SURVIVING OR THRIVING?
THE BRAVE NEW WORLD OF ASSET MANAGEMENT

There is a famous old adage, which is purported to be Chinese. *May you live in interesting times.* Like it or not, the asset management industry is going through a particularly ‘interesting’ period of transformation at the moment. Whether it is the way we engage with clients, our distribution models and fee structures, or the manner in which technology is underpinning and driving change, our industry is evolving at great speed. Asset managers will need to evolve with it, and meet new challenges by offering best-of-breed services for their clients. Otherwise, they will be in danger of falling by the wayside.

Meeting these challenges is no mean feat, for any investment manager. For one thing, investment firms are facing more cost pressures than ever before. Fees are falling across the board, and if current trends continue, average profit margins will fall from 38% to 36% over the next three years.¹ It is no surprise then, that we are seeing an increased polarisation between low fee providers, and other players in the marketplace.

On top of this, asset managers have increased regulatory responsibilities, with a host of new regulatory measures - and their accompanying acronyms - to get to grips with. In Europe, it is the Markets in Financial Instruments Directive (MIFID) II, and the European Markets Infrastructure Regulation (EMIR). Other recent legislation includes the Packaged Retail and Insurance-based

Investment Products (PRIIPS) regulation, the Retail Distribution Review (RDR) in the UK, the Alternative Investment Fund Managers Directive (AIFMD), and, in the US, the Dodd-Frank Act. It is no wonder then, that compliance costs for financial institutions could more than double in the four years to 2022.²

Regulators are also focusing on the culture and conduct of investment businesses, the remuneration they offer investment managers, and their governance and stewardship practices. The UK’s Financial Conduct Authority, for example, called for fund managers to take these duties seriously, and has looked into a range of practices, from fee disclosure to the promotional materials offered to customers, ensuring the products ‘do what they say on the tin’. It has singled out closet indexing as a particular concern.³

If that wasn’t enough of an interesting time, technology is transforming the industry at break neck speed. Technological innovation is proving to be a great game changer to new entrants to the market, but also forcing established players to re-think their approaches. Whether it is artificial intelligence (AI), the rise in automation and data analytics, or the development of scalable platforms, technology has dramatically altered the investment landscape, and will continue to do so.

It is not surprising then, that the asset management industry is going through a period of naval gazing. Investment firms are looking at how they can improve their balance sheets, and how they can gain efficiencies and competitive advantage. They are also considering their unique value propositions. Against the backdrop of ‘interesting times’, they are responding in a myriad of different ways, and while some are adapting quickly, others need to catch up to better build long term sustainable businesses.

POLARISATION

One of the ways the industry has adapted has been by polarising. This is not a new trend, but one that is becoming increasingly marked. Distribution powerhouses are getting larger. Smaller, specialised niche players are showcasing value through alpha generation and demonstrating risk adjusted returns. As time goes by, three key asset management business models are emerging.

Behemoths, whether they are exchange-traded fund (ETF) providers, passive houses or firms offering liability-driven investment strategies, will offer low cost, low margin investment solutions. These providers


³ The Telegraph “City Watchdog: We’re Taking On Asset Managers That Aren’t Transparent” Last Updated: 5 March 2018 https://www.telegraph.co.uk/investing/funds/city-watchdog-taking-action-asset-managers-arent-transparent/
will be scale and volume-driven, reliant on strong distribution networks and brand recognition.

PricewaterhouseCoopers predicts that by 2020, passive management’s share of global assets under management (AUM) will grow to 21% (it was 14% in 2015). In contrast, active management will see its 2015 share of 74% fall to 66% by 2020. Active managers will be forced to become as nimble as possible. They will need proven track records, and will be required to deliver risk adjusted returns that justify costs. They will also have to demonstrate where, and how they add value, and make sure they offer a unique client-centric service.

The third group will be alternative providers, ranging from private equity, to real estate, to infrastructure, and other more esoteric asset classes. These players will focus on innovation, and will not be all things to all people, instead focusing on their particular alternative sector. Alternative providers will grow from 11% in 2015 to 13% in 2020.

Investment firms that do not fit into one of these three models will have to decide where and how they will add value, and what exactly they will be offering their customers.

CONSOLIDATION: IGNORE THE HYPE

It is no surprise, given these challenges, that we have seen a plethora of consolidation in the industry. Last year saw the completion of three significant mergers. Janus Capital and Henderson joined hands to create a company with around $331 billion in AUM. Standard Life and Aberdeen’s merger brought together assets of £670 billion, while the acquisition of Pioneer Investments by Amundi raised its AUM to nearly €1.3 trillion.

Because of the size of these consolidations, there’s been a great deal of hype about consolidation trends and what they will mean for the industry. But consolidation will continue only if it makes sense, and it’s important to recognise that new entrants and new players are coming to market all the time. They are as much a part of the evolution of the industry as the larger global players. This is not a stagnant market.

