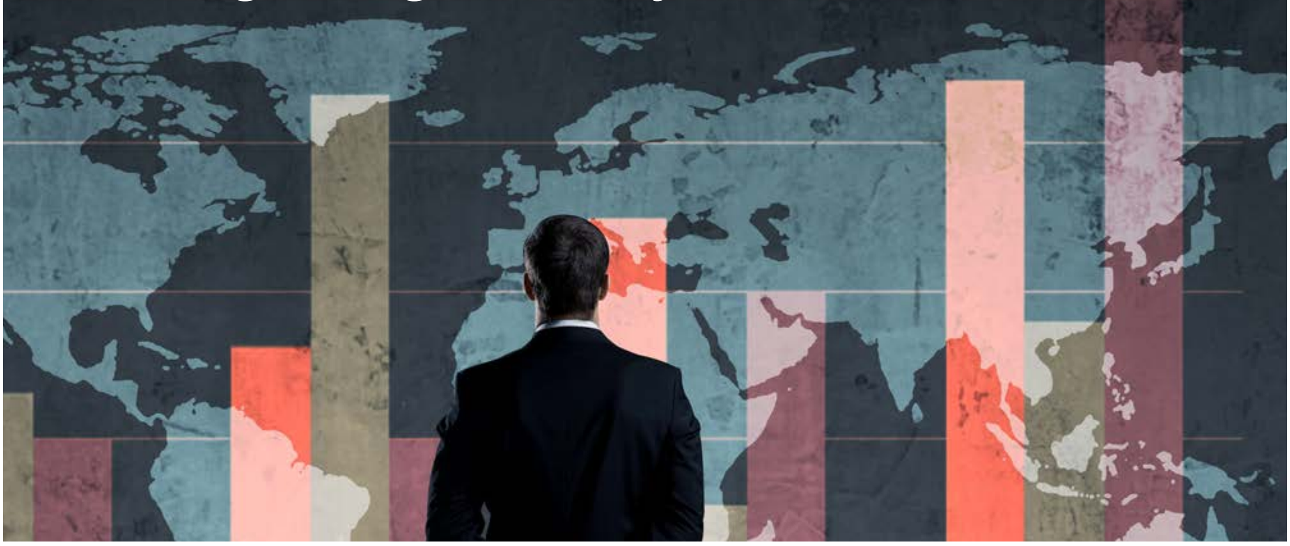
A game of catch-up: the drive to evolve wealth management in the Philippines

The wealth management industry in the Philippines is in a relatively early phase of development when compared to more advanced ASEAN peers such as Malaysia and Thailand. Hubbis invited a select group of industry leaders from private banks, asset management, and insurance to a behind-closed-doors discussion in April in Makati, Manila. The consensus is that the growth potential is as vast as are the challenges facing the industry.



THE PRIVATE, OFF-THE-RECORD DISCUSSION event was attended by senior management from private banks, universal banks, insurance companies, asset management firms and trust companies.

The objective was to interpret developments in the market extrapolating from the experiences of the experts at the discussion.

Topics covered in the wide-ranging discussion included: key priorities in 2018, business efficiencies, the challenge from new entrants, outreach to retail investors, client education, and how firms can differentiate their offerings.

