OLIVER WYMAN

Financial Services

POINT OF VIEW

THE PATH AHEAD

REDEFINING THE ASSET MANAGEMENT OPERATING MODEL

AUTHORS

Matthias Hübner, Partner

Samir Misra, Partner

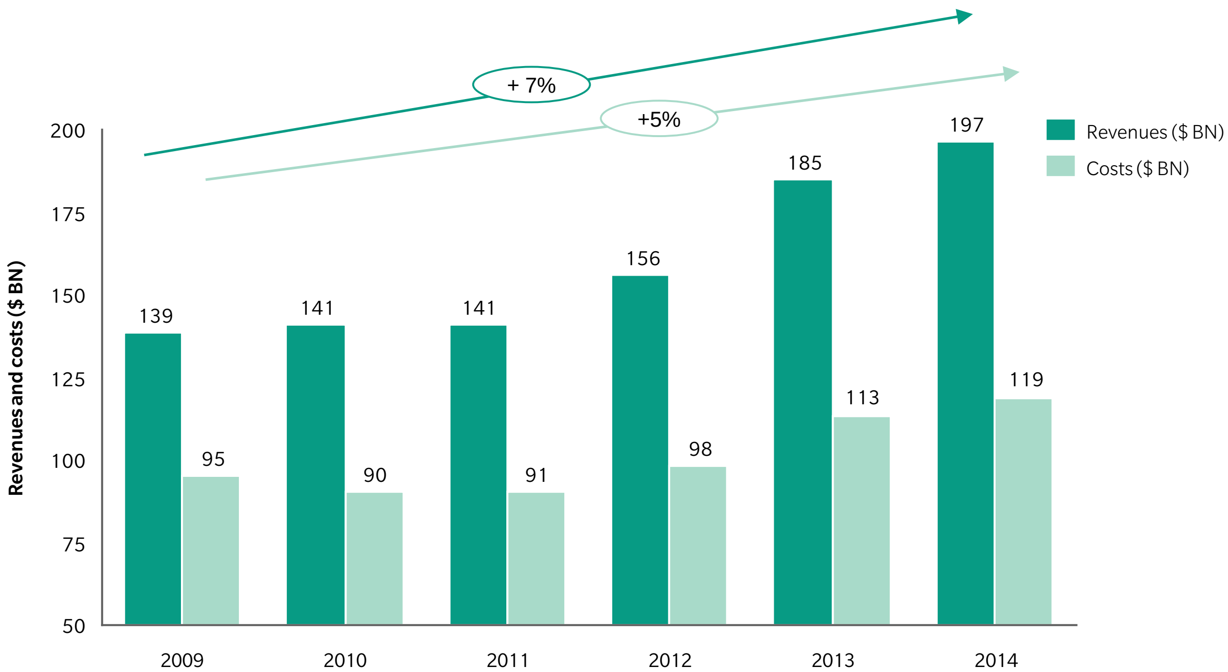
Gökhan Öztürk, Partner

Robert Urtheil, Partner

INTRODUCTION

Asset management firms have recovered well since the financial crisis, Assets under management (AuM) stand at record levels, net revenues have risen and costs (as a percentage of AuM) have been stable (see Exhibit 1). During the recovery from the global financial crisis, we have seen global **AuM growth of 8% per annum**. Current conditions, on the surface at least, would appear to indicate that asset management firms are entering calm waters.

EXHIBIT 1: GLOBAL ASSET MANAGEMENT INDUSTRY EVOLUTION



Source: Oliver Wyman analysis

However, despite a slight decrease in cost margin (from 16 to 15 basis points (bps)), overall **cost has increased by US$29 BN** (approximately one third), now reaching a total of US$119 BN. Therefore, while the current average **cost-to-income ratios of a little more than 60%** look acceptable, any external shock may well **hit asset management profitability hard** if companies do not adjust their cost base.

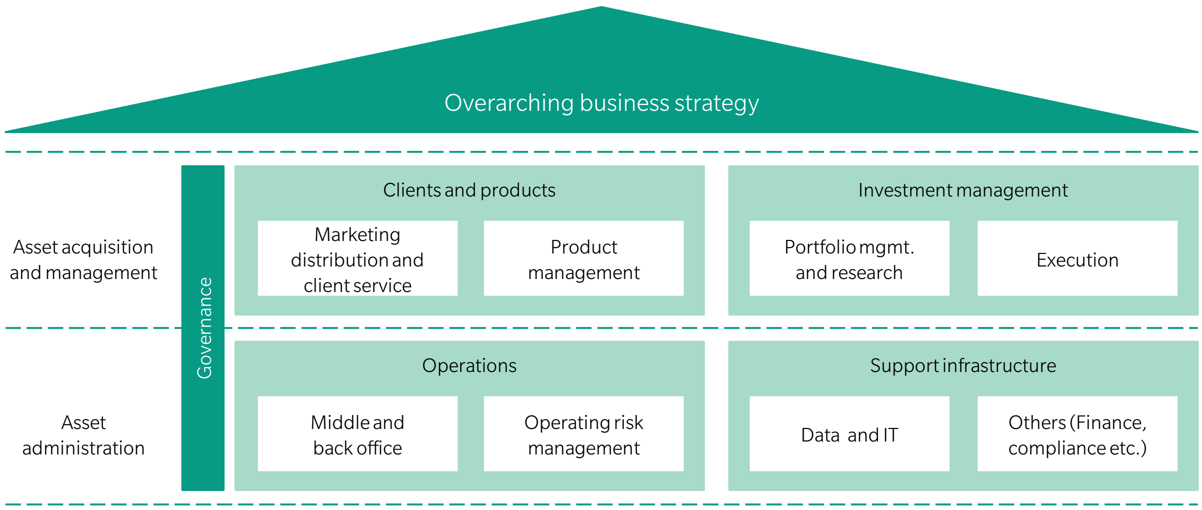
Indeed, even with the recovery since the crisis, asset managers are uneasy. Increasing regulatory costs, the sustained challenge to the asset manager value proposition due to the inconsistent delivery of alpha performance, and the secular shift to passive products will all influence profit margins in the coming years.

On the other hand, a trend towards alternative investments has bolstered returns as investors look to increase their chances of achieving the required yields. Moreover, the industry as a whole has benefited from the unprecedented accommodating monetary policies throughout the world.

But when those policies inevitably end, it will reshape the industry as we have come to know it.

