INSTITUTE FOR CAPITAL MARKET RESEARCH MALAYSIA

The Evolving Business of Asset Management in Malaysia

The Changing Landscape

Global assets under management (AUM) is expected to rise rapidly in the near future, estimated to almost double from US$84.9 trillion in 2016 to US$145.4 trillion in 2025.*[1] This growth has been premised on the asset management industry being able to fill in the financing gaps which emerged post Global Financial Crisis (GFC) due to the regulatory constraints on banks. However, this growth is likely to be uneven between developed and developing markets, as Asia Pacific is anticipated to be the centre of this expansion with estimated growth at 11.8% from 2020 to 2025.

In tandem, the landscape for the asset management industry is also rapidly changing. Apart from grappling with cyclical macroeconomic and market uncertainties, the industry has to also navigate structural evolutions such as the advent of digitalisation, changing demographic trends and investors' preferences, talent shortages and tighter regulatory requirements that demand higher thresholds of accountability, governance and transparency. Globally, this has led to further industry consolidation, indicating that the global environment may disrupt existing business models of asset managers.

Amidst these changes, it is important to remember that the asset management industry remains one of the core constituents of today's financial markets, and plays a vital role for the overall economy. It fulfills the essential function of intermediating savings into investment channels, facilitating greater capital mobility, and can create wealth effects while ensuring inclusive participation in the capital market.

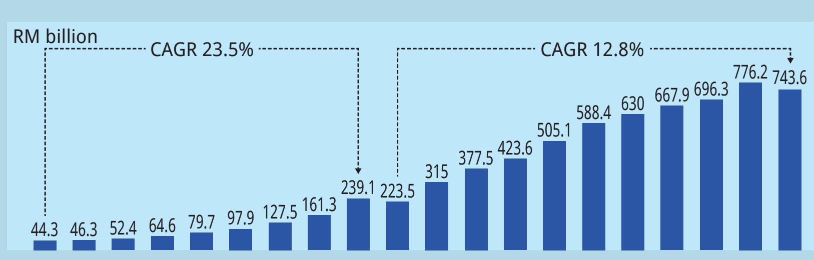
In addition, there are the non-financial positive externalities of enhancing the stewardship role and nurturing human capital development in the financial industry. Despite the structural challenges, it is imperative that policymakers continuously reassess whether the industry is aligned to these core functions in the overall economy.

Malaysia's State of Play

The Malaysian asset management industry has achieved strong growth over the last two decades, with total AUM experiencing a double digit compound annual growth rate (CAGR). However, CAGR of AUM has started to taper following the GFC, particularly in the last five years which saw single digit year-on-year growth with a contraction in 2018 (Figure 1).

While AUM growth is a reflection

Figure 1: Malaysia AUM, 1999 to 2018



Source: Securities Commission Malaysia

of headline figures, a cursory review of these aggregated numbers may mask certain important characteristics underpinning the industry's structure and dynamics.

The industry is highly concentrated with Malaysia's asset management industry being anchored by only a few large players. As at December 2018 there were a total of 80 portfolio management companies licensed by the Securities Commission Malaysia (SC), with the top five largest contributing 57.4% of total AUM in 2018.*[2]

Asset allocation remains mostly domestic, with a large focus on public securities. In 2018, 79.4% of the assets were allocated domestically, amounting to RM590.0 billion while assets allocated outside of Malaysia amounted to RM153.5 billion. The country has nevertheless seen an increase in foreign allocations from merely 16.7% in 2013 to 20.6% in 2018 (Figure 2).

The majority of the funds' allocations in 2018 were concentrated within traditional asset classes such as equities (47.2%), money market instruments (22.7%) and fixed income (21.4%). Only 1.5% of the assets managed are allocated for private equity and unquoted securities.

While the traditional equities and fixed income classes have taken the lion's share of the total asset allocations, the growth of other funds has been gradually picking up on a year-on-year basis with allocations in feeder funds (CAGR 17.4%) and private equity/unquoted securities (CAGR 8.0%). This suggests alternative asset classes, especially multi-asset solutions' feeder funds, private equity and private debt, have become more favourable as investors diversify their assets to reduce volatility and achieve specific outcomes.