From a little acorn

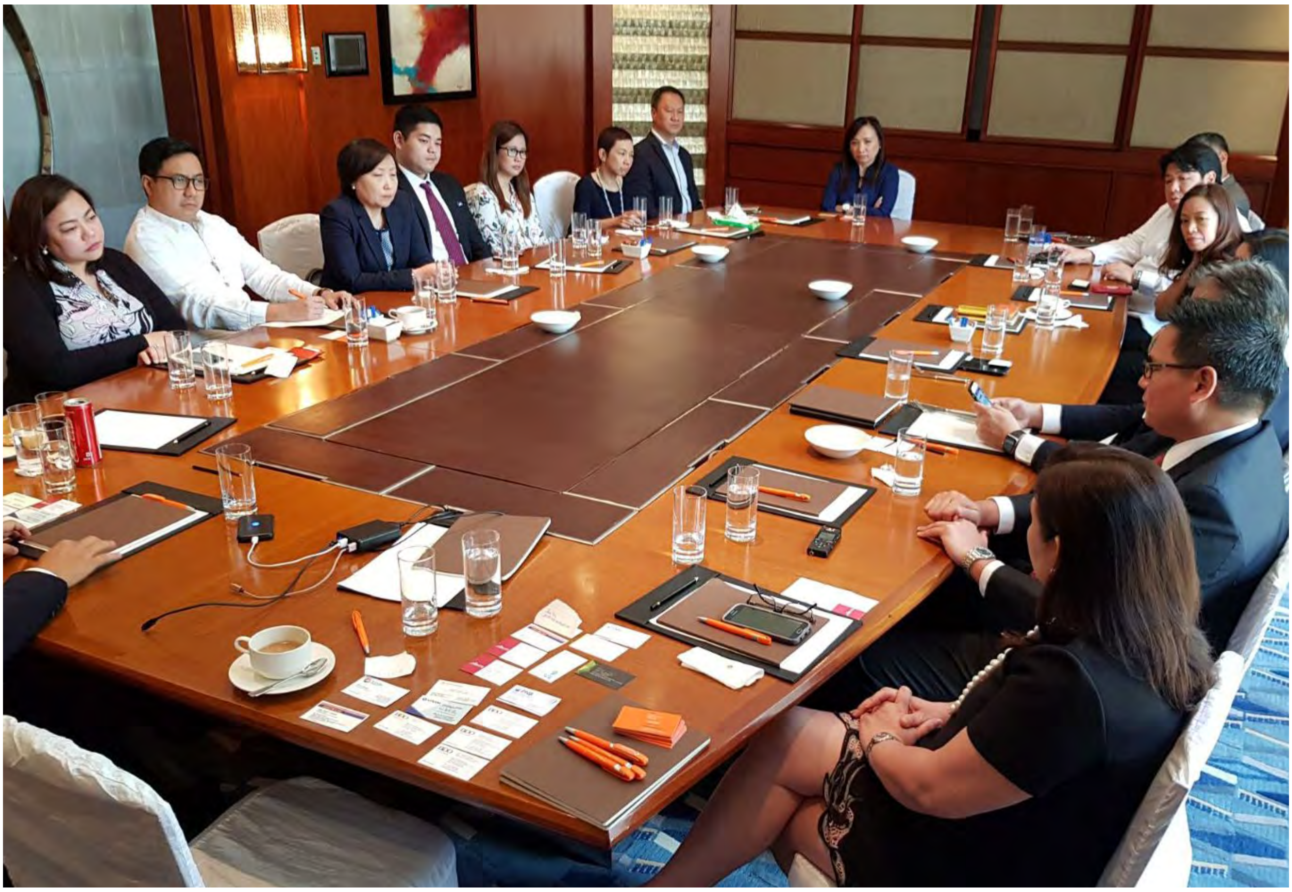
The asset management industry in the Philippines is in its formative stages, as is the broader wealth management industry in general. The total Unit Investment Trust Fund (UITF) industry is estimated at the equivalent of around USD17 billion and the mutual fund segment at about USD5 billion.

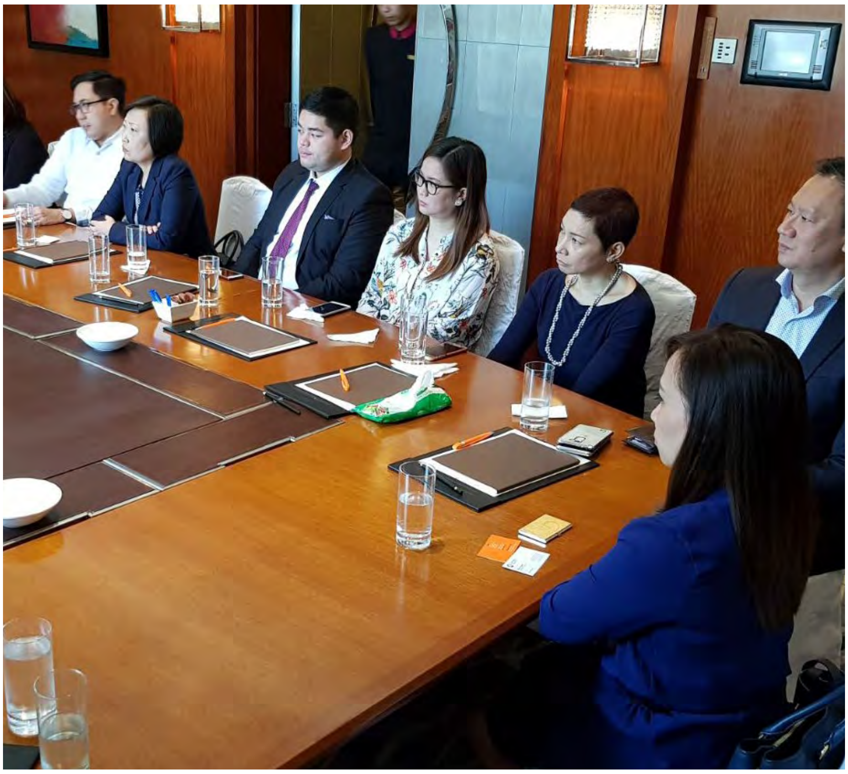
But there are winds in favour of the asset management industry. The Philippines now allows foreign firms to establish trust corporations, authorised by the central bank, the Bangko Sentral ng Pilipinas (BSP), to engage in funds management. Unlike the trust units of Philippine banks and non-bank financial institutions, these new corporate entities are stand alone and have their own dedicated capital and management structure. Trust firms principally sell UITFs, which can be distributed to both retail and institutional investors.

