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Funds & Asset Management – Middle East

GCC fund firms expect stronger inflows as Islamic and ESG investing grows

Asset managers in the Gulf Cooperation Council (GCC) countries expect a solid performance over the next 12 months, according to Moody's 2021 survey of chief investment officers (CIOs) from eight leading GCC fund firms. Growing demand for Islamic products and for investments that take environmental social and governance (ESG) considerations into account will likely support fund inflows. With competitive pressure mounting, many GCC fund firms are open to mergers and acquisitions (M&A).

GCC asset managers are cautiously optimistic. GCC fund firms expect to build on their strong performance in 2021, with half of CIO respondents expecting double-digit growth in net inflows, and another 33% foreseeing a high single digit increase. Improved investment results and stronger fees, already comparatively high in the GCC region, will further support revenue growth. Respondents' optimism is tempered by worries over geopolitical tensions, the economic impact of the pandemic, and volatile oil prices.

Demand for ESG products to increase. Respondents are bullish regarding ESG-compliant investment products, with 38% expecting a significant increase in demand for such assets. However, the survey indicates that GCC asset managers are still in the early stages of integrating ESG considerations into their operations, lagging behind foreign players. This could make it harder for GCC asset managers to meet investor expectations regarding ESG issues, putting them at a competitive disadvantage as foreign firms expand their presence in the region.

Islamic products to outgrow conventional investments. Half of respondents expect sales of Islamic products to grow more rapidly than sales of conventional investments in the next year. This reflects the GCC region's large Muslim population, and the industry's efforts to expand its range of Islamic investment options. The trend for socially conscious investing is also supportive, given the natural crossover between Islamic finance and sustainable investing. Nevertheless, the range of Shari'ah compliant investment products remains relatively limited.

Consolidation appetite is high. Around 50% of respondents said they were open to merger and acquisition (M&A) activity within the next two years. The industry's interest in M&A reflects the GCC asset management sector's growing sophistication, as well as mounting competitive pressure. These factors are prompting GCC asset managers to seek opportunities to strengthen their market positions, diversify their product offerings, and accelerate their digital transformation.

GCC asset managers are cautiously optimistic

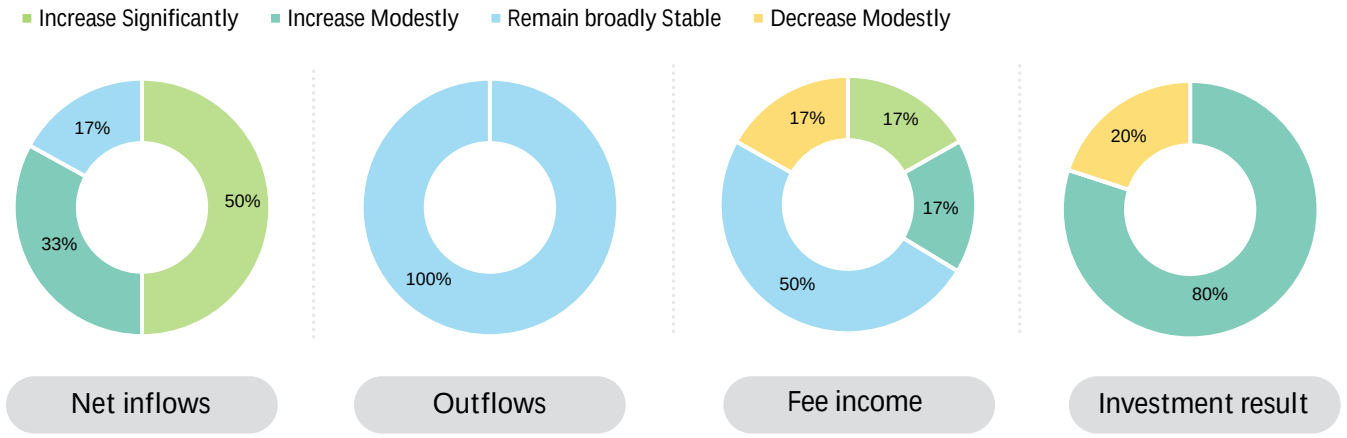
Asset managers in the Gulf Cooperation Council (GCC) countries expect to build on their track record of strong performance over the next year, despite concerns over regional geopolitical tension, the economic fallout from the pandemic, and volatile oil prices, according to a recent Moody's survey of chief investment officers (CIOs) from eight leading GCC fund firms.

