funds europe

A Funds Europe survey in partnership with CACEIS

Strategic choices for asset management in 2021

PRODUCT DISTRIBUTION AND GOVERNANCE

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Shifting priorities

WHAT THIS SURVEY REVEALS

Highlights

Uncertainties around the pace and sustainability of economic recovery are at the forefront of industry concerns as it designs a strategy for growth and innovation after the Covid-19 pandemic.

Decision-makers are also challenged by the continuing pressure of regulatory adaptation, and the need to redesign technology stacks and communication interfaces to fulfil the digital needs of the funds industry both for current and future generations.

In this survey, *Funds Europe*, in partnership with CACEIS, examines where priorities lie for asset managers in crafting their product strategies and fund governance for a world after Covid-19. We examine the growing importance of ESG and climate change factors in shaping investment strategies and investor preferences. We also explore steps to promote diversity and inclusion in the funds industry. Among the survey's key findings:

Economic outlook

• 52% of respondents said that uncertainties over the pace of economic recovery present the greatest risk to their business.

ESG and climate change

• 81% said that they are currently integrating ESG standards into their business practice or that they have already done so.

• 73% said that ESG standards will become, or have already become, a mandatory component of fund governance.

Priorities for pension funds

• 54% said low interest rates are the major challenge confronting pension fund boards.

• 64% said pension funds should direct more attention to alternative investments in their search for yield.

Digital transition and service outsourcing

• 85% said that data management and analytics are the area of digital transition where the funds industry most needs to focus investment.

• 67% said that cost pressures will be the primary driver for greater outsourcing.

A total of 172 funds professionals participated in the online survey, conducted during February 2021. See survey methodology (page 26) for more information.

The crucial next steps

WHAT ARE THE TOP PRIORITIES IN A WORLD RECOVERING FROM COVID-19, AND HOW WILL THE FUNDS INDUSTRY MEET THEM?

THE COVID-19 PANDEMIC has fuelled a period of economic and financial uncertainty rarely witnessed outside of wartime. The global economy contracted by close to 3.5% during 2020, according to IMF research, with only China among the G20 economies returning positive economic growth over this period.

This severe economic collapse has, in the IMF's words, "had acute adverse impacts on women, youth, the poor, the informally employed, and those who work in contact-intensive sectors". (IMF World Economic Update, January 2021, page 1)[1]

Although the pandemic sent global equities markets into sharp decline during March 2020, a feature of this crisis has been the resilience of the financial services industry in maintaining business operations during this period and the positivity of investor sentiment in powering a rebound in global equity markets from Q2 onwards.

Indeed, the S&P 500 lost more than 30% of its value in the initial weeks of the crisis, sliding from close to 3,400 in February to below 2,300 on March 23. The UK FTSE 100 plummeted from 7,600 in January to below 5,000 in late March. Meanwhile, on March 12, the FTSE All Share Index dropped more than 10%, its largest single-day fall since 1987.

Central banks and governments have stepped in with massive and timely policy interventions to counter a precipitous slide in consumer spending – which plummeted with lockdown – and to protect jobs and livelihoods for those unable to continue work. Asset purchases by central banks mollified pressures in bond markets, with the US Federal Reserve launching a comprehensive lending programme to support households, employers, state and local government, and financial markets.

With these interventions, the Federal Reserve's total assets have surged from US$4.1 trillion on February 1, 2020 to US$7.6 trillion in March 2021, dwarfing their levels prior to the global financial crisis when total assets on the Fed's balance sheet stood at below US$900 billion (source: US Federal Reserve).[2]

Multilateral agencies have also extended support to emerging markets (EM). For example, the IMF announced a new US$500 billion allocation of special drawing rights to its members in March 2021, equivalent to 3.5% of global reserves and 0.5% of world GDP. These reserve assets, which are backed by a mechanism ensuring convertibility to currencies, are targeted to help countries withstand external pressures in case of a potential tightening of EM financing conditions.

This abundant liquidity has driven a strong rebound in global equity markets, with the MSCI World climbing 15.90% during 2020 and the MSCI Emerging Markets growing by 18.31%. For the year to March 23, 2021, the S&P 500 was up more than 60%.

Despite this huge volatility in global financial markets, particularly during the first half of 2020, the European Fund and Asset Management Association (Efama) reports that investors' confidence has strengthened significantly during the second half of the year. With positive vaccine news driving a surge in net sales in Ucits and alternative investment funds (AIFs), this has driven European investment fund assets to an all-time high during Q4 2020.