To position themselves ahead of the curve, asset managers must proactively prepare themselves for a paradigm shift in their operating environment. They should focus on key initiatives that can ensure sustained growth momentum, while at the same time carefully managing costs. In doing so, asset managers must review their entire operating model (see Exhibit 2), challenging received wisdoms and questioning practices that may not be suitable for a fast-evolving environment.

EXHIBIT 2: ASSET MANAGER OPERATING MODEL



Pulling the right operating model levers will not only help asset managers to manage costs more effectively, for example through building efficiencies and thus eliminating wasted effort and expenditure. It will also help them to supplement revenues, notably through increasing nimbleness and reducing time to market.

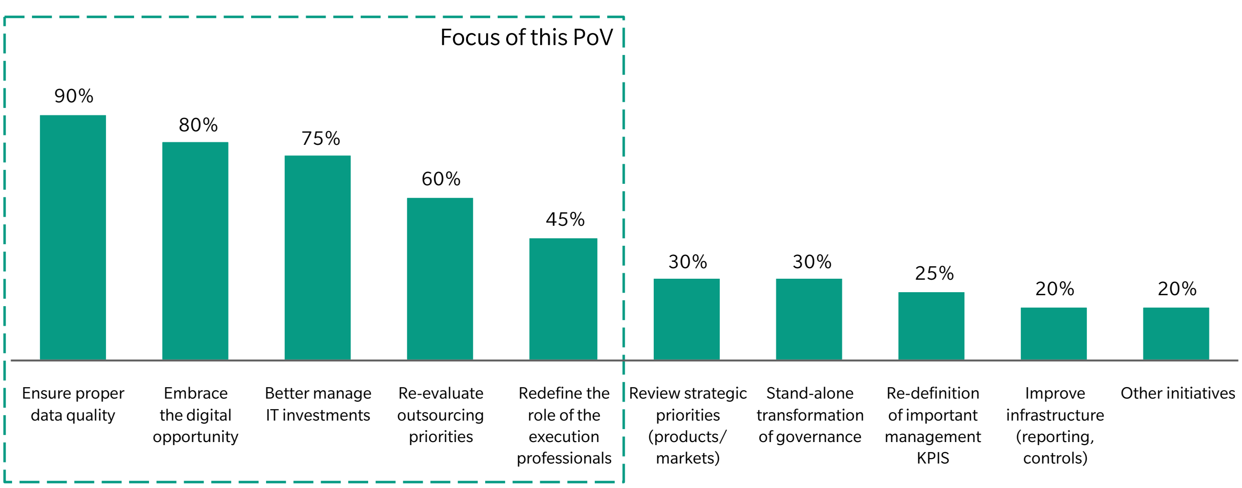
It is within this context that we are pleased to present this point of view. We have drawn upon our significant experience within the industry. We have assessed the state of the industry as a whole, the fundamental forces that are changing its shape and the key initiatives asset managers are already undertaking in a bid to achieve success. In addition, to garner a peer perspective, Oliver Wyman conducted multiple interviews on the subject with senior executives from asset management firms across the globe.

Our intention is not to introduce yet another operating model framework. We would like to concentrate on those areas which our discussions with asset managers highlighted as critical in their quest for eliminating costs and, more importantly, for building new efficiencies (see Exhibit 3). In this paper, we explore the five most important of these initiatives, which may well span more than half of total expenses of asset management firms.

EXHIBIT 3: OLIVER WYMAN SURVEY RESPONSES – KEY OPERATING MODEL EFFICIENCY INITIATIVES

Oliver Wyman survey responses

respondents ranking top 5 factors in driving operating model efficiencies



Note: Survey responses do not add up to 100% as participants could select more than one option, and Top 10 responses are listed

1. ENSURE PROPER DATA QUALITY

Data quality has emerged as one of the key challenges facing asset managers in managing their operating models effectively. Too often, however, firms struggle with poor quality data, mostly due to the unclear ownership and responsibility both at the point of entry and throughout the data lifecycle. This in turn creates a vicious circle in which attempts at remedial action are met with internal resistance, resulting once again in poor data quality and the waste of valuable executive time on inefficient activities, such as reconciliation, multiple checking and investigating discrepancies, often for apparently simple calculations.

These issues may relate to portfolio data (such as holdings of individual funds), transaction data (such as improper trade recording) or client data (such as funds and investment restrictions). Asset managers that fail to manage data effectively not only risk investment decisions being compromised. They also face an increase in reconciliation efforts and costs, and poor client reporting and service levels (potentially reducing client stickiness). They may also incur punitive financial penalties and, in extreme cases, bring about the closure of their business (see Exhibit 4 for recent data-related fines). For a broader discussion on what standards asset managers should live up to, please view our recent publication on conduct in asset management.

EXHIBIT 4: RECENT EXAMPLES OF DATA RELATED FINES ON ASSET MANAGERS

Year	Country	Asset Manager	Issue	Fine levied ($MM)
2014	UK	Invesco Asset Management	Did not comply with investment limits designed to protect investors; failed to record trades on time, which meant the funds could have been wrongly priced	29
2010	US	ICP Asset Management	Engaged in fraudulent practices and misrepresentations that caused the CDOs to overpay for securities and lose millions of dollars	23
2014	US	Western Asset Management	Breached fiduciary duty by failing to disclose and promptly correct a coding error causing improper allocation of a restricted private investment to the accounts of 100 clients	21
2015	Germany	BlackRock	The company was charged for publishing information late or incorrectly on its holdings of corporate voting rights and financial instruments	4
2013	UK	SEI	The company failed to separate client and company funds and check daily to ensure the right amount of money is set aside	2

Source: Regulator websites, web research

We believe that a combination of cultural and organisational factors, and poorly constructed technology solutions, stand in the way of improved data quality. Furthermore, we have seen large discrepancies between the best and worst practice in managing third parties, such as custodians. Many respondents indicated that there is a shortage of early-warning mechanisms to enable firms to be proactive, rather than reactive. Meanwhile, legacy systems and processes undermine efforts to improve data quality, and there are few incentives to set high quality standards.

