NORTHERN TRUST

DRIVING GROWTH IN ASSET MANAGEMENT

SOLUTIONS FOR THE WHOLE OFFICE IN 2020 AND BEYOND

A WBR Insights & Northern Trust White Paper

NORTHERN TRUST

WBR INSIGHTS

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Executive Summary

The asset management industry is going through tremendous change. While we have yet to fully realize the impact the COVID-19 pandemic will have, the current market stress has magnified what had already been a difficult environment of escalating costs and fee pressures.

In response to these challenges, we have seen an increase in M&A activity from some firms. Others have expanded their mandates, moving into new asset classes and markets in order to attract new clients.

Many have focused on cost containment, which has become more urgent during the COVID-19 era. Firms seeking greater efficiencies have looked at streamlining their operations through both outsourcing of non-core competencies and by implementing new technologies to improve reach and scalability.

While outsourcing isn't a new phenomenon, we see more asset managers turning their attention to areas that had not previously been outsourced, such as the front office. Clients recognize that functions such as trading, which had previously not been considered a candidate for outsourcing, can be done more efficiently by specialized providers who have expertise and reach.

The potential of technology to reshape asset management has become more evident in recent months, with COVID-19 shining a spotlight on digital interaction and resiliency. Our clients are looking strategically at implementing technologies that fit the way they work. This may mean choosing providers with open platforms that allow them to plug in services on either a component or fully outsourced basis, depending upon the activities they wish to keep in-house.

As we look to the future of asset management, the firms that succeed will find ways to support their growth while also reducing costs. Many have turned to their operating models to find ways to be nimbler. Leveraging today's innovative technology and scalable solutions can significantly reduce costs and enhance operational efficiencies.

Key Findings

Strategic priorities for a successful start to the 2020s

Controlling costs is a key strategic priority in the next two years according to 87% of respondents. This was closely followed by focusing on risk and compliance (86%) and supporting expansion into new markets (85%). Our survey results also demonstrate that 64% of respondents will achieve their strategic priorities through leveraging new technology, with 55% stating a change in the direction of product strategy and 41% citing M&A action.

Maximizing efficiency through outsourcing

When asked about their plans to outsource, 45% of respondents considered data management the function most likely to be outsourced. It was closely followed by back office operations (40%) and middle office/IBOR (38%). When asked about outsourcing their trading function, 85% cited that they either already outsource this capability or were interested or planning to do so in the next two years.

Entering new markets is key to distribution growth

When plans to drive growth include increasing their distribution, 49% are planning on entering new markets to achieve their goals. Continental Europe was seen as the area with the greatest opportunities for distribution growth at 31%, closely followed by the U.S. at 29% and the UK at 20%. When asked what products their investors sought, the majority of respondents said their investors preferred a regulated funds structure and domicile.

When asked if their distribution plans include increasing their alternative asset class options and how they planned to do this, 32% said they plan to outsource this capability.

Regulatory environment and keeping up in a dynamic landscape

50% of our respondents said the regulatory environment was the biggest challenge they might experience when launching new products. In fact, 45% of respondents expect to increase their investment of time and money on regulatory changes in the next two years.

Capitalizing on technology and data management

Managing changes to existing data sources or providers was ranked as the biggest challenge for asset managers when evaluating their data management, while consolidating data from multiple disparate internal and external sources was ranked second.

When asked how they would address data challenges in 2020, half of respondents plan to leverage new technologies such as AI and machine learning. Finally, 57% of respondents cited ensuring reconciliation activities are consistently completed to support the start of the trading day as their top challenge in supporting their front offices.

44% plan to improve decision support and analytics to address their challenges, while 43% plan to employ a component outsourcing strategy that leverages multiple providers to support post-trade processing.

Introduction

Today, driving growth in asset management requires more than finding new streams of revenue or reducing costs. The most successful asset managers are viewing their operations from the perspective of the whole office to build the optimum model for alpha creation.

According to Ryan Burns, Head of GFS North America, "Our clients are seeking holistic changes to their operating models to improve decision-making and drive business growth. As these managers focus more of their internal resources on core investment activities such as distribution, portfolio management, research, and risk and compliance, they have outsourced non-core activities including trading, middle office, foreign exchange, data management and accounting, to providers with focus and specialization."

"Asset managers today want true flexibility to choose the best outsourced providers for their investment processes," says Clive Bellows, Head of GFS EMEA. "For example, they want to be able to select an order management system, or a foreign exchange provider, or a trading solution that fits the way they work. This can help them build an ecosystem that integrates technology and capabilities across the entire investment lifecycle."

With a reduced internal footprint, asset managers can turn to optimizing idea generation, market research and portfolio construction, as well as leveraging technology to help ensure their success. "Our clients' thought processes have been shifting," says Caroline Higgins, Head of GFS, Asia. "They are proactively thinking of how to streamline and future-proof their operations, and they have turned to outsourced providers who can help them leverage technology to suit their business goals and objectives. These providers can give managers access to digital tools that automate workflow and provide information at their fingertips."

Historically, functions such as idea generation and portfolio construction have not benefitted from digitization, automation and scalability. For most asset managers these activities are analog and are trapped in the heads (or spreadsheets) of their key investment professionals. By embracing technology, firms have an increased ability to assess the effectiveness of their investment processes, to scale their businesses and to institutionalize how they train the next generation of investment professionals.

While the pressures to drive growth are significant, so are today's opportunities. When evaluating their whole office, whether it is leveraging the right outsourcing partners or implementing new digital data solutions, the successful asset manager of the future will integrate people, processes, and technology to future-proof their operating models.

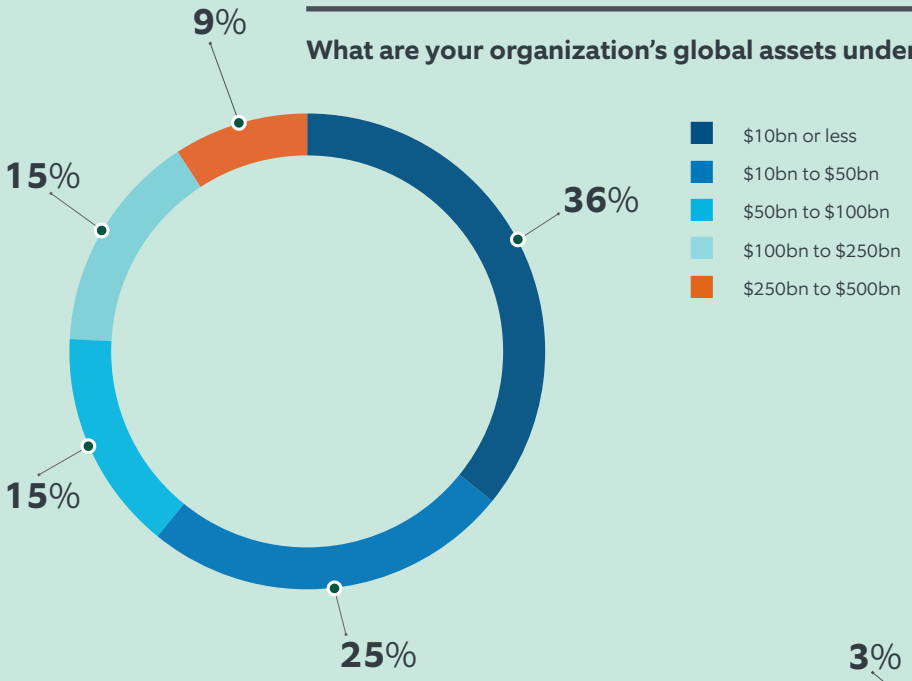
"Asset managers today want true flexibility to choose the best outsourced providers for their investment processes."

Methodology

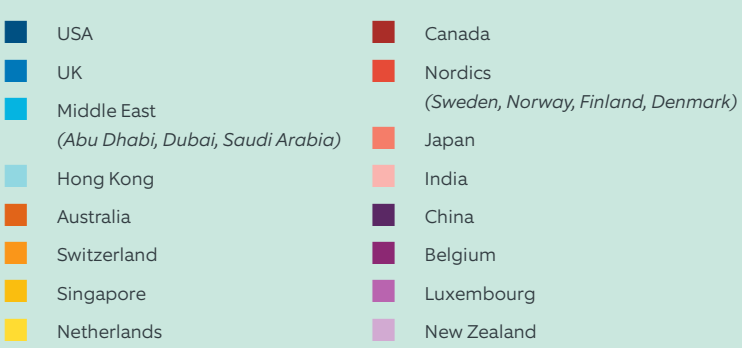
In Q1 of 2020, WBR Insights surveyed 300 Heads of Investment Operations from asset management firms across the APAC, EMEA and North America regions, with AUM ranging from $10bn - $500bn, to find out how they are looking to drive growth in a challenging market.

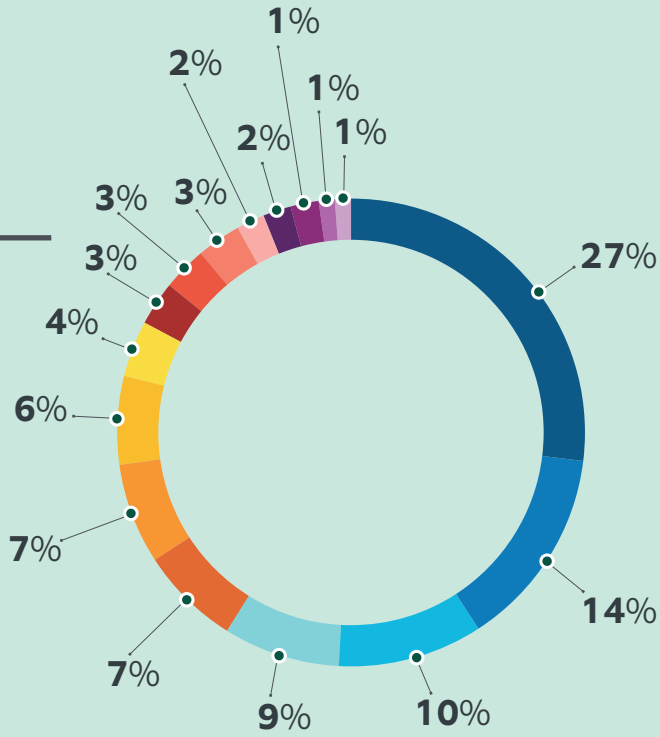
The results were compiled and anonymized by WBR Insights and are presented here with analysis and commentary from Northern Trust contributors Ryan Burns, Head of GFS, North America; Clive Bellows, Head of GFS, EMEA; and Caroline Higgins, Head of GFS, Asia.