Unit Trust Funds as the Biggest Segment

Prior to the GFC, unit trust funds accounted for more than 70% of the total asset management industry. By 2018 this has reduced to 57.3%, in line with the growth of wholesale funds and funds sourced through the Employees Provident Fund (EPF). However, unit trust funds remain the backbone of Malaysia's asset management industry as it is the largest contributor to the growth in assets, with Net Asset Value (NAV) increasing to RM426 billion, equivalent to 25.1% of stock market capitalisation in 2018. The majority of unit trust fund products remain concentrated in equities (69.4%) and money market (14.6%) strategies. As at December 2018, there were a total of 650 unit trust funds offered with majority similarly concentrated in equities (47.5%) and bonds (20.3%).

Broadening of Distribution Channels

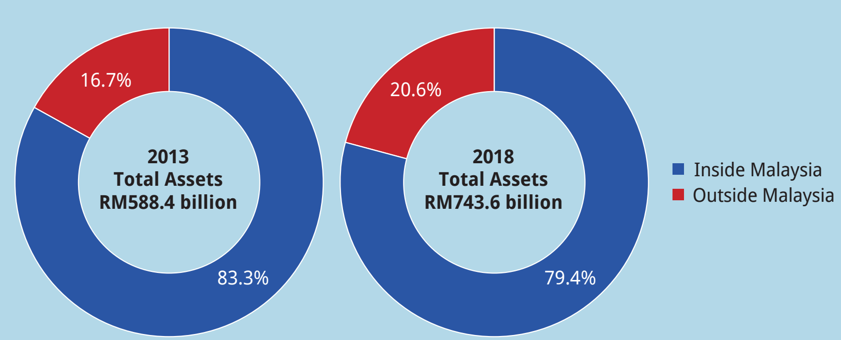
There are generally three different distribution channels for offering funds in Malaysia. The industry started off based solely on the agency model in the early 1990s where fund houses distribute their funds via their own agents or consultants. Unit trust agents and private retirement scheme agents have played a major role in developing the retail asset management industry, with growth in these two segments having provided employment and income opportunities for over 59,000 individuals in Malaysia.

However, according to market participants, this traditional agency-based model often requires clients to pay up to 5.0% commission to distributors and their agents. While the agency-based model has been successful in reaching out to retail investors, the lack of an open architecture system has led to concerns that the fee-based structure could be a cause for conflicts of interest, with clients' financial needs not being prioritised.

Faced with digital disruption and the rise of on-demand services, the industry has sought to introduce new channels to reach a broader audience. A supermarket for investment funds, Fundsupermart.com, was launched by iFast in 2008 following its debut in Singapore in 2002 and Hong Kong in 2007. The first roboadvisory, StashAway, entered the market in late 2018, introducing a purely digital platform with AI-enabled investment processes and lower management fees of 0.2%-0.8%. In August 2019, EPF launched its i-Invest online platform, which allows members to invest a portion of their retirement savings into approved unit trust funds. The online platform allows members to compare different unit trust funds, and to continuously transact and monitor their investments online. The relatively low fees of 0.5% on the i-Invest platform could potentially put pressure on the traditional agency model or other digital players.

As the industry seeks to broaden its customer base, some market participants have progressed to enlarge its distribution pipeline via partnership models. Through these models, agents are trained to approach clients more from a portfolio perspective--assessing client's financial goals, return expectations and risk appetite before recommending suitable asset allocations. Effort is then tilted more towards a client needs-based approach rather than merely pushing products.

Figure 2: Asset Allocation Composition between 2013 and 2018



Source: SC

Widening Range of Products

Although unit trust funds constitute the largest portion of the asset management industry, wholesale funds – which are sold to sophisticated investors[*3] – have the fastest growth rate in terms of fund category, rising 53.6% on a year-on-year basis from 2008 to RM64.95 billion in 2018. The number of wholesale funds offered has increased significantly over the last decade, from just 29 funds in 2008 to a peak of 313 funds in 2016, before tapering off at 307 funds in 2018. This growth is reflected in the various ongoing efforts driven by policymakers to enhance efficiencies and promote greater competition in the fund market.

