KPMG

cutting through complexity

Investment management

Seeking alpha in business transformation

kpmg.com


4,940
10,791
68,051
701
6,971
196,804
801
$5,741
11,476
18,268
$226,548
$110,290
11,720
73,089

A letter to our readers

The investment management industry has profited richly from a bull market in U.S. equities, now in its fifth year, an extraordinarily accommodative Federal Reserve monetary policy, and consistent economic growth. At the same time, investment managers are finding themselves navigating increasingly choppy waters because of the sea changes roiling their industry.

Yes, profits are up, but so are costs. Similar to banks, investment managers are grappling with a raft of new regulatory compliance and reporting requirements introduced by the U.S. Dodd-Frank Act, and U.S. and U.K. regulators, wary of the risks that the asset management industry poses to financial systems, are currently deliberating over whether to pile on more regulations.

Meanwhile, retail and institutional fund holders are demanding greater variety from investment managers in the way of investment options, but seem unwilling to pay higher fees for more innovative offerings. Also, the migration of clients into lower-cost, passively managed funds has hurt industry profit margins.

This one-two punch of higher regulatory compliance costs and escalating client demands is pushing the investment management sector toward an inflection point. Its business model is changing and, in response, industry participants are under pressure to redesign their operating models.

Investment management firms have said they will adapt to this marketplace evolution by growing their businesses, either through product diversification or geographic expansion. However, the growth these firms are seeking could prove elusive, unless their top-level executives put in place operating models that adequately address a wide range of formidable problems.

In this paper, we discuss eight steps investment managers can take to increase the odds that they will succeed in transforming their businesses. These steps, each of which we discuss in detail, are designed to tackle the following industry-wide problems: deficient information technology systems, duplicative business processes, employee resistance to change, ineffective data supply chain management, flawed data architecture strategies, data deluge, poor-quality analytics, and the marginalization of risk and compliance reporting functions.

In aggregate, these prescriptions are designed to remodel investment management firms so they can actually grow profits aggressively, expand geographically, diversify product-wise, and withstand the test of time. These recommended measures all circle back to the same premise, in that they advocate across-the-board, strategic change to ensure that investment management companies can prosper in the coming years.

These prescriptive measures are also meant to provoke thoughtful dialogue about industry-wide problems and to offer investment managers prospective solutions. These conclusions will undoubtedly not be met with consensus, and we are not suggesting they apply uniformly to all investment managers. They merely represent a starting point for deliberation and analysis.

We welcome your input and stand ready to open a dialogue on ways to change comprehensively and effectively.

Jim Suglia
National Sector Leader, Investment Management

A time for transformation

If a rising tide lifts all boats, then by all accounts the investment management industry should be cresting a wave. Five years of accommodative monetary policy have buoyed assets under management. With economic growth expected to improve throughout 2014, the wind should be filling the industry's sails by year-end.

Yet storm clouds remain on the horizon. In the aftermath of the financial crisis, consumers and regulators have become more demanding of asset management firms, and industry competition has grown considerably. Consumers want greater diversification and lower costs. Regulators are driving up compliance costs, forcing industry participants to spend more to maintain their market share.

All together, regulatory constraints, increased competition, and fee pressure are compressing asset management industry profit margins. The industry well understands these pressures. In fact, European asset managers said they believe one-fourth of the people and companies in the asset management industry today will disappear in the next decade.[1]

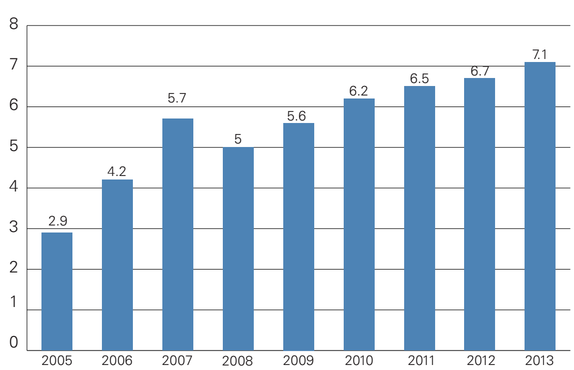
Investment management executives in the United States say they will confront higher costs, compressed margins, and regulatory demands by aggressively growing their businesses. Suddenly everyone wants to be a high-net-worth provider, even discount brokers. Some asset managers are looking at expanding their footprints—whether from a product or geographic perspective. There is also talk about broadening the depth and breadth of product portfolios to grow assets from existing clients.

At first glance, expanding into other regions and countries, and broadening the product line would seem to be a no-brainer, but the execution involved to make this happen is complex, introducing challenges well beyond those accompanying geographic and product expansion.