Managers indicate that even when they try to improve the situation, those steps are often unsatisfactory – taking the form of one-off firefighting initiatives with little lasting impact, or bespoke solutions which cannot be replicated, rather than thoughtful changes in the underlying processes. They have also witnessed half-hearted attempts driven more by cost consideration than by a recognition of the impact on the firm's reputation. We believe that the clock is ticking for asset managers on the data quality front. The recent implementation of BCBS239, a global initiative in the banking industry due to begin in 2016 to improve data management, is a harbinger of things to come for the asset management industry. As a result, it is important to be proactive in setting high standards for your data. In working with our clients on this critical issue, we have typically used the following framework:

- **Define governance and organisational structures**
  - Put a structure in place to ensure effective data management
  - Establish policies outlining unambiguous lines of responsibility for data processes throughout the lifecycle and across systems
  - Promote culture and incentives through executive-level sponsorship of high data quality

"Structuring the governance of data management, in order to ensure quality and agility, is one of our key focus points going forward"
–North American Asset Manager

- **Set out standards and policies**
  - Clarify policies regarding which data practices are acceptable
  - Set realistic targets that reflect the cost-benefit trade-off
  - Communicate policies to all key stakeholders, ensuring a common understanding
- **Ensure data processes adhere to key rules**
  - Eliminate processes such as manual uploading of data, routine manual adjustments and calculations
  - Streamline and automate, with the goal of achieving straight-through processing and minimising reconciliations
  - Minimise handoffs between different units
- **Define and measure data quality**
  - Put metrics in place for measuring and reporting on data quality throughout the lifecycle, such as:
    - % of data with defined owners
    - % of data corrections not applied at source
    - % management reports reconciled against multiple sources
  - Data should be complete, consistent, accurate, and structured, in order to support use cases

"High quality data has become increasingly critical, not only to drive growth, but for survival itself"
– European asset manager

- **Create flexible systems infrastructure**
  - Build auditable and retrievable data storage facilities
  - Develop flexible systems capable of responding to change
  - Institute continuous improvement and best practices
  - Execute calculations by all functions that can be implemented directly and efficiently in the data warehouse (DWH)
  - Execute calculations which need to be, and can be, adjusted flexibly in DWH

By adhering to these standards, asset managers will not only be able to avoid penalty payments in the future. They will also be able to significantly increase their flexibility and response time, enabling them to provide higher quality services which fit the specific requirements of their clients even more precisely.

2. EMBRACE THE DIGITAL OPPORTUNITY

With attractive margins and reliance on traditional business models, asset management has long been seen as ripe for disruption. The recent past has shown myriad industries all too often getting caught unawares by advances in digital technology. Music, photography and travel industries are stark examples of the disruptive impact digital technology can have.

"The asset management industry has to date not truly embraced digitally driven opportunities and is ripe for disruption from new types of players"
– Large European Asset Manager

A host of new FinTech players are now beginning to challenge the traditional asset management operating model by using a digitally powered omni-channel approach, leveraging Big Data analytics and other such innovative approaches and forcing a rethink of the asset manager value proposition. A wide variety of emerging examples (see Exhibit 5) offers insights into how asset managers may best embrace the digital opportunity.

EXHIBIT 5: SELECT EXAMPLES OF DIGITAL INNOVATION ACROSS ASSET MANAGEMENT VALUE CHAIN

	Asset acquisition			Portfolio management			Asset administration		
	Marketing	**Sales**	**Client service**	**Asset allocation and research**	**Investment selection**	**Trading**	**Perfor-mance analysis**	**Operations**	**Adminis-tration**
Retail Segment	• Third party distribution funds from online retailers	• Self directed sales channels	• Customised guidance and advice	• Social networks for research	• Investment strategy based on crowd sourcing of ideas	• Social networks for trading solutions	• Enhanced customer engagement • Investment simulators and reporting agents		
Institutional Segment	• Automated marketing activities, removing the need for large marketing teams	• Salesforce productivity management	• Cross balance sheet view of liabilities, assets and risks	• Online data repository to assess potential investments	• Data analysis to identify investment trends	• Portfolio manage-ment software improving investment performance	• Operational productivity enhancement • Real time portfolio data analytics tools		
Industry examples	Kurtosys Salesforce		Zoho nutmeg	SocialPicks DueDil		Etoro StockTwits	Advent Bi-Sam Calastone		OpenGamma Thunderhead.com

To many, digitalisation at best helps to combat rising costs (many of which have been brought on by the impact of increased regulations). However, in our interviews, it became clear that market leaders recognise the vital importance of digitalisation to their survival and growth, given the potential for disruptive impact.

"We believe the future of asset management will be tremendously influenced by digital technology, the effective use of which will be key in separating winners from losers"
– Global Asset Manager

Rather than adopt an approach which simply follows the latest trend, we believe the key to developing a coherent digitally-driven strategy is first to answer how digital technology can enable your own individual strategy (such as by supporting growth through capturing new clients, or by managing efficiency through reducing costs), and enhance the investor experience. Thereafter, asset managers should prioritise those parts of the value chain where digital technology will potentially have the greatest impact. For example, this may involve:

- **Asset acquisition**: Firms with retail clients can use various new digital applications for improved integration with various social media streams. Among other advantages, this would enable them to mine customer data effectively for insights, and establish digital linkages with intermediaries to enhance servicing. On the institutional side, asset managers can experiment with automating marketing activities – such as launching drip campaigns automatically tailored to specific clients, or working with centralised cloud-based data repositories to analyse prospective client potential at any time.
- **Portfolio management**: Various emerging platforms allow for the sharing of the latest investment ideas and research subjects. Carefully whetting the same, asset managers pay a fee to link with these platforms and capitalise on crowd-sourced ideas to help shape their investment strategies. Some asset managers are even beginning to use advanced geo-satellite data feeds from parking lots of retail stores to make an assessment of growth momentum and other similar measures. For more details, please see our recent publication on digital portfolio management.
- **Asset administration**: An area particularly suited to digital technology is middle and back office processing. There is significant potential for asset managers to improve efficiencies and save costs by using cloud-based client reporting solutions. These solutions can then be shared with end clients to allow them to tailor reports and query specific areas of interest whenever they wish.

While most firms seem well-acquainted with these opportunities, we believe that the true managerial challenge for asset managers will lie elsewhere. In our opinion, to emerge as future winners, firms will have to answer two crucial questions:

1. How do I define my own **digital ecosystem**?
2. How can I **mobilise my organisation** to live and breathe digital?

The first question includes **defining your digital battlefield** as well as resolving the make-or-buy consideration. It goes without saying that digital will not mean the same to all asset managers. The answer will very much depend on your current footprint in terms of business mix (whether it is more retail or institutional), geography (the more tech-savvy Anglo-Saxon, Nordic, and developed Asian markets or the countries that lag somewhat behind) and the existing operating model (such as the degree of automation and the agility of IT/operations). In Asia, in particular, some players have begun making aggressive plays in the digital space; for example, DBS has partnered with IBM and is deploying its "Watson" cognitive computing platform to improve investor guidance and identify opportunities to improve asset allocation.