The concept of Real Estate Investment Trusts (REITs) was introduced in 2005 to widen the breath of products offered by asset managers. Since the debut of Axis REIT, the first Malaysia-Real Estate Investment Trust (M-REIT), in August 2005, the market has grown by leaps and bounds in terms of both NAV and number of listed REITs. Over the last decade, total NAV of M-REITs has experienced phenomenal growth from a mere RM5.93 billion in end 2008 to a considerable RM34.57 billion by 31 December 2018, which is close to six-fold. M-REITs have had a stable ride over the past decade as they are viewed as a preferred safe haven amid the current market volatility and a tool to increase liquidity in a traditionally illiquid real estate market, as well as an opportunity to enrich diversification in a mixed-asset portfolio.

First introduced to the Malaysian market in 2005, as of December 2018 there are ten Exchange-Traded Funds (ETFs) listed on Bursa Malaysia with a combined market capitalisation of RM1.98 billion. In seeking to optimise market efficiency, policymakers have established a taskforce to revisit some of the development issues in relation to the domestic ETF market. The taskforce has introduced several initiatives and recommendations aimed at attracting greater participation and incentivising issuances by ETF managers in the Malaysian market.

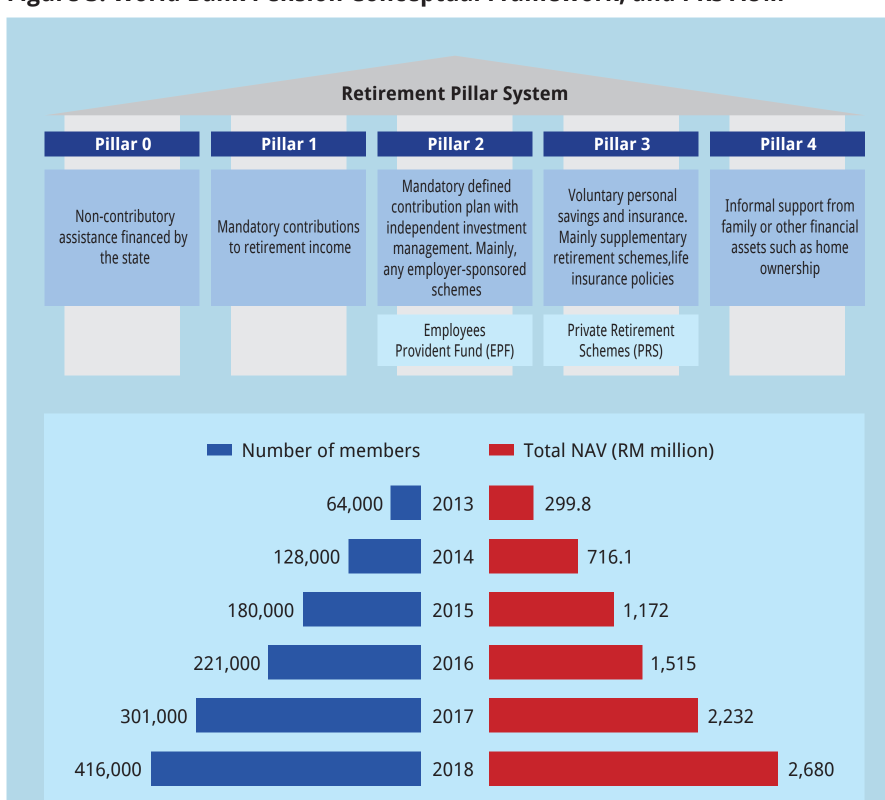
Private Retirement Schemes as a Means of Enhancing Retirement Savings

In line with global trends, it is estimated that 14.5% of the Malaysian population will be above 65 years of age by 2040, due to a combination of declining fertility rates and longer life expectancy.[*4] Private Retirement Schemes (PRS) in Malaysia were established by the SC in 2012 to address the growing challenges in relation to adequacy of retirement savings as the country progresses towards an ageing population. The PRS is a voluntary long-term savings and investment scheme designed to assist saving more for retirement. It forms the third pillar in a multi-pillar pension framework established by the World Bank, complementing Malaysia's mandatory retirement savings schemes.

