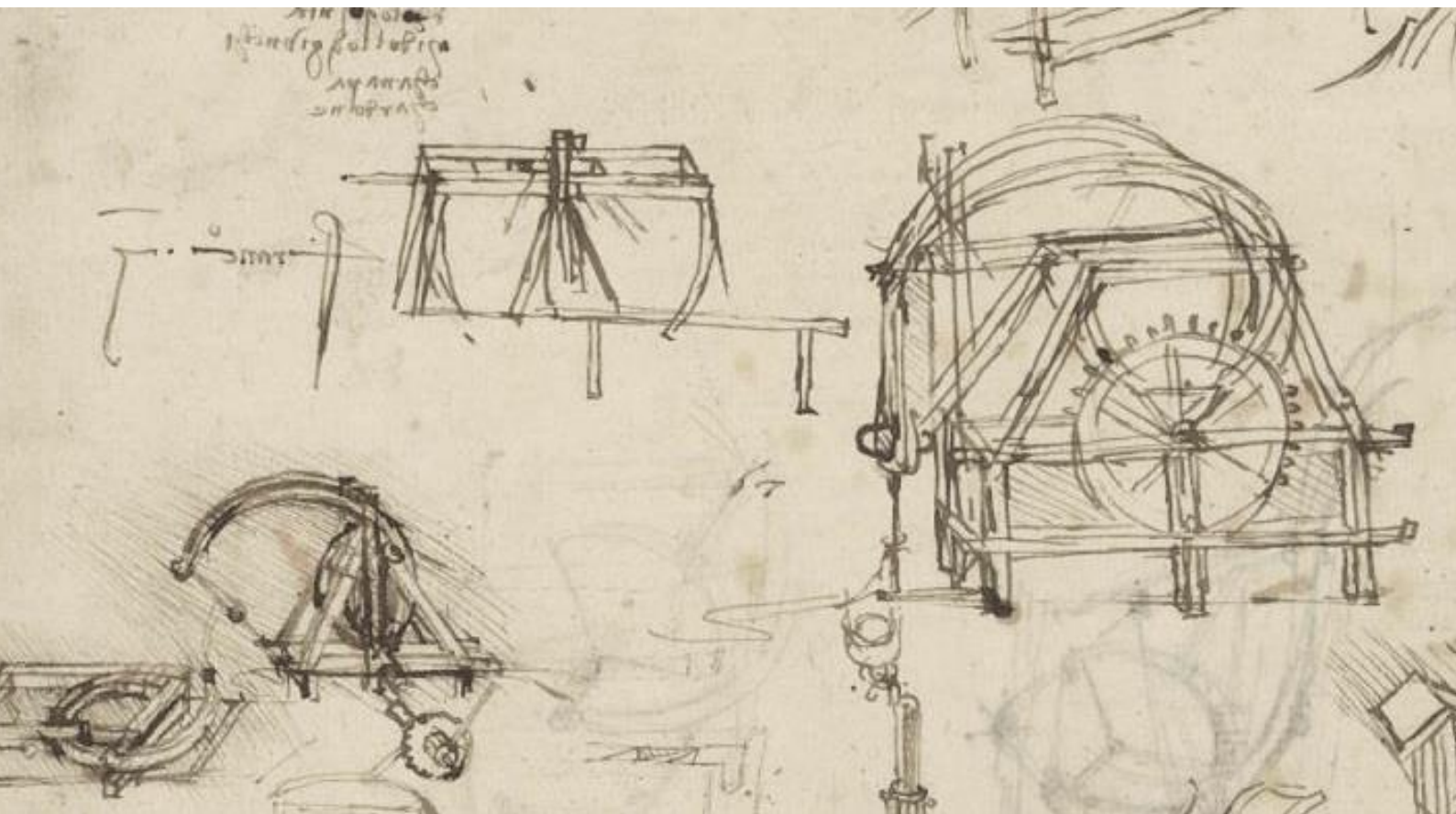
⁶⁴ *Piani Individuali Pensionistici, that is, individual pension plans*

⁶⁵ Sole 24 Ore

When considering also the fact that in the next years a very consistent portion of wealth in Italy will undergo a succession, it becomes clear that generally speaking, the asset management industry should not focus mainly on the older population groups. Rather, an increasingly decisive role will be played by Millennials. One of the main characteristics of this age group is its familiarity with technology, although the group still harbors some doubts over security. There is likely to be an increasingly widespread use of digital technologies. The main role will be an “informative” role, providing a high degree of transparency and

allowing investors to constantly keep track of their assets under management. Another characteristic attitude of Millennials is their liking for customization, which they perceive as an important feature of a premium good or service. Additionally, they will be more interested in technologies such as Robo-Advisory, which will be described extensively in the next subchapters. Finally, Millennials have a particular propensity to care about topics such as social and environmental sustainability; this will translate in increased attention to the selection process of suitable investments for such clients⁶⁶.

"Pension funds in Italy manage assets worth 10 percent of the Italian GDP, very far behind other European countries such as Finland, the United Kingdom and Switzerland, in which they are valued between 80 percent and 120 percent of the domestic GDP, and the Netherlands, where they reach a remarkable value of 200 percent of GDP."



⁶⁶ Pictet

MiFID II

The acronym MiFID stands for Markets in Financial Instruments Directive, and it has been applicable across the European Union since November 2007⁶⁷. This directive can be considered as the cornerstone of a long-awaited harmonization in the European financial market. In January 2018, about ten years after MiFID I entered into force, MiFID II was introduced with the aim of further integrating the widely diversified financial environment. Both directives share the same main goal, which is the safeguard of the weaker position of the investor in the financial industry, who was often subjected to information asymmetry⁶⁸. This purpose is fulfilled by guaranteeing the investor a higher degree of transparency and protection. A fact worth mentioning is the geographical application of MiFID: as of today, the directive only applies to investment firms having a physical presence in Europe. Apart from some asset management firms, non-EU financial firms managing European mandates and competing for European clients' assets are not subjected to the effects of this directive. This could appear as a legislative gap and, if so, it may represent a double-edged weapon for such companies in the long run⁶⁹.

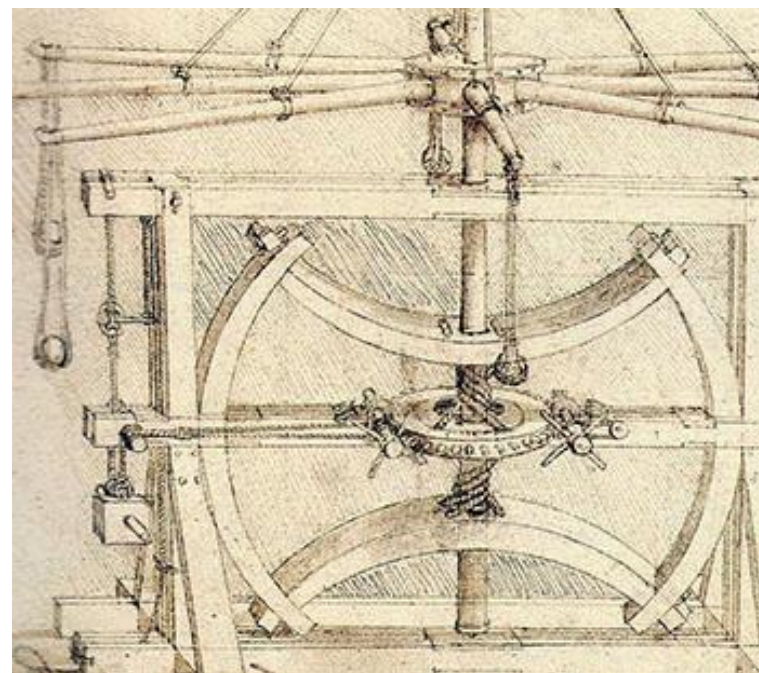
Broadly speaking, MiFID can be interpreted as a long process of transformation of the industry that started in 2007 and is yet to be completed. It is driven by a backbone of aims, among which the need of ensuring a safer, more efficient and especially transparent financial industry and, at the same time, harmonizing the EU financial market. The principles implemented by MiFID II are the result of an empirical analysis of the effects and gaps of the previous directive.

Main objectives

MiFID legislates on a broad variety of topics encompassing the whole portfolio formation and distribution process, from product composition to retail distribution. The prescriptions underlying this directive are related to either the whole value chain, like best execution and product governance, or specific portions and sub-processes, like the transparency of fee structure and costs, as well as reporting⁷⁰.

The directive has had a substantial impact on three main aspects: firstly, on the principle of best execution; secondly, on limiting, monitoring and controlling, and, lastly, on the transparency that must characterize all the industry's operations⁷¹.

Since the goal of this paper is to analyze the Italian asset management industry, this research does not presume to parse the entirety of the directive. It will therefore focus on highlighting the key consequences that arise from the introduction of this set of rules on this particular industry.



⁶⁷ European Commission

⁶⁸ FT Adviser

⁶⁹ MiFID II Act

⁷⁰ Bloomberg

⁷¹ Bloomberg

Best execution

The precept of best execution, which was already introduced by MiFID I, has been further detailed and strengthened in MiFID II. The obligation to achieve best execution is ruled by Article 27, which states that an investment firm must take all sufficient and necessary steps to obtain the best possible result and to maximize the satisfaction of its client when executing a client order. The policies under which financial companies operate must be clear and easy to understand by an average client. Moreover, a periodic control and re-evaluation of the practices must be carried out in order to verify their effectiveness and compliance with the directive. The key parameters that must be taken into consideration when trying to obtain the best possible client service are price, costs, speed, likelihood of execution and settlement, size and nature. Moreover, the quality and the costs of the transactions carried out by firms must be addressed in public reports on an annual basis⁷².

Product governance

The relevance of product governance is surely worth mentioning since it limits and controls the genesis of the product. Specific provisions, which were conceived following a “bottom-up” approach, have been introduced regarding both the stages of creation⁷³ of the financial products and their distribution⁷⁴. The development of new investment products, together with the emergence of new financial operators and trading venues, gave rise to the need for the EU legislator to protect the investor through a tailor-made discipline⁷⁵. The new directive provides five categories that have to be taken into consideration by fund manufacturers when clustering the different types of investors. In other words, in order to identify the target

market, the manufacturer has to consider, on the one hand, the nature and complexity of the product, and, on the other hand, the type of client divided into retail and professional clients or qualified counterparty categorized by his or her knowledge and experience, financial situation, risk and loss tolerance, aims and needs. Finally, each cluster of investors is matched with a specific target market⁷⁶. The identification of the “actual target market” relates to a preliminary phase that must be carried out in addition to the appropriateness and suitability tests⁷⁷.

Distributor intermediaries are also required to define their own, more precise and updated target market; this identification must be carried out on the basis of the information provided by the producers and that collected through direct contact with the end client. The data gathered allows the distributor to profile the investor and thus check if the financial product under negotiation is suitable for her. All of these aspects will lead to greater vertical integration between manufacturer and distributor.