Half of survey respondents anticipate double-digit growth in net inflows over the next year, while another 33% foresee a high single-digit increase. All CIOs expect investor redemptions to remain limited, and the overwhelming majority foresee a further improvement in investment results. Less than 20% of CIOs anticipate an increase in pressure on margins, reflecting the GCC region's comparatively high management fees (Exhibit 1).

Exhibit 1

Drivers for revenue growth over the next 12 months

Q: Do you expect the following revenue drivers in 2021/2022 to?



Source: Moody's Investors Service, 2021 GCC Asset Managers CIO survey

Respondents expect investment activity to remain robust over the next twelve months, supported by the global economic recovery, rising oil prices on the back of strengthening demand, and efforts by the GCC countries to reform and diversify their economies.

In 2020, GCC asset managers achieved double-digit growth in assets under management and consistently positive net inflows, despite the double shock of the coronavirus-related economic downturn and an accompanying slump in oil prices. The sector benefited from a robust capital market recovery in the second half of the year, which attracted new inflows from private investors and sovereign wealth funds (SWFs).

Saudi Arabia, the GCC's largest economy, accounting for over 80% of the region's assets under management, is recovering steadily from the pandemic-driven slowdown, helped by a resurgent non-oil sector and substantial investment from its sovereign wealth fund – the Public Investment Fund (PIF).

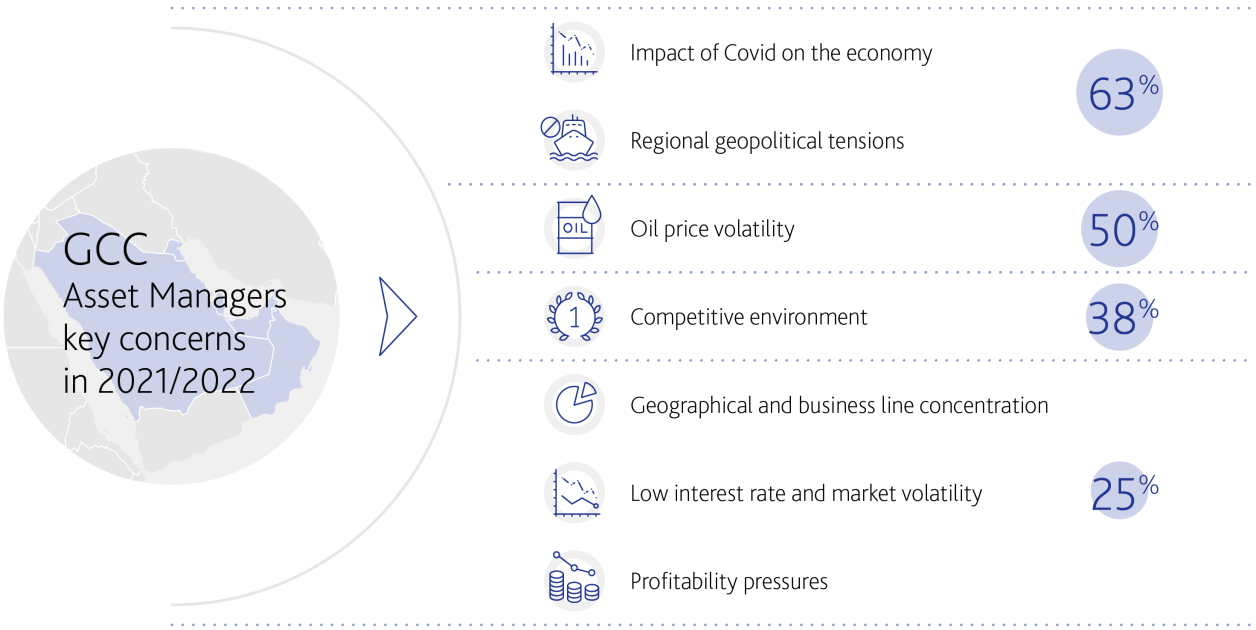
We expect Saudi Arabia's asset management sector to benefit from the government's "Vision 2030" plan to diversify the economy away from oil. Under the program, PIF plans to invest a minimum of $40 billion a year in local industries and manufacturing facilities until 2025, doubling its assets to $1.07 trillion. At the same time, economic reforms which have encouraged more Saudi women to enter the workforce, and changes to the sponsorship system for expatriate workers, will increase household incomes and support private demand.

