Downstream

Asset managers are facing increased demands for transparency from both regulators and their investors, along with heightened competition creating fee pressure. As a result, the demands they are placing on their own service providers and market infrastructure are evolving.

Despite an environment that could potentially increase downstream fee pressure or cause asset managers to re-evaluate and consolidate the number of vendors they work with, securities services providers and market infrastructures are identifying opportunities to deepen relationships and offer new services.

"If you look at the historic role of a custodian or securities services provider, it was limited to the safekeeping of assets and core custody and accounting types of functions. However, with the increased cost pressures asset managers are under, they are seeking to outsource more activities to service providers," says Sanjiv Sawhney, global head of custody and fund services at Citi. "Therefore our set of services has grown much beyond what the traditional custodian used to be four or five years ago to include a lot more middle-office elements like performance attribution, risk analysis, systems and trade execution, FX, etc."

Shifting business models

Although asset managers globally expect assets under management (AuM) to continue to grow — by 21% through 2025 — they expect fee income will only grow by 8% over that time, due to an 11% drop on fee margins, according to a survey by Bloomberg Intelligence and Simmons & Simmons. The top way asset managers expect to counteract falling margins is to alter their investment styles, with 27% of survey respondents wanting to expand into alternatives.[1]

Investors' shifting preference from active to passive management has contributed to fee pressure, which is why some managers are trying to address this change through higher-margin products. In other cases, asset managers are looking for ways to expand distribution and scale, either by adding new products or merging with other firms. As a study from Boston Consulting Group finds, the two basic ways to succeed over the next decade are either to become boutique, alpha-focused managers or to become massive firms

1 Bloomberg Intelligence and Simmons & Simmons. "Optimistic Forecasts for AUM growth in the Asset Management Industry are Overinflated, According to New Survey". 6 Feb. 2019. https://www.bloomberg.com/company/press/optimistic-forecasts-aum-growth-asset-management-industry-overinflated-according-new-survey/

blues?

with over $1 trillion in AuM and a full suite of products.[2]

"A lot of asset managers are having to choose between how they specialise in certain specific types of products or capabilities or the scale they want to achieve. So as a service provider, we need to be able to adapt to the new fund types or product types," says Sawhney. "For example, ETF capabilities has become a strong focus for us. We've enhanced some of the capabilities we had in only certain domiciles to become much more global, given the fact that the ETFs are propagating very strongly and globally. Private assets and bank loans have also become important focus areas for managers, and we have to keep upgrading our capabilities in a more agile manner, to be able to change our product catalogue to be able to cope with these new asset classes."

2 Fages et al. "Global Asset Management 2019: Will These '20s Roar?" Boston Consulting Group. 31 July 2019. https://www.bcg.com/publications/2019/global-asset-management-will-these-20s-roar.aspx

The spur of regulatory change

In addition to helping asset managers navigate a more competitive environment, service providers and market infrastructure can also overcome downstream blues by using regulatory change as a way to deepen relationships with asset managers. While regulatory change has been a consistent theme over the past decade since the financial crisis — and something that securities services firms and market infrastructures themselves have had to navigate extensively — there's a sense now that they can use this change as a way to offer new services, particularly by deploying data more effectively.

"The discussion of cost efficiencies comes in a very different shape and form than talking about rejection of custody fees or challenging a client about a minimum fee. It's more about how we can join together to come up with solutions where

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>
> SANJIV SAWHNEY, CITI

the clients can meet their regulatory requirements by getting access to accurate, timely, independent data," says Simone Vroegop, senior vice president, investor services, and head of European product management, financial technology at Brown Brothers Harriman (BBH).

With this greater focus on data, service providers and market infrastructure are moving beyond just providing back-office support to helping with asset managers' more front-office and client-facing responsibilities.

"A very important change we are observing with our clients is that the people we are talking to are no longer the administrator of the fund, or the person looking after operations," says Vroegop. "It's the person sitting in the front office who needs to have access, for regulatory reasons, to MiFID II reporting, or it might be a person who is responsible for the digital transformation, or someone who needs to look at the customer experience."

This broadening of services also increasingly involves playing a connecting role between asset managers and their end-investors. "Asset managers often start with a simple outsourcing exercise, and then over time realise that service providers and market infrastructures have access to a significant amount of flows and volumes," says Stephan Pouyat, global head of Capital Markets and Funds Services at Euroclear. The insights they can derive from this data can, he adds, be extremely important for asset managers and distributors to better match the right investors to the right product. "Data management and data mining has grown off the back of this outsourcing, simply because the more you outsource to a single place, the more insights you are able to derive," says Pouyat.

Clearstream has similarly expanded its role in helping asset managers and distributors manage increased regulation.

"MiFID II has triggered our move into a brand-new area of product for us," explains Bernard Tancré, head of investment fund services at Clearstream. "Twenty years ago, we had added investment funds as a new asset class to what we'd been providing for banks, having added a model routing facility so that we've been able to capture all the operational sides of all the routing, custody and settlement aspects of all the investment funds we service," he says. "Now we're getting in the middle of the distribution link between asset managers and the distributing banks, helping with the exchange of information regarding distribution, which helps comply with regulations like AML/KYC and MiFID II."

By providing this type of operational support, service providers and market infrastructure can help asset managers and distributors not only comply with regulation, but also relieve some of the fee pressure that regulatory change has created.

"The trailer fees and rebates that were passed through and were extremely profitable for the distributors have been under pressure in a number of share classes. That's the impact that has pushed us to most recently get into this business of intermediation at the beginning of 2019, helping our clients who are the distributors of the funds, as well as the asset managers who need to have efficient access to the right information," say Tancré.

Support through technology

In order to help asset managers gain the information they need to comply with regulation and adapt their services to counteract fee pressure, service providers and market infrastructure see technology as a key focus.

"Technology is a huge enabler for us to be able to continue to meet the demands of asset managers. For example, we're strengthening our data strategy to ensure there's a single set of data elements between us and our asset manager clients, avoiding duplication of activities and processing across our clients and ourselves," says Sawhney.

While newer technologies like blockchain and robotic process automation increasingly have their place in providing data transparency and reducing operational costs, the more established, perhaps less flashy technology of APIs is a recurring theme this year within the industry as a way to strengthen data management (see page XX).

"There's a strong interest in what we are doing from an API perspective so that clients increasingly can pull out data in a near real-time manner and not necessarily wait for an end-of-day or start-of-day batch file," says BBH's Vroegop.

Some asset managers are also looking for ways to leverage technology not only to manage regulation and understand their investor base better but even to offer their products directly in order to increase margins.

"There is a view that with the help of new technologies and more digitalisation, direct business models can become less complicated and grow in the future," says Tancré. "That's an evolution that we are watching closely and where we speak with asset managers in order to make sure that we can accompany them into this journey."

Overall, while these changes to asset managers' business models and regulatory requirements can be challenging and require downstream providers to adapt, the outlook remains optimistic among industry participants who foresee long-term growth in an asset management industry that will continue to need support from service providers and market infrastructure.

"Regulatory measures, in the long run, are good for the asset management industry as a whole," says Pouyat. "They will protect the end investors, as well as the underlying issuers that are wrapped around those instruments.". He compares regulatory change to the automobile industry, where regulations are a safety measure, like seatbelts, which can be expensive for car manufacturers in the short term, but in the long run, they improve customer experience, satisfaction and can help the industry as a whole grow.

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