What are your organization's global assets under management in U.S. dollars?

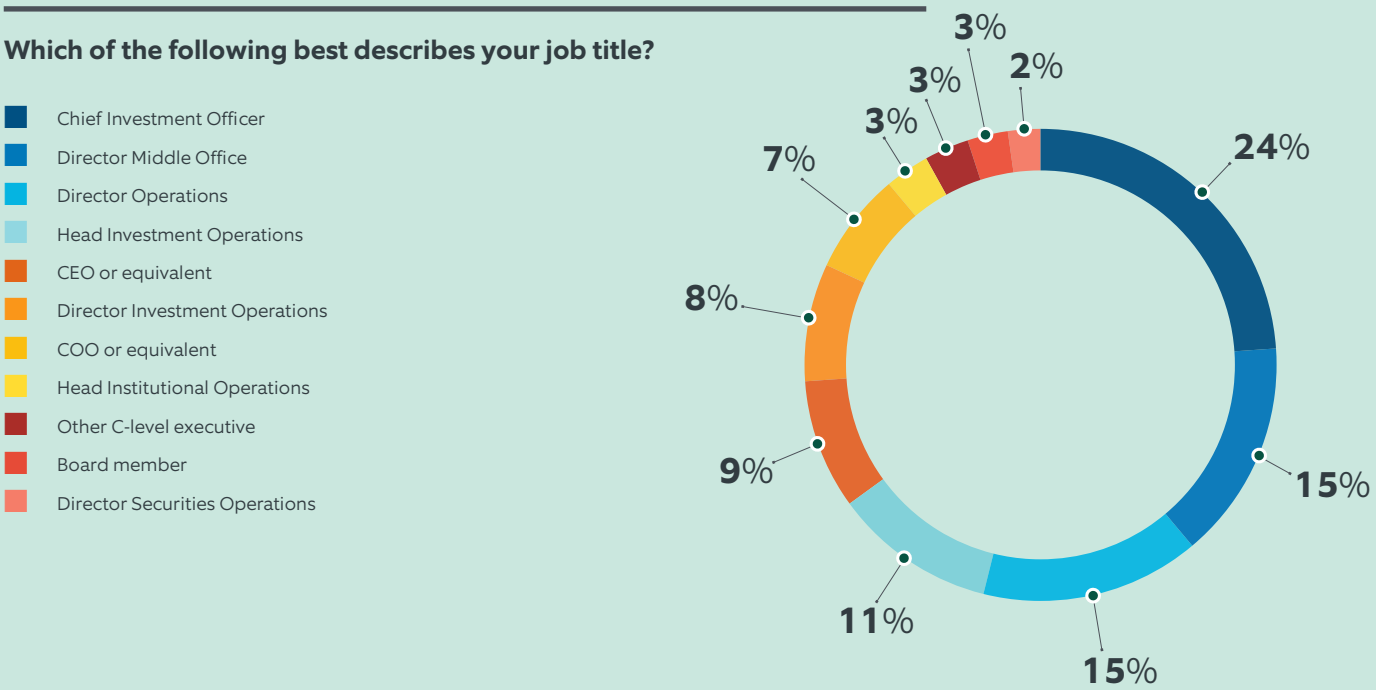


In which country is your company headquarters located?

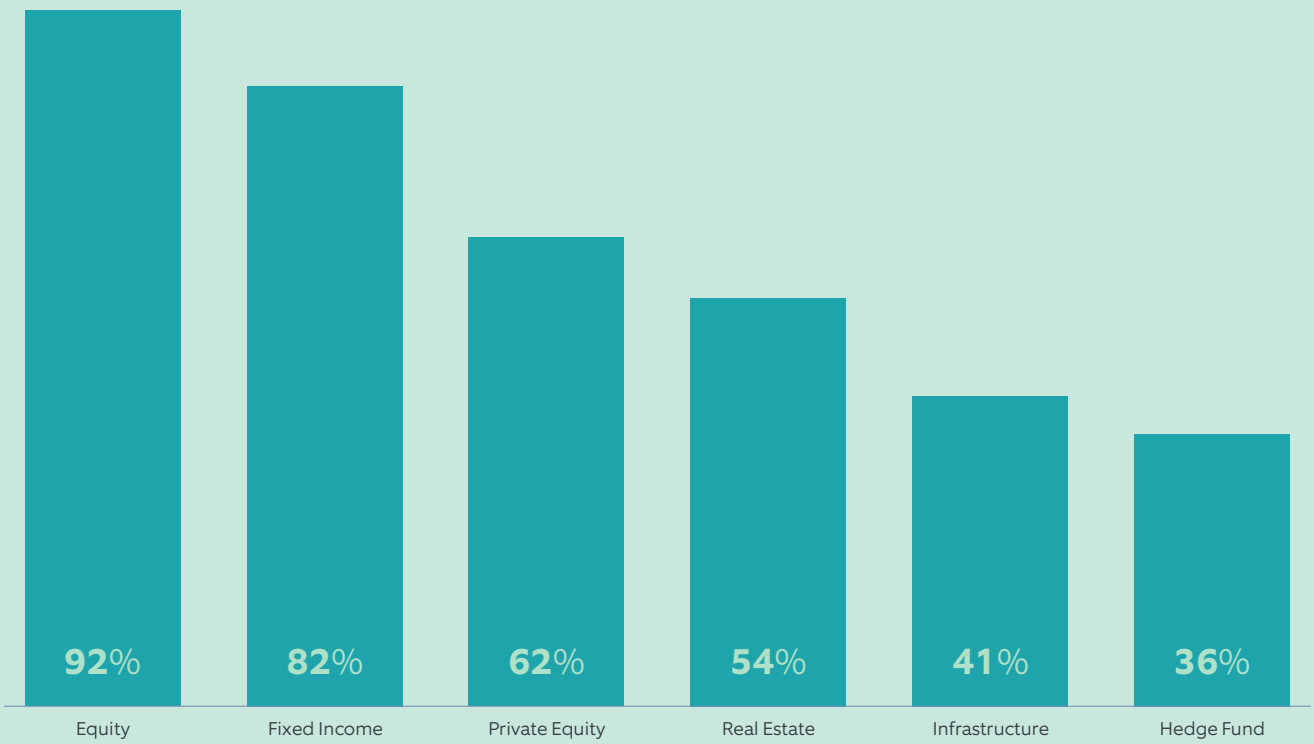




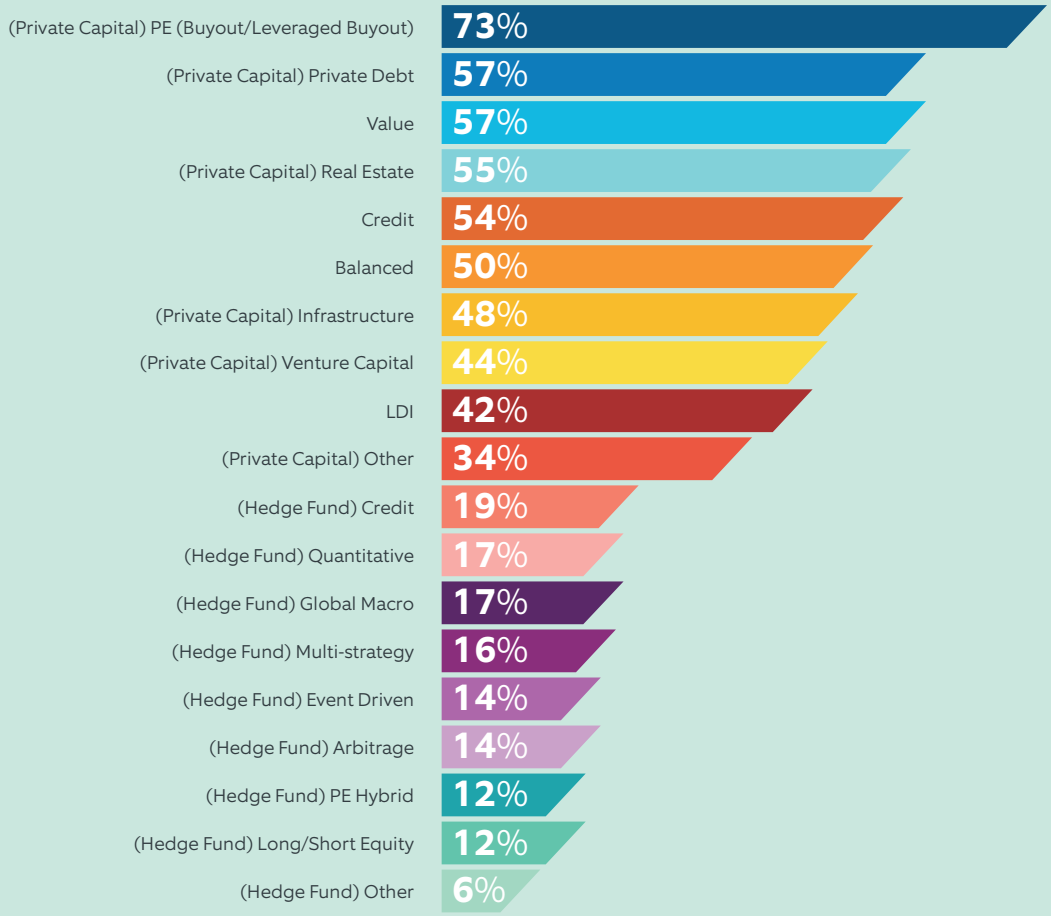
Which of the following best describes your job title?



What asset classes does your firm currently manage?