Survey respondents remain concerned over the long term economic impact of the pandemic, with over 60% identifying this as one of their top three worries. A similar proportion singled out regional geopolitical tensions as a source of concern. Although geopolitical risk has been moderate recently, it remains a key challenge for the GCC region (Exhibit 2).

Exhibit 2

Economic impact of the pandemic and geopolitical tensions are key concerns for GCC Asset Managers in 2021/2022

Q: Which are the key three concerns for your firm in 2021/2022?



The exhibit shows the cumulative results of CIOs' top 3 concerns for 2021/2022.
Source: Moody's Investors Service, 2021 GCC Asset Managers CIO survey

A significant escalation of these tensions would have wide-ranging implications, affecting economic and financing conditions in the GCC countries. This would damage investor confidence, delaying large scale infrastructure projects, and constraining regional growth and economic diversification. This would weigh on the asset management industry, reducing fund inflows and negatively affecting revenue.

Oil price volatility, cited by half of CIOs as a top three concern, is a further challenge for GCC asset managers. Despite GCC countries' efforts to diversify their economies, the region's economic performance remains highly dependent on oil prices. Weak oil prices can hold back economic growth and public spending, with negative consequences for GCC asset managers, whose customers depend on oil exports for the bulk of their revenue. A drop in oil prices would also negatively affect GCC stock market returns, weighing further on local fund firms' assets under management (AUM).

In early 2020, the coronavirus outbreak triggered sharp global economic slowdown, exacerbated in the GCC region by a slump in oil prices. While oil demand and prices have since recovered, the oil sector continues to weigh on the economy. For example, in Saudi Arabia, the International Monetary Fund (IMF) projects real oil GDP growth of -0.4% in 2021. This is despite the OPEC+ group of oil exporters' recent agreement to raise overall output in the last five months of the year.

GCC governments' efforts to reduce their economic dependence on hydrocarbon extraction should lead to more diversified economies in the long run. While we expect the transition to be gradual, it will over time stimulate private investment, attracting more international investors, and ultimately supporting the growth of the asset management industry.

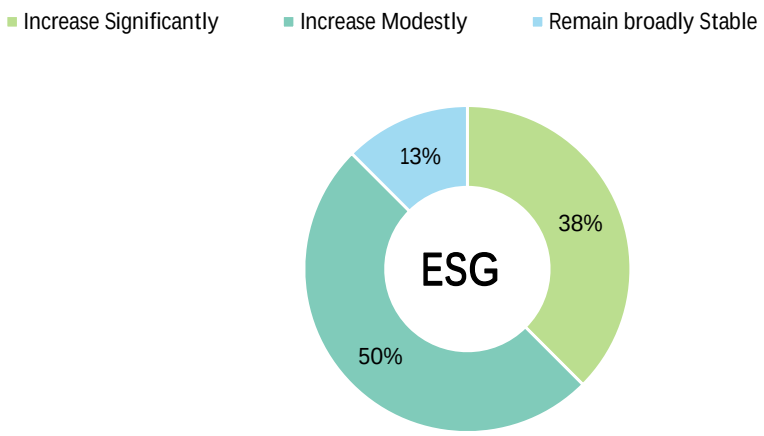
Demand for ESG products to increase

Survey respondents expect solid net inflows across all asset classes, but are especially bullish regarding investment products that take environmental, social and governance (ESG) considerations into account. Around 38% of CIOs expect a significant increase in demand for ESG-compliant investment products, while another 50% foresee modest growth in ESG asset flows (Exhibit 3).