Many firms, for one, lack an operating model that will grow their businesses. Their information technology (IT) systems lack flexibility and scalability, hindering their ability to mesh their systems with those of joint venture partners or acquired organizations. Companies are also awash in unreliable and impenetrable data. Many systems are ill-equipped to handle the data necessary for business, management, operations, and risk and regulator reporting. What is more, firms that made sharp headcount reductions and deferred IT spending during the downturn may now not have the right people in place to manage the data deluge. Business expansion will make the problem worse.

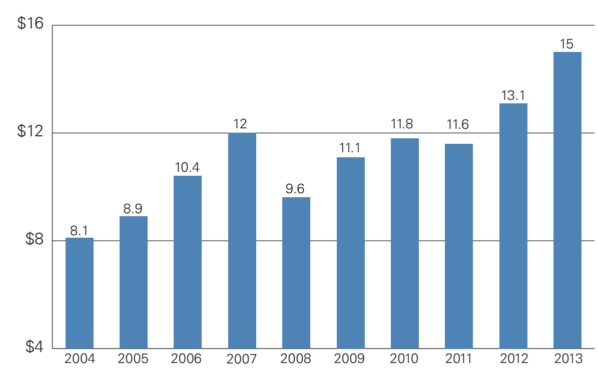
Industry snapshot

Global alternative investments AUM ($Trillion)



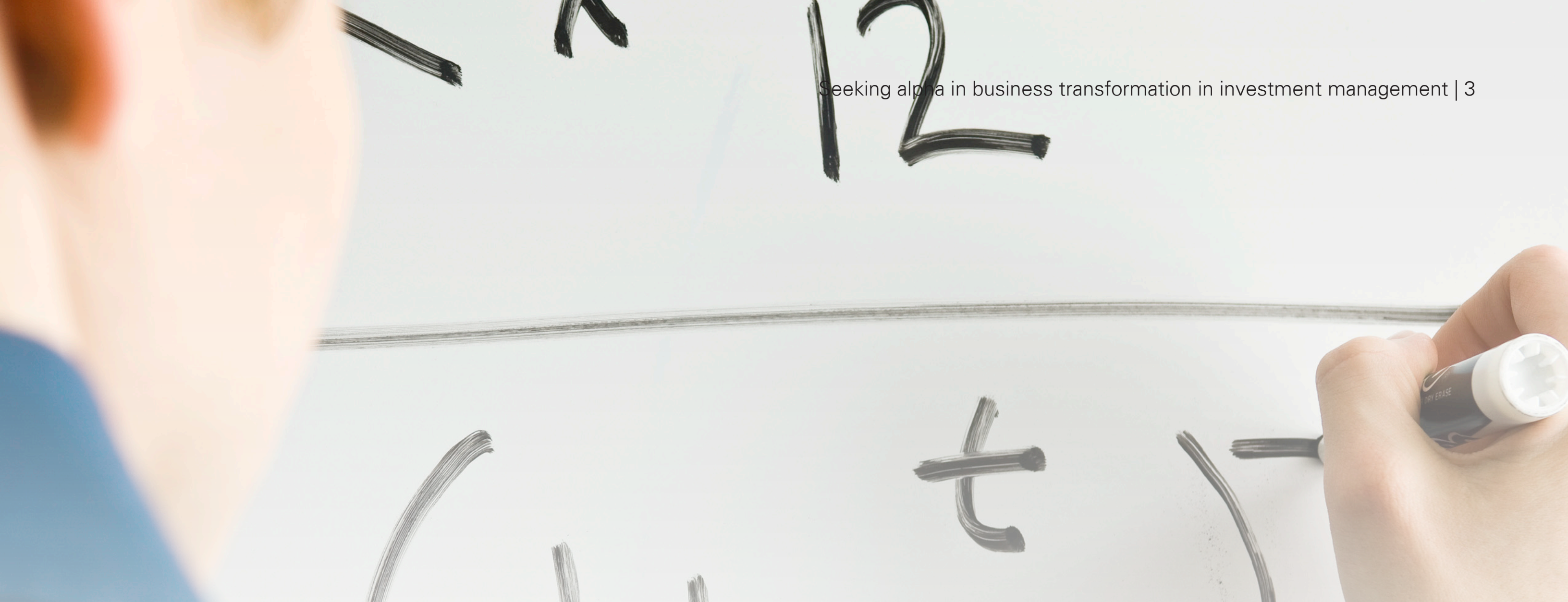
Source: Strategic Insights, McKinsey, KPMG Research (2013 is estimated)

U.S. mutual funds AUM ($Trillion)



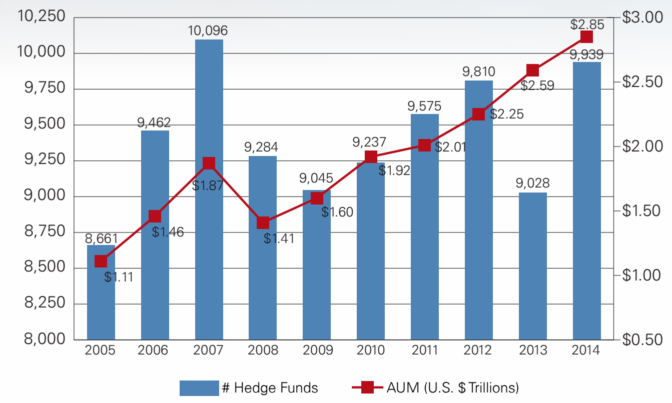
Source: ICI, KPMG Research, (2013 is estimated)

[1] "Industry Insights: A snapshot of the key trends, issues and challenges facing the investment management industry," KPMG, March 2013.