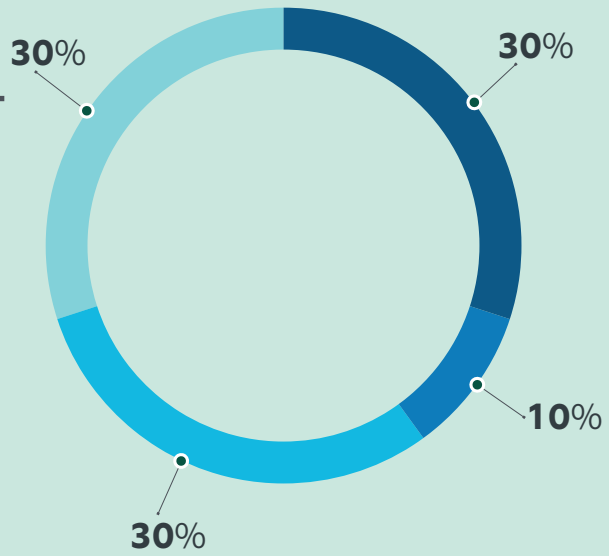


Which strategies do you specialize in?



Which country/region are you currently working in?

- Europe *(UK, Switzerland, Benelux, Nordics)*
- Middle East and Africa *(Abu Dhabi, Dubai, Saudi Arabia)*
- North America *(USA, Canada)*
- APAC *(Australia, New Zealand, China, Hong Kong, India, Japan, Singapore)*



CHAPTER ONE

STRATEGIC PRIORITIES FOR THE 2020s

Strategic Priorities for the 2020s

Over the last few years, the asset management industry has experienced decreasing margins due to pressure from competition, fees, regulatory and compliance challenges, technology costs and shifting product demand. While the outcome of the global pandemic has yet to be fully realized, the landscape for asset managers will remain challenging.

In order to meet the demands that they face, forward-thinking asset managers must develop clear strategic priorities that leverage cost containment, distribution growth, efficient operating models, and a focus on technology and data.

According to our survey, 87% of respondents revealed their key strategic priority for the next two years will be controlling their costs. With fee reductions and shifting product demand towards passive investment funds, asset managers are under considerable pressure, on a global scale, to pay more attention to controlling their costs.

Nearly as many respondents also plan to focus on risk and compliance (86%) and supporting expansion into new markets (85%). While both of these priorities carry potential costs, developing a well-thought out plan, that includes leveraging technology and third-party expertise, can help managers meet their strategic goals.

What are your strategic priorities for operations in the next two years?

While we all face different challenges in managing cost, a few areas remain on the top of the list, primarily regulation/compliance and staffing. How do you balance the cost versus the expansion and potential growth? The key is having the right people in place. Asia has been a key market for expansion for global clients, though its diversity requires people with specialist market knowledge, language and understanding.

When entering new markets, an extensive assessment regarding the value position should occur. It takes time and expertise to complete this assessment and to then implement a strategy. When confronted with competing priorities, those that are most successful focus on controlling costs and gaining efficiency through deployment of technology, enabling the transfer of staff focus from operations to growth and expansion.

Caroline Higgins

Our clients typically think of cost in two areas: one is people, and second is technology. When asset managers are looking to control cost, they often look to employ fewer people, and better leverage technology. To accomplish their cost-saving goals, they may delegate high-cost functions to a third party like Northern Trust for functions such as trading and currency management. They will still need to demonstrate that they have the right control and oversight structure from a regulatory perspective. Certainly, regulators are looking for clear governance of outsource arrangements and making it a personal responsibility of senior management.

Clive Bellows

The cost of systems and data will continue to go up, but another real cost for all of us is having the right staff in place. Supporting expansion into new markets is about balancing that cost with the eventual growth.

As political changes occur globally and new priorities arise, compliance will be more important than ever. The cost of compliance wasn't so prevalent a few years ago, so something else has to be offset. In order to improve efficiency, the most successful managers focus on employing the right people, taking a strategic approach when deploying technology, and then start looking at revenue growth as a way to help control costs.

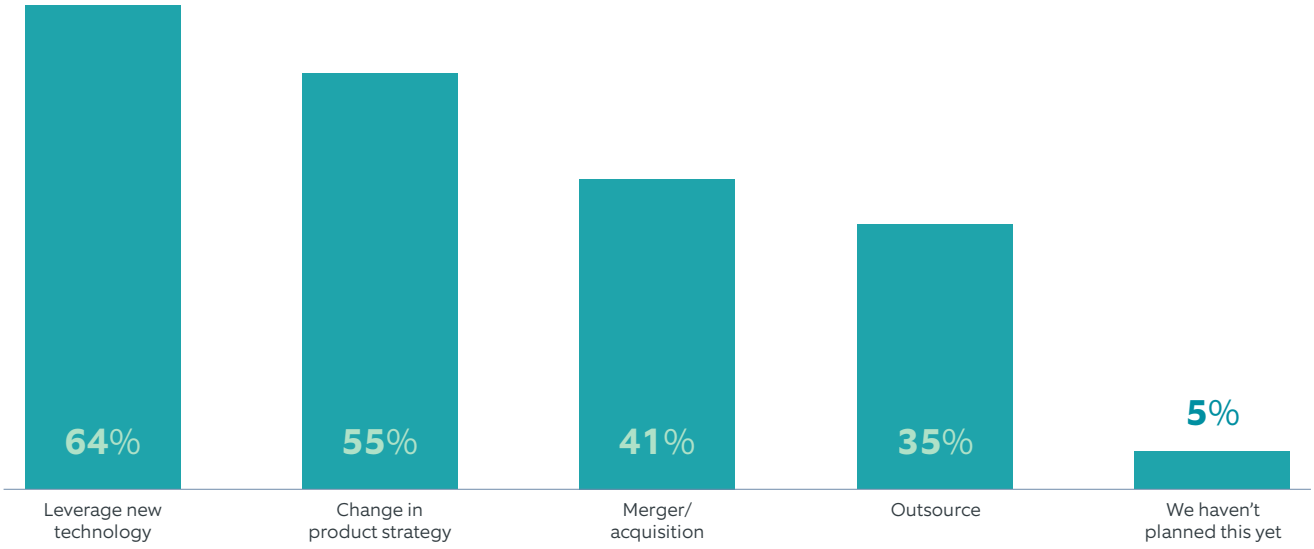
Ryan Burns

Many asset management firms have recognized the part that technology plays in enhancing their operational efficiency. According to our data, 64% of respondents said they will leverage new technology to achieve their strategic priorities in the next two years.

More obvious today than ever before, asset managers who have built technology into their operating models are able to maximize efficiency and keep operations flowing smoothly even in times of crisis. Automation can help drive accuracy and speed across many functions – including valuations, trading and reporting – while reducing execution costs.

However, investing in next generation technology such as AI, machine learning and cloud-based data management solutions comes with a high cost and asset management firms should be careful about how this investment will be balanced against the increasing pressures on their fee revenues.

How will you achieve your priorities in the next two years?



Employing new technology and leveraging the capabilities of new organizations to help you become more efficient and expand is absolutely the right thing to do. Managers need to be selective about the strategic partner they choose because making the wrong decision in terms of platform or provider can be very expensive.

Capability is always going to be a key consideration. Managers should also consider a provider's financial stability and their long-term commitment to their product. You want a technology provider that's committed to the business. You don't want to be revisiting your technology matrix of providers on a regular basis. Another key is having trust between the firm and their outsourcing partner. I think choosing the right firm and making sure that you're going to be able to demonstrate to regulators that you made those decisions in a sensible, controlled way are really important.

Clive Bellows

Newer technologies aim to be sustained at a more efficient cost point while improving control and consistency over risk and compliance activities. Integrating new technology with existing infrastructures can be tricky. Just taking a piece of technology and plugging it into your current infrastructure may not give you all the benefits that the new technology presents, and you may end up forcing it to be less effective because of the existing infrastructure.

Ryan Burns

CHAPTER TWO

INCREASING DISTRIBUTION

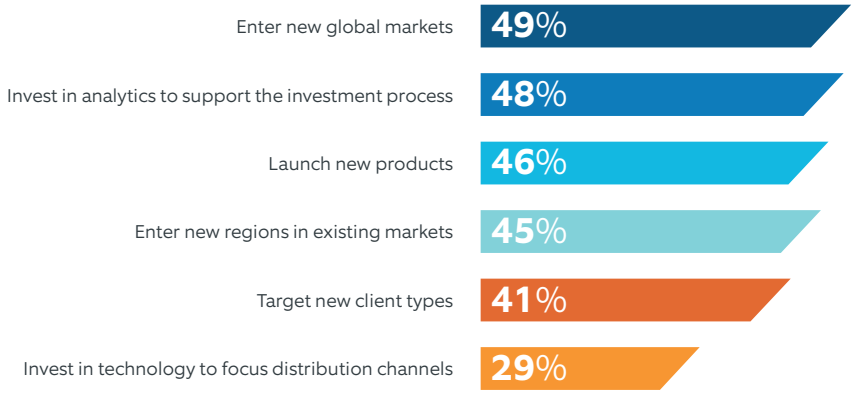
Increasing Distribution

Raising assets is the lifeblood of any asset management firm, and it is unsurprising that fund managers are focused on broadening their distribution, including looking to new asset types and markets for asset growth. Discovering new investors in previously untapped regions and adjusting their portfolios to meet these investors' requirements has enabled many firms to increase their returns.

Our survey results demonstrate that 49% are planning on entering new countries as their preferred method for increasing their distribution. Increasingly more asset management firms are looking to expand their global footprint in order to grow.

However, expansion must be carefully planned and well-executed or it can prove expensive and a drain on resources. Firms must carefully consider the cost/benefit calculations of market entry and develop a strategy to reduce the risks of rapidly escalating costs.

If your firm is considering or planning to increase distribution, how will you achieve this?



Rather than trying to build a strategy around one client in a new market, firms must develop a well-researched distribution plan that considers their product suitability and investor preference for each market, and then align their approach including presence, distribution channels, sales and support.

Within Northern Trust, we have dedicated teams supporting clients on their distribution journey, and experts within each region of EMEA, North America and APAC who can help clients as they define their distribution strategy.