Exhibit 3

GCC Asset managers are bullish regarding ESG-compliant investment products

Q: Do you expect demand for ESG asset classes in the next 12 months to:



Source: Moody's Investors Service, 2021 GCC Asset Managers CIO survey

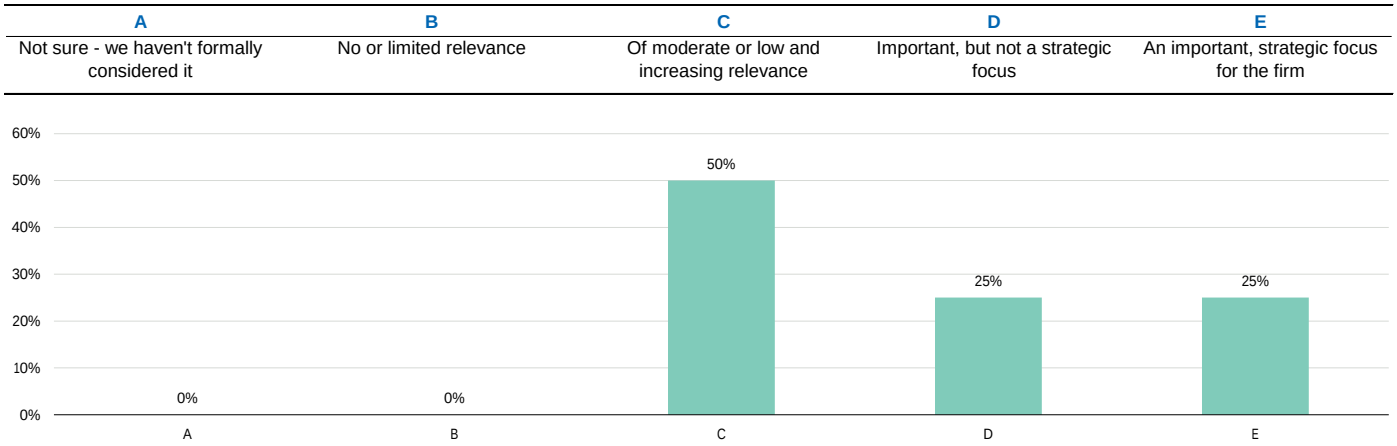
In the GCC region, ESG investing is rapidly gaining traction among investors, in line with increased awareness of ESG issues globally as a result of the pandemic. In an effort to attract ESG investment, GCC countries are taking steps to tighten sustainability reporting requirements for companies. GCC stock market operators have also put in place measures to meet demand for ESG products. Examples include the introduction of ESG reporting requirements for listed companies by the Abu Dhabi Securities Exchange (ADX), and the Dubai Financial Market (DFM). In April 2020, the DFM launched its first ESG index, and Saudi Arabia's Tadawul Stock Exchange said in August 2020 that it would follow suit in early 2021, although it has not done so yet.

However, the survey reveals that GCC asset managers are still in the early stages of integrating ESG considerations into their day to day operations. Only 25% of survey respondents cited ESG issues as an area of important strategic focus, while half of the CIOs considered ESG to be of moderate or low albeit increasing importance (Exhibit 4).

Exhibit 4

GCC asset managers are in the early stages of integrating ESG considerations into their operations

Q: To what extent does your investment strategy incorporate the risks and opportunities presented by ESG?



