Charting a course for the Irish asset management industry

KPMG in Ireland

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About this report

Over the past 30 years, Ireland has developed into a significant funds centre on the international stage with €6.6bn in total assets under management and over 8k Irish domiciled funds as of December 2021[1].

In this report we take stock of the industry, identify key emerging trends and outline what it means for asset managers, hedge funds and securities services providers.

In order to do this, we carried out a survey of 100 industry participants across geographies and organisation types (collection date: 17 November – 6 December 2021) and also interviewed a range of industry leaders from major firms to bring a rounded view of the market.

[1]Irish Funds Industry Statistics, February 2022

Further outsourcing of the front, middle and back office will be a key market trend over the coming years. In particular there are opportunities for asset servicers to move further into front office activity, which has the added advantage of enabling access to the C-suite.

Senior Vice President, Asset servicing division of major US bank

The global asset management sector is evolving at pace. Digitisation, advances in data and analytics, and shifting client expectations will require firms to reinvent operating models, customer relationships, and value chains. Ireland's asset management industry, which focuses primarily on securities services, will need to anticipate these trends in order to defend and grow international market share.

A landscape of change

Globally, asset management is already experiencing significant disruption from an array of trends, technological, commercial, and regulatory with the pandemic crystallising the need for asset managers to become more resilient, agile and flexible in an increasingly challenging environment. All parties are under huge pressure, whether they know it or not, to embrace rising digital expectations and evolving working practices, as well as investor demands for ESG, passive strategies, and alternative assets.

Specifically, we identify eight significant trends that all players need to be conscious of:

01. Data and analytics

The effective use of data is becoming a key differentiator in the market with clients expecting real-time data at their fingertips. Insights for asset managers may include assessing how market conditions impact investment decisions or enabling automated trade surveillance.

02. Digital Assets

Whilst they have been perceived as high-risk, major industry players are beginning to serve this market, often via partnerships with smaller niche providers. As interest continues to grow, asset managers that lack the capability to handle digital assets risk looking behind the curve.

03. ESG

Fast-growing investor appetites for ESG-linked products are driving innovation in the market as well as a dynamic regulatory response. In this highly complex and fluid area, there are huge opportunities for players to distil the aspirations of the movement into actionable and verifiable strategies and products.

04. Blockchain

Whilst its profile has risen, distributed ledger technology's real-world use cases remain underexploited in asset management, where it offers the potential to address important challenges faced by asset servicers, such as inefficiencies caused by mismanaged data, or transparency for stakeholders across the lifecycle of trades

05. Technology transformation

Advancements in technology should improve both internal processes to increase efficiencies (e.g. AI, robotic process automation) and reduce costs as well as improving client-facing platforms. Slick platforms for retail investors are now the norm and institutional investors now expect the same ease of use.

06. Outsourcing

As asset managers seek to reduce costs and keep their focus on investment decisions, a greater proportion of their activities (including traditional front office tasks) will be outsourced, presenting opportunities for securities services firms. The Central Bank of Ireland is strongly focused on outsourcing given its prevalence in the financial services industry and asset managers need to be able to demonstrate strong outsourcing governance arrangements.

07. Margin compression

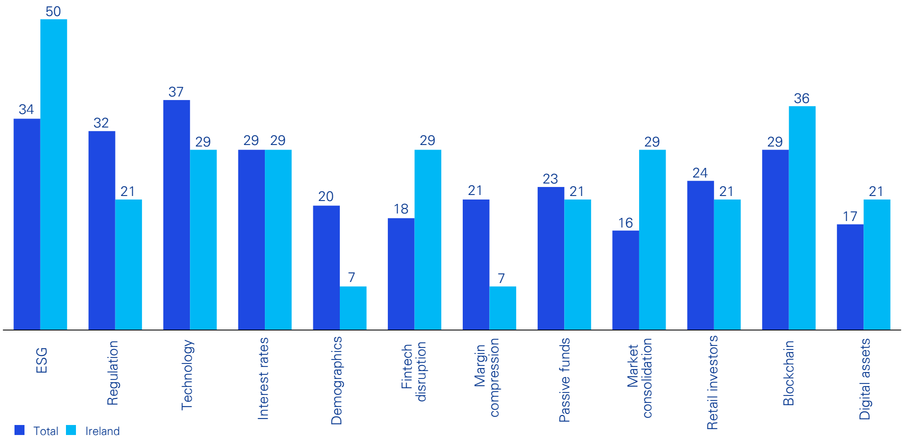
Investor expectations, market competition and the shift from active to passive investment strategies has led to the erosion of profit margins for many asset managers with an associated downstream impact on service providers.

08. Market consolidation

The need for scale as a result of regulatory cost pressures and margin compression will continue to drive consolidation in the market as smaller players struggle to compete. The aggressive growth strategies of some privately owned players are also a factor.

Which of these trends appears most significant will likely depend on your position in the market. According to our research, for instance, it is noteworthy that whilst asset managers see technology as a key driver of change, hedge funds consider regulation, interest rates, and prominence of retail investors as the key factors. At the same time, securities services providers consider passive funds and demographics as the main drivers of market evolution, whereas for market influencers, ESG is the key theme. Furthermore, a greater proportion of respondents from the Irish market consider ESG to be a key driver of change versus other jurisdictions. What is certain is that no market player will be exempt from the winds of change.