Caroline Higgins

Northern Trust holds a huge amount of data for our asset manager clients. We are one of the largest fund administrator custodians in the UK market. We're the second biggest in Ireland. We're a top 10 provider in Luxembourg. We're the biggest in Switzerland. We're the biggest in Guernsey. I say that to demonstrate that we can see what has worked well for our various clients. We can see what strategies are selling well and into which markets, whether it be end consumers, pension funds, sovereign wealth or retail consumers. We can share those trends with our clients.

We can also help advise clients about market-entry strategies. For example, how long does it really take to launch a fund in a particular market? How long does it take to get registered? How cumbersome is it? What regulatory approvals do you need? We help with the practical things.

Clive Bellows

The first question we always ask is, "Who are you selling to?" That's going to inform the vehicle type you're picking, that's going to drive the understanding of the cost that it's going to take to get into that market, and allow you to determine what needs to be done in-house and what can be leveraged through a service provider. Having a trusted partner, like Northern Trust, that you can ask those types of questions and understand how the answers align with your expansion plans is really critical.

Ryan Burns

48% of our respondents said they are planning on increasing their distribution by investing in analytics to help to support the investment processes.

Data analytics can help asset management firms make better investment decisions and more effectively focus their sales strategies on target investor types and locations. Many asset management firms are starting to realize the benefits of investing in this technology, from helping to remove bias from their core investment decisions and enhancing their internal research capabilities, to analyzing their alternative data more efficiently.

In order to remain competitive, many asset managers may look to increase their distribution by investing in new asset classes. 46% of our survey respondents plan to launch new products in order to meet their distribution goals.

Here, it is important that any new fund product is designed to meet the needs of the target investor audience. Managers must carefully plan where and to whom they intend to sell and look for the structure that meets the demands of their target investors.

Another challenge many firms face is that their investment management platforms are built with a single asset class solution in mind or they lack the servicing capability and expertise needed to support new security types.

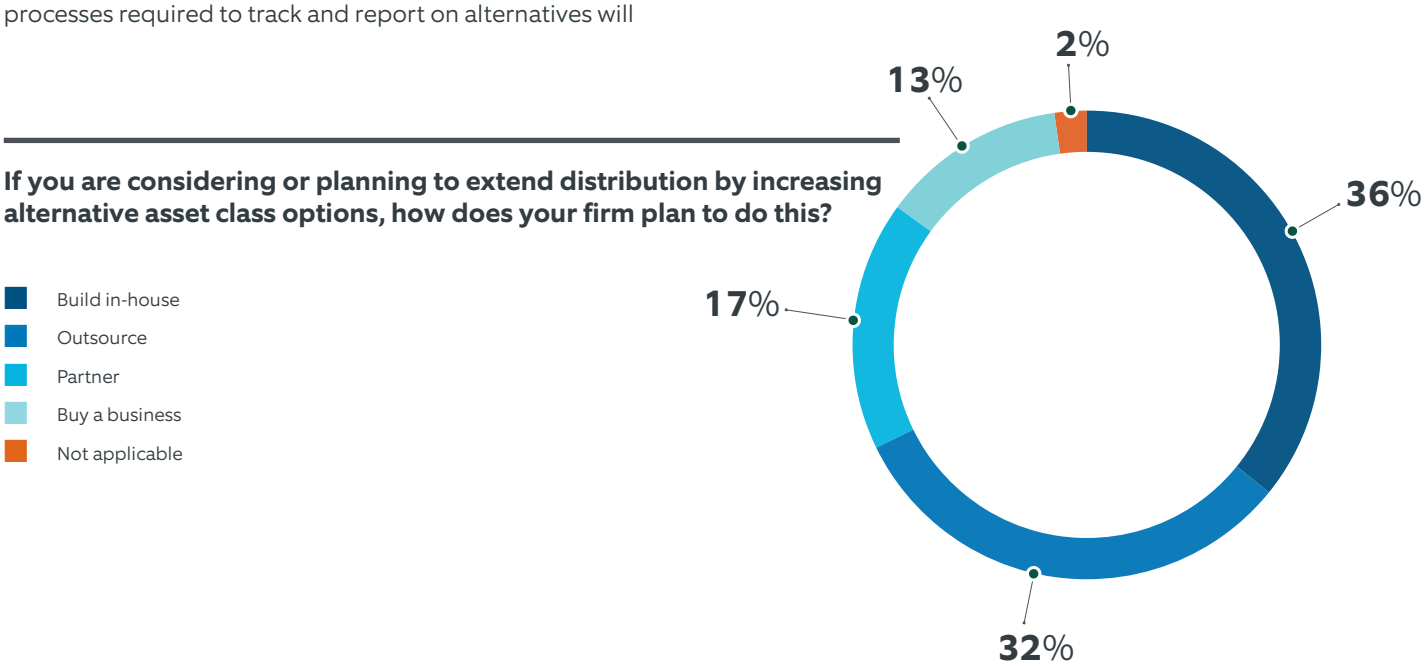
"46% of our survey respondents plan to launch new products in order to meet their distribution goals."

Outsourcing to a service provider that can offer support across the entire range of asset classes can enable firms to speed up their time to market for launching new products. In addition to fund servicing expertise, such providers can also provide the technological and systems capabilities needed to support new products.

When asked about extending distribution by increasing alternative asset class options, 32% of respondents plan to outsource this capability, while others are considering building it in-house.

Due to their illiquid and opaque nature, servicing alternative assets can present particular challenges. The systems and processes required to track and report on alternatives will likely be different to those for more traditional investments. Investment data may not be readily available for certain asset classes and sector-specific approaches to accounting and valuation may be required. Where managers are pivoting towards greater investment in alternatives, they may determine that an outsourcing partner that can help them deal with these complexities is the more efficient path to market.

If you are considering or planning to extend distribution by increasing alternative asset class options, how does your firm plan to do this?



Alternative assets cover a broad spectrum of investment strategies, which tend to be bespoke. From an operational perspective, alternatives are generally low-volume, more manual in nature and very high touch. Personalizing the investor experience is critical to every part of the industry, and this is especially true for alternatives.

Given that alternative assets tend to have a lower volume of activity, managers may consider it easier to handle this in-house. However, alternative strategies are complicated and have nuances that should not be underestimated when considering whether to build or outsource. The solution must be robust and cater for growth, changes in regulation, technology and reporting needs.

Caroline Higgins

You want some control over where your asset growth and distribution are going to occur. If your distribution team is in-house, outsourcing operational activities can be a viable solution. Things which differentiate your strategy should remain in-house, but oftentimes activities that aren't deemed to be unique and proprietary to the firm's goals can be outsourced.

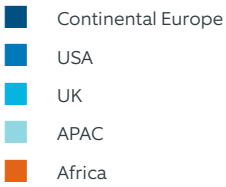
It's worth having the outsourcing discussion if you're comfortable ceding some level of control to a partner to carry out operations at a broader scale than you would like to handle internally. When extending distribution and sales growth, all managers should look at their own capabilities and determine if an outsourced provider might help them gain efficiencies.

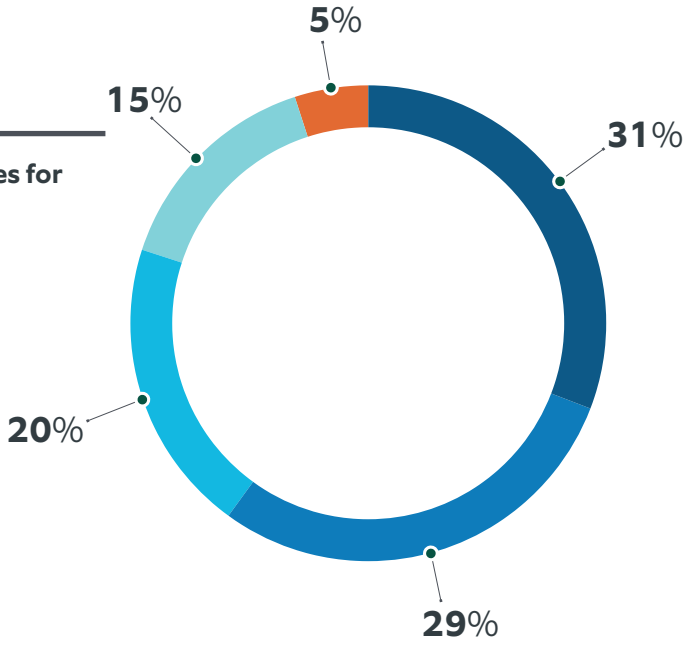
Ryan Burns

Being able to distribute funds across global markets has been a key goal for many asset management firms. According to our survey data, 31% of respondents chose Continental Europe and 29% chose the U.S. as the markets with the best distribution opportunities. However, there are many complexities when distributing across borders. For example, there are regulatory, legal and language differences to consider across individual countries, even where they are part of a common economic framework such as the European Union. Each of these can carry additional costs which could outweigh the benefits of new-market entry.

When expanding globally, managers need to understand the potential for their products in each market. They should think about how to implement a successful sales and distribution strategy, how to keep costs under control, where to domicile their funds, which investment vehicle to use and how best to navigate the many differing cultural and regulatory landscapes they encounter.

Which global region do you see the greatest opportunities for distribution growth?





The APAC region is diverse and a 'one size fits all' approach will not work in all countries. The region has some similarities to EMEA, with certain countries like Australia more focused on the local retail market. Hong Kong and Singapore are mature markets and widely accept the use of offshore fund structures such as Cayman Funds and UCITS. These markets are often targeted for distribution given the ability to use existing fund structures, the ease of business and more transparent regulation.

Developing a targeted approach to market selection will help to maximize resources and outcomes while controlling costs. The distribution plan must consider the target investors and investment strategy fit. It is also important to develop strong distribution relationships and understand the culture and language within each market. Managers who adopt a fly in/fly out approach may struggle to build inroads and be successful.

Caroline Higgins

Continental Europe has long been a popular distribution target for global investors. The longstanding UCITs and AIFMD frameworks provide a pan-country way of selling that can be attractive for managers who do not want to launch local products in a single specific country.