Source: Moody's Investors Service, 2021 GCC Asset Managers CIO survey

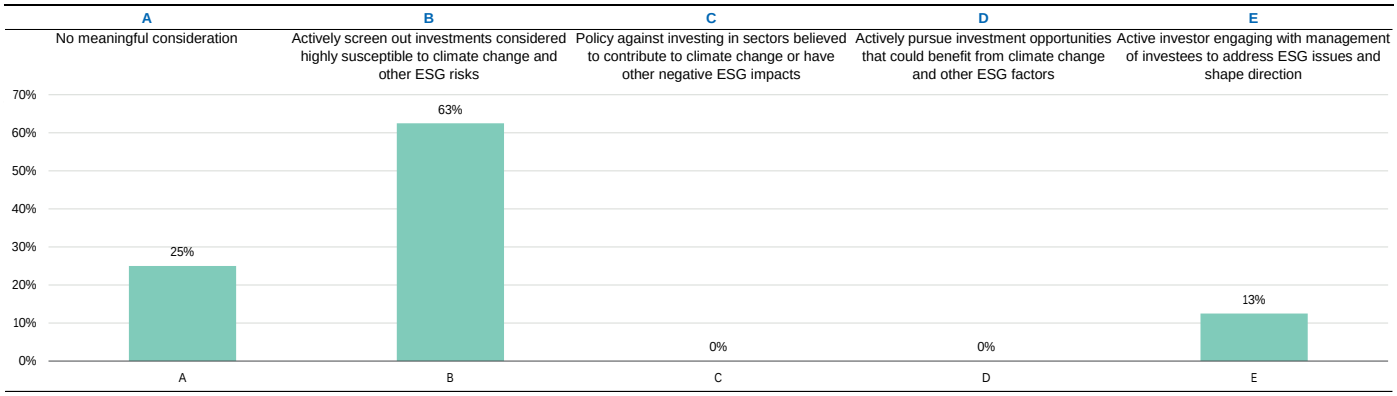
Our survey indicates that GCC asset managers' progress towards incorporating ESG considerations into their investment strategies is slow. Around 25% of the CIOs said they had not yet embedded ESG criteria into their investment management decisions. Most of the CIOs saidtheir firms actively screen out investments considered highly susceptible to ESG risks, but only a small number engage with the management of the companies they are invested in to address ESG issues and shape direction (Exhibit 5).

In contrast, global asset managers are placing strong emphasis on ESG issues to comply with more demanding regulatory requirements, and to meet investor expectations regarding transparency, oversight and corporate governance.

Exhibit 5

GCC asset managers are making slow progress towards incorporating ESG considerations into their investment strategy

Q: To what extent does your investment strategy incorporate the risks and opportunities presented by ESG?



Source: Moody's Investors Service, 2021 GCC Asset Managers CIO survey

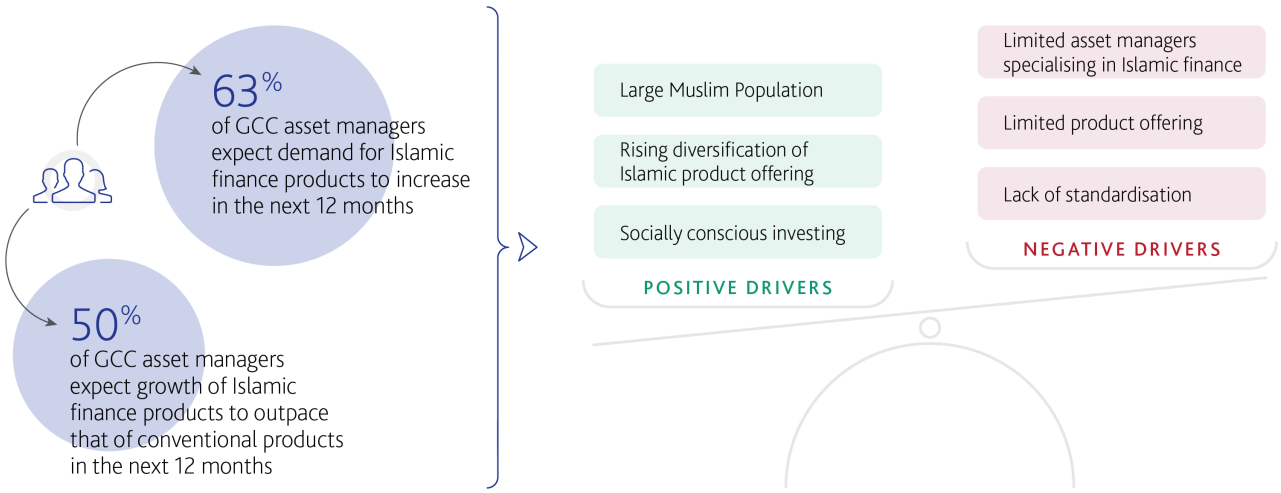
We expect GCC governments' diversification away from oil and gas, and the introduction of new ESG-related disclosure requirements, to raise the profile of ESG issues in the region. However, GCC asset managers' comparatively slow adoption of an ESG-led investment approach could make it harder for them to meet evolving investor expectations. This could expose them to increased competition from foreign players.