Transparency of cost and transparency of reporting

MiFID II aims to provide quality information that will reduce the asymmetric positions held by investors and advisors. Two instances are transparency reporting and the transparency of costs⁷⁸. The former, already introduced by MiFID I, consists in a document provided by the financial firms to the regulators indicating all the data regarding the details of the trade performed. The plethora of information included ranges from the personal details of the trader to the specifics of the algorithm. This measure has been consistently enhanced by MiFID II, which lengthened the list of required information. In order to ensure the respect of

⁷² AFM - Dutch Authority for Financial Markets

⁷³ Here “development” needs to be interpreted as creating and managing financial products

⁷⁴ FT Adviser

⁷⁵ Here “tailor-made discipline” needs to be interpreted as based on the characteristics and the needs of the single investor

⁷⁶ FT Adviser; The Trade

⁷⁷ Soldi Expert - Interview with Massimo Scolari, ASCOFIN President

⁷⁸ Soldi Expert - Interview with Massimo Scolari, ASCOFIN President

the aforementioned rules, regulators granted supervisory authority powers to both check the filings and apply sanctions in case of missed compliance. The latter, instead, focuses on the relationship between the company and the client. Financial firms have to provide the end client, at least on an annual basis, with a detailed overview of the investment plan's cost structure. This disclosure must be presented with both a precise separation between the cost of the financial instrument itself and the cost of the service⁷⁹, and a description of how costs are charged⁸⁰.

These brief examples illustrate clearly how the concepts introduced by the regulators revolve around the investor, lowering the information asymmetry and providing more transparency. One of the theoretical outcomes of this policy would be an increased efficiency of the financial markets.

Among the major changes introduced by MiFID, there is the identification of trading venues that are alternative to regulated markets. The various trading venues now available to be chosen by clients and intermediaries are Multilateral Trading Facility, Organized Trading Facility and Systematic Internalizer⁸¹.

All these relatively new trading venues are characterized by the same level of transparency and what is really innovative is that, unlike regulated markets, they can also be organized and managed by financial intermediaries authorized to perform services and investment activities. This may give rise to a substantial conflict of interest since the roles of financial controller and of controlled intermediate risk overlapping.

Impact of MiFID II

The actual consequences of the introduction of MiFID II are still uncertain due to the complexity of the directive, which is legislating on an extremely vast and dynamic environment. As the industry players foresaw, the implementation of MiFID II is a

medium-term process requiring a continuous alignment of financial institutions' internal operations with the directive.

Nevertheless, some early changes were seen to take place in this first year of application, which cleared the path for additional further developments.

Further key points introduced by MiFID II are the Organized Trading Facility (OTF) and the development of a new directive on algorithmic trading as well as the reinforcement of the already existing ones; the scope of the former is related to trading in non-equity instruments, whereas the goal of the latter is to provide regulatory authorities with additional tools in order to counter the spread of illegal practices based on the use of algorithms' power, while achieving, once again, the reduction of information asymmetry.

The second part of our analysis of the directive seeks to bracket the major impacts on the asset management industry into three macro-categories which proved to be interconnected: product composition, product management and distribution⁸². The concept of target market, which traditionally was intrinsic to the product, is now becoming more and more linked to the investor. This outlines the possibility of a shift from a supply-driven to a demand-driven industry. This may be the case because, with this new directive, the needs and preferences of investors, in terms of risk and returns, are becoming central to the asset managers' choices. Transposing this new regulatory framework into the Italian market unveiled the consequences on returns arising from Italian cultural peculiarities. Italian investors typically have a very low level of financial literacy, which implies that they cannot hold risky securities, which are the most profitable, in their portfolios and thus earn lower returns. Eventually, this could result in a market full of very simple products whose funds' and asset managers' fees may not be justified by the low returns offered.

⁷⁹ "Cost of service" for the law is defined by *Investment service + Ancillary services*

⁸⁰ Sole 24 Ore

⁸¹ KB Associates

⁸² Bloomberg

This deadlock for the AM industry may be solved by two different scenarios, depending on how the asset manager evolves and adapts. In the best-case scenario, this figure evolves from being a mere asset allocator to becoming a financial consultant, who manages the wealth of the investor with a wider approach. Otherwise, investors, unsatisfied with the high fees brought to light by the transparency cost measures, may want to switch to cheaper solutions, such as passively-managed products. These major issues will be discussed further in the next chapter.

Looking forward

Considering the above-analyzed logic behind MiFID II, it is reasonable to assume that the next directive in the matter will try to fill the gaps that the former left unregulated. The rationale underlying the set of rules consists in improving the existing ones while, simultaneously, introducing new aspects emerging from a prolonged and empirical analysis of both financial markets and interactions between players and the directive⁸³. Among the biggest inconsistencies found in the current directive there are the yet-to-improve transparency measures between the investment firms and the listed companies to which the funds go, and the legislative gap uncovered by MiFID pertaining to non-EU investment houses and SGRs.

Concerning the former, the regulators have tried to enhance the overall transparency of the proceeds that govern the relation between investors and financial intermediaries. This would hopefully lead to an increase of net inflows toward the AM industry, thus improving also the outflows generated by the investments; moreover, given the increased ability to monitor performance, the fund managers will be able to stabilize and better manage money flows. However, as matters stand, this superior allocation of resources could be endangered by a still foggy, unclear legislation on this side of the industry.

By contrast, the legislative gap uncovered by MiFID II, as already mentioned, may represent a double-edged weapon in the long-run. While in the short run not falling under MiFID II can obviously produce great advantages for the firms, e.g. not having to comply with what is stated in the directive and competing against the firms that fall under it, in the long run this benefit can turn into a curse. As MiFID's main focus is on investors and the creation of a transparent market in which they can freely invest, in the long term private investors could privilege MiFID-compliant environments, of which those companies are not part.

These are just two of the possible scenarios deriving from the recent introduction of MiFID II. Nevertheless, it must be highlighted that due to the lack of sufficient empirical evidence, some aspects are yet to be clarified. Interpretation, application and even the final impact on the key aspects of the industry, ranging from the creation of products to their distribution, are still under investigation. A further obstacle in the process of predicting future consequences of these changes is the very technicality of the subject under analysis.

Even though more time will be required to make reliable forecasts and comments, it is now possible to confidently state that, in order to implement the obligation of cost transparency and to give substance to the reinforcement of the investor protection system, greater proactivity on the part of the consultant is needed. The implementation of this directive should represent a significant opportunity for both the investor and the intermediary: the former is now able to become more aware of his or her investments, while the latter could transform a compliance profile into enhanced efficiency and competitiveness. To conclude, there is no doubt that the process of metabolizing the changes introduced by the new regulatory framework is physiologically quite lengthy. Whatever the case may be, the new legislation will probably turn out to be an opportunity for change that is expected to produce positive effects in the industry in the years to come.

⁸³ Sole 24 Ore

Tech

The combination of technological innovation and financial instruments intermediation should be the subject of an in-depth analysis, considering the impact that technological transformation is producing on the financial system. Technologies such as artificial intelligence (AI) and Blockchain are changing for good the delivery and use of financial instruments. To give the order of magnitude of the attractiveness of this sector to the financial industry, Global FinTech funding had a compound annual growth rate of 44 percent from 2013 to 2017⁸⁴. Additionally, artificial intelligence is expected to experience a cumulative global direct investment growth of 63 percent per year⁸⁵ in the years 2006 to 2022. In the development of this new technology, Asia and the USA are the main players. Nevertheless, the European and therefore the Italian financial institutions are also attempting to build these technologies into their operations and supplied services. Therefore, what is important to determine is how Italian institutions will deploy these tech instruments and what their effect will be on the Italian asset management industry and on client behavior.

AI and Big Data

The main potential of AI technologies lies in their ability to recognize patterns, anticipate future events and make decisions in a human-like fashion, but with a level of accuracy and speed far superior to that of the human intellect, without cognitive bias, and with the capability of analyzing extremely large amounts of data.

AI technologies are currently being applied in a variety of ways to the financial sector, pursuing several purposes. Such purposes can be broadly divided into two clusters: the

first consists in improving the service delivered to the consumer to achieve an edge over competitors, while the second entails reducing costs by streamlining and automating back-office and other operational activities.

Regarding the first purpose, machine learning can offer significant aid to asset managers by checking and reducing cognitive biases in their decision-making, which could lead to suboptimal decisions. Such “debiasing techniques” will therefore improve the quality of decisions in asset allocation and, consequently, the performance of asset management firms⁸⁶.

Furthermore, AI technologies can use data to develop new insights and help firms generate greater alpha for their clients⁸⁷. This is highly related to the fast growth in the volume of data generated globally: the international datasphere⁸⁸ is forecast to grow from 33 zettabytes⁸⁹ in 2018 to 175 zettabytes in 2025⁹⁰. Such a growing amount of data represents a huge opportunity for asset management firms: together with financial data, a growing amount of alternative information is being processed and used in order to gain a strategic advantage on competitors. To do so, investment firms are continuously looking for new ways of exploiting alternative data, by relying either on partnerships or on recruitments of professional figures experienced in data management and analytics.

Finally, AI can be highly effective in profiling and clustering clients, consequently tailoring solutions to their preferences. One application is Robo Advice, which will be further analyzed in the next sections.

On the cost side, AI can help employees in the back-office, non-core activities of investment firms, improving efficiency and likely reducing the workload in operational

⁸⁴ The future of FinTech and financial services - EY

⁸⁵ European Investment Bank

⁸⁶ Capgemini

⁸⁷ Deloitte

⁸⁸ *The notional environment in which digital data is stored; especially the Internet viewed in this way.*

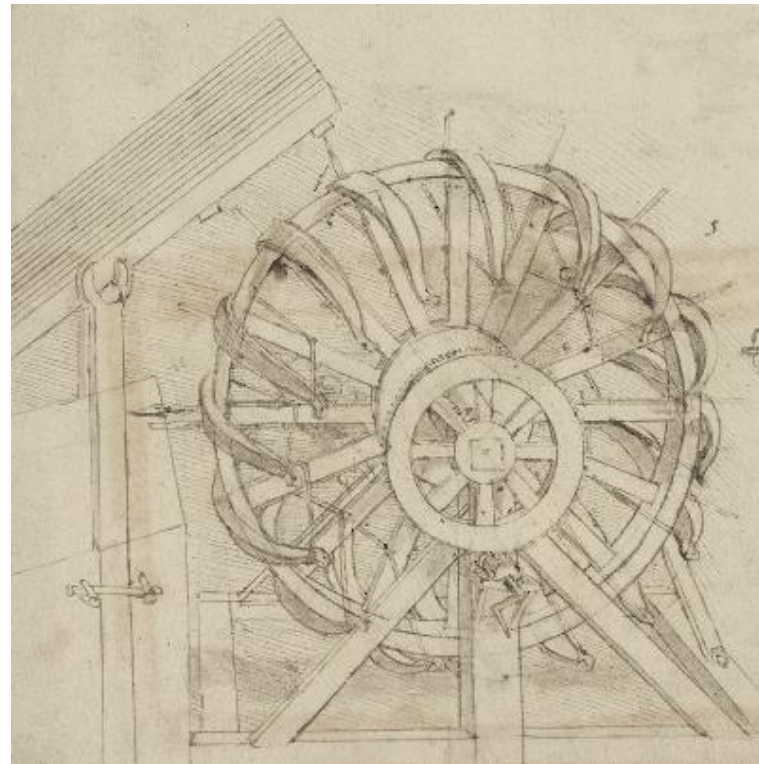
⁸⁹ 1 zettabyte is equal to 10^{21} bytes, i.e. a billion of trillions of bytes

⁹⁰ Seagate & IDC

functions, but it would hardly substitute for workers completely. The advent of such technologies could lead to a restructuring of the firms, reshaping their human capital structure. On the one hand, there might be a reduction in the overall headcount, and, on the other, the recruitment process is likely to attract a workforce with either strong programming knowledge or sharp soft skills⁹¹.