But even once you have decided that you want to go for, say, digital retail distribution (via robo or hybrid advice), or institutional client servicing, you will usually realise that the required capabilities are far beyond the traditional pedigree of an asset manager. At the same time, client needs and preferences will change so rapidly that what constitutes a competitive edge today will soon become a commodity. Therefore, rather than building the entire infrastructure internally, you may choose to work with technology partners for both front and back-end solutions, while focusing yourself on your core competence – superior investment management. When establishing your **digital ecosystem**, you should ensure that you meet the following criteria (see Exhibit 6).

EXHIBIT 6: DIGITAL ECOSYSTEMS: CRITERIA TO MEET

Scalable	Bionic	Accessible
• May sound trivial but is the most important aspect • Most digital ventures require huge upfront investments that make break-even difficult if you only apply to one specific market/segment/strategy • So build a nucleus that can be transferred to other opportunities with limited adjustment needs	• "Digital only" will become increasingly popular, but by no means become the only interaction channel with clients going forward • Therefore, smart digital solutions will also allow for multi-channel interactions, be it for personal advisors and/or portfolio managers or telephone/video/web chat tools	• Largely underestimated compared to traditional (mainly retail) banking • Asset managers may also profit from creating interfaces to third-parties via API or similar techniques • Internalize external innovation and be able to plug in innovative solutions "not invented here"

Although full of promise, embracing digital technology presents its own challenges, such as the significant investments required to deliver intended outputs. Given the fast pace of change, these deliverables run the risk of being out of date by the time they are implemented. It is therefore imperative that asset managers abandon their traditional, gradualist mindset to managing change, and instead adopt a more agile approach, including the following key building blocks:

- **Create awareness**: This typically starts with an analysis of your current **"digital readiness"**, not only as an institution, but also focusing on the individuals at an executive and operating level. Assuming that there are gaps between where you are and where you want to be, it is crucially important to make employees understand both the challenge, and especially the opportunities arising from digitalisation. A satisfactory answer to the question "what is in it for us and for me?" can ultimately win both the **hearts and minds** of the employees affected by change.
- **Build internal structures**: Some firms have started to break up existing structures, and replace them with specific **innovation tribes** with front-to-back responsibility. One tribe may, for example, be in charge of redefining the offering for a specific market in the digital environment, and work with mixed teams across functions to overcome silo thinking, make full use of innovative ideas and improve time to market. Other companies have enjoyed success with setting up a central **innovation engine** responsible for strategy, organisation and delivery.
- **Change behaviour**: Last, but clearly not least, you need to ensure that your employees live up to the digital challenge. In some cases this may even require injecting new talent from outside (including adjusting your own recruitment value proposition), but more frequently it involves changing individual behaviour. Empirical evidence shows that such rewiring of minds does not happen overnight and cannot be achieved by a simple decision to change. It should be considered an **adaptation process** rather than an event, spanning experimentation and reinforcement, trying to do things in a new way and promoting success through repetition. Leaders will contribute not only by providing positive feedback, but by being active **role models** for digital change.

3. IMPROVE MANAGEMENT OF IT INVESTMENTS

Driving growth in today's volatile environment requires an IT function that can be flexible and agile. Many asset managers indicate that they appreciate the importance of IT as being critical to their operating model's success, but also recognise the challenge of building and maintaining a function that can keep pace with the fast-changing environment, while still being cost-effective. Re-evaluating current IT expenditure is vitally important in ensuring that investment is directed to future growth engines (for example, in developing digital capabilities).

*"I think we have a very solid technology infrastructure,
and our opportunities lie in how we can leverage this going forward"*
– North American Asset Manager

Managing IT investments also enhances time to market and agility, while architecture modularisation and agile methods act to reinforce the impact of IT investment management.

To address this complex challenge, we believe asset managers must **build a zero-based IT cost transformation journey by defining IT organisational goals on all dimensions, and by simplifying the asset management front-office application landscape.**

To accomplish this, we follow three principles that we believe can help asset managers extract the most of out of their IT functions:

