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The C-Level Perspective

Key findings and observations from an asset management industry survey

A BISAM SURVEY

Introduction

BISAM recently completed a survey of individuals operating in C-Level roles across the buy-side. The objective of the survey was to collect information about the challenges faced by investment managers as perceived by the C-Suite and how programs to address these challenges are being prioritized.

Our motivation for canvassing opinion from the C-Suite was driven by the fact that the asset management industry remains in a state of flux, eight years after the Global Financial Crisis. An internal BISAM research project identified three **primary** change drivers:

- **New regulations in financial services and asset management**
- **Changes in investment strategies**
- **Changes in investor behaviors**

In view of this, we recognized the importance of obtaining a perspective on the state of the industry directly from individuals operating in the most senior roles. Information was collected from CEOs, COOs, CTOs/CIOs, and from a variety of Functional Executive roles such as Global Head of Operations and Global Head of Investment Relations. The firms surveyed included institutional managers, retail managers, wealth managers, and managers whose business is diversified across two or more of these areas. In this paper, we highlight some of the key findings from the survey and present our observations and perspective on the asset management industry in 2016.

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Drivers for Change in Asset Management

BISAM's internal research identified three primary drivers for change in asset management.

Regulatory Change
Following the Global Financial Crisis of 2008, the financial services industry has had to adapt to a much tighter regulatory environment. Many new financial regulations have been introduced by regulatory bodies in all of the main economies.

Coping with regulatory change is non-negotiable and projects to adapt operating platforms to ensure compliance with new regulations must be completed on time. Different regulations apply to organizations operating in different sectors of the industry and in different countries, and the various regulatory bodies do not coordinate the introduction of the individual regulations. Asset management organizations are still running multiple projects in parallel to ensure compliance with a range of new regulations.

Changes in Investment Strategies
Volatility is the new normal in asset management and investors want more certainty about the value that will be delivered by investment strategies. Investors want more guarantees about how much their investments will be worth in the future and so are moving to outcome-oriented investment strategies, where the objective is not defined relative to a market index but in terms of a defined value-based outcome within a defined period of time.

Changes in Investor Behaviors
As well as demanding more certainty, investors are also demanding a new servicing model.

Individual and institutional investors want to see more, hear more and understand more about their investments than ever before. At the same time, the expectations of organizations and individuals as to how business should be conducted is being re-shaped by digital distribution and communication channels.

The need for traditional models for market communications, client communications and for client servicing will continue for many years to come. But asset management organizations have to develop new communication and servicing models that can operate in parallel with the traditional models. New models that are reinventions, not refinements, of the traditional models.

Implications for Asset Management Organizations

The primary change drivers are creating an industry dynamic that has implications for asset management organizations in five areas.

More Competition
It is now much easier than ever before for individual investors to manage their own assets, and an increasing number of providers are introducing low-cost, self-service platforms to facilitate this.

The new low-cost providers do not have legacy operating platforms and can better exploit the latest technology. They are more agile and flexible than the traditional providers of investment management services, who are having to find ways to reduce the time-to-market for new products and enhanced client services within the constraints of legacy operating models.

Lower Margins
Significant project costs have been incurred to ensure compliance with new regulations. For more than five years, regulatory projects have been diverting Change-the-Firm budget away from investing in new infrastructure, especially in areas where the impact of new regulations has been limited.

> **Traditional investment managers are under pressure to demonstrate the value they provide and justify the higher fees that they charge.**

As new regulations come into force, organizations are seeing a corresponding increase in operating costs. They are also experiencing new data management challenges because of the need to maintain records of what was done, said, and sent to clients and to their representatives and advisers.

At the same time, organizations, particularly investment managers, are experiencing pressures on fees. This means that cost pressures cannot be alleviated by increasing fees and so profit margins are being squeezed, resulting in an ongoing focus on cost control for the foreseeable future.

Demand for New Products
Investors are demanding more customized, outcome-based investment solutions. For example: to meet defined risk/reward targets, to provide a defined income stream, and to achieve target-dated retirement goals. This demand will not just continue, **it will increase**.

Alternative assets allow asset management organizations to meet investor demands for outcome-oriented products. At the same time, they offer incentives for organizations because alternative-based investment products usually command higher fee levels. So there is both a **market share upside** and a **revenue margin upside** for managers who increase their asset allocations to alternatives and away from traditional assets.

However, many asset management organizations do not have systems that provide full support for alternative assets.