Overall, the development of AI technologies will favor those firms that will be able to quickly embrace technological changes, developing or acquiring the right competencies and resources to make the best use of such technologies. Big firms clearly have an advantage in this respect, as they can often acquire the resources needed through M&A deals with small FinTech startups. Research has shown how, since 2010, 12 percent of startup acquisitions have been made by firms in the financial sector (second sector after IT & software), while software startups have been the major target of acquisitions, occupying an increasing share in the last years. Around 80 percent of the deals have been carried out by US or European companies. However, while acquisitions by US firms have been higher in number than US startups created, meaning that US Firms bought foreign start-up as well, Europe shows an opposite figure, with a negative M&A balance. In a sense, this reflects how knowledge tends to flow from European firms to foreign firms. The case of Italy is particularly relevant, as the ratio of exits to acquisitions is 1.36, higher than the European average of 1.07⁹². With regard to AI specifically, research carried out for the financial sector has considerable relevance: among the 194 producers and users of AI mapped by AGID's AI task force in 2018 (among which companies, startups, and universities), 44 operate in the FinTech sector⁹³.

Competitive advantage can also be created by securing proprietary data points that competitors cannot access, as the quality of AI-based solutions largely depends on both the amount and quality of data used, and as data becomes more and more widely available. A way to do this can be collaborating with or acquiring alternative data providers: informational advantage can be generated through strategic partnerships and M&As. Compared with developing the necessary capabilities internally, acquisitions would allow financial players to secure proprietary data quickly, with low risk and in a cost-effective way. Again, big companies will have an edge in this respect: not only do they usually have the financial resources necessary to buy out small companies, but also the gains they would benefit from by relying on better data would be spread over a large volume of activities, therefore justifying even a possible acquisition premium.



⁹¹ BCG in collaboration with China Development Research Foundation

⁹² Mind The Bridge & Crunchbase

⁹³ Agenzia per l'Italia Digitale

The power of algorithms

It is evident that technological solutions are already changing the market dynamics. For example, many experts see in the anomalous performance of the stock exchanges, in the four months from December 2018 to March 2019, a very strong effect of trading algorithms. A characteristic “V” pattern occurred: in less than four months, the market completely changed opinion about future perspectives, despite the fact that some critical points still had to be solved, such as Brexit and the custom tariffs . Every day, new and increasingly sophisticated algorithms are entering the market, enabling funds and other institutions to apply strategies that are more and more complex compared with those applied by their older versions. These new strategies aim at abandoning the old “trend follower” approach, which consisted in following the market based on seasonality or statistical models, to move toward new algorithms capable of reacting with increased responsiveness to sudden market movements. These new instruments based on big data analysis and artificial intelligence can actively contribute to more frequent changes of sentiment in the markets, possibly leading to a future increment in volatility. Moreover, events such as disclosure of economic data, announcements on social networks and natural disasters are very likely to gain importance with respect to consolidated market trends, and with respect to the roles, they played before the spread of automated systems. The diffusion of these trading tools is already impressive, considering that in the United States almost 85 percent of the market is already determined by algorithms, 55 percent of it being represented by HTF⁹⁴, and medium or long-term quantitative strategies accounting for an additional 30 percent⁹⁵. In the HTF industry, geographical and physical boundaries also come into play. Since automated systems are often very similar to one another, an important factor in the race

between opponents is the speed at which decisions are made whenever an event occurs, with differences in the order of fractions of seconds; thus, factors such as the location of trading headquarters, providing the highest possible connection speed, become crucial.

However, the increasing automation of the market does not come without a cost: the incredible computational power and speed of these instruments can also be applied in order to produce distortions in the market. Spoofing, pinging and quote stuffing are becoming the new form of financial market fraud. In particular, these techniques aim at using the ability of automated systems to produce a huge volume of movements, both on the stock market and on other channels such as social networks, in a small period of time in order to induce wrong impressions in the market, exploiting the subsequent artificially-generated movements thanks to the information advantage. These techniques have been banned by regulatory authorities, and MiFID II itself is addressing them by implementing stricter requirements for HTF systems; however, the lack of funds provided to regulatory authorities heightens the difficulty of keeping abreast of the development of these new fraud systems⁹⁶.

Robo-Advisors

Robo-Advisors are internet-based advisory services that use algorithms to create investment recommendations with no human input⁹⁷. This technology has significantly developed since its emergence in 2008 from offering basic services with single product proposal or portfolio allocation after assessing the clients’ needs, to the latest sophisticated risk management profiling algorithms. These make it possible to shift between different asset classes following market changes and individual investment needs, adjusting single clients’ portfolios in real time. This considerable improvement has been accomplished through significant

⁹⁴ *High Frequency Trading, i.e. trading systems operating in the order of nanoseconds*

⁹⁵ Sole 24 Ore - Plus 24

⁹⁶ Sole 24 Ore

⁹⁷ *Regulating Robo-Advisory* Robo-Advisory - Philipp Maume

investments made by financial institutions, driven by a strong need for cost reduction through efficiency gains⁹⁸. Artificial Intelligence has pervaded all the features of asset management, ranging from end distribution to human advisory.

Despite the promising potential benefits arising from an attractive variable cost structure, which is on average 70 percent lower than traditional services⁹⁹, Robo-Advisory has not yet been able to conquer a significant portion of assets under management.

This slow start can be explained by its initial value proposition aimed at the lower end group of savers in terms of account dimensions, which were traditionally underserved. The players who made the most out of this technology in recent years are financial advisors and agents of insurance companies. The former group exploits this opportunity to increase their client base by also serving smaller clients without hurting productivity and the latter to provide and develop asset management services while maintaining the focus on insurance sales.

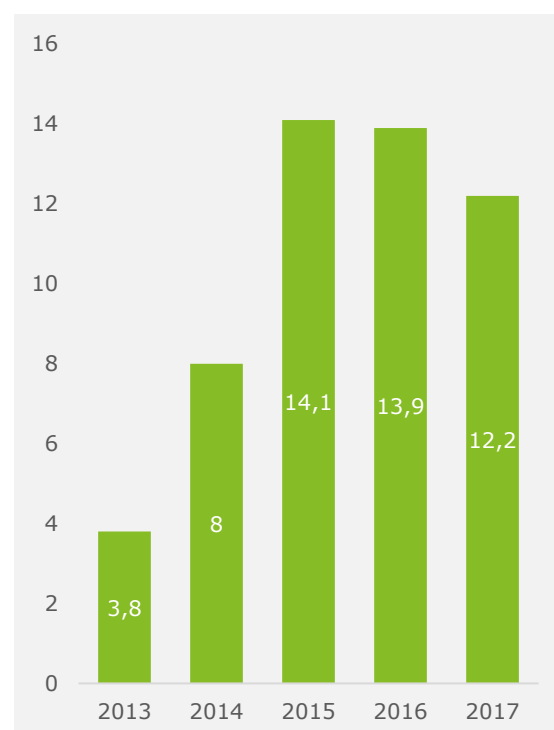
"In general, Robo-Advisory will smooth the transition from a product-oriented to a client-oriented distribution model. An example could be the application of AI technology to facilitate scaled distribution of customized products, enhancing operational efficiency and reducing the time-to-market."

Although it is fast growing, the market for this technology is still relatively small; this is due to the burden imposed by the massive investment requirements, which could threaten the possibility to break even, thus undermining the development of Robo-

Advisors in the marketplace. Additionally, the fact that financial institutions have invested heavily in advertising has brought the cost of acquiring a client in the US (which is the leading market for Robo-Advisory) to between US\$300 and US\$1,000¹⁰⁰.

Moreover, increasing the medium size of account under management takes time, making it difficult for providers to break even. The Italian market has not been as receptive as other markets like the US, which is the biggest player in terms of number of Robo-Advisors, amounting to more than 200. In the first semester of 2017, only nine players in Italy, ranging from FinTech start-ups to banks, had developed Robo-Advisory both for consumer use (B2C) and for advisors (B2B).

3.4. Graph: Global FinTech VC investment, \$ billion



Robo-Advisory usage in the Italian market substantially departs from that in the US, the most visible differences being the presence of fewer players and different fee structures. An in-depth analysis of the latter has