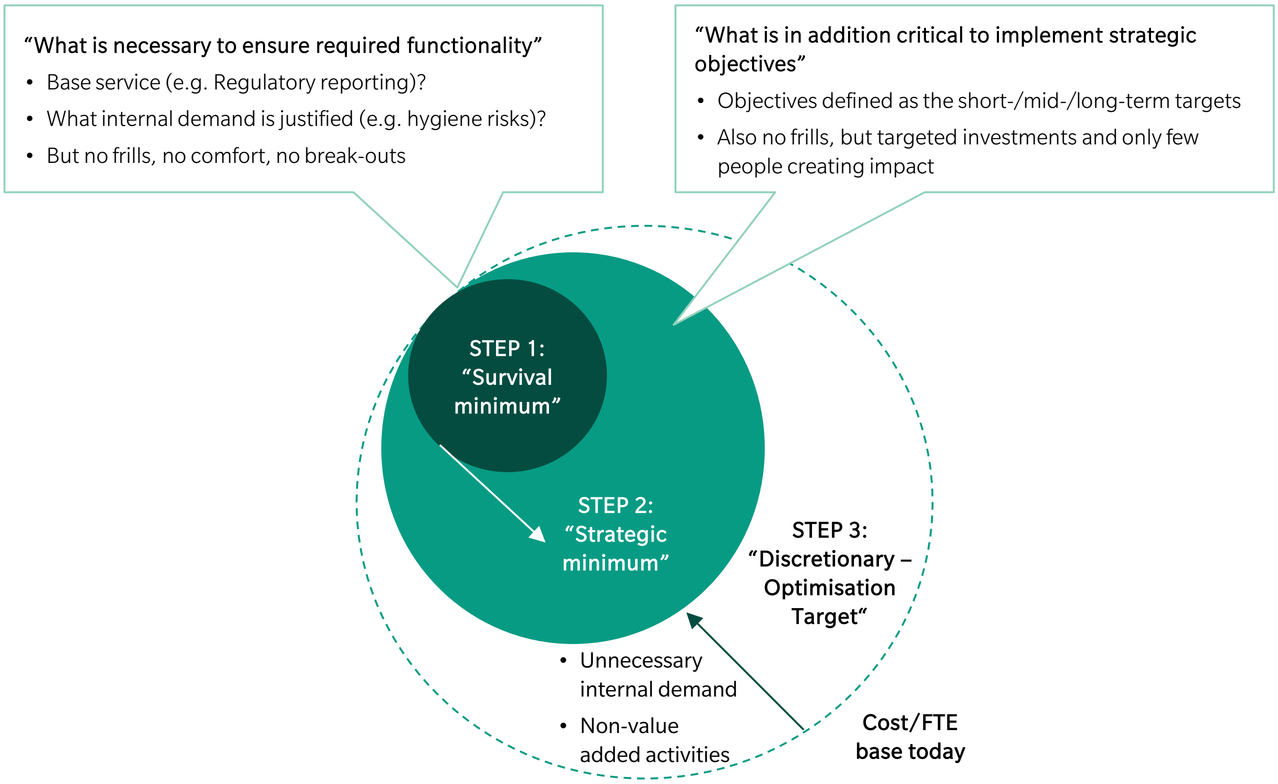
Build cost transparency

- A series of questions should be raised and systematically answered to create transparency relating to the drivers and the evolution of costs (i.e. those business units most impacted by expenditure, the type of cost being incurred (fixed or variable), the nature of the cost drivers (external or internal), and how costs are being split (project or administrative)).
- Identifying the real cost drivers would enable more efficient allocation of IT expenditure to all departments (including front, middle and back office), and ensure a common and clear understanding of who commissions what type and what proportion of expenditure. This would lead to appropriate scrutiny, with assigned responsibility for any proposed IT investment, thereby minimising wasteful effort and expenditure.

Conduct a zero-based assessment of costs

- We believe the most efficient way to optimise costs is through a zero-based cost approach. This would involve asset managers reviewing their IT expenditure and segmenting it according to the following categories: a) critical for survival, b) strategic minimum, c) discretionary – target for optimisation.
- The discipline imposed by zero-based costing (see Exhibit 7) will force asset managers to review all spending (not simply incremental annual expenditure). This review would involve the need to justify every expense item and assess the frequency with which should they be allocated, and would also provoke discussion about what should be retained and what should be outsourced.

EXHIBIT 7: OLIVER WYMAN APPROACH TO ZERO-BASED COSTING



Convert fixed costs to variable

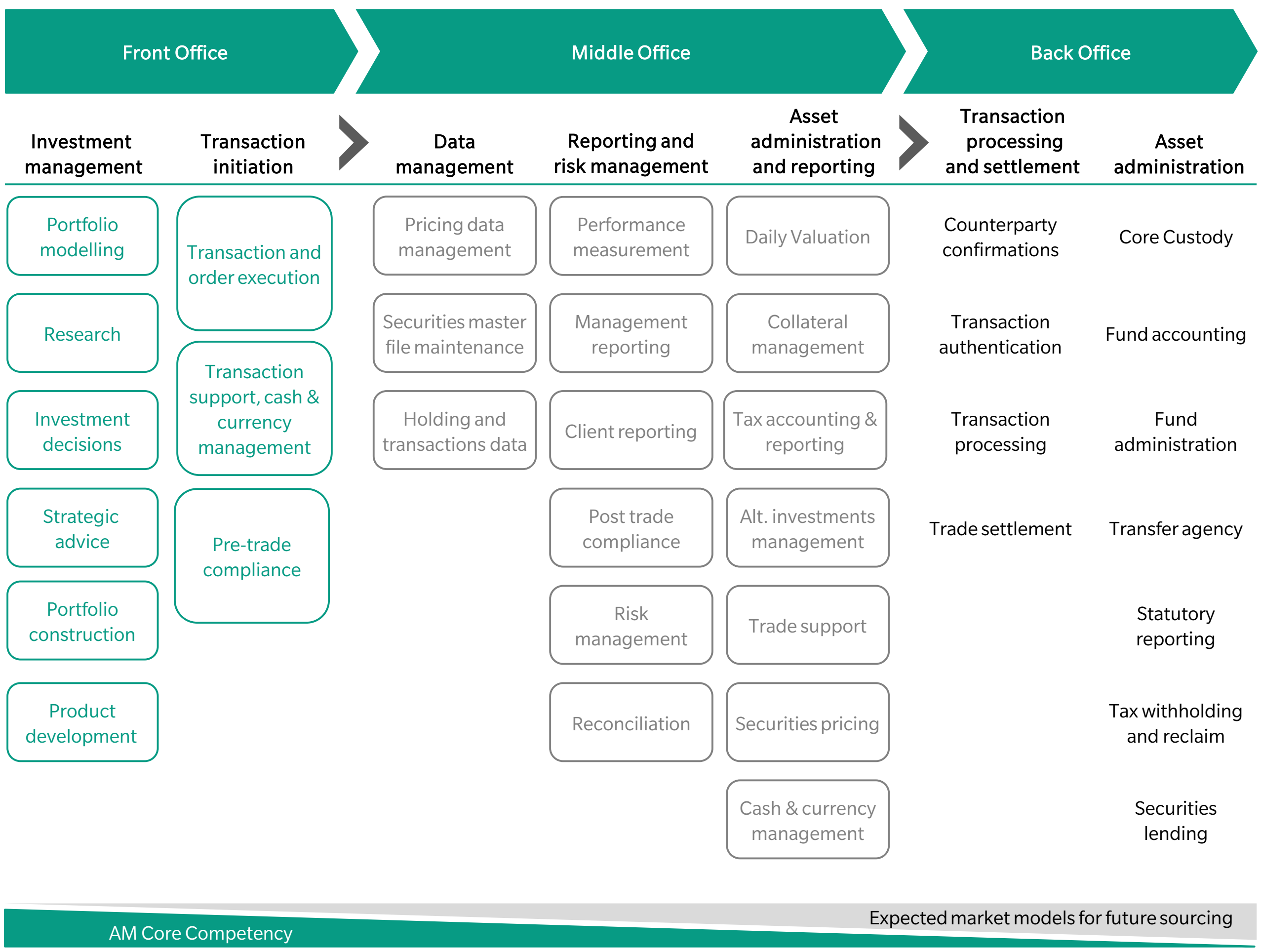
- Finally, to retain agility in response to dynamic market conditions, IT departments must adopt a rigorous approach for assessing which functions can be outsourced. This could convert fixed to variable costs, providing asset managers significant flexibility in adapting to a fast-moving environment.

The principles outlined above should help executives to spend less on IT. It will also enable them to direct expenditure in a way that not only improves efficiencies, but positions the business for continued growth in a volatile environment. Our empirical research suggests that rigorously managing IT in either a run-the-business or change-the-business environment can reap substantial rewards. For very large projects, such management can reduce costs by up to 30%, and for more standard projects, it can cut them on average by 10–20%. Furthermore, it ensures that business owners actually extract value, for example by enhancing their top-line growth. In a recent example for a financial services institution, we realised run-the-business savings of around 30% of the baseline.