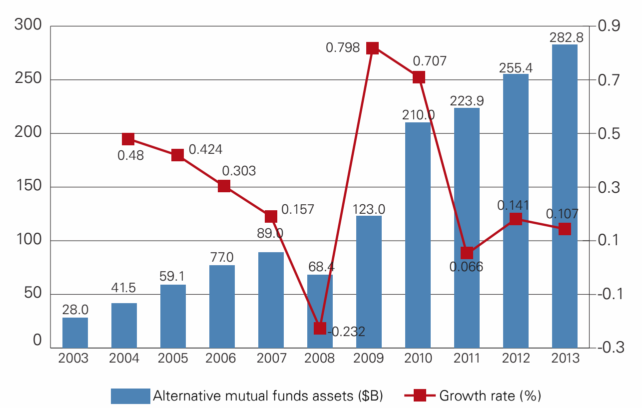
> Although the past five years have provided real industry growth, we believe the investment management industry must focus on business model transformation to sustain this growth into the future.
>
> **Jim Suglia**
> National Sector Leader, Investment Management

Global hedge fund growth



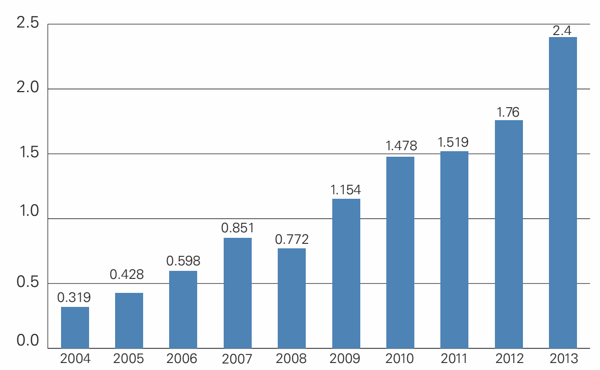
Source: Aite Group LLC, 2013 and 2014 are estimates for both number of funds and AUM

Alternative mutual fund growth



Source: The Cerulli Report – Alternative Products and Strategies 2013

Global ETF AUM ($Trillion)



Source: BlackRock Investment Institute, Bloomberg, KPMG Research

We see the industry at an inflection point, in that it is an ideal time to address long-standing problems in a wholesale, rather than a piecemeal or incremental fashion. In our view, the business model is changing, and, as a result, the operating model must change. It needs to be more scalable and agile to support the new business strategy. It also should be sufficiently robust to grow the company for years to come.

Business model is transforming, driven by:

Growth

- Alternative investments
- Retirement plans (products and administration)
- Wealth management
- Geographic expansion (notably Asia and Latin America)
- Inorganic opportunities stemming from regulatory change

Regulatory change

- Increased requirements across the globe (FATCA, Form PF, CPO-PQR, AIFMD, among many others)
- Challenging rules with significant cross-border implications
- Complex regulatory and systemic risk reporting requirements
- Volcker rule and capital adequacy driving mergers and acquisitions activity

Margin management

- Ongoing fee pressures
- Separate risk, internal audit, and compliance agendas straining operations
- Costs associated with increased investor demands, such as due diligence and reporting
- Investment professional, distribution/ sales, compliance, risk and regulatory reporting staffing needs

Pressure on operating models to be more scalable and agile to support the evolving business model

Operating model is transforming, driven by:

Process

- Wide-ranging redesign to scale and develop portable capacity
- Continuous improvement and LEAN
- Focus on a global sourcing model including shared services and COEs that leverage low-cost/high-value locations
- Holistic assessment of regulatory changes and convergence of risk, operations, and compliance
- Particular focus on client on-boarding, regulatory reporting, and a renewed focus on controls

Data

- Optimizing data management and governance to be a competitive differentiator
- Data management and mining tools for compliance programs and enhanced analytics
- Integrated risk and performance reporting
- Greater use of predictive and historical analytics to drive growth, facilitate compliance, cut costs
- Effective management of data relies on understanding/optimizing the data supply chain
- Greater emphasis on capturing/using metadata increases data quality, enables certification of analytics, and helps ensure that the right data is used for the right purpose

Technology

- Massive platform upgrades, such as OMS, and fund/portfolio accounting
- Increased use of work flow tools
- Strategic solutions for regulatory and risk reporting
- Upgrades of risk management, performance and attribution tools, and applications

Eight steps to investment management transformation

Business transformation is about comprehensive change rather than incremental adjustments. A solid target operating model should be at the center of any transformation effort. According to a KPMG LLP survey published in December 2013,[2] nine out of ten U.S. companies plan to respond to a shifting landscape by changing some aspect of their business models. Yet 45 percent of the respondents said they had no formal process in place to transform their businesses.

