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# EMBRACING THE TRANSFORMATIONAL POWER OF OUTSOURCING

How Asset Management in Asia Pacific is  
Driving Change Across the Whole Office

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## How Asset Management in Asia Pacific is Driving Change Across the Whole Office

The Asia Pacific asset management industry is a widely diverse market. Despite its diverse practices and needs, managers across the region overarchingly face similar pressures – shrinking margins, changing distribution models and regulatory challenges.

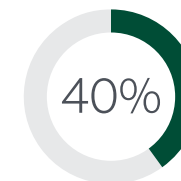
As a result, much of the industry is leaning into the value that outsourcing can provide – firmly in the back office, and now with a newer focus on the middle office. According to a Northern Trust survey, 40% of Asia-Pacific based asset managers are considering outsourcing their middle-office and investment book of record functions so that they can focus on alpha-generating returns and solutions that provide greater scale, flexibility and speed to market.<sup>1</sup> And for some of the largest managers, the prospect of outsourcing non-core front office operations, such as a global trading desk, is now on the table. In fact, 37% of asset managers plan to evaluate the potential of outsourcing trading over the course of the next two years.<sup>2</sup>

Despite the tumult and uncertainty that accompanied the onset and spread of the COVID-19 pandemic, viewed through a long-term lens, demographic trends indicate continuing high-growth potential for asset management in Asia Pacific. The efficient public health responses throughout much of the region and the swift comeback of global financial markets encourage a much rosier outlook than initially anticipated as the pandemic unfolded.

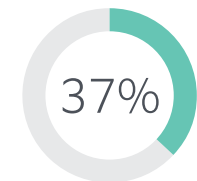
As the industry continues to address these challenges and opportunities, the drive by asset managers to outsource their non-core functions will sustain. Whatever the coming years do bring, this trend toward greater use of outsourcing across the back, middle, and, increasingly, the front office promises to introduce a new age of efficiency for asset management in Asia Pacific.

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## BALANCING OPTIMISM AGAINST INDUSTRY PRESSURES

Despite facing a broad set of pressures, asset managers have cause to be optimistic. Demand for investment products is becoming truly global, particularly as developing markets mature. China, for example, has relaxed ownership requirements for foreign firms – and citizens are moving from a savings-orientated culture to one more focused on investing.

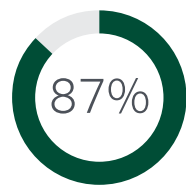
While COVID-19 seemed to present a major barrier to continued industry growth, a rapid recovery of the financial markets has instilled new confidence in managers and investors alike.

These developments are making way for significant growth in the Asia Pacific asset management market. In China alone, experts predict its asset management market will more than double by 2025.<sup>3</sup> More broadly in Asia Pacific, PwC predicts the region's assets under management will grow from USD 16.9 trillion in 2020 to USD 29.6 trillion in 2025.<sup>4</sup>

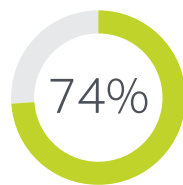
While these trends are encouraging, the industry's challenges are a powerful force as well. Fee and cost pressures and eroding margins will continue to have an impact. Morgan Stanley and Oliver Wyman forecast that total asset management industry revenues will grow at a compound annual growth rate of just 1% over the coming five years, and they say it's difficult to see how current fee pressures will abate in either passive or active management.<sup>5</sup>

Global regulatory obligations have also spiralled in recent years, resulting in rapidly growing compliance costs. In 2018, 21% of financial services executives expected to spend less than 1% of annual revenue on compliance costs. In 2020, only 6% said the same, while 33% now say they plan to spend more than 5%.<sup>6</sup>

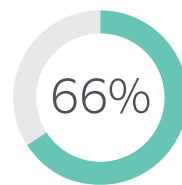
Costs are only one facet of the pressure asset managers feel to operate more efficiently. A global Northern Trust survey provides a snapshot of asset managers' key priorities over the next two years:<sup>7</sup>



Controlling costs



Enhancing quality and accuracy



Creating great efficiency in operations

With these pressures in mind and more capital flowing into the asset management industry than ever, managers feel the pressure to elevate the efficiency of their operations across the whole office. In balancing the potential for growth with the cost of expansion, outsourcing will be a key factor in getting them where they need to go.