4. RE-EVALUATE OUTSOURCING PRIORITIES

With potentially significant benefits but a long history of failed attempts, outsourcing continues to be one of the most relevant management topics within the asset management industry. Asset managers must become more strategic and proactive in using outsourcing effectively if they are to operate efficiently and competitively. Traditional outsourcing arrangements suggest the following models are prevalent within the marketplace (see Exhibit 8):

EXHIBIT 8: ASSET MANAGEMENT OUTSOURCING OPPORTUNITIES



Purely back-office outsourcing:

- Traditional focus on outsourcing the entire suite of back office operations (such as custody, fund accounting and transfer agency)
- Asset managers concentrate on core competencies and retain control over middle office activities

Hybrid middle office outsourcing:

- Back office functions outsourced
- Selective outsourcing of middle office activities – such as client reporting, tax accounting and reporting, collateral management and valuation

Complete back and middle office outsourcing:

- Back office functions outsourced
- Most middle office activities outsourced – including post-trade compliance, pricing data management, performance measurement (over and above the hybrid model)

However, our discussions suggest that asset managers are broadening their perspective and looking beyond transactional back and middle office activities, to review potential in the traditionally off-limits front office.

Our discussions with asset managers suggest that parts of the front office, such as pre-trade compliance, commoditised trade execution, and cash and currency management, are now believed to be administered more effectively and efficiently by third-party outsourcing companies.

By focusing on their core business of investing, the asset managers we spoke to expect to add maximum value in what they do best, while also achieving collateral benefits. Such benefits would include improved execution, extended dealing hours and proximity to markets due to the service provider's multiple locations, as well as potential access to the more up-to-date systems of the service providers. As this is their core business, there is a higher chance that service providers will invest in front-office operational infrastructure.

"Asset managers are at a crossroads. The search for yield is getting increasingly complex, requiring focus on new asset classes and geographies, and putting pressure on the front office to find more specialist expertise"
– European Asset Manager

While we believe there to be significant potential in asset managers extending their outsourcing relationships, it is nevertheless imperative that they approach outsourcing in a strategic manner. There is no one-size-fits-all strategy when it comes to using outsourcing effectively, and asset managers must select the right functions to outsource if they are to operate efficiently and stay competitive.

Too often, we find that apart from the goal of wanting to reduce costs and employ resources better, asset managers have only vague notions of the outsourcing process and their objectives. In defining an appropriate outsourcing strategy, while heeding the failed attempts during the era between two financial crises (2001–2009), here are some key considerations we ask asset managers to take into account:

- Follow a fact-based approach on the **"what"** and **"why"** of outsourcing – define what you want to achieve where, and ensure your outsourcing strategy is aligned to your overall strategic and operational vision and goals.
- **"How"** – define a consistent and well-integrated outsourcing and vendor model (selective or broad; straight outsourcing versus joint venture or captive company); pinpoint the benefits you seek to achieve from your outsourcing decisions (such as efficiency, cost or simplified operations); decide on a timeline for the above.
- **"With whom"** – Consider the **realities of vendor capabilities and economics** in advance. If there are doubts, work together with vendors to create any capabilities that are currently lacking, and review the outsourcing

market's potential to meet your specific requirements, both current as well as those which may arise from potential future growth.

- **Ensure a well-designed and managed transition phase** – Consider how to preserve and control internal expertise. Assess the long-term economics of an external sourcing arrangement, and ensure that shareholder value will not be destroyed.
- Define and contractually agree a robust **post-transition service model** early on. Consider the preferences of the end client, the existing infrastructure and your unique strengths and weaknesses, before assessing key functions that are most suited for outsourcing, and those for being retained in-house.

"The outsourced shared services organisation is a phenomenal way of governing and is cost-efficient, but in our experience can be inefficient and value destroying if it becomes a bottleneck or staff feel too far away from the customers"
– North American Asset Manager

5. REPURPOSE THE TRADE EXECUTION TEAM

The importance of efficient trade execution in the current global financial markets cannot be overstated.

Firms that plan on succeeding in the new world will need to leverage the expertise and capabilities of their trade execution professionals, especially given the magnitude of regulatory changes in the financial services industry and the potential liquidity issues asset managers may face in the coming years.

The impact of new regulations, such as the Dodd-Frank Act (DFA) in the US, and Markets in Financial Instruments and Derivatives (MiFID II) and European Market Infrastructure Regulation (EMIR) in Europe, will affect capital market participants in unprecedented ways. These regulatory regimes will change global markets, transforming market infrastructure, the scope of available products and distribution channels, as well as creating new trade execution processes.

The second major influence on operations and processes is the liquidity challenge presented, for example, by the interest rate and credit markets. This factor, coupled with the continued consolidation of sell-side players, has led to a shortage of liquidity in the market which, in all likelihood, mostly affects fixed-income instruments initially.

While these developments are worrying, they are not currently threatening the core business, given the current monetary stance of global central banks. Central bank policies have supplied unprecedented liquidity to the market. As a result, net cash inflows into asset manager bond funds have been robust, and asset managers have not lacked attractive investment opportunities. However, the lack of liquidity is already affecting asset managers. Prices are becoming more volatile, Alpha is becoming more difficult to achieve due to the lack of investment opportunities in specific areas, and spreads are widening with a resulting impact on fund performance.

As central banks around the globe begin to revert to more normal monetary policies, this topic is likely to become a major issue for asset managers. This is especially true for the retail business side, where liquidity (that is to say, immediate redemptions) is core to the value proposition. Institutional investors, on the other hand, are more knowledgeable of market conditions, and understand that liquidity will come at a price when it is in short supply.

Consequently, as monetary policy returns to normal and market conditions change, trade execution will become more important to the asset management operating model. The upcoming challenge includes a balanced management of liquidity for both sides: asset liquidity and liability (funding) liquidity.