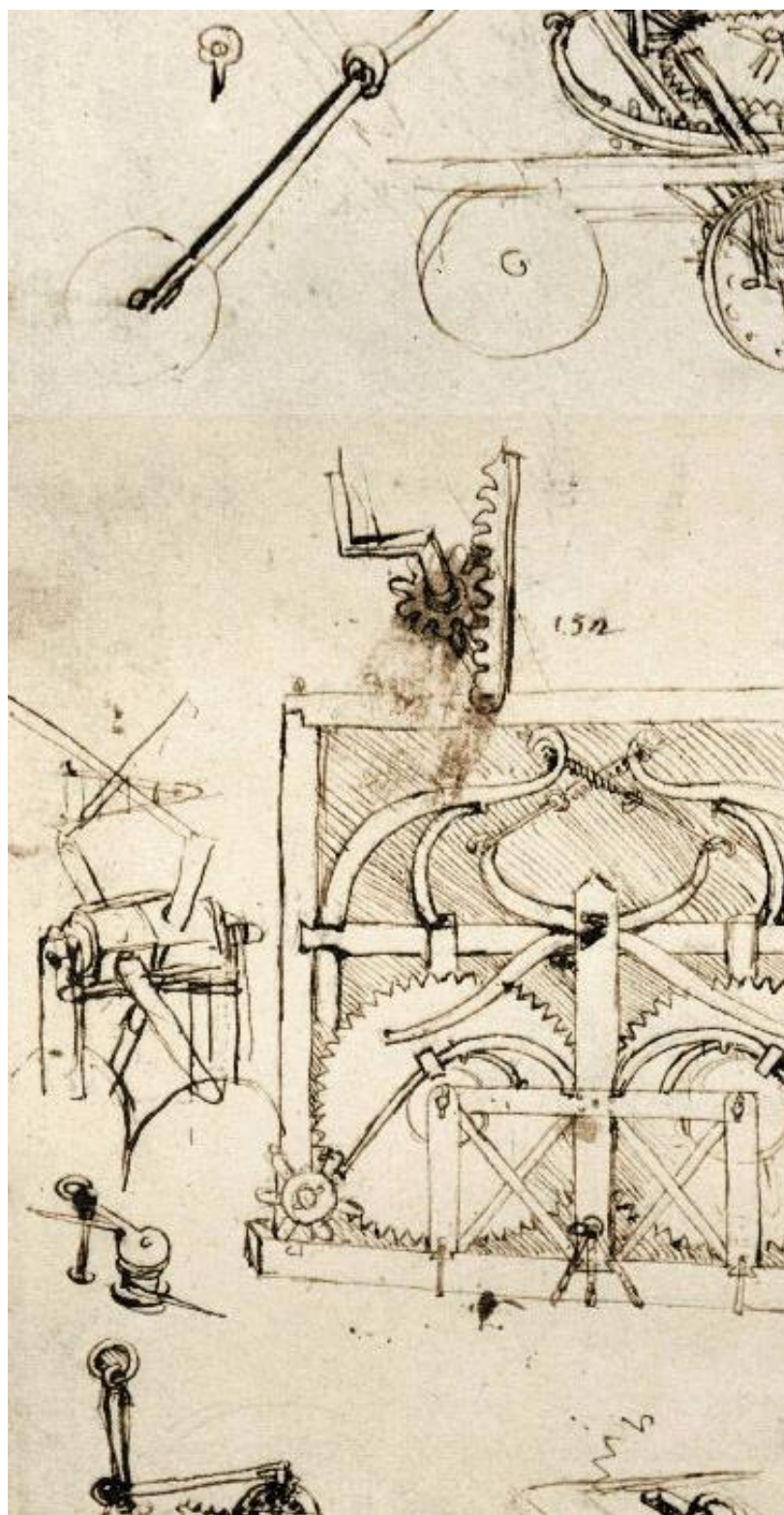
⁹⁸ Ernst & Young

⁹⁹ Accenture

¹⁰⁰ Ernst & Young

highlighted that US providers have lower fees than European ones. This feature can be explained by a strong determination to scale up the business, the amount of AuM being the main driver of profitability. On the other hand, Italian providers have a higher initial requirement to target more high-end consumers¹⁰¹. Given the possible future catch-up with the American market, the number of Robo-Advisory platforms is expected to increase, with the fee structures also probably aligning with the overseas market. The dissemination of this new technology is expected to be slower in Italy, mainly due to cultural factors such as low confidence in an automated process and the need for human interaction in the consulting process. These peculiarities of the Italian market will lead financial institutions to diversify also into the B2B segment, with platforms able to support both asset managers and banks to organize their back-office processes while maintaining the human advisor as a key selling point. MoneyFarm is the only Italian platform that matches the typical US model, creating ETF-based portfolios with a relatively low fee.

Even though there are cultural barriers to the widespread adoption of such solutions, there is increasing evidence of investor interest in this technology. For example, Italian affluent clients¹⁰² prove to be very open-minded, 70 percent of them being classified as “hybrid” investors, that is, investors willing to buy financial products both via traditional channels and via digital ones. This outcome is promising, considering that it is the highest percentage in Europe, where the average is around 60 percent. Furthermore, 26 percent of Italian small investors claim that they would like to entrust larger portions of their financial wealth to tech-based investment platforms, against an average of 19 percent in Europe. This is a possible incentive for suppliers to meet the currently unsatisfied needs of Italian investors¹⁰³.



¹⁰¹ PriceWaterhouseCooper

¹⁰² *Individuals owing financial assets between €50,000 and €500,000*

¹⁰³ Sole 24 Ore - Plus 24

A different approach to investment

The direct effect of Robo-Advisory is the increase of the client base since it uses its low fees to target Millennials and low-income households. However, it has not made its way in the management of high net worth individuals¹⁰⁴. These people are of particular interest for financial institutions, and even more for wealth managers. It is important to point out that they have specific characteristics and non-standard needs that substantially differ from those of ordinary investors. One requirement that such individuals frequently have is human interaction with their financial advisor. This leads them to choose traditional advisory and when they do choose Robo-Advisory, they tend to opt for a hybrid model, that is, one in which the classical interaction with a physical operator is complemented by advanced types of robo consultancy that include a higher degree of customization.

Despite the fact that this category is the most difficult to target, asset managers could leverage Robo-Advisory software to manage their complex needs. This competitive edge stems from the possibility to choose from a wide range of financial assets and derivatives, greatly simplifying the distribution process of more complicated instruments that could be crucial to hedge the portfolios of high net worth individuals. In general, Robo-Advisory will smooth the transition from a product-oriented to a client-oriented distribution model. An example could be the application of AI technology to facilitate scaled distribution of customized products, enhancing operational efficiency and reducing the time-to-market. This timidly increasing trend is likely to continue in the future, considering that 77 percent of wealth management clients trust their advisors and 81 percent say that face-to-face interaction is essential¹⁰⁵.

Moreover, this technology will also encourage self-management, thus enabling clients to handle their own financials with a meaningful set of information to guide them. This will prevent them from systematically underperforming the market. With the manifestation of the positive effects of this new technology, many users will consider the possibility of using it and casting aside their initial doubts. It is also important to point out that wealth management software is already available to small savers as well.

It has been estimated that an American investor could approximately halve the risk of his or her portfolio by diversifying into European stocks and bonds¹⁰⁶. In this respect, Robo-Advisory solutions will help investors, even the less educated, to reduce such bias and therefore efficiently minimize potential losses. The increase in the use of Robo-Advisory services will lead Italian savers, who tend to have irrational behavior patterns and a considerably low financial literacy, to make financially-wise decisions moving toward financial products with a risk profile that best suits their needs.

Tech as an industry to invest in

As outlined in this chapter, technology gives an outlook on the future. The possibilities related to the tech industry sector are huge and they permeate the entire economy. The main peculiarity of technology is its ability to shrink the cost portion of the firm's income statements, enhancing profitability, while at the same time allowing firms to exploit their business model at maximum capacity. The benefits related to the cost structure that have been explained in this paper apply, with some variation, to most business models, even if very different from that of the financial sector. In fact, after realizing the cost of the initial investment, the benefits deriving from it can be exploited for several years with minimal expenses, related only to maintenance. When talking about the value creation process, technology once again peaks for its

¹⁰⁴ HNWI is a classification used by the financial services industry to denote an individual or a family with liquid assets (€100,000 for many EU countries) above a certain figure

¹⁰⁵ Accenture

¹⁰⁶ Professor Bruno Solnik's computation – Professor of Finance at Hong Kong University of Science and Technology

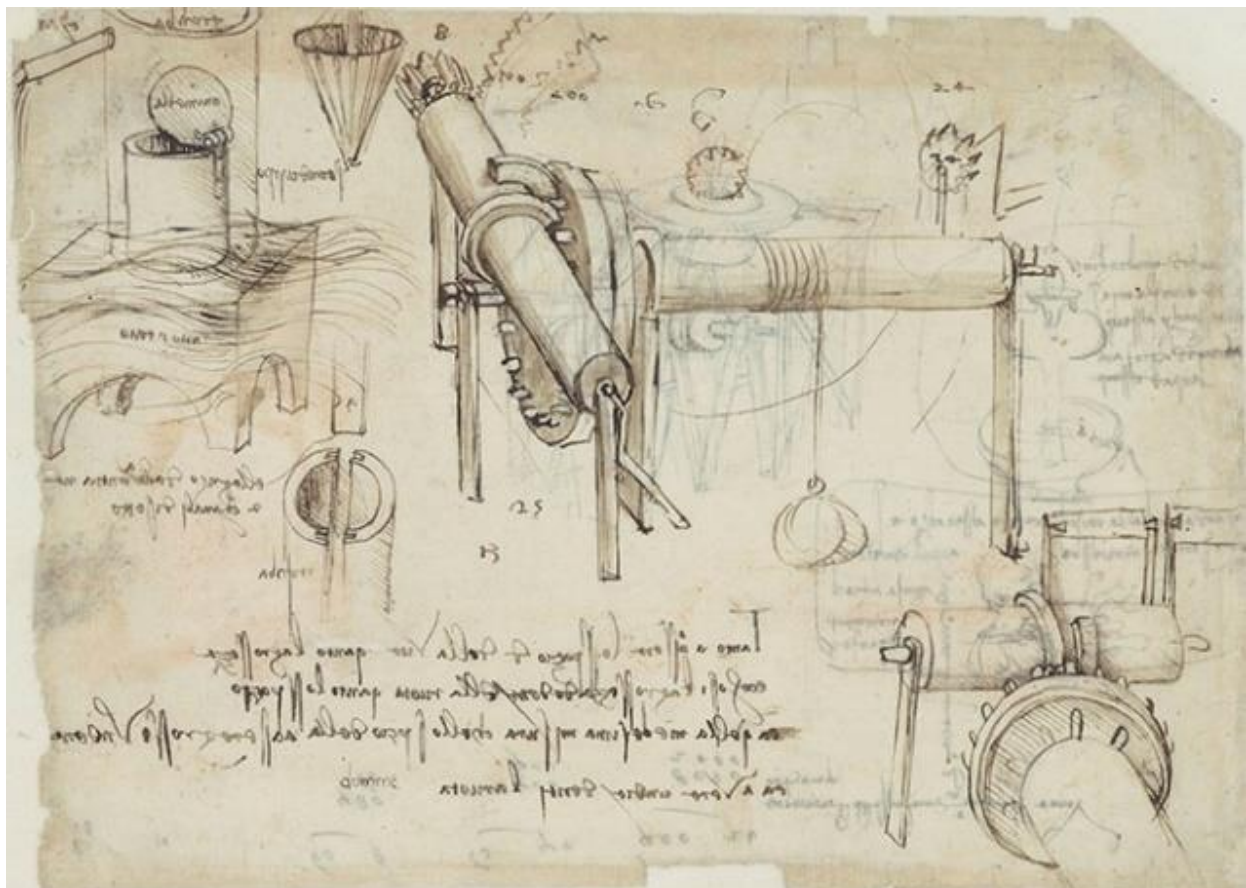
capability of gathering and analyzing huge amounts of data in an efficient and comprehensive manner.

Firms that have been surfing the “tech wave” have reaped outstanding advantages. The most famous example cited among asset managers is possibly that of Amazon, which has risen 105.81 percent since August 2017 compared with 33.15 percent for the NASDAQ composite. The company, which is one of the largest retailers in the world, has one of the most sophisticated logistics systems and an incredibly advanced Big Data collating and analysis process, aimed at profiling clients’ consumption patterns in order to best fit their needs.

Amazon is one of the most significant examples of tech-based revolutions able to generate immense value for their shareholders (together, the FAANG have generated an annualized return of 79.95 percent over the last 20 periods, compared with +10.56 percent for the S&P 500), but the dream of future unicorns is far from over.

The interest in the tech industry has also been shared by private equity funds, who find this segment extremely attractive for two major reasons: discovering unicorns and exploiting possible synergies with other firms in their portfolio. The former encompasses all the possible deals, which involve the purchase of a private firm and, after proceeding with the restructuring phase, exiting the investment after having taken the company public. The latter, instead, refers to the possibility of acquiring tech companies to share the patents and proprietary software developed to digitize and improve the other firms held in the portfolios.