Islamic products to outgrow conventional investments

Over 60% of surveyed CIOs anticipate further growth in demand for Islamic finance products over the next year, while the remainder expect demand to remain stable. Half of respondents expect sales of Islamic finance products to grow more quickly than sales of conventional investments (Exhibit 6). Islamic financial markets continued to expand in 2020 despite the coronavirus pandemic, reflecting persistently strong demand for Shari'ah-compliant investments.

Exhibit 6

CIOs expect rising growth in demand for Islamic finance products as positive drivers outweigh negative ones



Source: Moody's Investors Service, 2021 GCC Asset Managers CIO survey

Most survey respondents see the world's 1.8 billion-strong Muslim population, a proportion of which currently has little access to Islamic financial products, as a key driving force behind rapid growth in sales of Shari'ah compliant assets.

Survey respondents also cited the growing diversification of Islamic investment product offerings as an important growth driver. A broad range of Shari'ah-compliant products is more likely to match clients' evolving investment preferences, creating conditions for long-term growth. Asset managers involved in the development of new Islamic products and investment solutions are likely to benefit significantly.

Half of CIOs also cited growing demand for socially conscious investment assets from ESG-aware investors as one of the top three factors behind current buoyant appetite for Islamic products. Shari'ah principles prohibit investing in products and activities that are forbidden (haram) under Islamic law, including tobacco, alcohol, gambling and weapon manufacturing. The natural crossover between sustainable investing and Shari'ah-compliant social principles creates opportunities for the Islamic finance industry.

Even so, the development of the Islamic asset management industry faces challenges. Most CIOs named the limited number of asset managers specializing in Islamic finance as the biggest growth obstacle. A shortage of appropriately qualified Shari'ah scholars, tasked with ensuring that Islamic investment products comply with Shari-ah principles, creates a further hurdle for the industry. The limited number of Shari'ah scholars also creates potential constraints and conflicts, as some advise multiple financial institutions.

While acknowledging the growing diversification of Islamic asset managers' product offering, around 75% of survey respondents said they still regard the limited range of Islamic investment options as one of the three main impediments to growth. CIOs also see a lack of standardization across the global Islamic finance industry as a growth constraint. Greater harmonization in product structure and documentation, as well as in the global legal and regulatory framework for Islamic finance, would make Islamic assets more attractive to regional and international investors.

Consolidation appetite is high

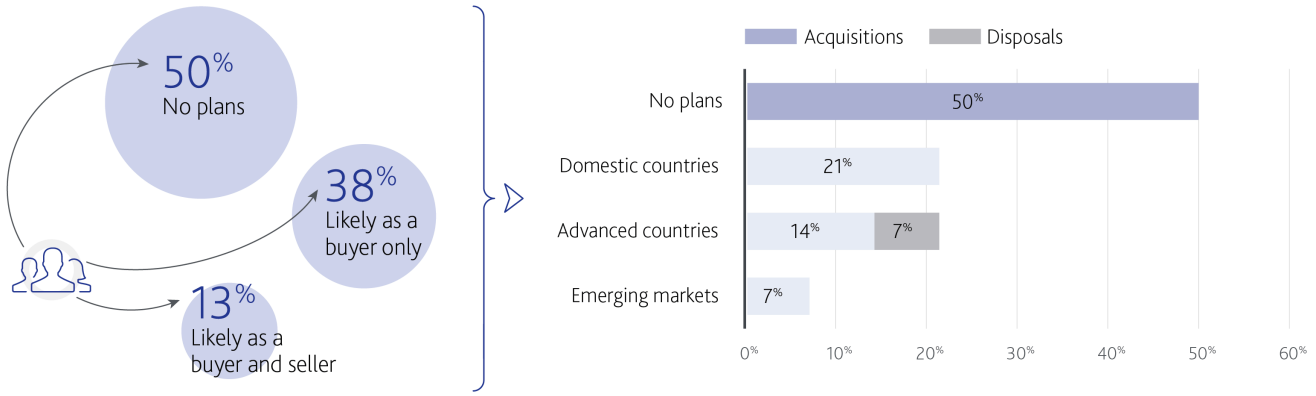
There has been a record number of M&A transactions in the global asset management sector over the last twelve months. In the GCC region, asset management industry consolidation has been driven in recent years by mergers between Islamic banks. Saudi Arabia's top five asset managers currently account for over 70% of industry AUM, up from 65% twelve months ago, as a result of the merger of NCB Capital and Samba Capital & Investment in July 2021.