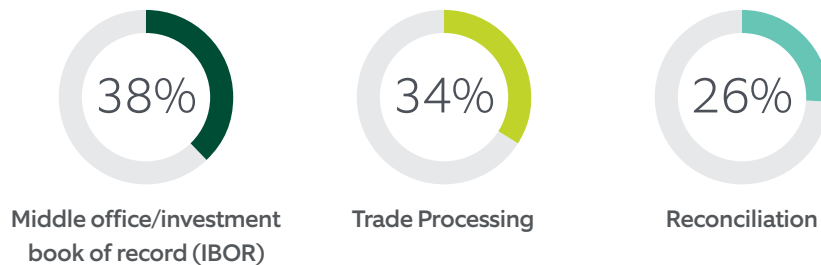
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## OUTSOURCING'S INFLUENCE REACHES THE MIDDLE OFFICE

Against this backdrop, it is no surprise that asset managers are looking to outsource their non-core services and focus more exclusively on “core” functions (i.e. portfolio management). Managers looking to outsource their middle office functions, are motivated by more than just saving costs. They want to transform their operating models to meet challenges posed by the increasing complexity behind investable assets across global markets. Simultaneously, they seek to increase transparency and monitoring capabilities, as well as access to automation, scale and security.

There is no doubt that the latest market cycle has resulted in an even greater demand for middle-office outsourcing. Investment managers have not only faced extreme margin pressure but also the ongoing requirement of doing more with less. Staff reductions and budget limitations continue to increase per capita productivity for operations and technology to all-time highs.

According to Northern Trust data, asset managers are considering outsourcing the following middle office activities in the next two years:<sup>7</sup>



The pandemic has also left a lasting effect in terms of planning for operational efficiency. The recent volatility and uncertainty brought on by COVID-19 will only continue the push to outsource. The feeling of deploying business continuity plans with the onset of a sudden global emergency won't soon be forgotten, and managers will be attracted to the idea of outsourcing in the interest of protecting their operations if a similar emergency were to occur in the future. Not to mention, investors and boards will be holding asset managers accountable to display a new level of resiliency in their operations, even when COVID-19 is in the rearview mirror.

Put simply, cost management will always be critical, but strategic capability and futureproofing are fast becoming the key drivers for middle-office outsourcing. The need for investment management firms to execute their business strategies better, faster, and more predictably has never been more top of mind.

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## AUSTRALIA AS AN APAC OUTLIER

Australia's AUD2.7 trillion superannuation fund sector<sup>8</sup> experiences fee and margin pressures just as the rest of the asset management industry and thus is naturally drawn to the cost-cutting and efficiency-boosting potential that outsourcing presents for the right processes. However, its embrace of outsourcing takes the form of a more delicate balance. Insourcing remains a heavily relied-upon strategy for many large super funds who find they can deliver savings to members by insourcing a portion of their investment management. For example, 73% of super funds deem Australian equities the best asset class to insource, while niche assets are the best options to outsource to asset managers.<sup>9</sup>

While outsourcing versus insourcing sees a more balanced relationship in Australia, the appeals of outsourcing are clear. For example, a 2019 Northern Trust survey found that nearly 80% of Australian superannuation funds and asset managers would consider an outsourced trading solution to help meet their end-to-end trade execution and middle office needs.<sup>10</sup>

The growing trend of merging super funds to form "mega" funds, with \$100 billion or more in assets under management, also presents the possibility that outsourcing across the whole office will be embraced in Australia. As funds grow in size and take part in mergers, they face greater regulatory requirements and scrutiny, causing regulatory and compliance costs to rise.<sup>11</sup> Outsourcing non-core functions across the back and middle office would present a viable option for these mega funds to control their costs as they balloon in size.

## THE SEARCH FOR AN OUTSOURCING PARTNER

This concept of middle office outsourcing is particularly important for mid-size and boutique investment managers (in terms of AUM). These firms' size often means fewer resources in terms of real and human capital, and thus the inability to scale as fast as their larger competitors. Whether striving to introduce new products faster, globalising, or changing business models, these firms face steep competition from larger managers. Middle office outsourcing is a key consideration in their quest to compete on a playing field with industry giants.