Each PRS offers a choice of retirement funds from which individuals may choose to invest in based on their own retirement needs, goals and risk appetite. Funds under PRS have expanded 55% CAGR to RM2.68 billion and the number of PRS members also grew significantly to 416,000 (Figure 3).

To date, there are eight PRS providers approved by the SC which offer retirement investment solutions designed for three different risk profiles, namely conservative, moderate risk and growth/risk takers. Members are permitted to switch funds anytime within the same scheme, or alternatively transfer their scheme to another provider on an annual basis. While the contribution is voluntary, withdrawal is however permitted once a year and some types of withdrawals could have an 8.0% penalty imposed on the withdrawn amount. As an incentive for contributors (both individuals and employers), they are accorded with the benefit of tax deduction up to RM3,000 on a yearly basis and employers' tax deduction for any contributions made above the EPF statutory rate of 13.0% with a maximum cap of 19.0%. In order to encourage greater savings amongst the younger generation, youth between

Figure 3: World Bank Pension Conceptual Framework, and PRS AUM



Source: World Bank, SC

20-30 years of age will be given a one-off RM1,000 incentive by the government if they open a PRS account with a minimum contribution of RM1,000.

Insights from the Industry

Amidst this fast-changing landscape, the Institute for Capital Market Research Malaysia (ICMR) collaborated with the Nomura Institute of Capital Markets Research (NICMR) on a research project that focused on the state of preparedness of Malaysia's asset managers for the structural evolutions of the industry. The research began with a compilation of data and trends over the last decade and an analysis of the overall landscape in Malaysia. In order to develop a comprehensive and holistic understanding of the asset management industry, ICMR and NICMR conducted eight focus group dialogues (consisting of 21 C-suite level personnel from licensed asset management companies) and interviews with three key institutions as well as engagements with the regulators.

Further, to ensure there was an objective and quantitative approach in undertaking this study, an online survey was rolled out to all licensed asset managers. Responses were received from asset managers that represented 78% of total AUM for 2017.*[5] The survey was structured around key structural challenges that had emerged from the dialogue and engagement sessions, namely shifting business strategies, changing demographic trends and investors' preferences, digitalisation, market regulation and talent. Some of the key findings from the survey include:

- In the next 12-24 months, it was highlighted that "changes in investors' preferences" was the most critical external shift affecting their businesses, followed by changes in regulatory requirements as well as macroeconomic and market conditions.
- In terms of the key customer segment asset managers are targeting over the next five years, 88% are targeting local clients, out of which the majority are targeting local institutional clients.
- 77% of asset managers foresee that there will be increasing demand by investors for both Sustainable and Responsible Investments (SRI) funds and private mandates. 71% also see a shift happening towards wholesale funds.
- In terms of asset class, while investors' preferences are moving towards non-domestic equities and alternatives, asset managers also highlight that these are precisely the areas where there exists a tremendous talent gap.
- While 89% of our asset managers concur that digitalisation will impact their business in the next 12 months, their digitalisation priority would focus on enhancing day-to-day middle and back office operations, as opposed to more disruptive technologies.
- In relation to the pervasive lack of talent in the industry, about 70% of asset managers agreed there was difficulty in finding capable professional talent.
- More than 50% of asset managers believe that streamlining regulations from different parities and flexibility to allocate assets in domestic and foreign markets are key areas that regulators could review to further facilitate growth of the industry.

Moving Forward

Based on jurisdictional studies, survey findings and feedback from our consultations, the report sets out nine interconnected recommendations that holistically address underlying structural issues, as well as specific industry challenges. The recommendations also leverage on NICMR's in-depth knowledge of the Japanese asset management industry to identify possible solutions. These recommendations were designed to be considered by both policymakers and industry players in a holistic manner.