Demand for a New Type of Service
All of us in our personal and business dealings are enjoying a new form of B2C servicing, that has been made possible by the digitization of the customer experience. From our own houses, we can connect to all kinds of service providers, whenever we want to, and arrange for products and services to be delivered without having to call anyone or visit a store.

And this is permeating the asset management industry.

> **Investors now have easy access to more information about markets and funds than ever before, via a wider range of delivery channels. Their expectations of what information should be provided are changing, along with their expectations of how it should be delivered.**

Investors of all types want something more than generic market commentary because they can get that for themselves via digital channels. They want **value-added information** provided in a **more flexible** and **more customized** form. Failure to provide a 'new world' customer experience is becoming a barrier to attracting new business and to retaining existing business.

Greater Oversight and Governance
The Global Financial Crisis exposed significant problems in the way that asset management organizations tracked and mitigated risks such as market, credit, counterparty, and valuation. Regulators have stepped in to require organizations to put stronger risk management policies and processes in place.

Pension schemes are moving to higher risk investment strategies and more complex blended strategies to reduce funding issues while keeping volatility within acceptable levels. They will need **scheme-level risk-adjusted performance**, which many of their providers are unable to deliver. Larger schemes are likely to move more asset management in-house to improve transparency, governance and oversight.

> **The cost pressures associated with regulatory compliance are not going away. Asset management organizations are facing a sustained period of cost pressures.**

The results

The C-Level Perspective

The implications described above represent BISAM's view of how the primary drivers for change are shaping the asset management industry. We commissioned a survey of C-Level roles to gain insight into how these implications are perceived by executives and into how they are prioritizing action programs to address them.

Industry Challenges

Respondents were given the following list of ten industry challenges and trends and asked to indicate the main ones affecting the industry:

1. **The adoption of digital strategies in client & market communications**
2. **The adoption of big data analysis techniques**
3. **The rise of low-cost providers of investment management services**
4. **The cost & impact associated with increased regulation**
5. **The increased use of alternatives in mainstream investment management products**
6. **Increased demands from investors for enhanced services**
7. **Greater disintermediation from investors**
8. **Pressure on fees**
9. **Globalization (global products, global distribution, global competitors, etc.)**
10. **The need to reduce costs**

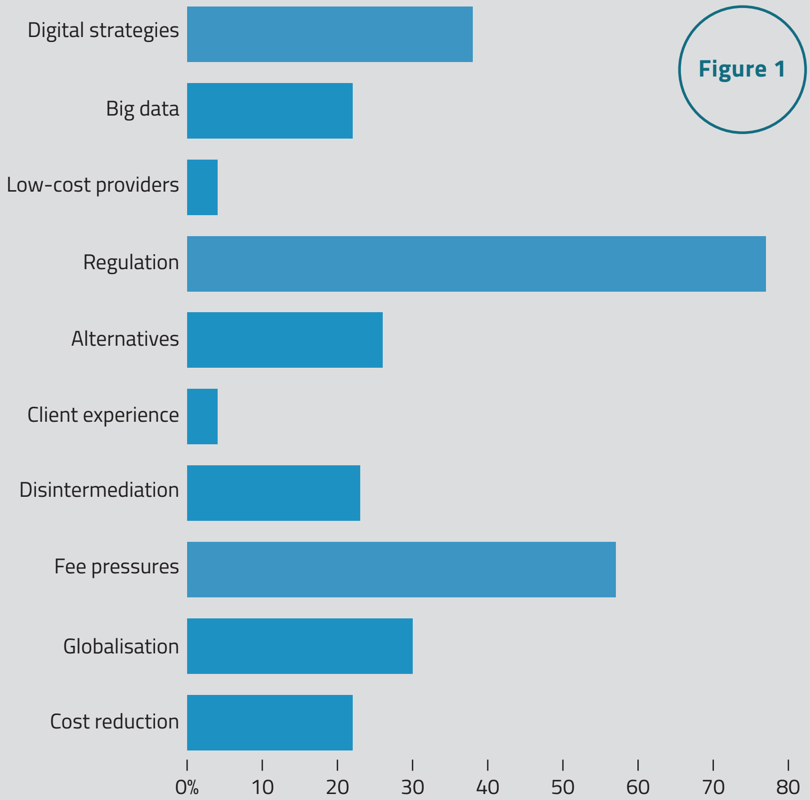


Figure 1

Figure 1 shows how respondents answered this question.