Meanwhile, the universal banks in the country are now allowed to create dedicated asset management entities by moving their existing operations into new corporate entities.

The new regulations that define banks being able to set up a separate trust corporation could potentially make the process somewhat cheaper and more efficient. But so far, only some universal banks are taking this step, while others prefer to maintain the current status quo.

The wealth management sector is also taking technology increasingly seriously for internal efficiency and accountability, as well as to improve the client experience. Some banks, for example, have now connected accounts to allow clients to access their UITF accounts via ATMs. Moreover, they can open a UITF account online if they already have an account with some banks.





Regulators are oiling the wheels… but progress far from smooth

The central bank has been trying to encourage trust funds, and other managed funds to develop additional products for clients outside the plain vanilla deposits, for example, fixed income, equities, and so forth.

But to distribute products that are not so well known to a retail market that lacks sophistication is challenging to say the least.

Education of investors on products and opportunities is therefore vital. It has begun, but it is not yet an orchestrated, nationwide initiative. Many in the industry believe a more concerted and energetic effort is needed, and urgently.

There is often considerable confusion amongst retail investors, especially those seeking their first investments, as to precisely what are the differences between UITFs, mutual funds, and unit-linked products.

The entire asset management industry in the Philippines desperately needs to win over more small investors to invest in unlocking its true potential and therefore needs to focus further on client education if it has to evolve for the future.

Best practices or best-for-client practices?

The strict initiation or onboarding process for new investors is a core hurdle as the client procedures are document-heavy and time-consuming for all parties. The Philippines might endeavour to follow the best international practices in dealing with client onboarding and risk profiling, but these practices often prove excessively cumbersome for the average investor who has maybe only a few hundred dollars a month to invest. The requirements are so stringent that it all too regularly becomes too much of an effort to invest. Many in the industry are therefore urging the authorities to help facilitate easier access to opportunities.

On many wish-lists is a shortened electronic form that allows for the requirements to be used by all members of the trust industry through the regulators. In other words, a one-time process.

A more digital approach is even more vital due to the extensive geographical spread of the country across 7107 islands.

Needless to say, the regulatory environment is gradually improving, but it is a painfully slow process. One problem industry experts note is that unitised fund products (UITFs, mutual funds, VULs) sold in the Philippines are governed by three separate regulators, who often seem to be almost in competition with each other.

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The pension industry in the Philippines is also in great need of a wide-ranging overhaul; the pension sector is under-funded, does not offer portability, and it is inadequate. Current studies show that maybe around 2% of retirees are financially prepared for their retirement, according to one expert that Hubbis interviewed recently.

And for a nation whose population is ballooning at the same time as longevity is rising sharply, that is a potentially disastrous situation.

Industry practitioners say they want to change the currently defined benefit pay-as-you-go system to a mandatory defined contribution system, which is funded, has portability, and which could address the issue of having sufficient pension for retirement.

The PERA or the Personal Equity and Retirement Account, a retirement investment plan, was introduced during 2017 as a voluntary system; the theory is that with enough incentives, particularly tax incentives, people are going to be encouraged to save and invest for their future pensions. However, the PERA scheme offers only a 5% tax refund or credit, while in many other more developed markets most or all pension contributions are shielded from taxes. And many cumbersome requirements make it difficult to set up PERA accounts.