"Despite the impact of the pandemic on financial markets in March, net sales promptly returned to positive territory, reflecting the attractiveness of Ucits and AIFs

THE RIGHT BALANCE – Sustainability will play a key role in the global economic recovery.

as investment vehicles," says Bernard Delbecque, Efama senior director for economics and research.

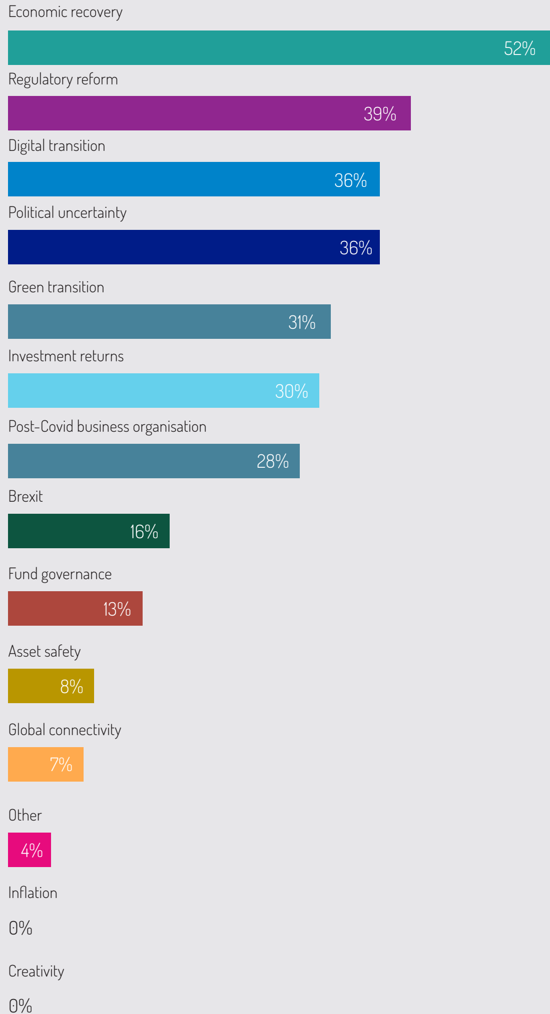
During 2020, total net assets in Ucits and AIFs grew by 5.7% to €18.8 trillion. An 11.1% decline in net assets under management (AuM) for the European investment funds industry during Q1 2020 was cancelled out by strong inflows during Q2 and Q4. Net sales for Ucits reached €466 billion over the year, up from €392 billion in 2019. Alternative investment funds also experienced net inflows during 2020, with net sales rising to €180 billion from €156 billion during 2019.

Equity funds were the primary beneficiary, fuelled by attractive entry points as valuations dipped in February and March 2020, before the major developed market indices recovered much of their lost ground by Q3. In contrast, low yields and high levels of stress in fixed

"Despite the impact of the pandemic on financial markets in March, net sales promptly returned to positive territory, reflecting the attractiveness of Ucits and AIFs as investment vehicles."

BERNARD DELBECQUE, EFAMA

Fig 1: What are the greatest risks for the funds industry in the next 3 years? (Please select 3 answers)



income markets triggered net redemptions of €82 billion in Q1 2020 and total net outflows of €105 billion over the year.

Against this background, the survey asked respondents to nominate the three greatest risks that the asset management industry must confront as it rebuilds after Covid-19 (fig 1). Uncertainties around the pace and sustainability of economic recovery sit at the top of the list, nominated by more than half of survey respondents. Pressures to implement, and to adapt to, new regulations appear second – an issue discussed later in this report. We also focus on the challenges and opportunities presented by digital transition in the asset management industry in a later section.

Scale and specialisation

Consolidation has been a constant feature in the funds industry as investment houses have used mergers and acquisitions to build market share, to expand into new asset classes and to extend distribution reach into new locations and investor segments. Firms may also consider this strategy as they seek to manage digital transition and adapt to the investment preferences of younger generations.

With this in mind, the survey asked whether, in asset management, firms need to be big to survive (fig 2).

This question divided opinion across the respondent group, with 41% agreeing that size is important to an investment firm's survival. In contrast, 39% said they disagreed with this statement and 20% were agnostic, stating that they neither agreed nor disagreed.