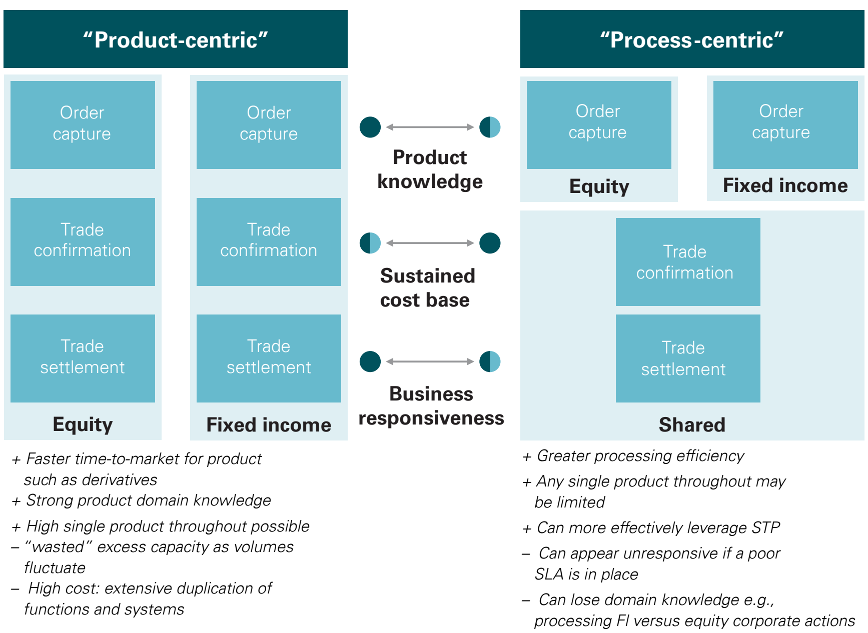
[2] "Business Transformation and the Corporate Agenda," KPMG, November 2013. Respondents to the survey included 67 percent from the ranks of C-level executives; the rest were managing director or above.

1. Build a target operating model that aligns to the business strategy

To bring about lasting change, a business must start with a target operating model that defines specifically the scope of the desired change. Rather than focus solely on "reducing operational risks," for example, a stronger plan would include a differentiated product portfolio supported by an operations infrastructure that can scale with market trends and client needs.

Taking into account business strategy and changing market dynamics, a firm's target operating model should encompass the following five guiding principles:

- Operations and technology should be highly automated, cost effective, robust, and scalable.
- Operations and technology should be extendable to other parts of the business.
- Operating models should separate generic products from higher-margin products.
- Operating models should combine functions across products/services to eliminate silos.
- Operating models should allow for potential joint ventures or consortia structures that combine in-house capabilities, processes, and functions with another firm's capabilities, scale, and cost structures to deliver greater benefits.



> A profitable and sustainable operating model must "industrialize" the same internal processes that are performed by multiple people inside an investment management company.
>
> **Bill Cline,** National Advisory Leader, Capital Markets, KPMG's Advisory practice

2. Ensure that your operating model build-out streamlines and simplifies processes

To begin with, a profitable and sustainable operating model must "industrialize" the same internal processes that are performed by multiple people inside an investment management company. Industrialization is designed to simplify, standardize, and consolidate processes in a bid to reduce complexity of operations, cut costs, enhance client service, and improve the bottom line.

The new operating model seeks to transform operations. It touches on everything from IT processes and internal controls, to product development and regulatory compliance reporting. Operations may not be revenue centers, but the duplication of processes and inadequate risk management and control functions often have a negative bottom-line impact. The cost of lapses in risk management and other failures—and the public transparency of failures in these areas—are now far greater than in the past.

In general, there are two types of models worthy of consideration. The product-centric model delivers faster time to market, strong product domain specialization, and high single-product throughput. The drawbacks of this model are often excess capacity when volumes trend down and duplicative functions and systems. Excess capacity includes systems and staff.

In contrast, process-centric models offer greater efficiency that can more effectively leverage straight-through processing (STP).

Two other model variations exist: A utility model, based on the concept of metered use, is another possibility for operational functions that are similar across products. There could also be a hybrid approach, which could be used with a joint venture or consortia.