Will global regulation pull HNW money back onshore?

The top tier of High Net Worth (HNW) individuals from the Philippines have mostly had considerable experience of investing their wealth offshore, generally through the Hong Kong and Singapore offshore centres.

Industry experts at the discussion noted the increasing prevalence of global private banks either setting up representation in Manila or teaming with leading local players.

A driver, many believe, is the global regulatory proliferation. Although the Philippines is not currently a signatory to the Common Reporting Standard (CRS), many bankers and other advisers are cautioning HNW clients to prepare for this eventuality. “CRS is an issue for the HNW and ultra HNW market,” explained one attendee. “Many of these have in the past worked hard to hide a lot of their wealth offshore. So, how does the local wealth industry attract more wealth back from offshore centres in the face of the potential of CRS and other pervasive regulation coming instream? It is an opportunity for us that we must address and embrace.”

Another banker noted that he is seeing more global private banks set up in Manila, with execution offshore, usually through Singapore, or Hong Kong.

And one expert said she sees major foreign banks becoming very aggressive in their hunt for local clients. “They often hunt in teams of three including with

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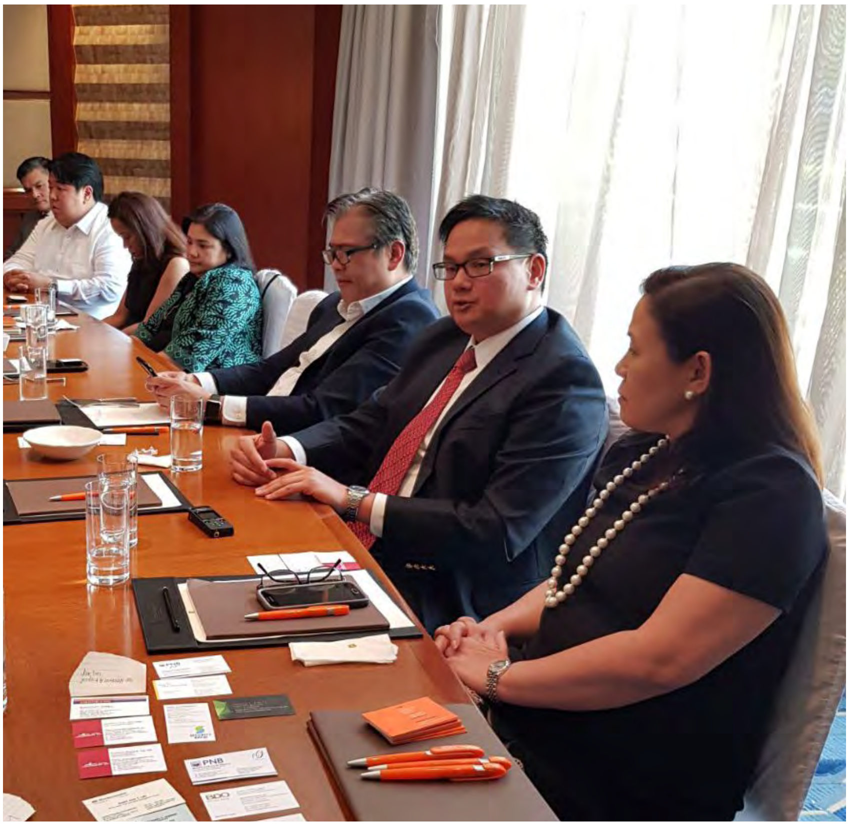

their lawyers." These brand name global private banks are evidently preparing for the day when less money disappears offshore, and more of the HNW wealth is managed transparently locally, and offshore, but is entirely visible to the local and global regulators.

Another expert added: "I am hoping our local HNW clients will keep their money here and with the probability of CRS coming, as well as FATCA, I believe that clients need to understand there will be two-way flows between the authorities fully. The Philippines might not yet have signed up to CRS, but it is only a matter of time, as happened with AMLA [Anti Money Laundering Act], which we eventually signed up to."

Another expert noted that if the money is kept in the country, there is little or no reporting to do. "Filipino clients are well protected here by secrecy, bank secrecy and data secrecy," he said.