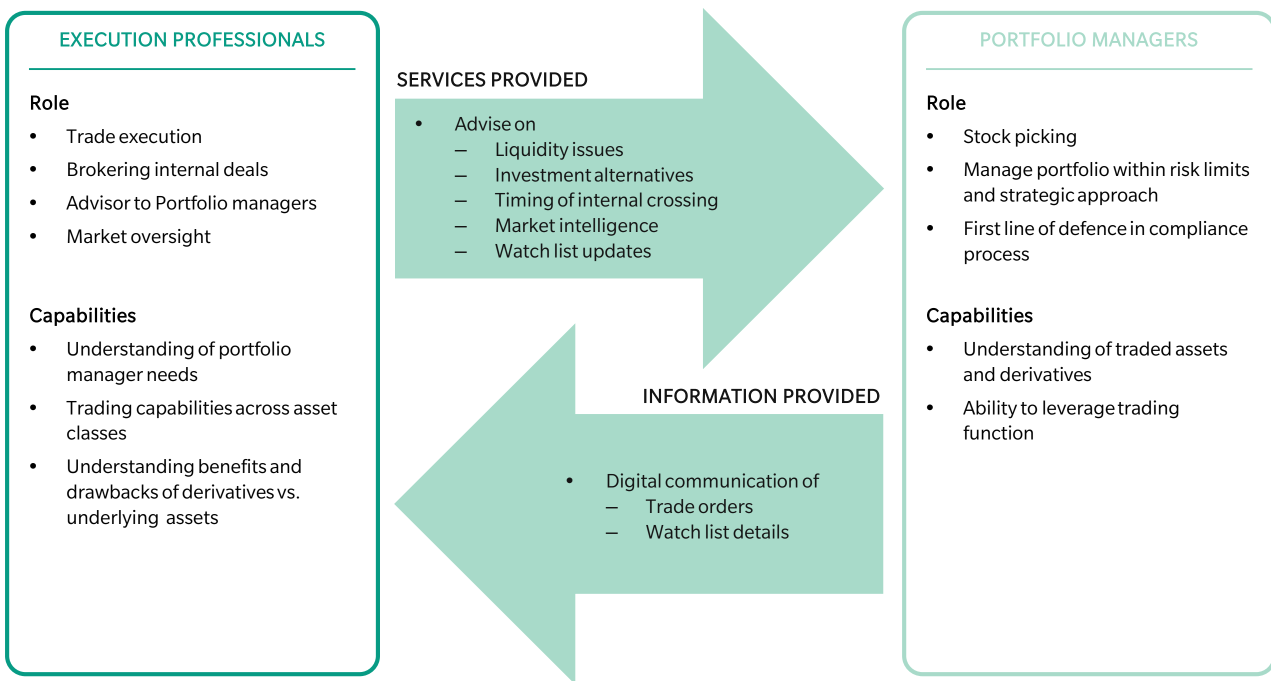
Until recently, executing trades after an investment decision was regarded as an ancillary support service, little more than a technical afterthought. But given the new market structure, liquidity challenge and enabling technology, trade execution has become an opportunity to add value to the firm or, alternatively, to extract value from it. Early adopters have well-structured, centralised execution teams with differentiated processes, depending on ticket size, complexity and counterparty risk.

To manage the regulatory response and liquidity challenge and to turn execution into a competitive advantage, asset managers must change their methods of working.

A first step, as a result of regulatory requirements, is that asset managers should look to redefine and specifically separate the roles and responsibilities of portfolio managers and trade execution professionals (see Exhibit 9), and agree on the services and information each must provide to the other.

Execution professionals should conduct all trades, and serve as a source of market intelligence to portfolio managers. Moreover, execution professionals should offer portfolio managers alternative investments in case of liquidity issues, advise on the timing of a deal and be the source of broader market intelligence. Portfolio managers, on the other hand, should focus on stock selection, managing portfolios within risk limits, and acting as the first line of defence.

EXHIBIT 9: SEPARATING ROLES AND RESPONSIBILITIES OF EXECUTION PROFESSIONALS AND PORTFOLIO MANAGERS



Our market interviews confirm that asset managers have begun to exploit the potential of the execution desk by making their role more focused on the advisory aspect, rather than simply implementing trades for portfolio managers. The increased cooperation between the two teams is enabling asset managers to stay ahead of the curve by being better positioned to take advantage of emerging investment trends and strategies.

"Our execution professionals frequently find deals which they inform portfolio managers about so they can match it with their investment strategies and approve the deal"
– US Financial Services Firm

Furthermore, going beyond regulatory demands, asset managers should look to review the organisation of the execution function to enact further efficiencies and consider the following principles:

- **Segment requirements by type of trades**: Differentiate between complex high-touch trades and standardised, or commoditised, trades that can be executed with little or no manual intervention. The high-touch desk should also act as internal adviser to the portfolio managers, providing market intelligence on liquidity situations, alternative investment structures (derivatives) and internal crossing opportunities. Commoditised trading, on the other hand, should enhance the focus on algorithmic and direct market access trades, and ensure a streamlined and automated process.

- Our client discussions suggest that a few asset managers are leading the rest, having effectively separated execution desks according to the complexity of trades handled. This has enabled a nuanced management focus, improving the asset manager's ability to capitalise on investment trends.

"To increase the potential of our execution professionals, we have instituted a separate mechanism for larger and more complex trades versus the smaller ticket items"
–North American Asset Manager

- **Develop tailored location strategy** – Set up a centralised organisation of execution professionals for commoditised trades across asset classes to produce benefits of scale, while establishing pockets of expertise for high-touch trades, located in close proximity to portfolio managers.
- **Consider outsourcing opportunities** – Supplement potential efficiencies from the execution function by reviewing opportunities to outsource the commoditised execution desk (see Section 4).