3. Engage operational staff

For operational transformation to be truly effective and sustainable, the people involved with and affected by the transformation must become engaged in, committed to, and competent in the new ways of doing business. Otherwise, the people within the organization get left behind in the process, and the transformation delivers less-than-optimal results.

To help ensure profitable change, executives must consider the challenges affecting the organization's people. Executives must have a plan that takes into account how to motivate employees to do things differently and ensures that the right people in the right job doing the right things.

Companies that fully consider the people implications—communication, training on new systems and processes, and identifying the relevant skill sets—are far more likely to truly transform their businesses.

> Alignment of business strategy with an organization's operating model can help institutionalize the transformational process, embedding enough agility to help the organization evolve more quickly and easily as new marketplace challenges come along.
>
> **Stephen G. Hasty Jr.,** a KPMG partner and U.S. Innovation Leader for Advisory

4. Confront and manage the data supply chain

Data is critical to running every business—driving decisions, supporting operations, creating an audit trail, and delivering market insight. Yet huge investments in IT do not necessarily guarantee better information, just more of it.

Most asset management firms have so much data that they are unable to get their arms around it. They cannot organize the knowledge in a way that helps them make better decisions.

In this industry, an essential capability that distinguishes an organization is leveraging information management as the foundation for improved decision making around managing a portfolio of investment products and services. That capability is critical in knowing when to enter key markets and knowing when to sunset products and services in the organization's portfolio. Leaders must enhance their data management capabilities so that they can:

- Understand where emerging market opportunities exist and and find the investment management portfolio gaps that should be addressed to support continued growth and market innovation
- Define the right management reporting and product portfolio management analytics to measure:
  - Marketplace adoption of product offerings
  - Product profitability
  - The relevance of existing products in order to "sunset'' certain investment products when necessary.

The objective is to get the *right* high-quality data to the business in a fast, flexible manner. Addressing this challenge is less about technology and more about logistics flow: This is the "business side" of managing data.

Optimizing the data supply chain will enable certified reporting because the data will be accurately sourced, clean, relevant, integrated, and broadly available. All these conditions allow management to make timely, information-driven business decisions.

5. Build a sustainable data architecture

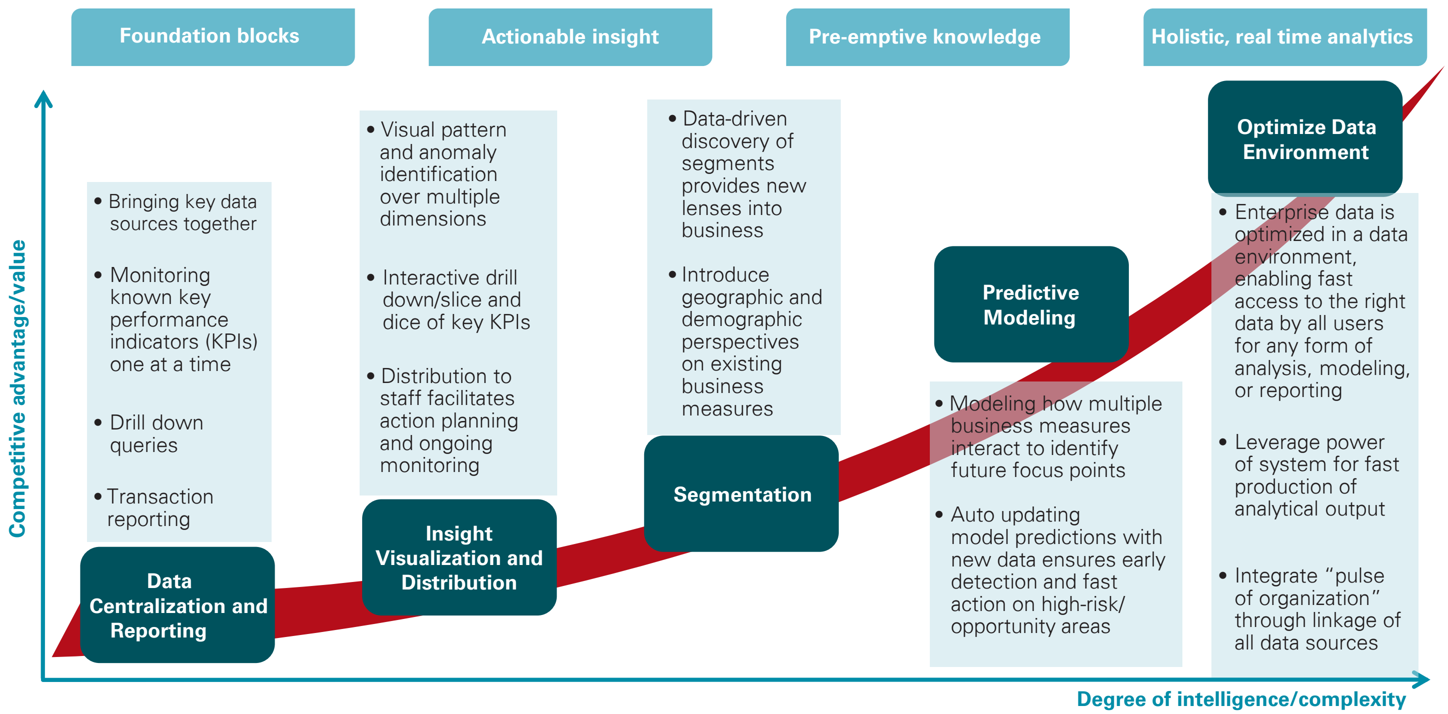
The best way for asset management firms to master this torrent of data is to build a long-term data architecture strategy, based on an optimized data supply chain that will keep pace with the rate of change.