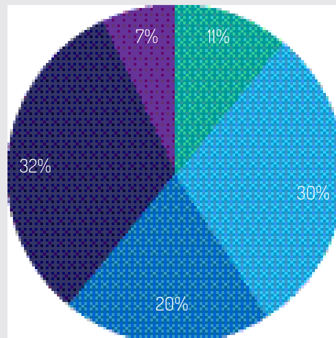
"Consolidation has been a constant feature in the funds industry as investment houses have used mergers and acquisitions to build market share, to expand into new asset classes and to extend distribution reach into new locations and investor segments."

A report from Willis Towers Watson (WTW), published in October 2020, indicates that assets under management for the world's 20 largest asset managers represent just 43% of industry assets. In total, the industry's assets exceed US$100 trillion.[3]

However, direction of travel suggests that the industry is consolidating over time, with market share for the largest 20 firms rising from 38% in 2000 and 29% in 1995. This report indicates that 232 asset manager names have dropped out of its ranking over the past ten years.[4]

Roger Urwin, co-founder of WTW's Thinking Ahead Institute, comments: "The

Fig 2: How much do you agree with the statement, "In asset management, you have to be big to survive"?

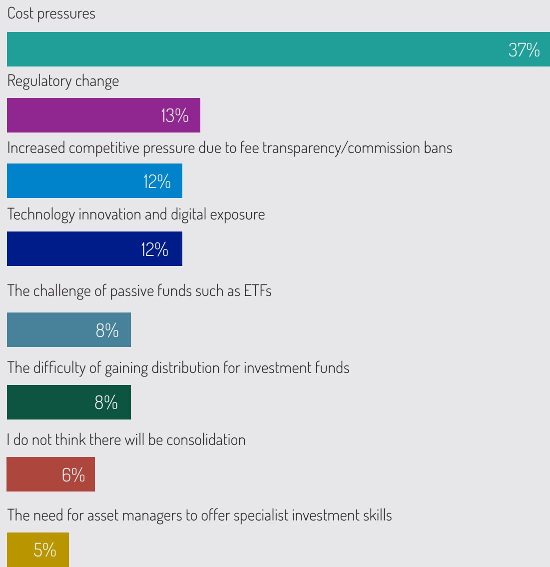


investment industry has always been dynamic, but the pace of change is speeding up, notably through consolidation. Rapidly advancing technology is also changing the shape of mandates and producing products that require less governance and are more streamlined. This has led to the growth of passive and index tracking [along with factor-based solutions]." The report points out that passively managed assets globally have grown from US$4.9 trillion in 2015 to US$7.9 trillion in 2019.

Looking at the factors most likely to drive consolidation in the funds industry (fig 3), the survey highlights the dominance of cost pressures, which attracted nearly three times as many responses as any other single factor (37%).

Beyond this, respondents indicated that companies may consolidate to make them better positioned to manage regulatory change and to manage the resource cost of technology upgrades and innovation.

Regulatory changes (such as MiFID II – the second Markets in Financial Instruments Directive – in the EU, for example, or the Financial Conduct Authority's Assessment of Value regime in the UK) are driving greater cost transparency across the fund transaction lifecycle and forcing the industry to review its charging structures and procedures for cost disclosure. The ongoing transition to fee-based advisory models (driven by the Retail Distribution Review in the UK and its equivalent in some other EU markets) has prompted a tighter focus on the costs of investment and a review of how investment products and investment advice are provided to, and paid for by, retail customers. Among other factors, this has driven an advance in the market for clean share classes.



> *"The investment industry has always been dynamic, but the pace of change is speeding up, notably through consolidation. Rapidly advancing technology is also changing the shape of mandates."*
>
> *ROGER URWIN, WILLIS TOWERS WATSON*

Private market investments

Investment into private markets has surged over the past decade, with many institutional investors and private wealth clients responding to a low interest rate, low fixed income yield environment by increasing allocations to private markets.

A recent research paper by PwC predicts that assets under management in private market strategies are likely to grow between US$4.2 trillion and US$5.5 trillion in the period to 2025, boosting aggregate AuM in the sector to between US$13.7 trillion and US$15.0 trillion. PwC forecasts that private markets will represent more than 10% of global AuM by 2025 in its base-case scenario.[5]

Against this backdrop, this *Funds Europe* survey finds that specialist investment boutiques (cited by 37% of respondents) will be the primary route through which investors access private market assets (fig 4). This was more than double the percentage of those who believed that these specialist products will be sourced from large asset management houses.