When I say Continental Europe, I think it's the major markets such as Germany, Italy, Spain, the Netherlands and other Scandinavian countries where there are big pools of assets. These are markets where I see investors really focusing, and they're countries that do have a good track record of individual savings and strong pools of pension assets.

Clive Bellows

Our dialogue with clients starts with defining goals in the region and pinpointing the right investor audience for the strategy. From there you're going to makes decisions around the type of vehicle and the way in which you sell. Understanding what the goal is and who your buyers are is critical, particularly in a market like the U.S. where there are various fund wrappers that can be leveraged. These wrappers cover different costs and regulatory considerations for the ultimate investors that can be pension plans, high net worth, or retail audiences.

Ryan Burns

76% said their investors prefer a "regulated fund" structure and domicile and, with regards to product access, seek the best product on a domicile-neutral basis.

In the last few years, there has been increased competition across the major jurisdictions and location is now an important factor when choosing where a fund will be domiciled. With several strong locations competing against each other in Europe alone, this is clear evidence why asset management firms are increasing global distribution.

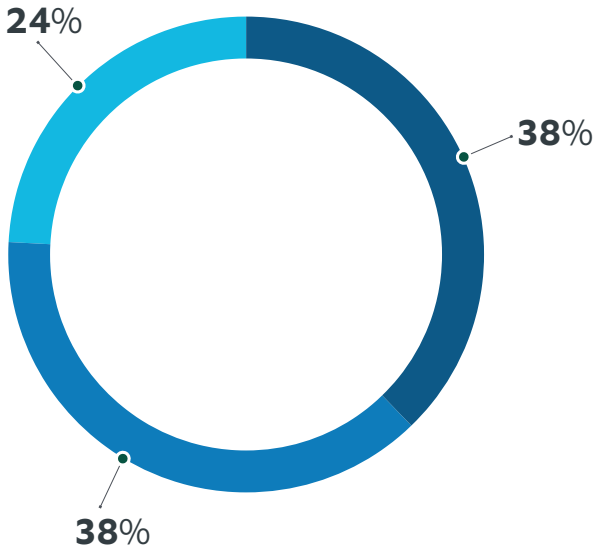
Ireland, for example, has recently been the main European domicile for ETF issuers, offering investors diversification across an entire market segment or sector in one single investment that can be traded like a stock on the exchange.

Ireland has made up 50% of all European ETF assets since 2000. Our respondents ranked Ireland as the fourth most popular fund domicile to consider when refining their distribution strategy in 2020.

In recent years, pension funds have diversified by moving large sums of capital out of steadfast assets and invested them across broader portfolios. According to our research, local funds were cited as the fund domiciles that our respondents would most often consider in 2020.

Which of the below do you expect your investors will prefer with regards to product access?

- A "regulated fund" structure and domicile
- The best product on a domicile-neutral basis
- The most cost efficient structure

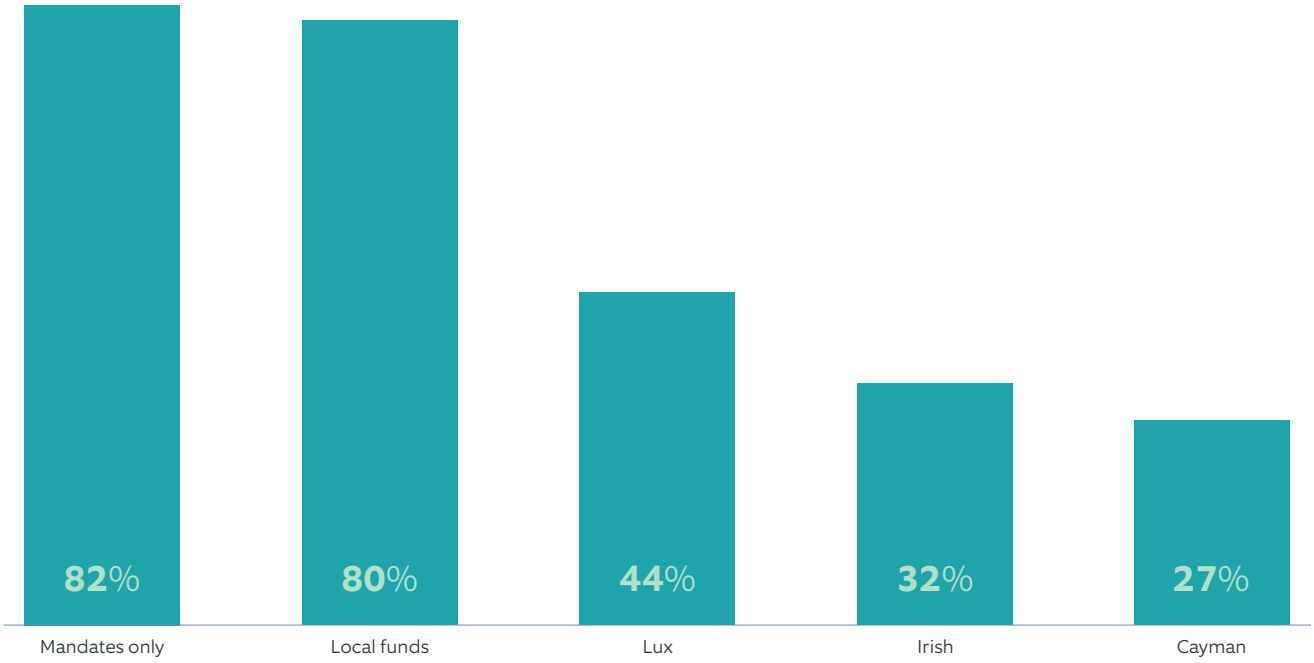


There's no doubt that regulators of the investors are telling them that they need to be very careful on how they invest their money and that regulated fund structures with depositories and with all of the governance that comes with a regulated product is the best way to make sure that investors are not exposed to non-investment risk. Although it seems a long time ago now, I think some of the issues that the industry had with funds in unregulated domiciles not being what they were meant to be, I do think whether it's a UCITS fund or whether it's one that's governed under AIFMD, there is no doubt there is a level of investor protection there which comes at a cost.

Clive Bellows

It is more important than ever to build the right operating model around distribution, and to understand the needs of the target investor. Leveraging the expertise of service partners to support a global model that delivers in a local time zone and language, and provides investors with timely access to their data, will be a key consideration.

As you refine your approach to distribution, which fund domicile would you consider?



The U.S., UK, and Australia have very large domestic markets which tend to have a preference for local products for their retail market. Managers will often use mandates to allow customization for larger institutional and high net worth investors. Overall the data results show that there is some flexibility in approach to the fund domicile and is largely driven by the investor's preference.

A successful strategy will incorporate fund structures that enable cross border distribution and can create scale and cost efficiencies. One pitfall managers should avoid is establishing the same strategy across many fund structures or locations.

Caroline Higgins

CHAPTER THREE

REGULATORY CHANGES

Regulatory Changes

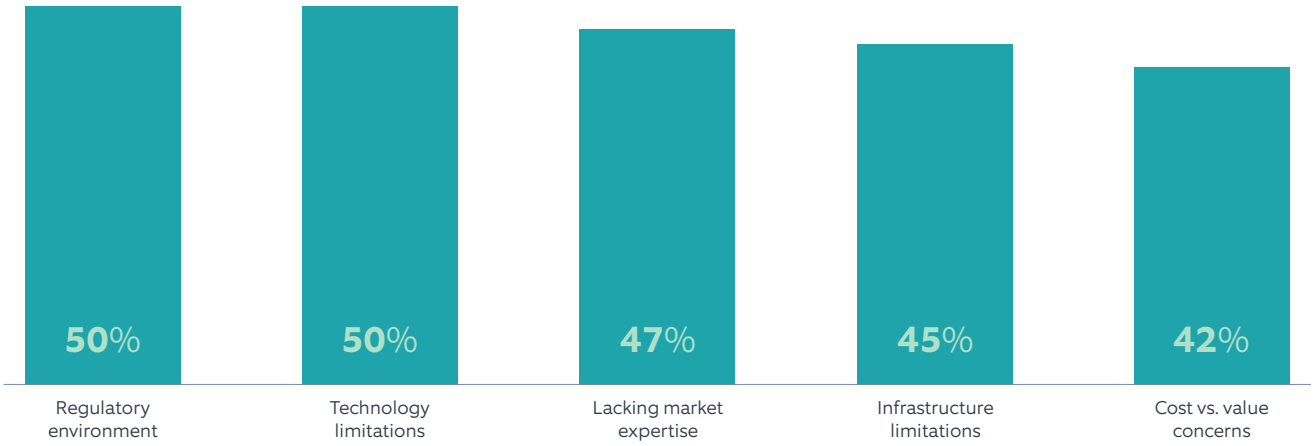
The number and scope of securities regulations across the U.S., Europe and Asia continue to evolve and asset managers looking to increase distribution often struggle to keep up. In fact, 50% of the asset managers in our survey cited the regulatory environment as their top challenge when launching new products. This was closely followed by technology limitations and lacking market expertise.

One way that asset management firms can better prepare for complex regulatory requirements is to build a regulatory-ready operating model with processes designed to manage and quickly adapt to changes in the compliance environment. This can help reduce their risk, especially when designing, building and launching new products.

Firms may also choose to work with a key partner to navigate global regulations. Outsourced providers with global scale have the knowledge and local presence to help managers deal with local requirements and language differences, as well as having access to data to assist in regulatory filings. For example, an outsourcing provider's access to transaction data can help managers meet their transaction reporting requirements under MiFID II in Europe.

Regulatory changes can also be a key driving factor in whether asset management firms overhaul their legacy architecture to invest in next generation technology. This may mean working with providers of regulatory technology ('regtech') to automate tasks such as the scanning of changing

What are the top challenges you might experience when launching new products?



Regulation is not a static environment. It continues to change. Even if you launch your product, you can't be guaranteed that in a year's time you're not going to have to be doing something else for a particular regulator. I use the example right now that understandably after some recent events, regulators are very focused on liquidity ratios and are looking for reporting on that.