Teaming up with global names

Some of the local universal banks are teaming up with bespoke private bank brands as a means of positioning themselves for the future, as well as to obtain access to a broader range of investment products going forward.

"For example," explained one local banker, "we have a partnership with a leading Swiss private banking group. They bring a great name, a lot of expertise and centuries of experience in private banking. They offer their expertise in investments and in other aspects of family services and ideas that we can present to clients. At the same time, we offer the domestic experience which they do not have. The collaboration allows us to offer the best of both worlds for our clients."

He added that given their vast experience in private banking in Europe and across the world, there is an excellent transfer of knowledge to local professionals. "They are regularly with us and helping us develop our teams and expertise in global investments, global best practices in family services, investments and all these things."

Another expert explained that looking ahead to amnesties and the repatriation of wealth back to the Philippines, a partnership with an established private bank group also brings other advantages. "They have that experience from other jurisdictions, which they can share with our clients and us. On CRS we tell our clients to expect that they will have to comply and to prepare for that, whether they like it or not. You comply with the requirements sooner, so you do not put yourself on the radar. But we see that as a result there will be big opportunities for all of us as a result."

The influx of brand name global firms does not cause undue concern for the local wealth sector. "But this does not worry us too much," reported one banker, "as the market is big enough, growing fast and we can compete in a friendly manner with each other here, without burning any bridges."

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Another banker agreed and noted that different firms have different skills. "We do not aim to advise on all the assets the customer might want to invest in, whether onshore or offshore, as we do not pretend to have the competence to advise on offshore assets. But we see a service gap here that nobody seems able to give good advice on onshore assets; this is where we come in because we know our tax laws, we have our lawyers to give the advice, we are on the ground, we understand the domestic market."

"But," she added, "we also recognise the value of advice on other investments covering offshore products and services, so we also work closely with some counterparties who will have the confidence to give the proper advice offshore. Although local clients do not love paying fees, we believe the customer who sees the value is willing to pay, and they are then loyal."

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More products, please

Access to products to feed investors of all types is an issue that occupies many minds. "Our private bank operates on open architecture platform," explained one banker," so working with a leading distributor of mutual funds helps us obtain the best deals for our clients, which is our fiduciary duty. We increasingly aim to work on advisory fees, which I hope and believe is the future trend here. I do not believe we will become 100% advisory, but some sort of hybrid model is the likely, and positive, outcome eventually."

He explained further that he does not need, for example, to tens of thousands of securities to pick from, as offered on the leading open architecture platform.

"I need far less actually, but enough choice and best of the breed and so forth. That requirement will increase, but the Philippines is still behind Thailand, for example, which is probably ten years ahead of us in this regard."

A representative from an independent firm explained that his team realised early on it must try to differentiate itself by bringing more product to the investor market as there are not a lot of products available in the market today.

"Moreover," he said, "what is available are products of the same type, whether they are equity funds, fixed income, money market instruments and so forth. So first, we managed to get feeder funds going in, about five years or so ago, working with a global fund house and now expanding to about a dozen feeder funds with different fund houses covering various global and regional asset classes," he added.

"Thereby we can provide the wealth managers and banks with more products so that they can construct their portfolios on a more global portfolio type basis."

It is a widely acknowledged truth that regulators can both facilitate and hinder financial markets and nowhere more so than in the Philippines, which has a long history of reluctance to embrace change.

A global perspective

"Right now, what I am seeing is a lot more of the wealthy, but not super HNW, clients looking at offshore investments and I would like to see more facilitating regulation instead of structures," he added.

"So, for example, to access a mutual fund we use the feeder fund route to get into that, whereas in the international markets it is so easy for them to access all these funds all over the world."