We recommend firms assess their strategies annually to take into consideration changing conditions and needs. We appreciate that it is difficult to think long term when you are drowning in data, but it is critical to do so, in order to adapt to the rapid changes occurring in technology and in the investment management industry.

Global megatrends—demographic and technological changes, shifts in social values, governance, and regulatory demands—will affect every aspect of the investment management business. Companies possessing good data will be able to respond to the twists and turns of tomorrow's marketplace, rather than be overwhelmed by it.

6. Move up the analytic maturity curve

There are also plenty of actions a company can take to improve its analytics and reporting while building out a target-state data plan. This is simply a matter of realizing incremental improvements as a company moves forward with its long-term architecture transformation. These improvements will materialize along the following analytic maturity curve:



The best "low-hanging" fruit starts with internal data—harnessing and analyzing data and information inside your organization to accomplish key goals such as improving investment performance, product design, client acquisition, operational efficiency, and activity monitoring for regulatory compliance. From there, firms need to better leverage third-party data and unstructured data that reside in the public domain to help them achieve these goals.

With growth at the top of the agenda for so many firms, a vital capability that must be honed is around leveraging sales and marketing analytics. A focus on building out that competence will allow investment firms to:

- Optimize scarce sales and distribution resources across territories
- Understand key business performance growth drivers and how to replicate success across key market segments
- Leverage predictive analytics to optimize sales and marketing campaigns.

Once companies put in place a better data architecture structure and mature analytics, they can ask themselves the following questions:

- How can we increase member engagement?
- Are we investing in the right channels?
- What range of products and services should we have?
- Growth pockets—where are they?
- How can we take advantage of changing demographics?
- Is there a way to retain members during a major downturn, such as the Great Recession?

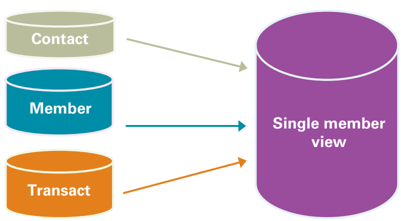
Investment management firms can answer these questions once they begin to think about data from a holistic, rather than a piecemeal perspective.

For example, during the recent downturn one investment management firm experienced a substantial increase in redemptions. The firm did not full understand the drivers behind the exits and was unable to quantify both the number of members likely to exit and the funds at risk.

To overcome this challenge, the firm used multiple data sources to produce a single-member view, and it built a predictive model using previous-member exit data. The model predicted correctly that more than 90 percent of members in the top two risk deciles would exit.

With the key drivers behind churn identified and quantified, the firm devised and put in place proactive retention strategies.

- Multiple data sources were combined to produce a "single-member view"



- A predictive model was built based on previous-member exiting data and used to identify members most at risk of exiting the fund:

- The resulting algorithm was used to score members in terms of likelihood to exit and was deployed for on-going scoring