It's very hard to draw up a budget on regulatory matters because the playing field keeps changing. Depending on where you're distributing, there isn't a consistent level of regulation between markets. So if you're going into Hong Kong, for example, there's a set of compliance requirements that differ from those for distributing in a European market. If you have a product that is attractive globally, it can increase the complexity of what you need to do from a regulatory perspective.

Clive Bellows

regulations and the potential solutions available to support compliance. Forward-thinking firms are building and investing in resources to better evaluate their operating models to meet their plans for business growth.

The regulatory environment and technology limitations were ranked the top challenges our respondents might experience when launching new products in 2020.

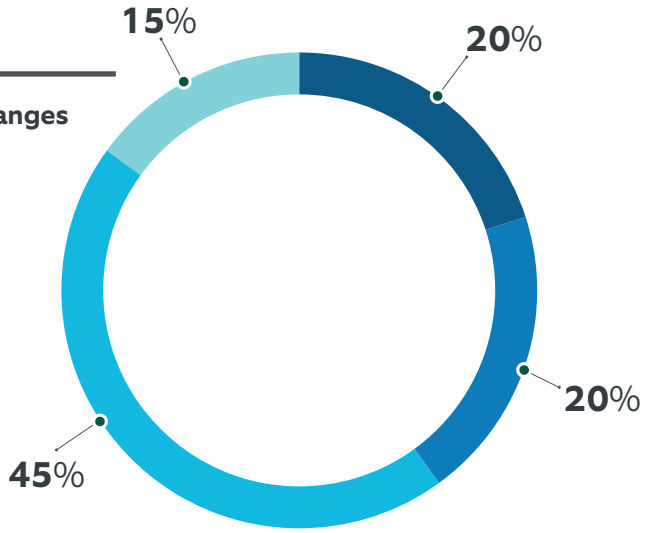
It's important to note that many investors are also putting increased pressure on their investment managers via increased due diligence demands, which can result in a squeeze on the manager's entrepreneurial approach.

In order to attract interest from new clients, firms need to be able to effectively communicate and demonstrate that they are a sound choice for their clients. Some key ways that asset management firms can achieve this is by implementing a scalable and stable operating model and having a strong focus on transparency for their investors.

However, it can be expensive to keep on top of the dynamic regulatory environment. 45% of our respondents cited that they are expecting the amount of time and financial investment they will be spending on regulatory changes in the next two years to increase compared to 2019.

How will your investment of time and money on regulatory changes develop in the next two years?

- We expect it to stay the same as 2019
- We expect it to be less than 2019
- We expect it to be more than 2019
- We don't know how this will change in the next two years



The rate of evolution in our industry has never been faster. With the shifting focus to new technologies such as cloud storage, AI, robo adviser, and new types of tokenized securities, regulation is often playing catch up, whether it's with technology or new types of assets.

Over the last three to five years, whether you're a global or a local asset manager, the amount of new regulation has been unprecedented, and it can be challenging for asset managers, service providers and regulators to keep pace. Northern Trust is leading a number of industry initiatives, both globally and regionally, and leveraging our knowledge and expertise to help our clients navigate the regulatory environment.

Caroline Higgins

We can firmly expect to be in a constant state of evolving regulation, which can increase time and cost commitments. The right operating model can help asset managers feel comfortable that they're meeting their regulatory requirements.

A good example is the recent changes in the U.S. last year around regulatory filings for N-PORT and N-CEN. That was a very significant data aggregation effort for clients. We developed a solution that provided the information our clients needed and built a process that helped make their operating models more efficient. That helped reduce the amount of people, time and energy that clients may have needed to deploy themselves in order to be compliant.

Another way we help is by being a trusted partner with whom our clients can have a dialogue. We have access to a broad range of clients who handle things differently and sharing that anecdotal information helps people understand what others are doing in the market and what may be the right solution for their firm.

Ryan Burns

CHAPTER FOUR

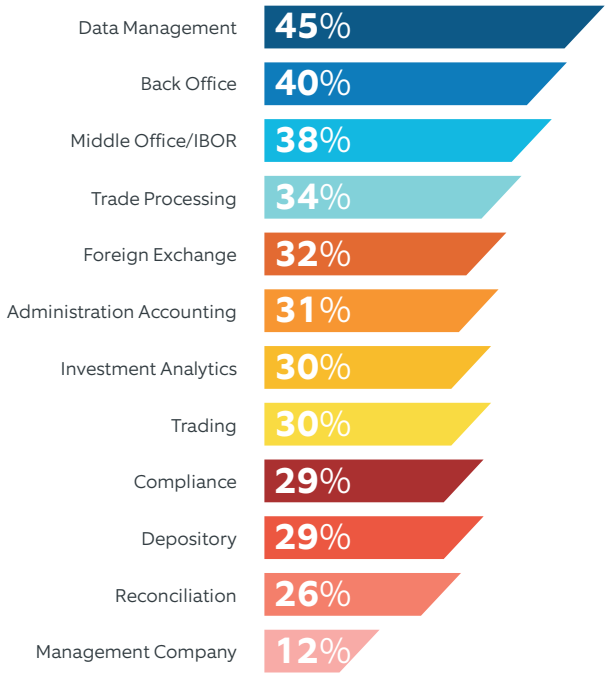
OUTSOURCING

Outsourcing

As asset managers move into new areas of business and diversify their strategies, the tools they use and the approaches they take to manage different products and services can change. As they grow, firms may look to outsourced providers to enhance or replace their in-house capabilities. By embracing outsourcing, asset managers can create solutions that provide greater scale, flexibility and speed to market.

Outsourcing allows an asset management firm to focus on core, alpha-generating functions while a partner manages the non-core, high-capital intensive functions of their business. It also provides access to the capabilities of a provider that is an expert in that specific area of the business.

If you are considering outsourcing in the next two years, what areas have you considered outsourcing?



The move towards outsourcing goes back to how organizations can become more cost-efficient. There is no doubt that those operational areas that include data management represent some of the biggest fixed costs that managers have. Moving that cost to an organization who does that for many firms and as a result can get economies of scale makes very logical sense.

Outsourcing allows a manager to focus on what they're really good at, which is generating alpha return for clients. As processes have become more atuomated, there is strong evidence that asset managers may not have the most updated technology solutions around operational process flows.

Clive Bellows

Asset managers are facing cost pressures, from their investors, from the increasing costs of regulation, and from the increasing costs of technology and people. That really lends itself to looking at outsourcing as an option, meaning that in challenging economic environments, people are rightly taking stock of what activities are core and what are those that could be outsourced or performed elsewhere.

I think when you look at data management, back and middle office and IBOR, those are the most costly items in the operational infrastructure that managers must maintain. Obtaining and normalizing data, data warehousing and infrastructure, and the back and middle office systems to support an IBOR, trade matching, foreign exchange client reporting - all of those require investments in both technology and people. So when a manager looks at cost structure, those things probably leap to the top of the page in terms of costs being incurred today which will continue to grow over the next few years, and may be considered non-core and viable for outsourcing.

Ryan Burns

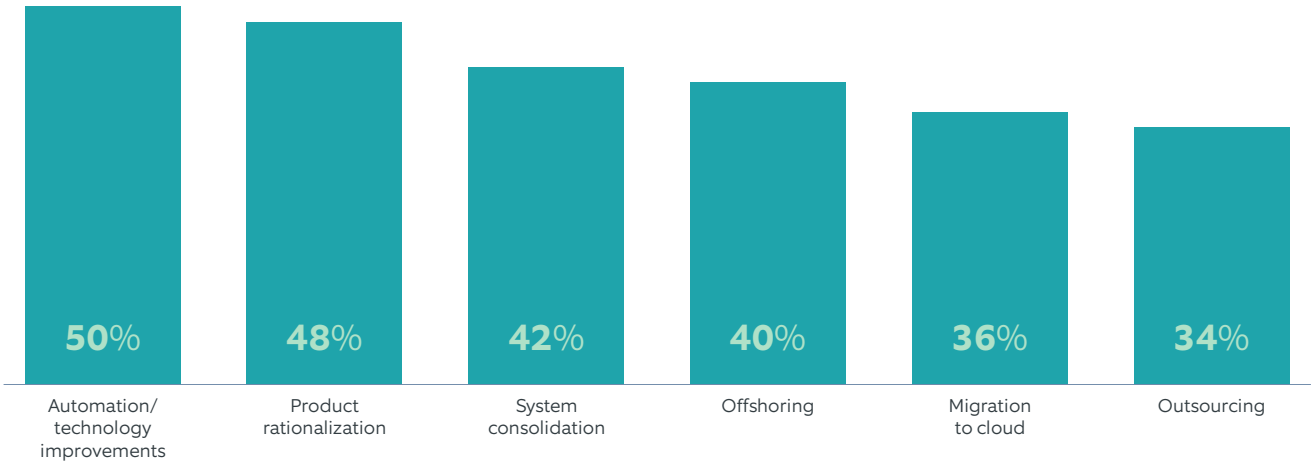
Many asset management firms are increasingly realizing the benefits that can be gained by partnering with external providers to outsource their business processes. Outsourcing is a way for many firms to achieve scale and gain access to capabilities usually only available to the largest players – potentially levelling the playing field.

45% of our respondents cited that they are considering outsourcing their data management in the next two years. This was closely followed by 40% who cited the back office and 38% who cited the middle office/IBOR as outsourcing candidates.

Outsourcing can help asset managers to concentrate their efforts on maximizing efficiency, realizing cost savings and improving their margins. Data management is a focus area for outsourcing as firms depend upon efficient data processing and aggregation in order to make investment decisions as well as report effectively in an environment where there is a wealth of information to digest and reducing risk is paramount.

As data becomes increasingly more complex, it has impacted how asset managers are able to operate and outperform in a competitive field. Data is used across the whole office and therefore, an enhanced data management process is necessary to stay ahead of the curve.

How do you plan to control costs in 2020?