In line with this, the recommendations were formulated with the overarching aim of strengthening the asset management industry across the value chain, while anchoring it with three strategic outcomes that reflect the core functions of the industry (Figure 4).

Figure 4: Overarching Strategic Outcomes

Promoting inclusive capital markets	• Regulators, asset managers and industry players alike need to be cognisant of the broad range of investors (both existing and potential) and their differing preferences. In order for the capital market to be truly inclusive, greater segmentation as well as tiering of regulation, widening of products and distribution channels is required.
Strengthening intermediation role	• Asset managers can play an important role in promoting capital accumulation by facilitating greater capital mobility for investors, both retail and institutional. Malaysian asset managers that can increase their market share abroad can also play a virtuous cycle in attracting more foreign capital into Malaysia, which will help enhance the vibrancy and liquidity of our capital market.
Enhancing value creation	• Given the ongoing structural of the asset management industry, asset managers will need to enhance their value creation for capital market stakeholders in order to survive. They will need to find innovative ways and rethink their strategies to obtain greater competitive advantage and shift from traditional business models.

Source: ICMR

Summary of Recommendations

Facilitating market diversity for revitalisation

For asset managers, diversifying the investor base and asset classes is an important facet to enable them to serve the growing needs of an evolving economic structure and increased societal demands in Malaysia. There is a need to look at how asset managers can internationalise and tap on the growing wealth in emerging markets, be it from government initiatives like regional harmonisation efforts and further domestic regulatory flexibilities, or private-sector driven like setting up of overseas offices, consolidation via mergers and acquisitions or through cross-border partnership structures such as strategic alliances or joint ventures. This is also important for the purposes of capital mobility, diversification and to reduce risks stemming from concentration in the domestic market. Asset managers play a key intermediary role in ensuring a good balance and a virtuous cycle of capital flows which will contribute to the growth of Malaysia's market. Underlying this, all market stakeholders need to ensure that there is a vibrant market with sufficient breadth and depth of both investors and high-quality issuers.

Going beyond mere capital with differentiated strategies

In light of increasing competition and changing structural trends, asset managers have to rethink their strategies and embrace different business models. Asset managers that look beyond the traditional role of mere capital intermediation and are willing to adopt specialised strategies will be able to differentiate themselves from their competitors, while also enhancing the long-term value of investee companies. This could include looking at ESG strategies and the convergence between Islamic and SRI value propositions, as well as embracing smart-beta strategies and other thematic investments.

Developing talent through internationalisation and reciprocal relationships

Throughout our engagements and survey, talent has been highlighted as a perennial issue, and this extends to even the ancillary services. Asset managers should look towards internationalisation efforts, including leveraging cross-border partnership structures or existing regulatory frameworks that allow for cross-border flexibilities. With increasing competition for the same sources of funds, there also needs to be a reassessment of the relationship between asset owners and asset managers to one that is more reciprocal in nature, with asset managers receiving more transparent, performance-based compensation in exchange for providing specialist skills to asset owners. There should also be a reassessment of the effectiveness of special schemes in bringing in talent.

Embracing the digital disruption

Digitalisation is rapidly disrupting many industries, including financial services and asset management. Asset managers will need to look beyond short-term profit to develop long-term digital strategies and make the necessary investments for the future. Digital strategies should also be tailored according to each asset manager's target clientele, with an eye towards the future generation of investors. There is a need for asset managers to be cognisant of and be prepared for the global shift towards digital platforms and roboadvisory models. Regulators and asset managers should also think of innovative ways in which asset management can harness other fintech and digital offerings, for instance microinvesting, digital-only banking and mobile payment systems. In addition, traditional asset managers can look toward tapping into accelerator programmes within the fintech and venture capital community to identify key challenges where fintechs and other startups can be leveraged to deliver innovative investment offerings and experiences to investors.