To understand the relevance of this major trend, it is worth noting that, on the total value generated by the acquisition of firms in recent years, a large part was represented by tech firms, and, given their growing importance, this phenomenon is not expected to end any time soon.



ESG

Global perspective

One of the significant developments in the last decade has been the emergence of climate risk, transitioning to a low-carbon economy and ESG integration - with ESG standing for Environmental, Social (and) Governance - as important focal points for policymakers, companies and investors alike. Policy, technological and climatic changes, which are evolving more palpably than what many experts could have possibly predicted, are the main causes of a rush toward sustainability.

The focus on economic, social, and environmental sustainability is generating tangible value in the world's largest companies, and even in medium and small-sized businesses.

One of the most common misconceptions about corporate efforts to address environmental and social issues is that, while they satisfy the requests of certain stakeholders, they mainly constitute a cost to the business, which ends up reducing shareholder value. For this reason, many entrepreneurs and institutional investors have been, and some still are, reluctant to embrace ESG integration into analysis and decision-making. But, as evidence has grown that ESG objectives actually have positive financial implications, their integration is seen as part of a fiduciary duty in many significant markets, including the EU and the US.

A considerable amount of research has been carried out in recent years to better understand the economic effects of integrating ESG issues into corporate financial decision-making, both from companies' and investors' perspective. The general finding is that, at least for certain kinds of companies in some industries, those stakeholder investments can prove to be a source of competitive advantage.

For instance, companies often mention more effective risk-management strategies as a benefit of sustainable business practices, since they can help preserve the company's brand value and reputation from being undermined. Moreover, sustainability practices can enhance company values as a result of their effects on brand values and corporate reputation, by attracting a more brilliant and committed workforce, together with happier and loyal clients.

Definition of ESG

The steady ascent of ESG as a cornerstone of the asset management market has given rise to much confusion as to an accurate description of what it actually consists in. The term has been used indifferently for several investment policies, which do not always deserve such an epithet. ESG investing is the integration of environmental, social, and governance evaluation criteria in order to identify potential risks and opportunities, which may have an effective impact on the performance of the investment.

The rapid growth of ESG integration builds on the Socially Responsible Investment (SRI) movement that has been around for much longer. ESG integration is based on the assumption that ESG factors have financial relevance.

It is clear that this concept differs from Sustainable and Responsible Investment, which implies the exclusion a priori, following specific ethical guidelines, of particular industrial sectors (such as addictive substances manufacturing, weaponry production and, generally, socially and environmentally controversial companies), or impact investing (which has scored an impressive growth in the last two years, rising from €2 B to €53 B of net inflows in Italy)¹⁰⁷, which sacrifices the quest for an optimal financial return in favor of entirely positively-impacting investments.

¹⁰⁷ Corriere della Sera - Economia

Today, the UN-backed PRI (Principles for Responsible Investment) is a thriving global initiative with over 1,905 members representing more than €80 T in assets under management¹⁰⁸. In Europe alone, the number of signatories increased by 10 percent in 2018. The role of the PRI is to promote the integration of ESG into analysis and decision-making through thought leadership and the creation of tools, guidance and engagement.

At the beginning of 2018, sustainable investments in Europe reached €12.3 T, an 11 percent increase in two years. Nevertheless, Europe is the only region in which sustainable investing assets have declined as a share of total managed assets since 2014 (from 58.8 percent to 48.8 percent)¹⁰⁹. At least part of the market share decline in Europe stems from a shift to stricter standards and definitions for sustainable investing.

The value of ESG is now being recognized by investors. In particular, Millennials are becoming more and more concerned about environmental and social issues, with global warming being one of their main worries¹¹⁰. For them, ESG investing means looking at their future and protecting it, as they believe that their investment can have a positive impact. A survey carried out in 2017 on 1,000 active investors showed that Millennials were particularly interested in sustainable investing (86 percent vs. 75 percent of the total population in 2017)¹¹¹. The survey also showed that their concern was growing. Between 2015 and 2017, the percentage of Millennials who were “strongly interested” in responsible investing rose by ten percentage points.

Sometimes concerns are raised over the packaging of responsible investing at a time when the industry is facing the risk of greenwashing, a term to describe cases in which asset managers pretend to be “green” through marketing rather than fully building ESG criteria into their investment processes. Offering products of companies that, without

questioning their business model and following ESG principles, only pretend to adopt a good governance or to commit to social and environmental issues, could undermine the whole meaning of ESG investing. This phenomenon is one of the main reasons why in March 2019, the European Parliament and EU member states came to an agreement on disclosure requirements related to sustainable investments and sustainability risks. The new regulations, welcomed by the European Commission, will urge asset managers, insurers and pension funds to disclose environmental risks and integrate environmental, social or governance (ESG) risks and opportunities in their processes. One of the pillars on which the new regulations are built on is precisely the elimination of the greenwashing phenomenon, which the commission describes as “unsubstantiated or misleading claims about sustainability characteristics and benefits of an investment product”.¹¹²

“The value of ESG is now being recognized by investors. In particular, Millennials are becoming more and more concerned about environmental and social issues, with global warming being one of their main worries.”

¹⁰⁸ PRI Annual Report 2018

¹⁰⁹ Global Sustainable Investment Review 2018

¹¹⁰ Pictet

¹¹¹ Morgan Stanley

¹¹² European Commission

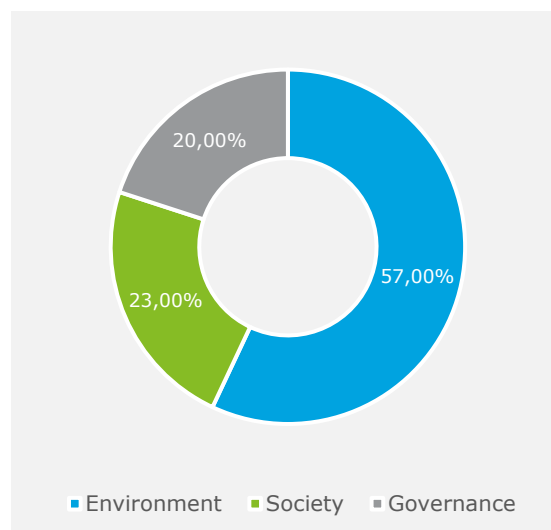
Factoring E, S and G

Although the three different factors have been considered together in the broader ESG concept, there are some underlying differences relative to their specific weight in the industry players' decision-making and, more importantly, to their effective impact on investment performance.

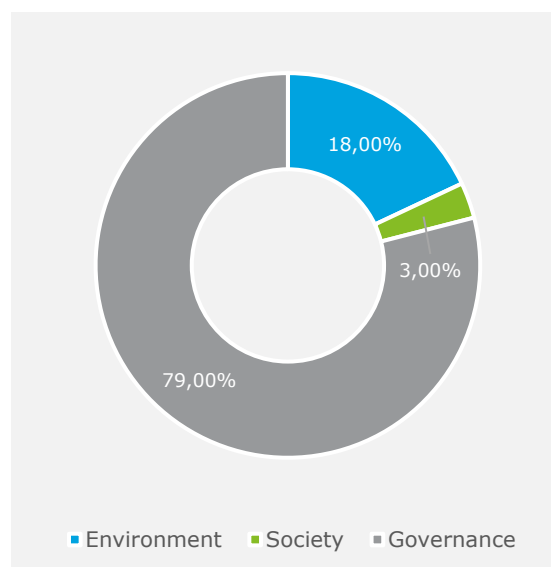
Environmental themes, such as companies' carbon emissions, hazardous waste management, and energy efficiency and so on, are, without any doubt, the most accessible to any retail client and asset owner. As shown in a recent survey by Barclays¹¹³, 57 percent of the asset owners consider the E component as the most important, far exceeding, in their opinion, S aspects (such as labor management, human rights policies, working conditions, etc.) and G aspects (such as corporate governance, anti-corruption policy, business ethics, etc.). On the other hand, asset managers generally tend to agree on the fact that governance, as a measurement of management quality and whose presence is a necessary but not sufficient condition to support sustainable and environmental policies, is by far the predominant criteria to be adopted in an ESG screening.

The asset managers' intuition seems to be confirmed in terms of actual returns: although companies with favorable environmental and social factors tend, on average, to outperform companies with negative characteristics, the degree of statistical relevance is quite low, whereas the impact of governance is way sharper and clearer.

3.5. Graph: What feature is most important for investors



3.6. Graph: What feature is most important for asset managers

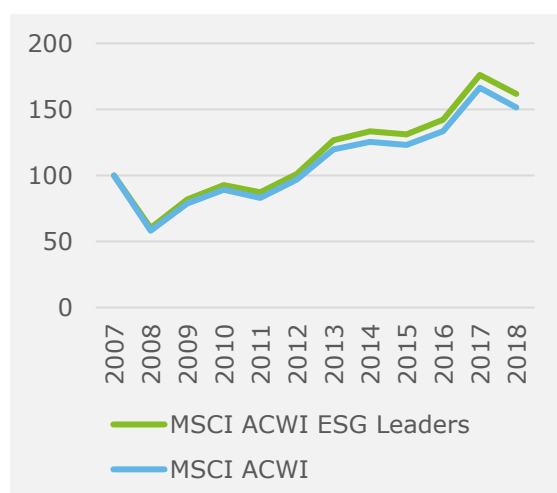


¹¹³ Barclays survey of large fixed income asset managers

Performance of ESG Investments

In order to discredit investors who believe that there is a trade-off between sustainable investing and return, Graph 3.7 shows the MSCI ACWI ESG Leaders Index¹¹⁴, a capitalization-weighted index that provides exposure to companies with high Environmental, Social and Governance (ESG) performance relative to their sector peers; what stands out is that “ESG leader companies” outperformed the benchmark, scoring a higher gross return (+67.5 bps¹¹⁵) for the whole time frame considered.

3.7. Graph: Cumulative Index Performance - Gross returns



Many academic and industrial studies suggest that, in reality, the integration of ESG criteria can lead to an improvement in investment performance.

For instance, an MSCI study¹¹⁶ of 2017 analyses the impact of ESG factors on performance, risk and equity valuations, proving that companies with stronger ESG profiles typically exhibit higher profitability, lower frequency of episodes of sharp decline and a better contained systematic risk.