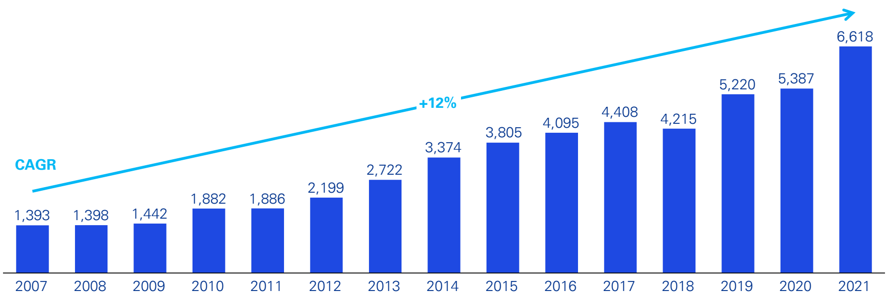
Survey question: Which of the following will act as the key drivers of change in the asset management industry over the next 3-5 years (% of respondents in each category)



Ireland's place in the ecosystem: servicing dominant

Ireland holds an enviable position in the broader European landscape; over 1,000 fund managers from 50+ countries have assets administered in Ireland whilst 17 of the top 20 global asset managers have Irish-domiciled funds, a consequence of Ireland's transparency, emphasis on investor protection, tax efficiency and excellent human resources. Ireland has especially established itself as a centre for UCITS and AIFs, with particular expertise in hedge fund servicing and ETFs, a feature shared by its closest European competitor, Luxembourg.

Total assets under administration in Ireland, €bn



Crucial differences of emphasis distinguish the two markets, with Ireland's strength in alternatives contrasting with Luxembourg's focus on more traditional stocks and bonds, and Ireland's geographical skew towards US promoters versus Luxembourg's greater appeal to European asset managers

"Asset servicing is increasingly a scale game as a result of lowering margins, costs constraints, particularly the regulatory impact. The other option is to be small and excellent at a particular niche."

Senior business development executive at leading US headquartered asset servicing firm

"The alternative hedge fund market is mature but private assets are less so and significant opportunities exist. At an industry level, Ireland is in a position to take advantage of this."

Declan Quilligan, Head of Hedge Funds Services, Citco Fund Services (Ireland) Limited

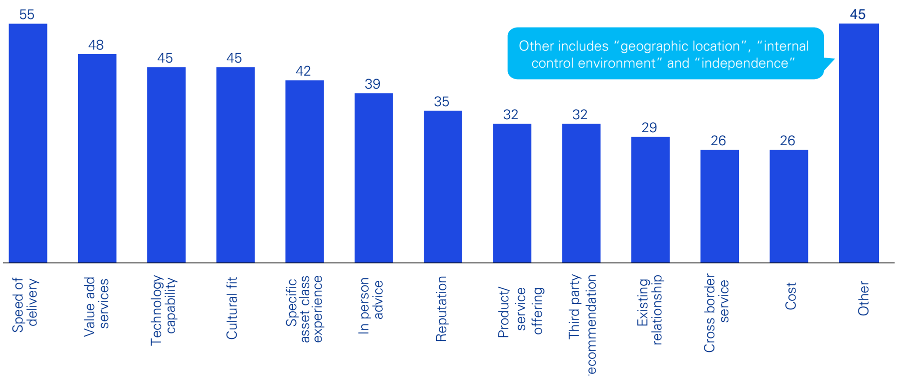
"Opportunities arise for competing securities services providers when the legacy incumbents cannot service a particular product or provide sufficient resources at short notice."

Senior institutional investor, Global asset manager

Adaptation and opportunity

We have led extensive research via interviews with global asset managers and other major financial institutions, based on which we identify a small number of important factors that managers are looking for when choosing asset servicers. Speed, cultural fit, technology, product provision, value added services including insights and data, and relevant experience with value-added specific asset classes are all highly valued, whilst geographic location is seen as relatively trivial.

Which of the following were the most important factors when choosing your securities services providers (% of respondents in each category)?



So what does successful adaptation look like? In Ireland, we see four main areas of focus:

- Embedding ESG across the investment approach
- Responding to an evolving risk and regulatory landscape
- Accelerating digital and technology uptake
- Redefining business and operating models

ESG

The prevalence of ESG – whether in the form of green or blue bonds, direct environmental investments in difficult sectors such as shipping and infrastructure or social impact investing – can hardly be overstated, with some analysts projecting that global ESG assets could exceed USD53tr by 2025. We expect a new generation of investors to continue to fuel demand for responsible investment, with around half of millennial millionaires claiming to make investment decisions based on social factors, and USD400bn estimated growth in ESG ETFs over the coming decade.