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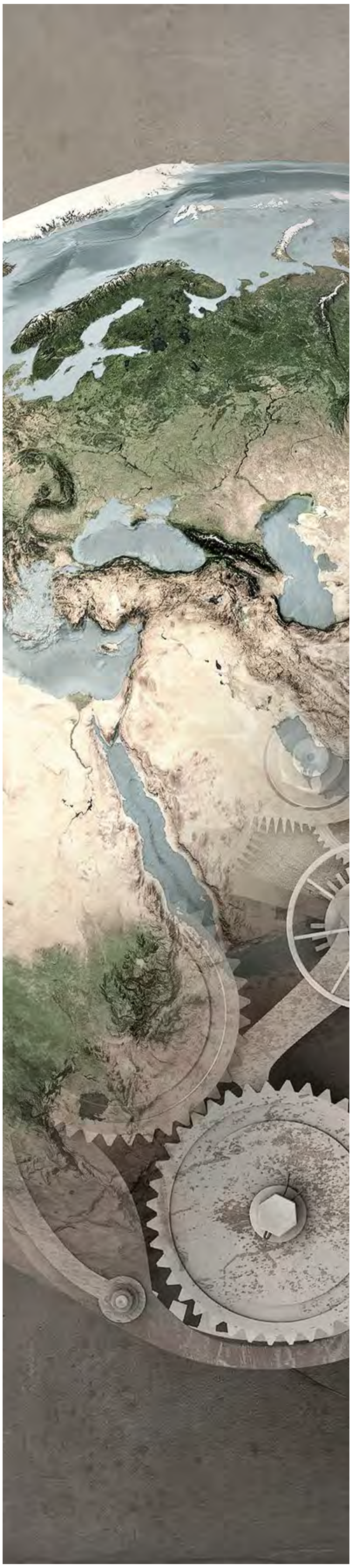
One attendee noted effort the Central Bank is making to update the trust business.

"We will have a roadmap workshop with the Deputy Governor on May 25, and we will be looking at the whole spectrum, from financial inclusion," she explained. "This will cover the retail investors all the way from those investing a few hundred dollars a month and up to the ultra HNW individuals.



The concept is to broaden the market, make regulations relevant."

She explained that the concept is also to look at how to allow investors transparent, visible access to the offshore market. "So, for example, if HNW and ultra HNW individuals are bringing money back here, there must be an avenue for our investors to access the investments that they are used to. At the end of this programme, we should come up with a clear roadmap looking several years ahead."

Progress, yes… but slow progress

But can this sort of initiative help the country move ahead to the standards and inclusiveness of Malaysia, or Thailand, for example?

"Progress has admittedly been slow," said another banker, "but with changes at the central bank, we are optimistic we can make some advances, at least in the trust sector."

There was a general agreement around the table that regulation is moving forward and sometimes on a proactive basis. But as one attendee commented, it is seldom easy, or rapid, obtaining approvals.

"For example," he noted, "a lot of offshore feeder and other funds have provisions on derivatives, for efficient portfolio management, so we are always wrestling with the regulator and what that means. I feel that based on current regulations and regulatory mindsets and practices, it will take too long. Eventually, we will have to work on some mutual recognition or registration of offshore funds into this market; if that happens, it will open the opportunities for wealth managers to offer the full range of advice and portfolios."

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For example, he pointed out that the BSP has indicated that if there are things that the trust sector needs to implement, and there is a need to isolate the implementation to test it, firms will be allowed to so.

"We will be allowed to create the sandbox where certain institutions or certain trust institutions can actively participate in the experimental stage," he revealed.

Another attendee explained that the trust and asset management sectors have grown out of the banking system, so the regulators always tend to have a banking hat on, whereas in other markets the asset management industry is typically regulated by the securities regulators that oversee what they sell and how they sell.

The call for regulatory coordination

The Philippines also suffers from having a seeming lack of harmonisation and coordination between the three regulators.

"Unlike Singapore, where you have a super-regulator, the Monetary Authority of Singapore, here it is what we term a monster with three heads," said one banker. "The BSP, the SEC and the Insurance Commission have a committee, and there are attempts at harmonisation, but I am not so encouraged yet from what we have all seen."

As it stands, all the unitised fund products (UITFs, mutual funds, VULs) sold in the country are governed by three separate regulators. UITFs are issued by trust departments of banks and non-bank financial institutions and therefore regulated by the BSP. Mutual funds are managed by investment companies and thus regulated by the SEC, while insurance companies issue VULs under Insurance Commission supervision. But one expert warned to be careful what her peers wish for. "For lack of a better alternative right now, where we are today is probably an okay situation. Moving everything, for example, to the SEC as a regulator of the asset management industry may not necessarily be a better alternative. It is slow as it is but might not improve if things changed."

Many in the private banks and general wealth management industry want to enhance the level of advisory fees in their revenue streams, but that is still some way off given the state of evolution of the market.

"There is little or no regulation on advice right now," explained one trust banker, "so the model of making your money on the product is still the norm."