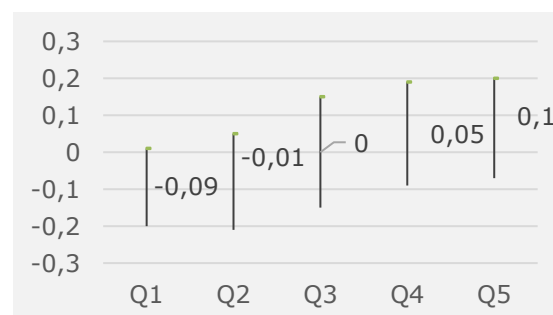
There are three different channels through which ESG information embedded within companies is transmitted to the equity market. Firstly, high ESG-rated companies

are more competitive than their peers. For instance, this competitive advantage can be due to a more efficient use of resources, better human capital development or better innovation management. The competitive advantage is used to generate considerably higher returns, leading to higher profitability and dividend payments. Secondly, high ESG-rated companies are better at handling company-specific business and operational risks. Due to better risk control standards, they have a lower probability of suffering episodes that can affect their share price, such as fraud, embezzlement, corruption or litigation cases. Consequently, their stock prices may present lower idiosyncratic tail risks. Finally, high ESG-rated companies tend to have lower exposure to systematic risk factors, which means that the company's equity has a lower beta value, inducing the investors to require a lower rate of return. Ultimately, this could translate into a lower cost of capital for the company, leading to higher valuations in a DCF model¹¹⁷.

3.8. Graph: Systematic volatility of ESG quintiles



3.9. Graph: Gross profitability of ESG quintiles



¹¹⁴ MSCI ACWI (all country world index) ESG Leaders Index consists of large and mid-cap companies across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries

¹¹⁵ Annualized excess return over 11 years

¹¹⁶ Foundation of ESG Investing - MSCI

¹¹⁷ Foundation of ESG Investing - MSCI

In addition to this, to fully understand the impact of ESG integration, it must be determined to what extent extra-financial information is relevant and how it adds value to the investment process by looking for quantitative relationships between corporate financial performance and the breakdown of extra-financial characteristics.

A research carried out by Barclays isolated the ESG effects from the other sources of risk in measuring the impact of ESG investing on credit portfolios. The core of this research was the creation of pairs of well-diversified portfolios that differed drastically in their ESG scores and accentuated the differences in individual E, S and G scores, but whose risk profiles were nearly identical.

The average return differences represent the asymmetry in performance between high and low individual E, S and G score portfolios. According to both MSCI and Sustainalytics data, the E rating has been associated with incremental returns over the past seven years. The return differences between the high and the low E score portfolios are small (0.36 percent/y in one case and 0.17 percent/y in the other) but positive. It is remarkable that, despite different approaches being used to evaluate bond issuers, a similar pattern is observed for both providers: Governance had the strongest link with performance (0.82 percent/y according to MSCI and 0.29 percent/y to Sustainalytics data) and social the weakest with 0.17 percent/y in one case and 0.04 percent/y in the other. Environment lies in between. Hence, the claim of portfolio managers that governance is more important to portfolio risk and return than the other two aspects of ESG is confirmed by this analysis. In fact, the return associated with the governance score has been considerable (5.5 percent of cumulative outperformance) and constant over the past seven years.

Conclusion on ESG

It is interesting to understand how the rise of social media as a communication channel has made it far easier for the end client to be informed about environmental and social scandals in which a company may be involved, thus resulting in a faster and sharper negative impact on the company's stock performance.

Companies that effectively manage ESG risks and can take advantage of the opportunities offered by sustainability could actually represent better long-term investments.

Cynics may claim that ESG integration is just a fad. But looking at the drivers of the market movements over the last decade, it can be deduced that the outcome is different. To begin with, technology enhancement and the rise of transparency will continue to characterize the global economy, as new directives (such as MIFID II) are periodically being introduced. Shrewd algorithms will increasingly permit a more enhanced interpretation of non-traditional financial information due to easier methods of harvesting and processing data. Climate change and other environmental challenges will continue to increase the demand for good stewardship and low carbon practices as non-artificial assets will appreciate in value over time.

For these reasons, ESG investing might be a self-fulfilling prophecy, which, from being a mainstream practice, is going to become a new standard in the years to come.



Conclusion

The purpose of this chapter was to advise the reader about how, especially during the last few years, a substantial revolution has been taking place in this industry. The events and trends previously mentioned have reshaped both the way in which people conduct their lifestyles and the way corporations manage business. These effects not only relate to the past or present, but are also affecting the future.

For instance, it is worth taking a look at the dissemination of tech, which is one of the most impactful drivers of future performance. It will probably determine which asset management firms remain profitable by experiencing sustained, organic growth and which ones will be driven out of the market. If what has just been said is reasonable, it is also correct to point out that all the trends are strictly interconnected with one another. To understand this, it is sufficient to think of how technology, the means by which Millennials execute several of their daily activities, can at the same time be perceived as a solution - such as healthcare - to the problems of the oldest portion of society. Moreover, tech is a structural requirement

for many companies to pursue their sustainable objectives, and it can be presented as a solution for financial services providers to cut the cost structure of their businesses in order to survive the impact of MiFID II.

Lastly, tech is crucial for the development of its own sector, fostering a series of concatenated revolutions. Tech, as explained here, can be seen as a starting point for all these trends, but simultaneously it is also safe to assume that it can be the landing point of all the necessities and requirements of the present and future social, political and economic environment. In fact, the aforementioned demographic changes can be used to explain the need for technological improvements in the wealth management sector.

Moreover, it is always the new consumption patterns and socially responsible behavior of Millennials that have influenced the development of ESG investment products. To sum up, this chapter sought to outline the main characteristics of each of these trends, and the next one will try to suggest possible correlations between them.

"For instance, it is worth taking a look at the dissemination of tech, which is one of the most impactful drivers of future performance. It will probably determine which asset management firms remain profitable by experiencing sustained, organic growth and which ones will be driven out of the market."



Chapter four: looking forward

Chapter four:

Looking forward

Key players

Demand: the investor

The trends outlined in the previous chapter will have a profound impact on every aspect of the industry and, in particular, on its players. Given the shifts in the industry caused by the aforementioned trends, investors themselves are currently reshaping their behavior and consumption patterns, which directly affect their financial choices. As uncertainty about the future rises, there is a need for stable returns from the investment of personal savings. Individuals can achieve this result either by investing in low-fee products, a trend exemplified by the recent issuing of ultra-cheap ETFs by the major AM firms, or by outperforming the market through active investments. The former solution is more likely to be appealing for the mass market of low-income investors, while the latter is best suited to satisfy the complex needs of wealthier individuals, who will require tailor-made services and investment products.

In the near future, the main category of investors, represented by Millennials, will be requesting a new set of services: with their “tech-based” lifestyle, they are in search for immediate services like home-banking or online trading software and platforms. These will be the key distribution channels of the future, especially considering the sheer number of investors in this category and the total wealth that they will inherit in a 20-year time horizon.

The confidence of Millennials with regard to technology also facilitates and will further promote the spreading of innovations. As thoroughly explained in chapter 3, this generation will be a very natural clientele for services such as Robo-Advisory.

Given the ease that these instruments provide with respect to traditional channels, new online platforms are also very likely to attract investors that wouldn't have invested their savings otherwise.

Additionally, new online services, which are characterized by lower fees and entry capital requirement, will attract many more young individuals. The increase in the number of Millennial investors will inevitably bring a stronger consciousness in this portion of the population about the benefits deriving from early planning of savings and personal investments, driving interest in the financial tools at their disposal to invest their savings. This could eventually also contribute to an improvement in the general knowledge of investors about the financial systems.



The aforementioned boost in financial literacy could turn into an additional opportunity for the Italian investor. In fact, gaining more in-depth knowledge of the industry will ultimately allow Italian investors to build a portfolio that can include more risky and profitable products, as according to MiFID II a certain degree of familiarity with the financial sector is required to buy such instruments.

Finally, people and, in particular, Millennials are becoming more and more concerned about environmental and social issues, with global warming being one of their main worries¹¹⁸. The interest in these matters is leading Millennials to invest in ESG products with the aim of safeguarding their future and having a positive impact on society.

Based on an accurate analysis of the trends' future implications, what emerges is the increased centrality of the investor with respect to previous industry parameters. In fact, most of the trends' key aspects and future developments stem from specific investor needs. First of all, technological solutions are being implemented to satisfy clients' desire to be constantly up to date with respect to the status of their savings. Robo-Advisory and similar services are addressing the needs of lower income individuals, requiring lower fees and overall costs. Secondly, ESG products are offered in response to investors' willingness to commit to social and environmental issues. Additionally, MiFID II has recently been introduced to address clients' growing concerns about the lack of transparency in the industry, also following the recent scandals involving many Italian banks and institutions.

A peculiarity of all the macro trends presented in this paper is that they seem to emerge from the newly-arisen needs of investors: the industry is undergoing a process of renovation, moving away from a supply-driven structure to a more demand-driven one. It is in this sense that financial advisors now have to understand and try to

satisfy the preferences and necessities of their clients. An example stems from the needs of the mass market, which requires easily affordable investment solutions. This is becoming a progressively more competitive market, and this case has been exemplified by the price battle that the world's biggest fund providers engaged in over the last few months, which culminated in the creation of a zero-fee-pricing passive equity index fund¹¹⁹. Another example of the shift toward a more demand-based supply is related to risk-averse investors, which require the creation of a special kind of financial solution. The generation of such products is problematic because of the long-lasting period of meager interest rates, which on the one hand is flooding the market with liquidity, but on the other is depressing the bond market and therefore bond-based funds¹²⁰.

Supply: the asset manager

As a consequence of the trends that are transferring the bargaining power from the supply side to the demand side, the figure of the asset manager will also have to evolve. To keep up with the pace of innovation, they will have to modify their approach toward clients by implementing new strategies that can better suit the new environment, as well as offering a more extensive range of products.

Robo-Advisors, which allow investors to manage their wealth without the intermediation of a financial consultant, will constitute an increasingly powerful competitor for asset managers. Changes in the industry brought about by the new trends mentioned above will force asset managers to build on their core added values so as to remain competitive with the Robo-Advisor on the distribution side of the business. This can be achieved in two ways: they can either position themselves as substitutes to the tech-management or they can use it to complement their services.

¹¹⁸ Pictet

¹¹⁹ Financial Times

¹²⁰ Financial Times

Turning to asset allocation, AI will assist the asset manager by complementing human intellect. The two entities will collaborate by providing each its own strengths, in what is called “collaborative intelligence”. To keep abreast with innovation in this field, asset managers will need to develop new capabilities in working with AI: they will need to redefine their skill set and change the way they work, giving more importance to those skills that AI does not possess, such as intuition, empathy, and other typically human traits. On the other hand, the strengths of AI lie in data analysis, in the fact that these technologies are unbiased in terms of diversification, and that they can work uninterruptedly, unlike human analysts.

The importance of an evolution of the asset manager is amplified by the recently implemented MiFID II, which forces the former to communicate all the costs and fees to the investor and to consider a specific target market. As a consequence, the interests of the investor and of the asset manager inevitably tend to converge, as the transparency imposed by the MiFID II directive and by the implementation of new technologies serves the interests of both sides.

The technological developments and the shift in the industry expose the necessity for the AM to implement an effective “marketing strategy” aimed at communicating to the investor the value added by the intermediary role of the consultant. The AM will need to communicate clearly and effectively the benefit added by the service he or she provides, thus justifying the additional cost the client has to bear. Consequently, the asset manager will focus more on the service, which reflects different forms of client experience and needs, rather than mainly on the product itself.