Firstly, I think as you automate, you can mitigate the need for so many people, and that's one of the biggest expense lines in most organizations. I think automation, by default, reduces your exposure to expensive headcount, and most asset managers are sitting in locations where staff are expensive. In choosing a technology provider, it isn't just about going with the least expensive one. You do need to choose a provider who is going to be with you for the long run and with whom you can build a sensible business relationship going forward.

Clive Bellows

Automation and technology improvements reduce the costs associated with people and headcount, which can have a meaningful impact on the bottom line. In the same way, system consolidation can reduce spending on existing infrastructure and technology and allow a manager to be more efficient with system expenditure.

There are multiple considerations managers must make when planning for technology changes. For example, can the new technology integrate with legacy systems, or should the system be replaced? And if they are replacing their systems, can the new technology be deployed on a global scale?

The most basic thing managers should consider is what any given technology improvement could offer that current infrastructure doesn't. What are you gaining from it and what capability, data efficiency or ability to service your investor base would technology provide you in addition to the technology cost benefits? That's a really forward-looking way to continue to evolve your selection of technologies to ensure that you're growing and bringing new capability.

Ryan Burns

The asset management industry is facing unprecedented pressure as margins are squeezed. It's becoming more important than ever for asset managers to review their costs and contain their expenditure. According to our research, 50% of respondents said that automation and technology improvements were how they are going to reduce their costs in 2020.

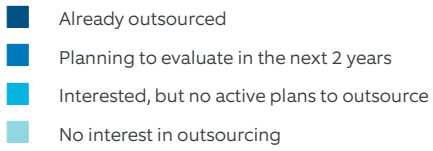
The financial services industry – and asset management more specifically – is adapting to the increasing importance of technology. For example, the use of artificial intelligence (AI) holds the promise of helping firms identify complex patterns and trends, potentially improving investment strategies. Automation can help drive accuracy and speed across many functions - including valuations, trading and reporting - while reducing execution costs.

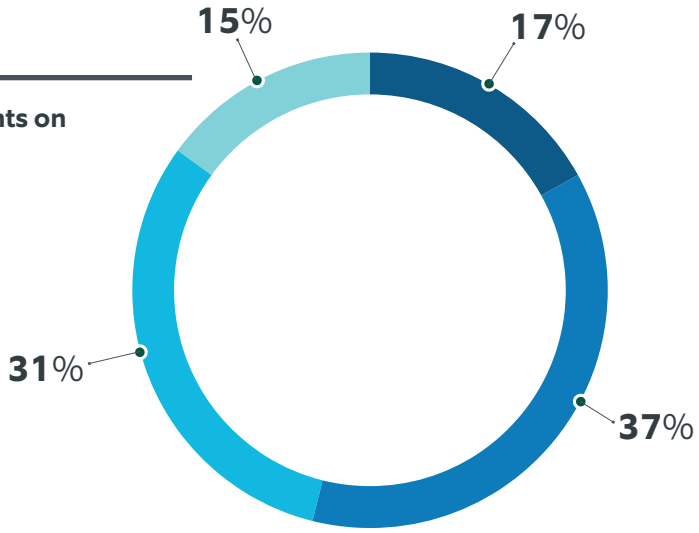
Automation can also enable better data-informed decision-making, helping firms drive their data analytics, improve investor relations via greater transparency, and meet their regulatory and tax reporting obligations.

While firms have outsourced their back and middle office functions for many years, recently many have turned to the front office as a candidate for outsourcing. Outsourced trading has moved from being viewed as a defensive measure to cut costs, to a more proactive decision to improve margins, streamline and future-proof operations and enhance governance and control processes. It's progressed from something once considered niche, to something resembling a more normal or optimal state: an efficient, scalable, "smart" way to access best-in-class execution capabilities while keeping focus on investment strategy and distribution.

When asked to express their thoughts on outsourced trading, 85% cited that they are already outsourcing or are interested in doing so. The many potential benefits available to asset management firms when it comes to outsourcing trading include increased execution quality, flexible market access, fixed cost reductions with regards to operational costs and enhanced performance for their investors.

Which of the following would best describe your thoughts on outsourced trading?





Given the current market impacts from COVID-19, the asset manager thought process is shifting from considering outsourced trading primarily as a cost-efficiency solution to proactively thinking of how to streamline and future-proof their operations. They can leverage solutions such as Northern Trust's Integrated Trading Solutions and CompleteFX to gain efficiency, scale and cost effectiveness while retaining focus on their core competencies of investment and growth strategies.

Caroline Higgins

Regulatory change around best execution has definitely created a shift towards outsourcing. Cost reduction is another key driver, it fits very well within a cost control model to assess whether or not trading is core to their offering and is something that should continue to be a focus for the firm, or if an outsourced solution would be better. And of course, there is the technology to consider. Often, new technology provides capabilities that in-house trading functions can't access, which is also driving the trend of choosing an outsourced provider that has enhanced technology.

Ryan Burns

CHAPTER FIVE

TECHNOLOGY AND DATA MANAGEMENT

Technology and Data Management

Today there is no shortage of available data. Many organizations feel overwhelmed by the amount of data they receive each day. The majority of our respondents ranked their key challenge with regards to data management as managing changes to existing data sources and providers. The second highest challenge was consolidating data from multiple, disparate internal and external sources and third was adding new data sources and providers.

Because of the abundance of information in the marketplace, it is vital that asset managers get ahead of their data needs. This starts with a strategy that defines what they need from their data, and what business priorities they want to address. By focusing on the right kinds of data, rather than trying to manage all of it equally, managers will successfully leverage the information that is integral for maintaining future growth in a competitive market.

What are your biggest challenges in data management? *Please rank in order of importance from 1 (most important) to 9 (least important)*

There are many data challenges, such as pressure regarding transparency, validation and auditing, multiple sources and legacy technology, which are facing the industry. Given the resources required to leapfrog to new technologies and infrastructure, now is the time for managers to consider outsourcing to providers who have invested in and are using technologies such as artificial intelligence and machine learning. Our clients can leverage Northern Trust's technology and expertise versus having to build these on their own.

Caroline Higgins

In many cases, managers have redundancies in their systems built from years of customization and technology add-ons. Typically, that's why managing change to existing technology stacks can be very expensive. It's all of the additional ad-hoc builds that they've done that then become non-standard.

Technology is constantly changing, and the use of APIs and data lakes and data fabric means that sharing data is going to become a lot easier. It's also expensive to build, which again leads back to the outsourcing decision. If you choose the right partner, they will effectively mitigate those risks for you because outsourced providers make big investments in that space. By outsourcing, you can leverage firms who can give you the same end result without you having to spend millions of dollars getting there.

Clive Bellows

Having the time, bandwidth, and resources to stay in front of this constant change of information is really a challenge for everybody. The consolidation of data is critical because we don't all operate in a single entity ecosystem. We all have service providers, custodians, and counterparties that you have to consider through the lens of data.

Ryan Burns

Those firms that don't focus on incorporating data management into their operating models are at risk of falling behind their competitors. When asked how they are planning on addressing their data challenges in 2020, the majority of our respondents cited that they would be leveraging new technologies such as AI, machine learning and cloud-based technology solutions.

Implementing next generation technology internally is an effective way to build on a pre-existing data strategy and IT infrastructure. However, before firms go down this road, they must have a clear understanding of how this investment will impact their current technology commitments and operating model and how it can specifically help them to achieve their business goals.

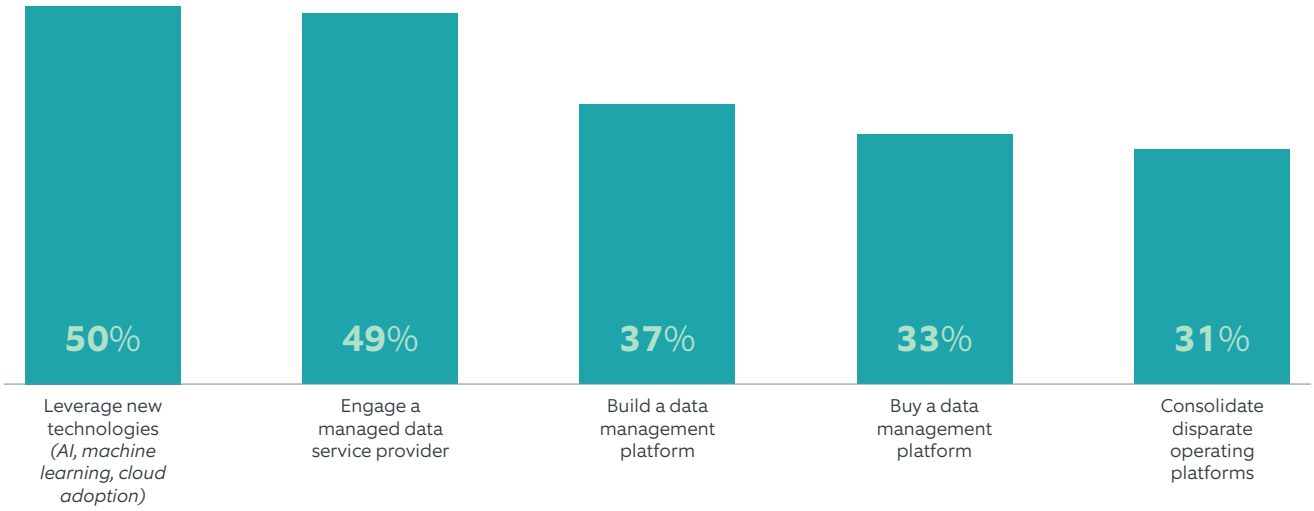
Supporting the Front Office

Many of the challenges faced by front offices are related to data, such as reconciliation; sourcing information and analytics; and cash forecasting. Our respondents cited ensuring reconciliation activities are consistently completed to support the start of the trading day as their biggest challenge when supporting the front office. Other top concerns: sourcing complete and accurate ESG/SRI ratings and sourcing and aggregating varied investment analytics.

Key challenges often arise because these functions rely heavily on data input. It is here that data management solutions can help firms streamline their reconciliation processes and better source their information and analytics. It is essential to have access to comparable data across multiple sources when managing accounts, deals and trades and the right data management platform must be able to offer this.