The top three industry challenges and trends as perceived at the C-Level are:

1. The cost & impact associated with increased regulation (selected by 78% of respondents)
2. Pressure on fees (57%)
3. The adoption of digital strategies in client & market communications (39%)

Table 1 shows that different perspectives apply for organizations of different sizes. The adoption of digital strategies is perceived as a greater challenge in investment managers with AUM of more than $100bn; managers with lower AUM, however, are more likely to see pressures on fees as one their main challenges.

Table 1

Industry Challenge	AUM > $100Bn	AUM < $100BN
Regulation	71%	89%
Digital strategies	50%	22%
Fee pressures	43%	78%

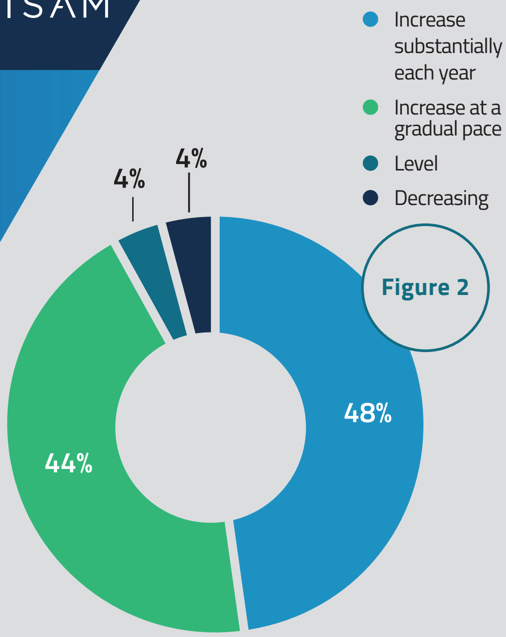


Figure 2

Coping with Regulatory Change

Figure 1 shows that the cost and impact associated with increased regulation is perceived at the C-Level as the greatest challenge facing the asset management industry, and Table 1 shows that this applies regardless of AUM.

This is supported by Figure 2 which shows the C-Level perspective on the **project costs** associated with the introduction of new regulations. It is clear from this chart that the introduction of new regulations continues to consume Change-the-Firm budget, which is why it is perceived at the C-Level as the main industry issue.

Regulatory projects are non-negotiable but do not increase the value created by asset management organizations, do not increase their efficiency, and do not enhance the service experienced by their clients. As Change-the-Firm budget continues to be consumed by regulatory projects, funding for change programs to enhance value creation, efficiency and the customer experience will continue to be squeezed.

There is also concern at the C-Level about the impact that increased regulation will have on operating costs. There is a unanimous view that new regulations have increased operating costs or will do so in the future, with 65% of organizations expecting (or already experiencing) a significant increase.

Prioritizing Change

In view of the expectation that Change-the-Firm budget will continue to be consumed by regulatory projects, it is interesting to observe how other change programs are being prioritized.

Figure 3 shows the main focus for asset management organizations over the past 12 months, and where it is expected to be over the next 12 months.

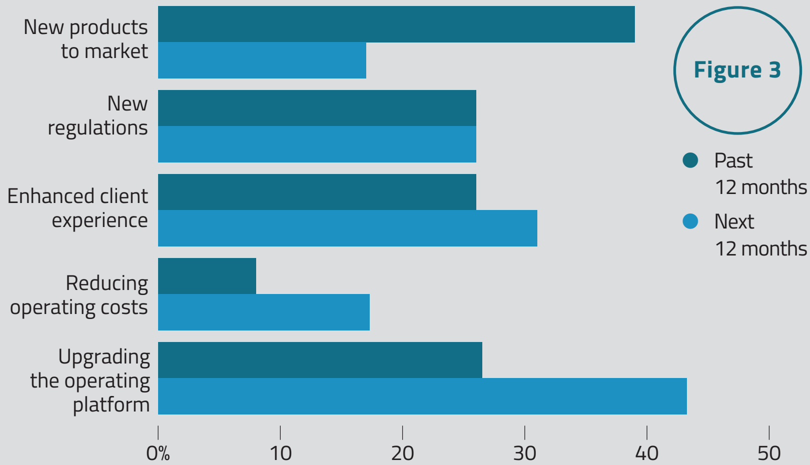


Figure 3

Figure 3 reveals that the C-Level is expecting a shift in priorities for change programs:

- The focus on bringing new investment products to market will decrease
- The focus on regulation and enhancing the client experience will remain around the same
- There will be greater focus on reducing operating costs and upgrading operating platforms

However, once again different perspectives apply at the C-Level in organizations of different sizes. Table 2 shows how priorities are expected to change in organizations with different levels of AUM. What is particularly striking about this analysis is that the perspective on priorities is not simply different in organizations of different scale it is **significantly** different, and in the case of new regulations and client experience the expected shift in priorities is in **opposite** directions.