These trends will transform ESG from a marketing tool to a fundamental component of core strategy, which will have to be embraced across all aspects of any asset management business. Those players who are able to simplify the vague promises and aspirations of the trend into clear, understandable, actionable and verifiable strategies, stand to gain huge rewards. Meanwhile, those that fail to manage the direct impact of ESG-related regulation on their operating models, or who cannot articulate the ESG impact of their investments, will likely suffer. All players will need to demonstrate a strategic and proactive approach to ESG investing principles, and ESG-related communications will need to be supported by credible, robust and accessible data.

> **From an EU perspective geography has very little influence on which service providers asset managers use. Key success factors for winning business are technology, product set, proven skill set, quality of people and being able to deliver an end-to- end client relationship that brings in all parts of the business. Ultimately it is about who will provide the best service.**
>
> **Global Business Unit Head, Securities Services Division, UK Headquarted Global Bank**

Regulatory environment

Whilst regulators want to encourage recovery and growth, they also want to ensure that it happens in a controlled way that protects financial stability and takes greater care of customers. Firms across asset management will be expected to ensure that all technology is safe as well as delivering benefits, and that firms put investor interests before their own. To align with these principles, the industry will see real evolution of the regulatory landscape in the coming years, with both European and domestic rulemaking creating a range of impacts, including:

- Irish Fund Service Providers can expect supervision to become more data-driven, agile and scalable, with the potential for demands on higher-quality regulatory reporting as a result
- Increasing PRISM ratings for many funds, with consequences for the resources and technical capacity of fund service providers as managers demand a higher degree of engagement with delegates
- Peer benchmarking on a pan-EU basis will result in higher expectations being placed on Fund Service Providers' AML/CFT programmes
- As a result of the EC's proposed changes to AIFMD, as well as the need for further regulatory alignment of UCITS to AIFMD, there is likely to be a direct and indirect impact on securities services providers in the medium term, with pressure placed on resourcing, technology and implementation costs
- Changes to macroprudential framework for investment funds likely to focus on leverage and liquidity

Digital

It is clear from our research that asset management as an industry has been slow to digitise, relying on scale and ignoring technological trends whilst other FS sectors have been grasping the technology nettle to speed processes, amplify client contact, and mine actionable insights. The range of potential technology investments can be overwhelming, but in our view the main opportunities for asset managers can be found in data analysis and client relationship improvement. Automation and AI will proliferate, enhancing digital channels and improving the investor experience. All players need to think hard about which of these opportunities they need to focus on, all whilst delivering fail-proof cyber security. In particular, the ability to deliver value-add insights through data will be a key differentiator, with securities servicer providers across the board recognising this as a key area for improvement.

Redefining business and operating models

Players across the ecosystem need the agility to transform business and operating models to become more resilient in a challenging environment. In part this is a recapitulation of the need to embrace digital operations and client interactions, but it also requires managers to consider resilience of the supply chain and third party due diligence, as well as market position in an evolving market and what partnerships (i.e. with FinTechs) are appropriate. Our research suggests for instance that there may be opportunities for securities services in tax accounting, trade support and pre-trade compliance, in the context of outsourcing activity from the front, middle and back office of asset managers in the 3-5 years ahead.

> **“From a broader industry perspective, flexibility hinders Ireland in comparison to Luxembourg. The new ILP structure is not selling and took significantly longer to get central bank approval than expected.”**
>
> **Senior Vice President, Asset servicing division of major US bank**

> **“The market is developing too quickly to build technology in-house. Instead you need to partner and iterate quickly, particularly in new areas of the market such as digital assets.”**
>
> **Executive Director, major US universal bank**

Conclusion

Asset management has emerged strongly from the pandemic but will experience major global redistribution in the decade ahead as a range of important trends assert themselves. All players need to understand now which trends are most relevant to them, and what operational and strategic responses are appropriate.
We conclude with some key considerations by stakeholder type:

Asset Managers/Hedge Funds

- Expedite digital solutions and emerging technologies to enhance client relationships, process efficiency, and insight provision
- Consider partnerships with established digital native companies or startups to accelerate technological development
- Identify partners to co-develop and distribute products and services to advisors and retail investors
- Identify strategic position in evolving market

Securities Services Providers

- Focus on providing insights through data as a means of differentiation
- Consider M&A to achieve scale or concentrate on niches
- Don't underestimate the impact that cultural factors can have on winning mandates
- Bring the full value of the wider organisation to your clients
- There is a growing need to service digital assets – don't miss the boat on this opportunity

Irish Policy makers

- Ensure new Irish Limited Partnership (ILP) structure becomes a key part of Ireland's overall value proposition, enabling the country to compete effectively in the private funds market currently dominated by Luxembourg
- Promote asset management as cornerstone of Ireland's FDI success story, targeting greater traction with European and Asian headquartered players
- Ensure skill-set of emerging Irish workforce is capable of meeting new industry demand in relation to digital, data, ESG and front office activities

> **The Irish market is currently heavily weighted towards institutions. Beyond the 5-year horizon, servicing retail investors will be the key growth area. This cohort are costly to serve and the regulatory burden is only likely to increase. The winners will be those that can present a very simple, intuitive proposition to the retail investor.**
>
> **Adrian Whelan, Global Head of Regulatory Intelligence, Brown Brothers Harriman**

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