When considering the growing embrace of outsourcing and the expansion of demand from the back and middle office to also include the front office, outsourcing providers become more than vendors. As discussed, the APAC market is a diverse one, and managers require specialist market knowledge. To meet this need, the major providers are evolving into "knowledge companies" and are no longer simply processing organisations. Their platforms can help investment managers achieve important strategic objectives. For example:

- A platform for acquisition integration
- Further market expansion (manufacturing, fund domicile, distribution)
- Enhanced focus on distribution
- Improved speed-to-market and diversity of new product capabilities

Outsourcing providers possess not only scale and operating leverage, but also a culture of accounting, control, risk-based oversight, and global market expertise that is critical in today's environment. Over the past decade, capabilities have evolved far into higher-value functions and capabilities that exceed the average investment manager; services such as complex derivatives processing, sophisticated analytics and highly differentiated client communications and reporting. These outsourcing innovations will continue to support an acceleration of capability beyond the incremental gains of a typical manager.

The rise of technological innovation will also encourage the drive to outsource non-core activities, providing an opportunity to make common processes more efficient and reduce costs. For example, machine learning can automate manual tasks to aid accuracy, efficiency and speed, while artificial intelligence can help select the most suitable trading outcomes and identify complex trends to potentially improve investment strategies.

From our perspective as an asset servicer to investment companies, we see many of the most proactive firms integrating technology into everything they do to gain efficiencies and maintain their competitiveness. Data capture and management is a key technology function that asset managers should be prioritising in their search for an outsourcing partner, especially as we see institutional investors seeking clearer, data-fuelled views into the investment lifecycle of their assets from their managers. Beyond an investor relations perspective, quick and efficient access to a consolidated view of data is key to supporting quick decision-making for an investment manager's strategy.

Technology can be a great equaliser for industry players – levelling the playing field and affording smaller, nimbler players the opportunity to disrupt more established firms. As opposed to building capabilities from scratch internally, smaller and mid-sized managers will naturally gravitate toward outsourcing certain processes to a partner who already provides access to these technologies.

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WHAT MIDDLE OFFICE OUTSOURCING LOOKS LIKE FOR A LARGE AUSTRALIAN ASSET MANAGER



**BACKGROUND**

A large global asset manager based in Australia managing assets on behalf of institutional investors, pension funds, wholesale distributors, and investment platforms sought to reap the benefits of middle office outsourcing.



**CHALLENGE**

The asset manager experienced a change in ownership structure, leaving them in a position to either build out their own middle office operations in house or outsource. Wanting to avoid making such a large time and resource investment in a non-core business function, they began the process of seeking the right middle office outsourcing partner.



**SOLUTIONS**

The asset manager chose to partner with Northern Trust to outsource their middle office operations, embracing our global operating model, proven expertise in middle office outsourcing, established track record of servicing complex global investment managers, and our client-first culture. They signed on for our comprehensive middle office outsourcing solution, which includes services such as transaction capture, OTC lifecycle management, investment book of record, and more.



**RESULTS**

By choosing to sign on with an established and respected outsourcing partner, the asset manager now benefits from cost reduction, greater operational efficiency and reduced operational risk.

### TESTING THE WATERS OF OUTSOURCING

When might outsourcing become a cost — and resource — effective solution for asset managers? Questions to ask include:

- Is there an operational or technology component your organisation does not possess – but will need in the future – that can be supported through outsourcing?
- Might outsourcing help you optimise costs and efficiencies?
- Could outsourcing support your regulatory compliance?
- Is outsourcing likely to support your focus on core competencies?
- What functions are central to your business model?

As APAC managers increase their exposure to investable assets outside of their region, partners with a global outsourcing partner will be critical to success.

## WHAT'S ON THE HORIZON FOR ASSET MANAGEMENT IN ASIA PACIFIC

In Asia Pacific, asset managers have shown a firm embrace of back-office outsourcing and a steadily growing incorporation of middle office outsourcing. In the aftermath of the pandemic as managers seek to ensure their operations can continue under any kind of business continuity conditions, this current trend will continue and even edge into front office territory.

Many of the largest asset managers have already set out on this initiative, outsourcing or automating many non-core functions across the whole office, buoyed by their deep financial resources. For mid-sized managers, the decision to outsource could become more of an involved customer journey, as will the subsequent search for the right partner. And as APAC managers increase their exposure to investable assets outside of their region, partners with a global outsourcing partner will be critical to success.

While different managers across Asia Pacific face unique challenges and differing landscapes, the payoffs of building outsourcing into a strategy could be the push a manager needs to set aside the challenges of non-core activities and focus on helping their investment strategy – and resulting returns – thrive.



## END NOTES AND SOURCES

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