Whether the Philippines moves to a US model or UK model where people pay for advice separately, he said that the regulator should really be more open to bringing in various products and strategies into this market. "So we do not have to create hybrid structures, or book things offshore just to be able to service clients properly."

Cutting the paperwork down to size

Another critical area of concern is the onboarding procedures. Does it take about four to five hours to complete the paperwork to buy a fund? In India for example, 1.2 billion people have now been retina scanned, and the end to end processes take hardly any time at all. Why is the Philippines still so remarkably document heavy, and is that ever likely to change?

"The idea being discussed in trust industry circles is to have a universal set of information and documents that the client fills out," explained one trust expert. "This is then to be lodged with the central bank, and that set of documents and authorisations can then be used to deal with another bank or new trustee. But although this is the ideal situation and remarkably sensible and practical, we are nowhere near achieving that yet."

Another attendee explained that the BSP's push towards greater financial inclusion and financial education in the retail investor market is working and that should see more of the millennials going into funds. "But," he cautioned, "this will take continued massive effort from the authorities, the government and the industry to move forward." To indeed improve things, attendees agreed that everyone, including the regulators, needs to consider the customer experience and to be customer-centric. "Fees can only really come down when the market grows, and there are more and more economies of scale," noted one expert.

"As a first step," he elucidated, "alleviating the tediousness of filling up documents manually would be an enabler, especially because nowadays everybody is going online for so many products and services."

Right now, he said, that it is now simpler for consumers to apply for a simple loan or invest in a plain vanilla treasury product than invest for their future security. "The trust and wealth management sectors must be able to catch up on these trends because otherwise, we will be outdated."

Another perspective was that 'baby steps' are realistically the most that can be expected currently. "For example," she explained, "it would be a great advantage to simplify those onboarding documents into the legally required basic information, thereby slimming down the initial document from a dozen to perhaps two pages. And if part of this process, or all, is available online, even better."

The client-centric approach

The regulators need to begin to think more about the clients, the investors. "Between the insurance side and the asset management side of our business, there should be ways to share more efficiently client information so that we can all help clients build better portfolios," remarked one insur-

ance expert. "These things need to be considered more holistically by all parties for the benefit of the end users."

If there are more investors, more products, more momentum generally in the market, there is the potential to reduce fees throughout the industry.

According to him, the funds market here is growing well but it under-developed and under-exploited, so most of the companies still need to build more scale before reducing fees. "The costs here are therefore still quite high compared to offshore, for the type of service that we are giving to our clients," he said. "A core challenge now is how we can lower our unit cost further so that you get better service and advice."

Expanding the range and availability of product is one step everyone is pushing for.

"The answer," said one expert, "is a platform which acts as an enabler. If you tie up with a new fund manager you need to spend six months understanding their agreement, training your team, working with economics and boy, by that time, the opportunity is gone, or the client has already decided to go somewhere else. That is where a world-class open architecture platform comes into play, with tens of thousands of funds available on the top platform."

An expert in the trust business concurred. "In reality, the trust business can become wealth management as well as asset management," he explained. "We have certainly tried to push the open architecture approach where obviously as a wealth manager you want to offer best of the breed and provide the advice that can help your clients. But there is still some important regulation that puts barriers around a bank that needs addressing."

The same expert also noted that his bank is grappling with the idea of whether wealth is going to be with trust or does his bank segregate trust and wealth.

"The differentiation and delineation will be according to business strategies determined by the respective financial institutions," he noted. "The client often asks for a wide range of services and needs that they have from product to family services to advisory. So, I see a synergy between trust and wealth."

They could be independent businesses, he rasoned, but focus on which product will be pushed, what is the threshold, and after that develop the platform as well, as that is what will make the customer experience considerably better."

Exploding retail market will drive future growth

To conclude the discussion, the attendees agreed that the growth potential for asset and wealth management is remarkable, given the dynamic demographics of the country and the rapid GDP growth, albeit with the fund management industry coming from such a low base.

"Retail is the new battleground where we can all win big," said one expert, "and the main thing is how to synergise everything that is currently modularised."

He pointed out that there are too many silos, and there is a need for change so that there is a dynamic between different modules and different businesses, but at the same time, can be controlled it separately. "If we do that and the regulators can facilitate our general development, the prospects are remarkably good." ■