Over time, specialist fund managers may look to new issuance models, particularly tokenised issuance of fund units on blockchain (13%). This offers benefits in terms of improved liquidity, potentially making illiquid assets available to a wider community of investors and allowing these to be traded more cheaply and easily in the secondary market. When they are 'tokenised', assets can also be 'fractionalised' – traded in smaller denominations – thereby reducing the minimum investment.

The overarching message from these survey results is that there is a position for both specialist boutiques and larger asset management houses in supporting investors' appetite for private market products. However, fund managers will need to pick their optimal position. Boutique investment houses need to target strategies and products where they have market-leading skills and can deliver outperformance.

Asset managers seeking to establish scale in the private markets area will need to identify how they can grow most effectively, whether through

"There is a position for both specialist boutiques and larger asset management houses in supporting investors' appetite for private market products. However, fund managers will need to pick their optimal position."

Fig 4: How will private market products be offered to the market?

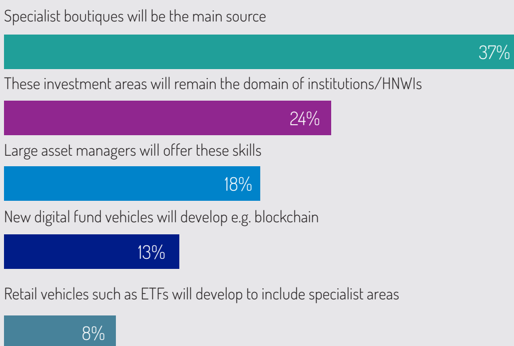
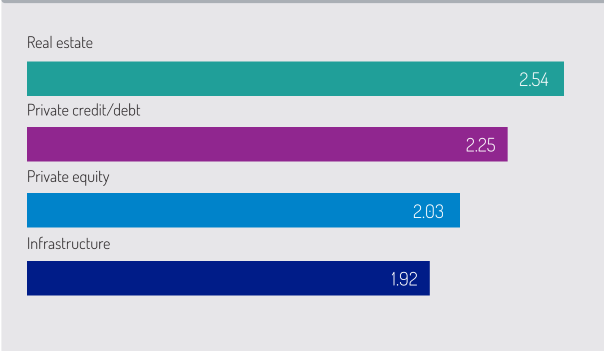


Fig 5: In private markets, which strategies offer the best growth prospects in the coming 12 months? (weighted mean)



acquisition, through building their capability internally, and/or through entering into strategic partnerships and alliances. These choices each shape how the firm meets its requirement for talent, for technology and how it expands its sales pipeline.

Intuitively, we anticipate that asset managers may look to position themselves towards either end of this barbell – as specialist boutiques or through creating scale. Firms that lack specialisation or scale may struggle to compete in the medium term.

Respondents were asked to rank opportunities in private markets asset classes, rating these opportunities from 'very strong' (4) to 'weak' (1). These were then listed in order on the basis of weighted mean, calculated from these survey responses (fig 5).

The survey finds that, in respondents' view, real estate funds will offer the most attractive opportunities for growth in the coming 12 months (weighted-mean score = 2.54). Private credit (2.25), private equity (2.03) and infrastructure (1.92) featured next, ranked in order of importance.

Real estate specialist CBRE observes that 2020 has been a year of convulsive change. For commercial real estate, many of the conventional measures of market activity, such as investment turnover and leasing demand, contracted sharply during 2020. But values have remained surprisingly resilient in other areas, bolstered particularly by huge fiscal and monetary interventions by governments and central banks.

For the real estate sector, closures and capacity restrictions in the retail and hospitality sectors have created inevitable challenges. However, new demand has also emerged over this period. The logistics sector offers opportunities as the UK and western European economies bounce back after Covid-19, backed by greater implementation of sales and leaseback strategies. Although the commercial office sector will restructure with the move to out-of-office working, CBRE reports that Grade A offices appear to be trading at a premium. Data centres are another niche sector that has benefited from the rise in home working and the transition

"For the real estate sector, closures in retail and hospitality have created challenges. However, new demand has also emerged. The logistics sector offers opportunities as the UK and western European economies bounce back after Covid-19."

to digital. (CMRE, 2021 EMEA Real Estate Market Outlook, pages 3-9)[6]