There are many asset management firms that rely heavily on spreadsheets to manage their data. As increasing trading requirements and transactions grow in volume and the asset classes in which they invest become more complex, these firms may struggle to access and manage the accurate data they need for well-informed decision-making.

How do you plan to address your data challenges in 2020?



None of this technology works well in isolation. Everything that you're doing from a technology perspective has to interact and interface with other organizations, and it is very difficult to be efficient on your own. It's important to choose the right technology and the right design principles and align with industry-standard protocols that are consistent with what your vendors, clients, and other service providers are also using.

The relationship with service providers is fundamental to long-term success. In choosing your partner, consider their long-term aspirations and how they work with you to meet your strategic goals.

Clive Bellows

New technology offers real cost efficiencies, and you need to carefully consider who is going to be managing that for you. I think that's why you see the managed data service provider so highly considered. Regardless of where the data service provider begins and ends there is likely a need for internal ownership to support the desire to utilize this data which was not previously available through prior technologies. You need the right resources to help you make the most efficient use of data – both within your firm and from service providers.

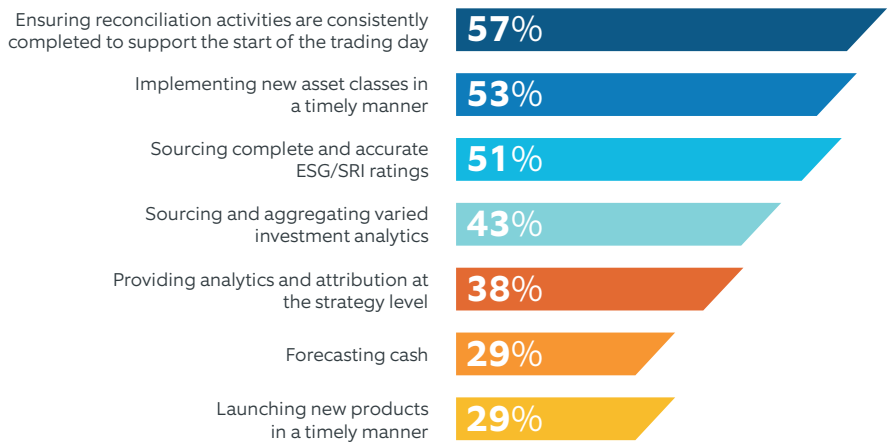
Ryan Burns

Outsourcing front office activities is one way to overcome this challenge. Outsourced providers have access to the systems and technology that can help asset managers gain the edge they need. When deciding to outsource, it is often helpful to split technology into two separate areas of 'core' and 'non-core' focus, and to take a different approach to each.
In the 'core' section, asset management firms should place anything that can support them in attracting or retaining business. This would include any technology or system that helps articulate their vision or informs investment decisions. The second area of 'non-core' focus relates to any technology that is commoditized, such as reconciliations, trading, foreign exchange, currency hedging, accounting and reporting, which could be procured as a service.

This can allow firms to devote greater resources to, and focus more closely on, their areas of expertise.

As asset management firms often compete for the same groups of investors, gaining access to wider product offerings that have better margins will require asset managers to act in a more flexible and efficient way in their front office. When it comes to improving the front office, it is vital for firms to assess if they would benefit from developing more sophisticated operating models and maximizing their use of technology.

What are your biggest challenges in supporting your front office?



The best solution for the front office should be focused on creating a single, timely, accurate source of data to ensure that the manager can maximize the performance of their mandates or funds. It's all about that seamless connection, in a centralized, real-time infrastructure that allows the front office to function as efficiently as possible.

Caroline Higgins

Start-of-day positions are really important, but as strategies get more complicated, I think managers are looking for intraday positions as well. They also need access to more data, and in a more timely and accurate manner. Again, it is important that asset managers partner with the providers that can support that.

I agree that implementing new asset classes in a timely manner is important, whether it's adding new derivative instruments, alternatives, or other new asset classes. There's a real run on private equity real estate private debt right now. Choosing a provider who not only supports what you manage today but is also able to support what you're planning to manage in the future is crucial to future success.

Clive Bellows

What underpins these challenges is the need for asset managers to have complete, accurate and timely start-of-day cash and positions so that they can effectively deploy their investment strategy. The infrastructure that supports this data must be consistent, particularly as managers expand into new markets and new investments in different jurisdictions.

Ryan Burns

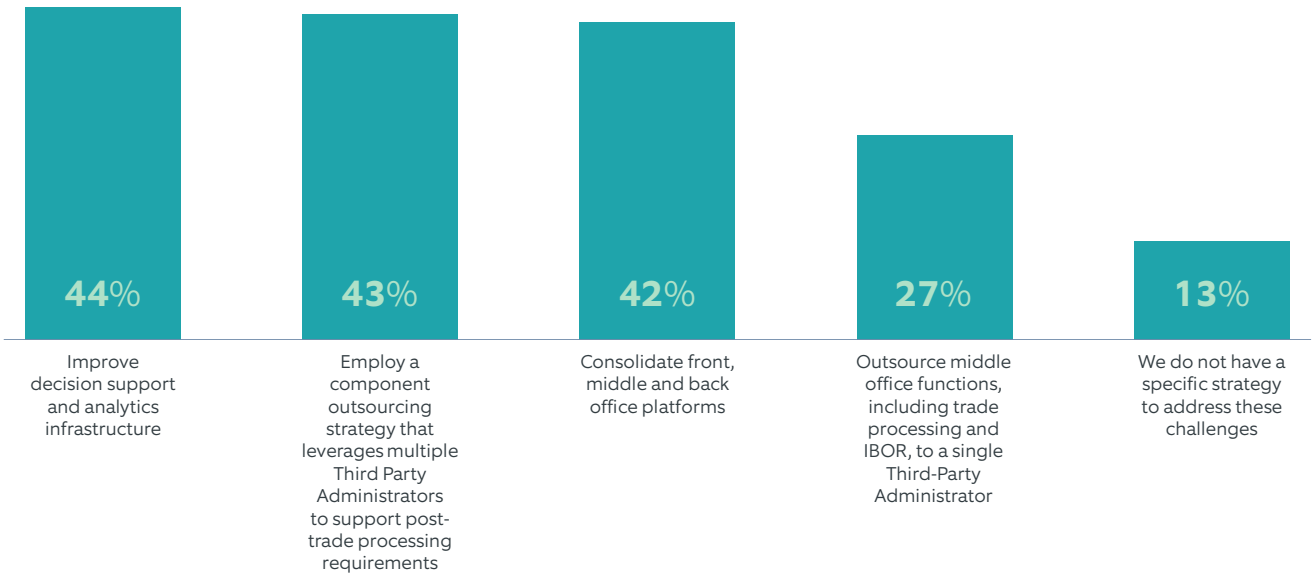
Some of the biggest challenges when supporting the front office are sourcing and reconciling data, implementing new asset classes, and improving decision support through analytics.

The front office is the investment-focused area within the asset management firm and it requires accurate, real-time data to enhance decision-making capabilities. When addressing challenges in the front office, 44% of our respondents said they would be focusing on improving decision support and their analytics infrastructure.

The middle and back office perform important strategic functions in every firm and these operations must be aligned in a way to better support the front office. This is where technology can deliver new solutions across the products and business lines to enable data to be integrated more effectively, facilitating a smoother flow of information to help inform the front office decision-making. 43% of our respondents plan to employ component outsourcing strategies while 42% plan to consolidate their front, middle and back office platforms.

Forward-thinking asset management firms are looking beyond outdated ways of working in silos across their front, middle and back office in order to improve processes. They are considering their whole office as an ecosystem that works together to deliver scale, efficiency, and flexibility across the investment lifecycle.

How will you address challenges in supporting the front office?



Decision-making requires timely, accurate, real-time data in order to maximize performance. Consolidation of data from the front, middle and back office platforms and having a single source of data is critical to ensure the front office can achieve its objectives.

Caroline Higgins

If you look at what's been happening in the markets recently, being able to react quickly to dynamic changing market situations is very important. I think the events surrounding the COVID-19 pandemic have only reinforced that you've got to be nimble, and you've got to be able to change as the world is changing around you.

Clive Bellows

Asset managers are focusing on where they can continue to serve their current investor base, while also forming a compelling argument to grow and expand to new investors and distribution channels. A revenue focus is a good way to help control costs and challenges facing the front, middle and back office. Improvements to decision support and analytics should improve the speed and accuracy of investment decisions which improve performance, lead to new investors and new revenue to the firm.

The outsourcing strategy and consolidation speak to the expense side of the coin and how you control your costs, how efficiently you're providing those services to your portfolio managers or front office. These results validate that managers are not just looking at reducing headcount costs, they're looking at improving the processes to manage expense in the most efficient way.

Ryan Burns

Conclusion

2020 is a pivotal year for asset management firms as they set their goals for future success. As the economic impact of the Covid-19 outbreak takes its toll and the threat of another global recession looms ahead, asset managers will face new challenges in growing their businesses in the coming years.

Our survey respondents cited cost containment and new market entry as top priorities for the future. However, containing costs while entering new markets is challenging, particularly when facing the confluence of existing margin pressures and a contracting market. To do this, asset managers of all sizes must be nimble and flexible and have operating models that are scalable, efficient and tech-enabled.

The managers that view their operations holistically as a whole office, rather than in silos of front, middle and back, have an advantage. They can more clearly see where procedures are bogged down by inefficiencies, where it makes more sense to outsource services that aren't core to their investment process, and where leveraging next generation digital technology can boost automation and improve decision-making.

In uncertain times, those who adapt first are often those who succeed. While there are significant challenges ahead, the asset management firms that view their operating models holistically, and increase efficiencies across their whole office, will be the ones that rise to the top in the search for alpha.

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A proven partner to some of the world's most successful and innovative investment managers, Northern Trust has over 30 years' experience administering the full spectrum of investment strategies for clients around the globe. We help facilitate improved speed-to-market, operational efficiency, business focus and distribution for our clients' traditional and alternative funds. Our solutions include fund administration; global custody; investment risk analytics; back-and-middle office investment operations outsourcing; institutional brokerage; and solutions to support regulatory change.

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