Table 2

Focus	AUM > $100Bn	AUM < $100BN
New products	Lower	Much lower
New regulations	Lower	Much higher
Enhanced client experience	Lower	Much higher
Reducing operating costs	Much higher	No change
Upgrading operating platforms	Higher	Much higher

The BISAM Perspective

There are two key themes that have emerged from the information we have collected on the C-Level perspective:

1 **There will be an increase in the focus on operating platform enhancement.**
2 **There will be an increase in the adoption of SaaS by investment management firms.**

Increased Focus on Operating Platform Enhancement
Over the past seven years, regulatory change projects have diverted Change-the-Firm budget away from change programs designed to increase the value delivered by asset management organizations, to increase operational efficiency, and to enhance their clients' experience. At the same time, profit margins have been squeezed and investors have developed higher expectations of the value that should be delivered and of the services that they should receive.

In other words, over a period when organizations should have been highly focused on increasing the value they deliver and increasing the efficiency of their business and enhancing the experience of their clients, they have been forced to spend their Change-the-Firm budget on projects that achieve none of these. This is not a situation that can continue for ever. At some point, despite the on-going requirement to comply with new regulations, asset management organizations will have to respond to the industry dynamics that are demanding strategic change.

There is a tipping point here, and it appears that we have reached it. Therefore, at BISAM we expect to see many more organizations investing in upgrades to their operating platforms over the next 12-18 months.

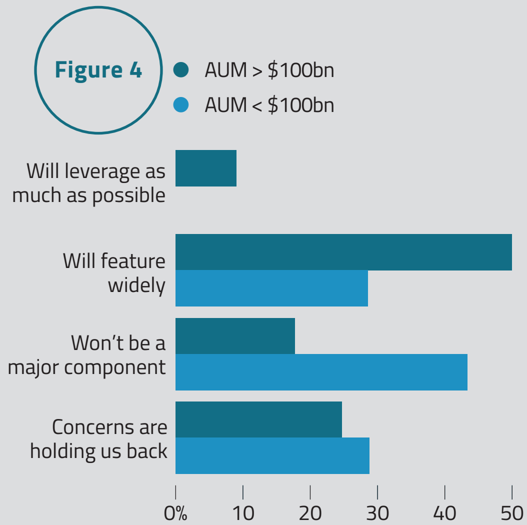
Increased Adoption of SaaS
The asset management industry is a huge global industry, but it is not homogeneous. There is a wide range of different types of organizations servicing different types of investors living in different countries with different regional preferences and where different regulatory guidelines apply.

BISAM's research has identified that smaller investment management firms operating in the retail and wealth sectors see new regulations as a greater challenge than other types of managers. It is also these managers that will be most focused on upgrading their operating platforms over the next 12-18 months.

However, we also found that it is this same group of managers that see pressures on fees as a more acute challenge. Therefore, the big issue that these managers will face is how to invest in necessary upgrades to their operating platforms, while continuing to face downward pressure on fees, without suffering unacceptable reductions in profit margins.

One option that many firms would be expected to consider when facing this challenge would be to extend the use of SaaS within their operating platforms. SaaS applications can be deployed quickly and cheaply, and fee scales are usually flexible with on-going costs increasing and decreasing in line with usage levels. This makes SaaS an attractive option for smaller firms that do not have the in-house IT resources and the large IT budgets that are typically found in larger firms.

However, Figure 4 shows that smaller investment managers appear less committed to SaaS than larger managers.



At BISAM, we believe that there is now a strong incentive for smaller managers to extend the use of SaaS within their operating platforms and we expect this to emerge as one of the key industry trends over the next 1-2 years.

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For more information, contact us

EMEA
43-47 Avenue de la
Grande Armée
75016 Paris
France
T +33 (0)1 42 85 73 00
F +33 (0)1 42 85 73 04

12 Mason's Avenue
London
EC2V 5BT
United Kingdom
T +44 020 7796 9010
F +44 020 7796 9039

21 Srebarna Street
Floor 5
Sofia 1407
Bulgaria
T +359 2 962 4645

North America
295 Madison Avenue
11th Floor
New York, NY 10017
United States
T +1 646 590 0300

225 Franklin Street
26th Floor
Boston, MA 02110
United States
T +1 617 933 4400

info@bisam.com

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