Preqin, a provider of data and analysis for alternative investments, indicates that there was a flight towards larger real-estate providers as the pandemic took hold. Real estate megafunds attracted 75% of the aggregated capital raised in Q2 2020, a rise from 59% in Q2 2019. In the face of market volatility generated by the pandemic, Preqin finds that there has been strong correlation between AuM growth and the brand strength of leading private markets fund managers, with the market share of strongly branded names increasing substantially over this period.[7]

This may be reinforced by the ability of larger asset management groups to apply technology to deliver competitive advantage. In private credit strategies, for example, analytics and AI are being applied to profile potential borrowers and evaluate credit risk. In private equity, the ability to apply alternative data sets, to manage big data and to apply advances in analytics is enhancing opportunities for some managers to identify value in private equity transactions and to provide ex-ante analysis of how key value drivers will perform under different investment conditions.

ESG standards

Almost a quarter of a century after the Kyoto Protocol, which established a practical framework for implementing the United Nations Framework Convention on Climate Change, the financial industry's progress in meeting commitments to environmental, social and governance principles has at times been disappointingly slow.

But climate change is moving to the forefront of the regulatory and policy agenda in Europe. In the UK, this will be prominent as the UK government hosts the COP26 UN Climate Change Summit in Glasgow – and may be used by the country's policymakers to reinforce its appeal as an investment destination after Brexit. Across the Atlantic, the Biden administration has shown initial signals that it intends to reintegrate the US into global environmental policy initiatives.

The Task Force on Climate-related Financial Disclosures (TCFD) has set out recommendations for helping businesses to disclose climate-related financial information,

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guiding governance around climate-related risks and opportunities, strategy, risk management and the use of metrics and targets. Established by the Financial Stability Board in December 2015, with more than 30 global members, its recommendations apply to a broad range of financial organisations, including institutional investors, asset management companies and banks. Its aim is to encourage voluntary, climate-related financial disclosures that are useful to investors, lenders and insurance underwriters in understanding material climate-related risks.

The TCFD is explicit about the key role to be played by beneficial owners and fund managers in promoting this initiative. It states: "Large asset owners and asset managers sit at the top of the investment

chain and, therefore, have an important role to play in influencing the organisations in which they invest to provide better climate-related financial disclosures".[8]

As a component of the European Commission's Sustainable Finance Action Plan, the Sustainable Finance Disclosure Regulation (SFDR) requires fund managers, financial advisers, and some other categories of regulated firms with activities in the EU to disclose information to investors on the ESG implications of their investment strategies (see box, right)

European regulators published their final report on the draft regulatory technical standards (RTS) for SFDR on February 4, 2021. EU member states were required to implement key

"Large asset owners and asset managers sit at the top of the investment chain and therefore have an important role to play in influencing the organisations in which they invest."

THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES

SUSTAINABLE FINANCE DISCLOSURE REGULATION (SFDR)

SFDR requires fund managers to publish a statement on their website regarding the steps they are taking to assess the 'principal adverse impacts' of their investment policies from a sustainability perspective (the 'PAI Statement').

The PAI Statement should include both quantitative and qualitative evidence. Fund managers should publish quantitative data on 14 key indicators (nine relating to environmental impact, five relating to social factors) for assessing adverse sustainability impacts across a range of ESG factors.

Under the qualitative disclosure, fund managers will be expected to provide:

- A description of policies to identify and prioritise principal adverse sustainability impact.
- Information on the fund manager's engagement policies and steps designed to mitigate the effect of any adverse impact identified above.
- Reference to international standards, including responsible business code of conduct, international standards for due diligence and reporting and, where appropriate, the degree to which the fund manager's approach is aligned with the objectives of the Paris Agreement.

At the time of writing, national regulators have proposed that the reporting requirements outlined in the regulatory technical standards (RTS) will apply from January 1, 2022. In practice, this will mean that managers will file their disclosure in 2023 for the 2022 reference period.

In addition, fund managers must make product-level disclosures on their websites and in fund documentation for ESG-focused funds ('Article 8' and 'Article 9' funds). This will include:

- Details of what environmental or social characteristic is promoted by the fund and which sustainability indicators are used to evaluate whether these objectives are met.
- Details of the investment strategy used to deliver these objectives.
- Details of the asset allocation of the fund and specific additional details dependent on this asset allocation.
- Whether product-specific information is available online and whether investors can access it.
- Whether a specific index has been designated as a reference benchmark and its alignment with each of the environmental or social characteristics promoted by the fund.