The big players have already started, and will continue in the future, to implement new in-house specialized behavioral finance training for their consultants and partners, as well as third-party distributors, aimed at avoiding

the common judgment mistakes that are responsible for reducing portfolio value. These mistakes are usually linked to a misunderstanding of the client’s primary needs and intentions, which is where the real service value lies. The purpose of such training also lies in providing the asset managers and partners with the tools to be familiar with and analyze different personality profiles, so as to offer the client tailored solutions, fully consistent with his or her needs and attitude toward investing. How the asset manager adapts and implements his or her strategy to match the clients’ needs and profile in a customized way will determine his or her value in the future. In this sense, the value chain is changing, giving more attention and relevance to the strategic role played by the financial advisor or distributor themselves, whose soft skills now gain a crucial role in attracting and retaining clients.

In conclusion, technological innovations may give a competitive edge to the big players that have the financial resources needed to quickly acquire such capabilities, thus possibly taking smaller competitors out of the picture. However, at the same time, high net worth individuals do need and value the relationship with a trusted advisor, so the smaller players could specialize in this niche market by targeting this clientele. The asset manager will therefore move from being an asset allocator to becoming the trusted advisor of his or her clients, providing comprehensive wealth management services, and thus becoming a wealth manager. In this new role, instead of just allocating clients’ assets and creating their portfolios, he or she will now manage all aspects of the investor’s wealth “through financial and investment advice, legal or estate planning, accounting and tax services, and retirement planning”¹²¹. A professional profile such as described would probably have a competitive advantage in Italy arising from Italian cultural peculiarities, which, as mentioned in the first chapters, value a personal, empathic relationship with the consultant.

¹²¹ Investopedia

Products

Introduction

Since the launch of the first ETF, there have been major changes in the financial markets. Now, more than ever, these products are enjoying a new phase of growth and fame. Their key characteristics are the ability to cheaply diversify the portfolio of an investor while simultaneously granting the possibility of generating generous positive returns. This was the case in the last ten years, when a period of sustained economic and financial growth led to average market returns of 10 percent. In order to better grasp this trend, it is useful to notice how an SPDR ETF, which mimics the NASDAQ, would have earned an annual return of 12 percent. The other main feature of such a vehicle is its extreme versatility and suitability to different types of both investors and investment strategies. Asset managers use it to obtain efficient portfolios which hedge idiosyncratic risk through the creation of a bundle of ETFs, stocks and possibly bonds. Less literate investors find it attractive because of its extremely high liquidity and because it allows them to cheaply diversify their portfolios. With the advent of Robo-Advisory and the possibility that the latter offers to operate with passive investment strategies, the role of asset managers is further endangered. Advisory software can also help improve the diversification capabilities of a not-so-literate investor without depressing the returns with high fees. In this sense, Robo-Advisors tend not to outperform the market but rather to take defensive positions against it and leverage the lower costs to boost the gains from the investments. This feature is very interesting, especially if the ordinary investor is not capable of the same degree of precision, but it requires simultaneously high return and low risk. The unavailability of the old-style Italian 10y BTPs, and the decreased effectiveness of the Markowitz model, are pushing asset managers to discover new solutions and new positive alpha securities. They must be able to provide such services before savers begin to have more confidence in tech advisory mechanisms, which are

currently capable of meeting their needs, even if only partially.

One of the most important characteristics of portfolio managers is their ability to generate alpha by setting up positions in mispriced securities. Another investment strategy that advisors can use to “beat the market” is investing with a long-term time horizon. The benefits are linked to the portfolio makers’ ability to set up positions at an early stage that will generate superior profits when and if other participants perceive their potentiality. At the same time, three- to five-year strategies improve the stability of AuM for the whole investment horizon, further enhancing the profit generation capabilities of asset managers. These wider time frames are permeating the current fund market. ESG funds, Long-Term Trend Funds, PIR, ELTIF, and Private markets are major examples of this phenomenon. The next paragraphs will give an overview of the Private markets and their future role in the asset management industry.

A different perspective on passive investing

In the recent past, the market for ETFs has gained new momentum as low-cost products and the services offered appeal to an ever-growing market share. In this sense, some asset management corporations are beginning to issue new types of index funds that leverage the benefits of human and algorithmic analytical capabilities to grasp every possible basis point of return in the market. Two of the most prominent examples are closet indexing and filtered ETFs. The former rests on the concept of exploiting mispriced securities. The strategy seeks to create better performance by slightly adjusting the weights of securities of directly competing firms in the index. The benefit of this strategy is the creation of Beta 1 assets, which generate alpha and maintain a risk profile consistent with the benchmark index. The latter, by contrast, aim at creating index funds composed solely of those securities whose companies satisfy the requirements imposed by the so-called

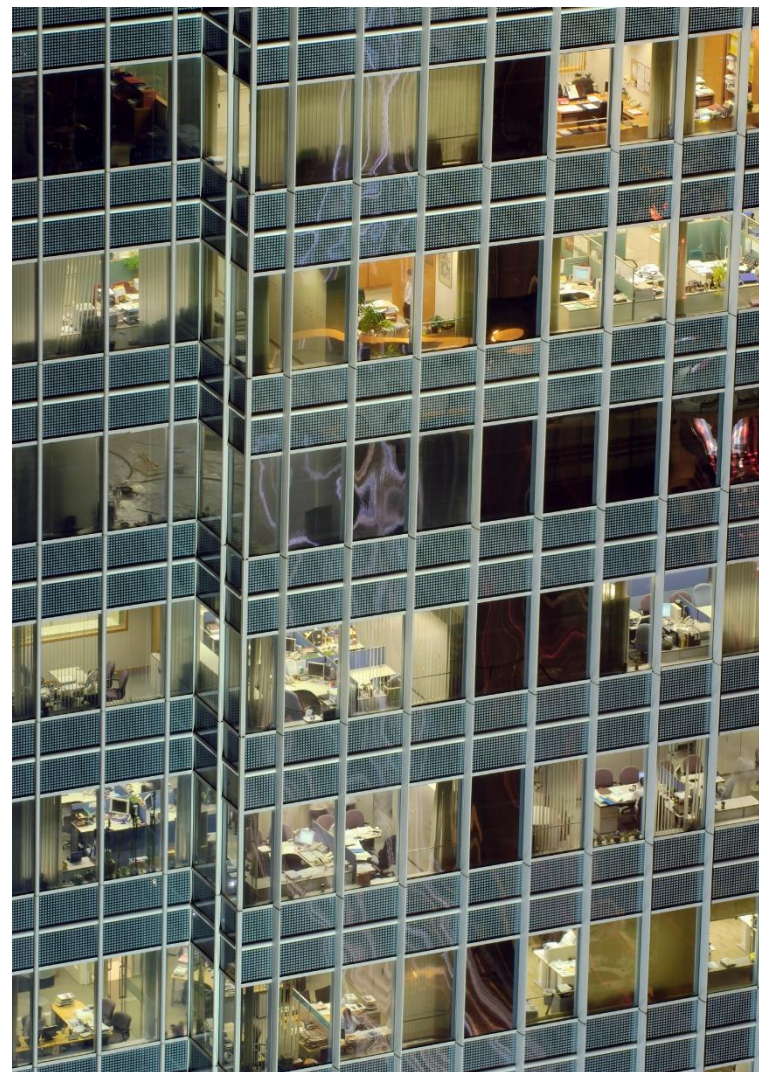
“filter”. A recent application of this strategy is the creation of ES indices, which, through proprietary databases and active participation of analysts, aim at including in the portfolio only companies whose activities are environmentally sustainable and that do not harm society as a whole.

The aforementioned products are already present in the market, and major companies are already entering this hybrid market by creating ad-hoc products and proprietary databases in which they store specific information on companies.

Overview of private markets

The term “private markets” applies to labeled investments, which are not traded on a public exchange or market. In the past years, they have often been considered as complicated and risky to access for traditional investors. However, private markets are gaining momentum and are starting to be considered as an attractive investment to both diversify a portfolio and achieve higher long-term potential return. First, it is important to point out that the growth of private equity and debt funds is strictly linked to the enormous amount of liquidity that has been injected in the economy by entities like the ECB and the Fed. This drastically reduced the cost of capital, especially considering that nominal rates have been, and in countries like Germany still are, very close to zero: capital could, therefore, be invested in margins in order to benefit from the spread between the borrowing cost and the ROI. The second macroeconomic driver of private equity and debt funds has been the general level of economic growth, which has been massively influenced by the outstanding performances of the US (driven by monetary and then fiscal stimuli) that lifted many countries out of recession (almost every country except Italy and Greece returned to pre-crisis GDP levels). The momentum gained by private equity and debt funds is also determined by several other advantages and disadvantages, which are specific to the industry. On the one hand, they can be considered inefficient if compared to public markets, due to the low liquidity and the asymmetrical distribution of information. These factors result in higher

transaction, screening and exit costs, which, in turn, constitute stronger entry barriers for potential players in the market. On the other hand, these same features allow the creation of positive alpha. In this scenario, asset managers occupy a prime position by having access to information of superior quality, benefiting from economies of scale and greater negotiation power: this means they can influence the value of the deal and therefore the expected return. Moreover, since in this industry the funds acquire a substantial stake of ownership, if not the majority of the shares, the existing management team will either be directly influenced by the directives of the majority shareholder or replaced by a trusted team. Such control over the future actions and decisions of the acquired corporation leads to the development of strategic growth opportunities.



Current situation in Italy

2018 has been an important year for Italian Private Markets, which closed with a portfolio value of €33 B, of which 36 percent was held by domestic investors and the remaining 64 percent by international players. These funds were allocated to 1,254 companies, 94.7 percent of which are Italian.

Taking into account the sources of new funds raised, pension funds and insurance companies were those recording the highest growth. The former more than doubled the size of their holdings while the latter were up almost ninefold.

When considering the amount invested, the geographical distribution appears to be heavily unbalanced: the North of Italy had access to 83 percent of the investments, leaving only 14 percent and 3 percent to the Centre and the South, respectively. Among the regions with the highest concentration of investments, Lombardy occupies by far the first place, with 144 investments, followed by Emilia Romagna, Veneto and Piedmont, with 33, 27 and 24 deals, respectively.

Finally, shifting the focus to the sectors toward which most of the investments have been directed, ICT held the leading position, followed by Business products and services and Healthcare.

With respect to the investment stage, funds seem to prefer Buyout and Early Stage. The number of players which invested in the former increased from 56 in 2017 to 67 in 2018, while the amount of the latter almost doubled, from 23 to 42. Investors focusing on Expansion, Replacement, Infrastructure, and Turnaround decreased in the period taken into account, even if they represented a marginal portion of the overall number of investments, accounting for only a quarter of the total. The most capital-intensive stage proved to be the one related to infrastructure, which recorded an average of €190 M compared with €48 M for Buyout and €40.4 M for Replacement.