$$\textit{Probability to exit} = \frac{\exp(X_\beta)}{1+\exp(X_\beta)}$$

$$X_\beta = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \ldots$$

7. Bring data to life with visualization and context

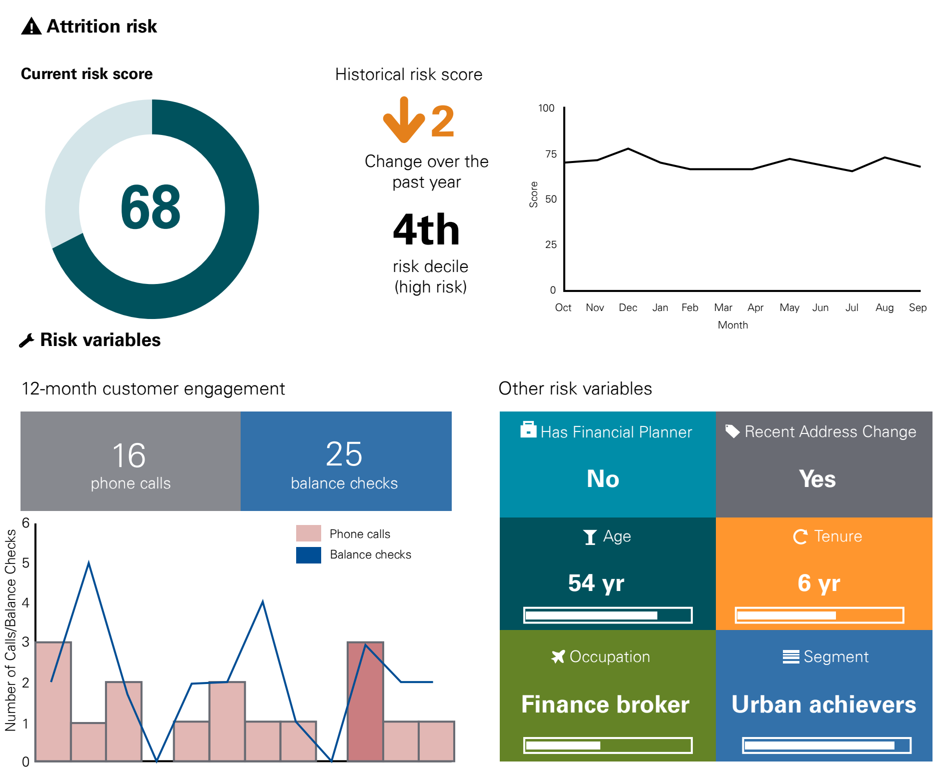
Some investment management firms have very strong data and analytics capabilities. They are good at measuring, quantifying, warehousing, and cataloguing. On occasion, though, they may have difficulty picking out the salient facts that tell a story, and presenting a narrative that piques the attention of decision makers.

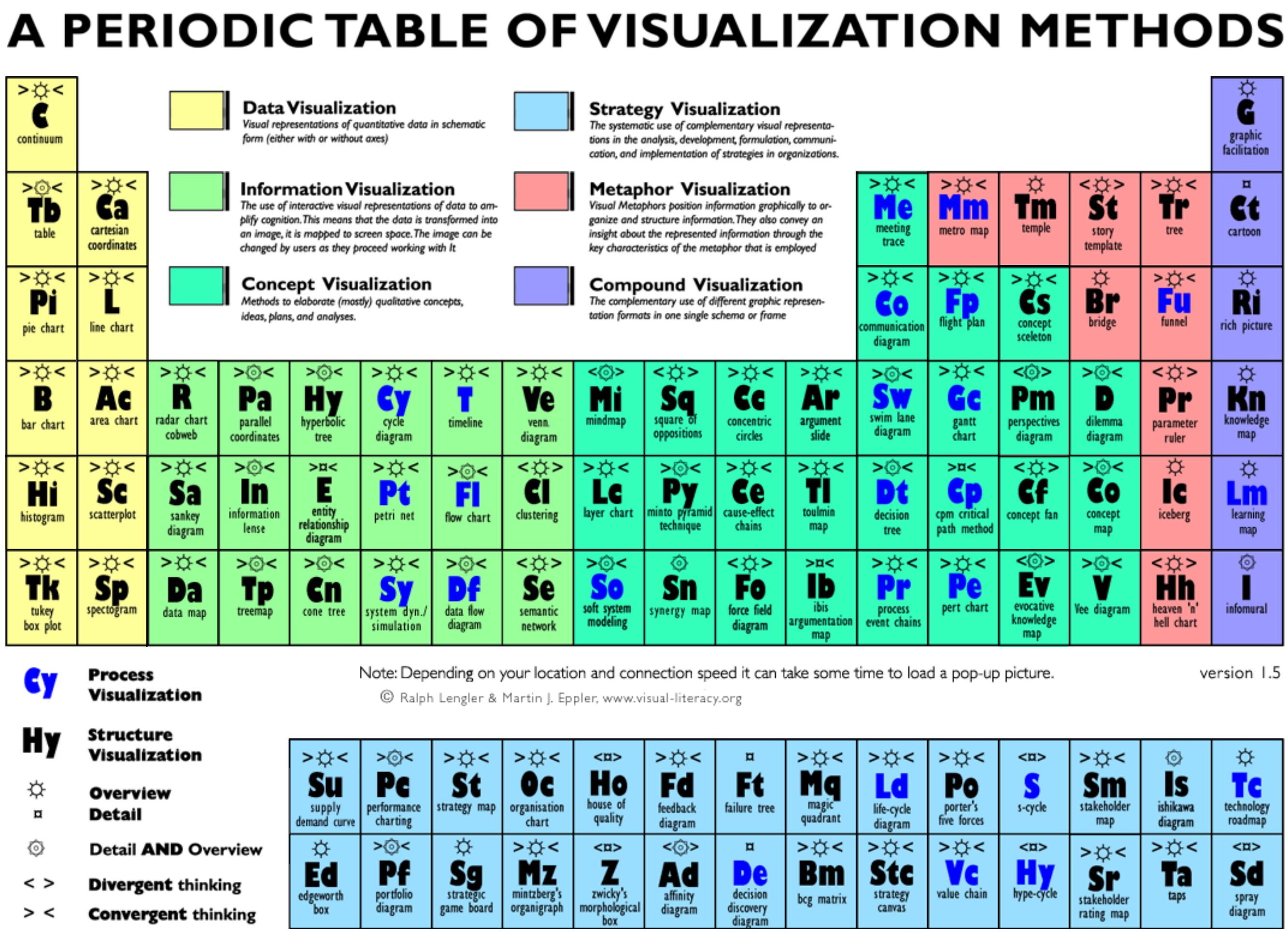
The best way to bring data to life is by asking the right questions. Five disparate data points embedded in a spreadsheet or multiple spreadsheets may be meaningless. But when those data points are put together, they may tell an invaluable story about the business and its customers.