Half of respondents to our survey said they would be willing to engage in merger and acquisition (M&A) activity the next two years. All said they would be willing to act as buyers, while 13% said they would also consider acting as sellers (Exhibit 7).

Exhibit 7

GCC asset managers are open to M&A activity

Q: Do you expect your firm to be involved in M&A/disposals in the next two years?



Source: Moody's Investors Service, 2021 GCC Asset Managers CIO survey

With the market opening up to international investors as the region seeks to diversify its economy, and with competitive pressure on the rise, GCC asset managers will likely target acquisitions designed to increase scale. Larger managers with a diverse mix of assets will be better positioned to withstand future economic disruption, and to exploit opportunities created by the GCC region's economic diversification.

GCC asset managers might also engage in M&A to enhance their product and geographic diversification, better equipping them to meet investors' evolving needs. While half of respondents interested in acquisitions said they were considering opportunities in their home markets, the remainder said they would likely act as a buyers in other developed and emerging economies.

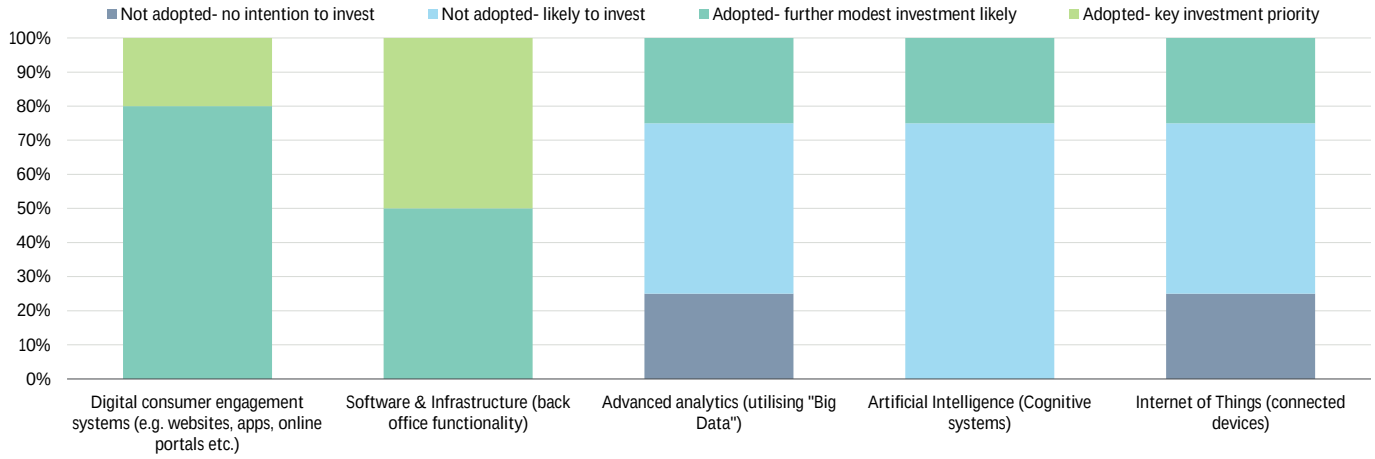
With the pandemic demonstrating the importance of digital distribution for financial services firms, GCC fund companies may also seek deals that help them accelerate their technological transformation. GCC asset managers are already investing actively in digitalization, which is integral to GCC governments' economic diversification programs. All surveyed respondents said they had adopted digital consumer engagement systems and back office functions, and are planning to continue investing in technologies designed to improve customer experience (Exhibit 8).

In the coming years, GCC asset managers will likely increasingly prioritize investments in "big data" analytics and automated ('robo') advisory services to improve operational efficiency and product distribution. While around 80% of the CIOs see technologies such as advanced analytics and artificial intelligence as an important opportunity, most of their companies have not yet adopted them.

Exhibit 8

GCC asset managers have adopted consumer engagement technologies and back office systems

Q: To what extent your firm has adopted or is investing in the following types of technology?



Source: Moody's Investors Service, 2021 GCC Asset Managers CIO survey

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» NCB Capital - Saudi Arabia – NCB's merger with Samba will reinforce NCB's asset management arm, January 2021

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