In 2018, the Italian Private Debt market showed signs of growth, with the total amount of investments reaching €1,018 M, up from €617 M the previous year (+65 percent). The main sources of fundraising were represented by banks, with 39.1 percent of the total, followed by pension funds with 26.6 percent, and institutional

funds of funds with 17.9 percent. The majority of investments came from international players, with €641 M invested in this market. Another specificity is that domestic players prefer to invest in smaller scale projects than foreign players.

Looking at the future

Private markets developed in the US during the 1960s and 1970s and surged drastically in the 1990s, just before the dotcom bubble. On the Italian side, this movement is far more recent and, as mentioned above, started to gain momentum in the last few years.

Italian productive capacity is mainly driven by SMEs and mid-cap firms, generally family owned. This environment is particularly buoyant and offers several potentialities to investment managers who can gain control of these enterprises with a relatively limited amount of capital. Once the fund becomes the new majority investor, it can grow the business on a stand-alone basis, by replacing or influencing its management, or even by creating a portfolio of firms that together generate both synergies and economies of scale. With these premises, the development of private markets will most probably remain on a growth trend and possibly become part of a virtuous circle in which Italian firms will increase their revenues and market valuation, thanks to the human and monetary capital provided by the funds, therefore attracting even more capital. If what has been said is true, one must also consider that there could be several possible downturns and obstacles in the diffusion of private equity funds. The main hurdle is that, as mentioned before, many of the Italian SMEs are family owned and it may therefore prove challenging to gain control of them. Another hurdle could be related to the maturing stage of the global economy, which could drastically reduce the demand side of the market and therefore put the funds in a situation of stress dictated by the capital requirements to sustain the company and the difficulties related to the disinvestment process, due to the lack of liquidity in the private markets. A third one could be the expansion of a new emerging market, which could attract the flow of investments out of the Italian peninsula.

Looking at the future, it may be predicted that private markets will become more and more important for asset management companies. In particular, this is due to the difficulties asset managers are experiencing in generating the expected returns. As a consequence, they are looking for investment targets with high alpha values to justify the fees of their actively-managed funds. In doing so, investments in private markets currently represent the best opportunity to achieve such a result, at the expense of illiquidity and a higher level of risk. Despite these expected upward trends, things do not appear to be so positive in the short term for private markets. In particular, based on a survey conducted by a management consulting firm, it emerged that, on a European level, optimism in the private equity industry will decrease in 2019 when compared to the previous year¹²². Less than one-third of the respondents expected an increase in the number of M&A deals involving Private Equity firms, and almost half of them forecast a decrease. In particular, these expectations derive from uncertainties on a geopolitical scale, as well as the pessimistic economic forecasts. Taking into account different European countries, Italy is among the ones with the lowest expected growth (0.1 percent in 2019), along with the United Kingdom (at 1.3 percent) which is set to be affected by Brexit. Overall, the availability of targets in the market is expected to remain stable. In particular, the slight decrease of the large-cap segment, including firms with a value higher than €500 M, should be counterbalanced by the positive trend of the mid and small-cap segments. On the one hand, considering the different phases of the Private Equity value chain, most of the respondents expect that financial investors will focus on the development of the companies already in their portfolio and on making new investments. On the other hand, limited attention should be paid to other phases of the value chain (prolongation of existing funds and fund-raising). Looking at the competition, the proportion of Chinese investors is not expected to increase particularly over the year, with 43 percent of

interviewed asset managers agreeing on that point. 29 percent of Private Equity professionals expect a decrease in Chinese direct investment competition, while the remaining 28 percent anticipate an increase. These expectations stem mainly from the increasing number of regulations in Europe. Finally, positive expectations by Private Equity investors are decreasing in comparison to 2017 and 2018, while there seem to be no variations concerning the top industries for M&A transactions. In particular, Pharma & Healthcare, Technology & Media, and Business services & Logistics are expected to maintain their leading positions¹²³.



¹²² Roland Berger

¹²³ Roland Berger

PIR and ELTIF

The recent trajectory of the Italian asset management industry made room for some financial products, such as PIR, ELTIF or private market instruments, able to meet the new necessities of a market facing an adverse economic scenario, which ultimately led to generally lower interest rates and lower long-term returns.

PIR – Piani individuali di risparmio

PIR is a specific financial instrument, benefitting from tax breaks on capital gains, yields, and inheritance, included in Italian law with the 2017 Legge di Stabilità¹²⁴. The main objective, as conceived by the legislators, was to boost the real Italian economy, burdened by a chronic shortage of SMEs' ability to raise capital, which directly impacts their growth and expansion possibilities.

Although PIR's introduction was an unequivocal success in terms of net inflows for the first two years, with €15 B and €2 B, respectively, their main aim was only partially reached: PIR's main achievement has been to generate trading and make the secondary market far more liquid, but only €150 M was actually earmarked for AIM-listed SMEs' capital increases. Consequently, the Italian government, in an attempt to intervene on this particular aspect, introduced in the 2019 Budget Law stricter requirements regarding PIRs constituted from 1 January, bonding to them the eligibility for taxation benefits. In particular, it inserted a mandatory investment amounting to 3.5 percent of the total value of financial instruments belonging to SMEs admitted to trading in AIM Italia and a second compulsory investment, also amounting to 3.5 percent in shares or stocks of Venture Capital funds located on the national territory, in the European Union or in ASEE-compliant states¹²⁵. These stricter limitations, considered by many operators quite difficult to respect as they deprive PIRs

of the liquidity necessary for products such as mutual funds targeting small investors, together with the lack of a Decreto attuativo (implementing decree), drastically slowed down the PIR market, which ended up recording a negative net inflow in February and March 2019¹²⁶. On May 7, the implementing decree was finally published in the Official Gazette. This long-awaited law did not meet the expectations of industry players: several of the regulation's articles heartily disappointed the prospects, sources reported¹²⁷. The same harsh opinion was also voiced by the Italian Central Bank, which commented that a financial instrument designed for retail investors - families for the majority - is now riskier than ever before¹²⁸. Furthermore, the decree did not raise the extremely low 3.5 percent mandatory requirement for investing in AIM and Venture Capital funds. Thus, it appears that PIRs remain a nice idea on paper but very limited in fulfilling their primary purpose: bringing money to the real economy.

ELTIF

ELTIFs, European Long Term Investment Funds, are new generation investment instruments introduced by European Regulation 2015/760, which took effect on 9 December 2015 and was accepted in the Italian financial system in February 2018. This new type of closed-end fund was introduced to give retail investors access to asset classes that were considered too illiquid to be served by existing fund structures. Similarly to PIR, their main focus is to drive investments toward the real economy, channeling money into infrastructure investments and loans to small companies (listed or not, with a capitalization of €500,000 or higher), providing them with alternative long-term funding options besides bank loans and the recourse to the stock market through an IPO. ELTIFs, given their nature, are attractive for entities aiming at generating fixed long-term returns, such as pension funds or large insurance companies.

¹²⁴ *Stability law (one of the two public financial measures of a State)*

¹²⁵ Corriera della Sera

¹²⁶ Sole 24 Ore - Plus24

¹²⁷ Sole 24 Ore

¹²⁸ Sole 24 Ore

The first ELTIF for the Italian market, Eurizon Italian Fund, was introduced by Eurizon at the end of 2018. The instrument, a closed fund with a seven-year maturity span, sets a minimum of 70 percent invested in long-term assets, an exposure of 50 percent or more to Italian stock instruments and a 25 percent cap for non-listed companies. Moreover, Eurizon, like many other firms in Europe, dictated the ELTIF be accessible only to investors with adequate financial resources so as to fit their risk/return profile.

Differences, similarities, outlook

ELTIFs and PIRs, despite sharing many features and having a common objective, present some differences regarding their nature as investment instruments. First of all, ELTIFs are closed-end funds, binding the investment for at least five years, while PIRs are open-end funds. Nevertheless, PIRs' tax breaks require the investor to hold the investments for a minimum of five years to trigger the entitlement to such benefits. The aforementioned stricter limitations contributed to the PIRs' decline, as well as to the simultaneous rise of interest in ELTIFs in

the Italian market. This trend will probably grow even stronger in the near future, for two different reasons. Firstly, corrective actions, that is, the proposal to allow mutual funds to gradually reach the VC investing targets imposed by the 2019 Budget Law (precisely on a three-year span, reaching 5 percent in 2021), have been removed by the last Decreto Crescita (Decree Growth)¹²⁹ after intense debate between the Ministry of Economics and the current Italian executive, with the latter committed to starting right away with the maximum threshold. Secondly, fiscal benefits for ELTIF investments, which could amount to 30 percent of the total value, are currently being discussed by the Italian executive¹³⁰.

These examples underscore how, once again, a substantial shift in the industry, which in this case concerns financial products, is induced by a mix of heterogeneous causes. From a demographic change to an economic deadlock, through wider use of technology on a daily basis, everything makes an impact on the asset management industry and on its dynamics.



¹²⁹ Milano Finanza

¹³⁰ Milano Finanza

Conclusion

The aim of this paper is to analyze the main trends that are affecting asset management in Italy, to understand their impact and forecast the influence they will exert on the industry in the years to come. As set forth in the last two chapters, there is indeed a widespread evolution in the general mindset that leads to a critical tech-based culture. Different terms such as Millennials and Generation Z were used to cluster the features of the different types of investor, but what they all have in common is the demand, although characterized by different degrees of intensity, for a tech-based service. Their attitude is that everything can be done with a mobile phone or a PC, and investing is no exception. MiFID II is actually the turning point in that, drafted with the aim of coping with this new mentality, the directive promotes, among other things, full transparency allowing investors to access all information in just one click. Moreover, a focal point of this new mindset is the necessity and willingness to have a positive impact on the current scenario, with the understanding that otherwise the global outlook in the years to come will not be as bright. The newly-established environment is seeded with a prominent ESG-approach, namely a 360-degree transition toward something more sustainable in a broader sense.

"The newly-established environment is seeded with a prominent ESG-approach, namely a 360-degree transition toward something more sustainable in a broader sense."

Thus, a boom in the demand for ESG products has been recorded in recent months. People now understand the value added by the integration of ESG principles in investment decisions for both companies and investors, and, at the same time, sustainable investing better aligns investors with the greater objectives of society.

The aforementioned changes in the industry and the growing fragmentation of demand will likely change the asset manager, who will now evolve into a more wealth manager-type figure. This will allow the supply to focus on the true value that consulting an asset manager brings to clients: experience.

Every industry has always had to find a way to deal with changes and challenges, and, most importantly, to embrace them and evolve. For example, the music industry has faced the advent of new online streaming services, which have to some extent, changed the way people perceive music. While streaming has resulted in a more affordable method of acquiring music, conversely the cost of the live experience has increased. People pay less to access the latest albums, but pay more for the experience event of seeing the band live in the arena.

In light of these considerations, the asset manager of the future will allocate fewer assets and provide more solutions, thus ensuring a more meaningful experience. The most surprising element that emerges from the research is that almost every possible consequence can eventually lead back to one underlying and uncontrollable force: human beings.

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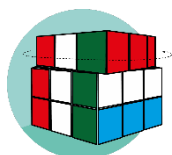


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