Once those data points are agreed upon, it is critical to display that information in a way that highlights patterns, trends, and correlations that often go undetected in a spreadsheet. Crisp, high-level views of corporate information, metrics, and key performance indicators shed light on overall business patterns and help analysts drill down into the data for further query and analysis.

In the prior example, fund management was concerned about attrition risk. However, once management identified the proper, it was easily able to monitor the situation in real time, using the following dashboard.

In some cases, the variables are too large and disparate for an easy dashboard display. Other visualization methods, such as a "periodic table" method, can aid decision makers to pick and choose variables for further display.





Organizational transformation of the compliance function allows firms to operate more efficiently, manage their compliance function more effectively, and become more disciplined in fulfilling their regulatory reporting obligations.

Scott Marcello
National Leader,
KPMG's Financial Services practice

8. Reconfigure regulatory compliance and reporting function

The seemingly endless stream of new regulatory requirements, especially in the area of regulatory reporting, has prompted the asset management industry to react in one of two ways: 1) firms have beefed up their regulatory compliance headcount or 2) they have assigned additional compliance-related responsibilities to existing employees, overloading them with risk-management duties. Both of these strategies are proving untenable over the long term because they lack a unifying vision of regulatory compliance and, as a result, clear objectives in meeting regulatory requirements. Moreover, these strategies are costly and inadequate in terms of risk management.

For example, asset management firms that have not holistically evaluated their responses to new regulatory reporting requirements are now realizing they may be reporting inconsistent information to regulators. In addition, these companies are missing an opportunity to ensure consistency in their regulatory reporting and to leverage economies of scale.

We recommend that asset management firms rethink their approach to regulatory compliance and reporting. What most firms will discover, in our view, is that they need to shift front-line risk management and supervision from compliance to the business lines. This realignment will free up their compliance units to provide more guidance on interpreting legal and regulatory requirements and to focus on overseeing high-risk functions. The compliance units will be better positioned to do forensic and surveillance work.

In our view, asset management firms are best positioned to exploit this new world of multiple, overlapping regulatory and business regimes once they have shifted their compliance programs into their business lines. One they have done this, these firms will benefit from stronger central compliance units and will have created business-funded project management office (PMO) functions to manage the scoping, design, and implementation of these changes. When management embraces this strategy, it creates a tone at the top that these programs are an integral part of the business and that senior management takes seriously its obligation to understand the drivers of regulatory compliance.

PMO teams of asset management firms act as a lynchpin between their core businesses and strong institutionalized silos for risk management, operations, client services, and other functions that have their own missions and drivers. There is also a growing awareness among senior management that surviving yet another regulatory obligation is not the mission, but that the goal is to build better business processes through a more thought-out approach to compliance and reporting.

Lastly, we recognize that in carrying out these comprehensive changes, there will be some hiccups in execution. However, we believe that as they soldier through the process, asset management firms will start to see results from converging their regulatory risk reporting and client reporting solutions with their portfolio management and risk-management operations. In the end, firms will be able to leverage their regulatory reporting function to the benefit of clients, and their client-reporting operations will, in turn, support regulatory reporting.


QUICK
7/23
15:13
本日の動き
94.25
ドル/円
ユーロ/円


+0.70
12カ月の動き
94.25
+0.70
ドル/円
115.0
110.0
105.0
100.0
95.0
90.0
85.0
7/1
10/1
1/5
4/1
7/1
+1.45
12カ月の動き
香港ドル/円
12.17
+0.10
14.5
14.0
13.5
13.0
12.5
12.0
11.5
11.0
2/2
5/1

Contact us

Jim Suglia
National Sector Leader, Investment Management
T: 617-988-5607
E: jsuglia@kpmg.com

kpmg.com