---

4 PricewaterhouseCoopers “Asset Management 2020: Taking Stock” June 2017
5 Citywire “Janus Henderson Mega Merger Completes” Last Updated: 30 May 2017
http://citywire.co.uk/wealth-manager/news/janus-henderson-mega-merger-completes/a1020785
6 BBC News “Standard Life and Aberdeen Asset Complete £11 billion Merger” Last Updated: 14 August 2017
http://www.bbc.co.uk/news/uk-scotland-scotland-business-40922985
7 Project of acquisition of Pioneer Investments, 17 December 2016
PART THE BRAVE NEW WORLD OF ASSET MANAGEMENT

THE RISE OF THE PLATFORMS

Part of the reason the market won’t stagnate is because technology has levelled the playing field for new entrants, and platforms are an important component of this. We’ve seen innovative examples of providers leveraging technology to build platforms that service new entrants and connect them to institutional investors. These types of platforms have centralised back offices, and they provide smaller players with fund infrastructure at lower costs. They also increase transparency, and offer economies of scale. They ensure that smaller managers are getting recognised, and do not need huge swathes of start-up capital to get off the ground.

One example of a platform is The Asset Management Exchange (AMX), launched by Willis Towers Watson last year. The AMX is an institutional asset management marketplace, where asset owners can invest in external asset managers directly, standardising and centralising the investment vehicles that managers and investors use. The AMX is one of many platforms in this area, and it is an area that will continue to grow. It means costs, resources and time are all reduced, and that economies of scale can be built in relationships with third parties such as clearers and prime brokers. Fees can be negotiated, and new managers have access to capital.

Platforms are also becoming more accessible for retail investors, with a surge in popularity in online platforms in recent years. Additionally, the development of regional and global platforms has allowed for pan-regional and global accessibility, and increased sales. In the UK, platform assets broke the £500 billion mark for the first time last year.

But platforms provide both opportunity, and a challenge for the industry, and for asset service providers specifically. Every manager on a platform will behave differently. Service providers such as Northern Trust are responsible for ensuring that data flows smoothly and consistently, regardless of manager strategy or approach. It is about understanding that no one size fits all, while also being flexible and nimble for our clients.

TECHNOLOGY

It is also about technology.

Technology is changing the game in many different ways. Whether it is through cloud computing, or machine learning, or predictive systems and AI, the asset management industry has fundamentally adapted and integrated new ways of doing things. From the way it

---

8 Financial Times “Online Platforms Surge In Popularity” Last Updated: 21 July 2017
https://www.ft.com/content/5f5a1c2-6d59-11e7-bf6b-33fe0c5b7eaa

 Asset managers will have to be agile, and truly understand their value propositions to succeed.

 communicates with clients, to investment strategy approaches, building cost efficiencies, or simply remaining competitive in the market, technology is at the core. If you think about the fact that 90% of the data in the world today has been created in the last two years alone\textsuperscript{10}, you see just how exponential the growth in technology has been.

We predict technology will continue to evolve over the next decade with distribution moving onto platforms and utilising technology for deal execution and downstream reporting. Asset servicers, as well as providing traditional solutions to asset managers such as custody and depositary, will be evolving into data providers and aggregators for our clients as the demand for middle office investment data increases.

Service providers like Northern Trust are helping asset managers with their technology requirements, whether by providing the first commercial deployment of blockchain solutions to add efficiency in esoteric markets like private equity, or by creating software defined data centres and hybrid cloud initiatives to help data flow.

But for the investment industry as a whole, technology is just at the cusp of future possibilities. Investment firms who do not have a grasp on integrating technology into everything they do, will struggle to survive.

LOOKING AHEAD

It is worth noting that the investment industry, in some shape or form, has existed since 1700 BC. It is constantly evolving. This current period of transformation is no exception. Going forward, the popularity of passive strategies will continue to grow and investments in ETFs will remain relevant in an overall balanced investment strategy. However, there will still be a key role for active managers as long as they can demonstrate agility and value to the end investor. ETFs have increased the scrutiny on the cost of more traditional products and active managers will need to focus on their expense ratios, because if they are going to demand a premium price for their product, they will need to provide premium performance to justify it.

All the themes discussed, whether they are fee pressure and tightening margins, increased regulation, the polarisation of the industry, or growing requirement for technology, are taking us into unchartered territory in asset management. Our industry is going through an evolution, and when the dust settles on this interesting period, there will be clear winners and losers. Asset managers will have to be agile, and truly understand their value propositions to succeed. The winners will already be embracing these themes.

\textsuperscript{10} IFLScience “How Much Data Does the World Generate Every Minute?” Last Updated: 26 July 2017