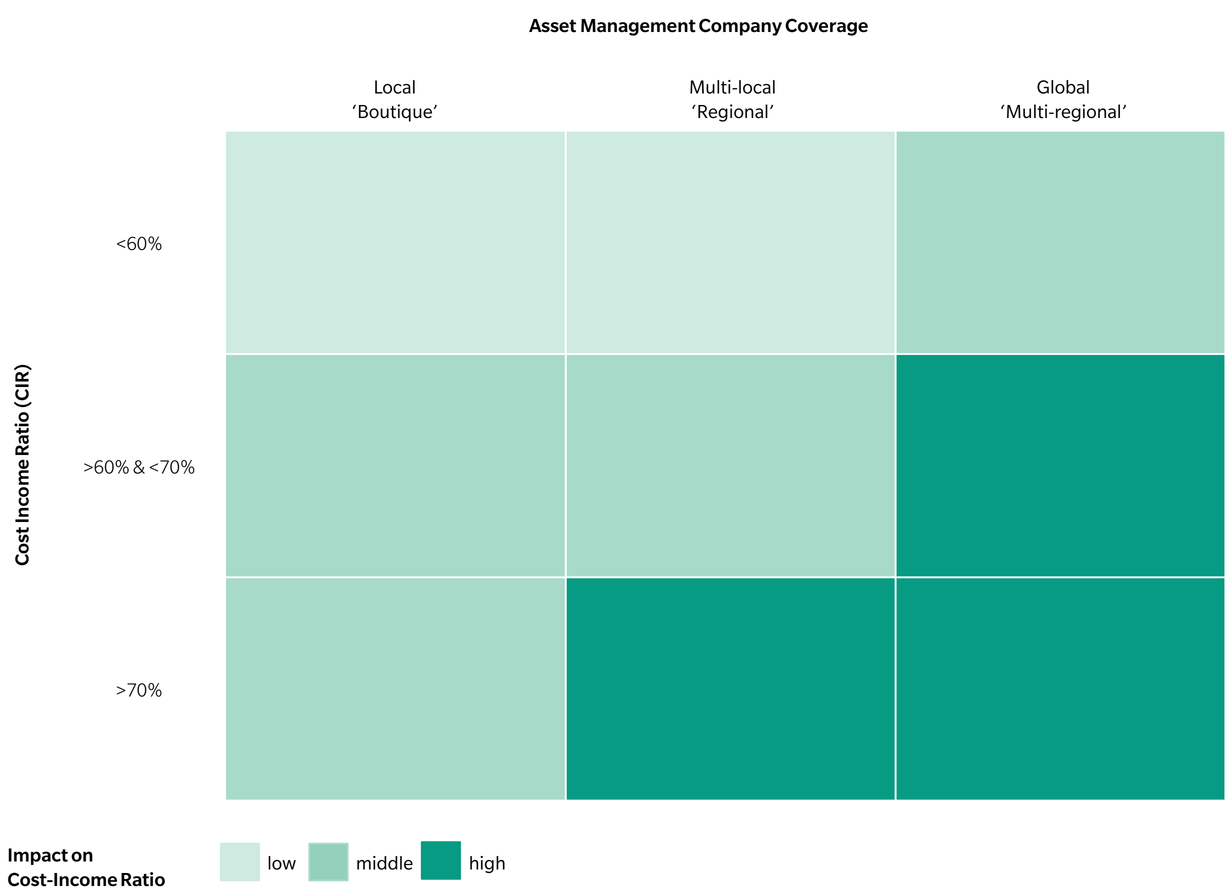
CONCLUSION

Due to regulatory changes, a global return to less expansive monetary policies and competitive pressures from the entry of new and innovative players, asset management is entering a new era. The older model, which once served asset managers well, now needs to become more efficient and be reinvented. But, ultimately, why should you bother to focus on these imperatives? Is refining your operating model just another "L'art pour l'art" exercise proclaimed by consultants? No - we are convinced that this issue will have a significant economic impact for asset managers. Failure to address it could have highly damaging consequences, particularly in the event of a major external shock.

While the exact impact will depend on both the efficiency of your existing franchise (measured in cost/income ratio terms) and the complexity of your operating model (see Exhibit 10), we envisage a difference – all other things being equal - in the range of higher single-digit percentage points between the best and the worst performers. Such benefits for early and stringent adopters will not only involve actual cost reductions relative to the current baseline. Just as importantly, future cost uplifts will be avoided as your business grows and capitalises on new areas for expansion.

It may seem obvious that truly international, or even global, asset managers have the greatest potential to capture efficiency gains from revisiting their operating models. When it comes to multi-local and regional houses, the picture is more complex. While regional asset managers have more levers at their disposal than local boutiques (for example, they can expand their network to more countries or arbitrage between workforce locations), they also have to deal with greater complexity with regard to local regulations that differ between countries. Therefore, we expect the overall impact to be similar, even though they are affected by different forces.

EXHIBIT 10: INDICATIVE IMPACT OF OPERATING MODEL RE-DESIGN ON CIR OF ASSET MANAGERS



In doing so, our market experience and insights from leading global asset managers suggest focusing on five key imperatives:

- **Recognise data as a competitive advantage**: Data quality has emerged as a key challenge facing asset managers. It is imperative that asset managers develop comprehensive data management standards and a robust governance framework to deal with this challenge. Firms that can succeed in producing quality data will thrive in the coming era of Big Data and analytics. Those that fail will not only lose the opportunity to understand clients better, but will risk penalties and reputational damage.
- **Embrace the digital opportunity**: New FinTech players are beginning to challenge the traditional asset management model by using a digitally powered omni-channel approach, leveraging Big Data analytics, and other innovative approaches. We believe the key to developing a coherent digital strategy involves not only defining your own digital priorities, but also agreeing the appropriate delivery model and ensuring that employees are committed to building the necessary digital capabilities.
- **Improve the management of IT investments**: A nimble and agile IT function is key to creating growth in today's volatile environment. To boost efficiencies in their IT teams, asset managers must work relentlessly towards making costs transparent to relevant business units, focus on identifying and challenging discretionary expenditure (using techniques such as zero-based costing) and aim to convert fixed costs to variable.
- **Re-evaluate outsourcing priorities**: Too often, we find that apart from the goal of wanting to reduce costs and employ resources more efficiently, asset managers have only vague notions of the outsourcing process and its objectives. Asset managers must become more strategic and proactive in using outsourcing effectively if they are to operate efficiently and competitively.
- **Redefine the role of the execution professionals**: To achieve success in the new world, firms will need to exploit the expertise and capabilities of their trade execution professionals, especially given the impact of regulatory changes on the financial services industry and the potential liquidity issues asset managers may face in the coming years.

While obviously asset managers will and should continuously revisit their strategies and business models, we believe that significant potential can be unlocked by adapting operating models along the main levers as described above. This will not be a simple task to achieve, but should prove highly beneficial in the mid to long term, not only by improving economics, but even more so by gaining flexibility to react quickly in a highly volatile environment.

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation.

For more information please contact the marketing department by email at info-FS@oliverwyman.com or by phone at one of the following locations:

EMEA
+44 20 7333 8333

AMERICAS
+1 212 541 8100

ASIA PACIFIC
+65 6510 9700

ABOUT THE AUTHORS

Matthias Hübner is a Partner in Oliver Wyman's Wealth and Asset Management Practice
matthias.huebner@oliverwyman.com

Samir Misra is a Partner in Oliver Wyman's Wealth and Asset Management Practice
samir.misra@oliverwyman.com

Gökhan Öztürk is a Partner in Oliver Wyman's Strategic IT and Operations Practice
gokhan.ozturk@oliverwyman.com

Robert Urtheil is a Partner in Oliver Wyman's Corporate and Institutional Banking Practice
robert.urtheil@oliverwyman.com

www.oliverwyman.com

OLIVER WYMAN