Making PRS a more attractive option

In order to enhance the value proposition of PRS, it needs to be an attractive option for investors in terms of returns and diversity while still providing the necessary mechanisms to ensure savings are available for retirement purposes. There is a need to look across the PRS value chain, including a harmonised review of regulations to allow for a more sophisticated and diverse range of products, increasing diversity of PRS providers, encouraging employers to adopt PRS, and a review of tax incentives. Leveraging on the findings of behavioural economics (e.g., automatic enrolment, switching to opt-out default options, enhancing awareness of expected income replacement rates, providing more nuanced and targeted default options) could also be key to spurring growth of PRS.

Widening product range

It is crucial to ensure that there is a wide range of products that can attract new customers and help investors diversify their portfolios while also driving market innovation. Infrastructure funds could be a means of channeling available financing to support national and regional infrastructure development, while also meeting the increasing demand from investors for funds based on non-traditional assets. REIT-ETFs are also another product that asset managers could consider, as it will allow investors to engage in the property sector while enjoying the long-term stability of ETFs.

Strengthening the value of distribution channels

There have been concerns that Malaysia's asset management industry has one of the highest fee structures globally, particularly for retail investors. With digitalisation of financial services and downward pressure on fees, investors are faced with an increasing array of choices, each with their own benefits and value proposition. While the agency model remains a key distribution channel to retail investors in Malaysia, it becomes all the more pertinent that unit trust agents strengthen the value of their services to remain competitive. Unit trust agents should look towards moving up the value chain and becoming Certified Financial Planners and Certified Financial Advisors for the purpose of providing comprehensive financial planning and advisory services for their clients. Not only will one-stop financial advisory give agents an edge and maintain their relevance in this changing world, but also agents who have a holistic overview of clients' portfolios will be able to better assess their risk appetite and help them move up the investment curve, while also introducing new monies into the asset management space.

Embedding financial literacy

While various policymakers, regulators and agencies have undertaken significant efforts on financial literacy, there is still a pressing need to address the existing gaps. The private sector should step in and play a more active role in promoting investor education beyond mere promotion and marketing of their products. Regulators and policymakers should also adopt targeted approaches for more effective outreach, including segmented benchmarking and application of behavioural economics principles.

Establishing a high-level task force to address regulatory and policy harmonisation

Establishment of a high-level task force to ensure cohesive regulatory and policymaking from the top could drive more effective change in the asset management industry. This will require a holistic assessment, input and coordinated efforts of multiple stakeholders including various ministries, government agencies, regulators, Government Linked Investment Companies (GLICs), and industry players.

Extracted from *The Evolving Business of Asset Management: Malaysia's Perspective* that was launched in June 2019. This report presented the findings from a joint research collaboration between ICMR and our research partner from Japan, NICMR. The full report is available online at https://www.icmr.my/the-evolving-business-of-asset-management/

Notes

*1 PwC (2017) *Asset & Wealth Management Revolution: Embracing Exponential Change*

*2 Securities Commission Malaysia Annual Report 2018

*3 Sophisticated investors are either accredited investors, high-net worth entities or high-net worth individuals, as defined by Schedule 7 of the Capital Markets & Services Act 2007.

*4 Department of Statistics, Malaysia (2016) *Population Projections Malaysia 2010-2040*, available online at https://www.dosm.gov.my/v1/index.php?r=column/ctheme&menu_id=L0pheU43NWJwRWVSZklWdzQ4TlhUUT09&bul_id=Y3kwU2tSNVFDOWp1YmtZYnhUeVBEdz09

*5 Survey excludes AUM of Permodalan Nasional Berhad (PNB). Separate engagement sessions were conducted with PNB.

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The Institute for Capital Market Research Malaysia (ICMR) was established by the Securities Commission Malaysia as an independent think tank initiative that aims to promote sustainable development of the Malaysian capital market through providing focused, pragmatic and evidence-based research and solutions. ICMR undertakes research projects through a multi-stakeholder and collaborative approach, drawing insights and best practices from international experts as well as harnessing the knowledge and experience of Malaysia's regulators, policy makers, industry players and academia.