Fig 6: As policymakers extend legislation to promote ESG standards, how will this affect your business?

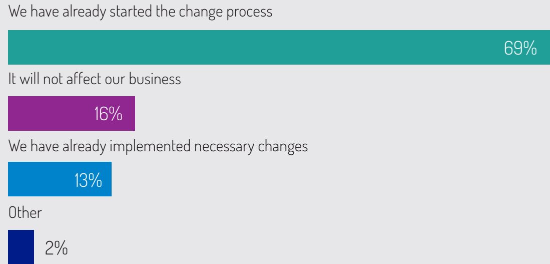
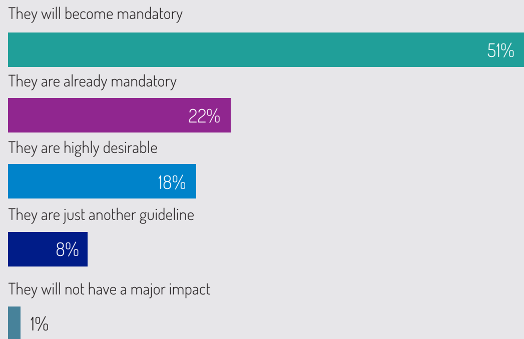


Fig 7: How important will ESG standards become in fund governance?



provisions of the regulation (i.e. Level 1) by March 10, requiring financial institutions to provide reporting on their sustainability activities at both legal entity (i.e. company) and product levels. However, some Level 2 provisions have been delayed subject to consultation on the draft RTS.

The UK has elected not to follow the SFDR or the EU's taxonomy on ESG funds. Consequently, any firms intending to market their ESG funds in the UK and EU will need to comply with more than one set of disclosure requirements.

When we asked survey respondents how their business will be affected as policymakers extend legislation around ESG, almost 70% say that they have started the change process of integrating ESG standards into their investment strategies. A further 13% said that they have already implemented necessary changes under this ESG agenda (fig 6).

From fig 7, the majority (51%) of respondents believe that ESG standards will be (or already are) a mandatory component of investment fund governance. This substantially outweighs the 18% of respondents that believe that ESG standards are 'highly desirable' in the investment process, but will not be mandated by policymakers or financial authorities. Only 1% said that ESG standards will have no impact on fund governance.

These trends, in respondents' opinion, will translate into a significant rise in demand for social investing, green bonds and impact investing strategies (fig 8). Impact investing strategies are targeted to generate a positive, measurable social and environmental impact in addition to generating a financial return.

Social investment, according to the European Commission, is largely about investing in people. It refers to investment policies designed to strengthen people's skills and capacities and to support them in participating fully in employment and social life. This may include investment in key policy areas such as education, healthcare and childcare, assistance with job searches and with rehabilitation.[9]

Green bonds are debt instruments issued to fund projects that promote a positive environmental or climate impact. The first green bond, the European Investment Bank's (EIB's) Climate Awareness Bond, was issued on the Luxembourg Stock Exchange in 2007. Currently, the EIB is the world's largest issuer of green bonds.

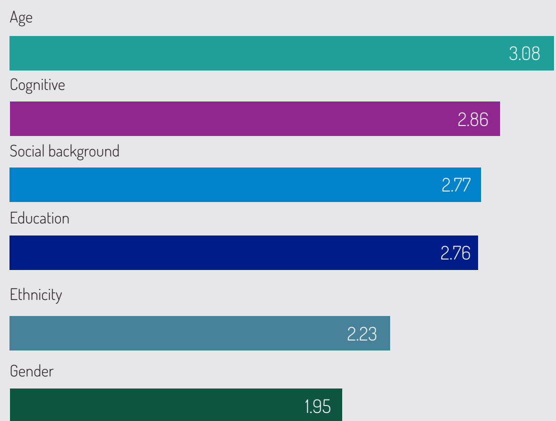
Diversity and inclusion

Diversity, inclusion and equality are the foundation stones of an environment where individual differences and the contributions of all participants are recognised and valued. In the workplace, these principles help to ensure each employee can apply their experience, knowledge and skills for the benefit of the organisation and its customers, staff and wider community.

But how well does the funds industry embrace these principles? And where will efforts to promote diversity be focused?

Fig 8: How do you assess growth prospects in the following strategies? (weighted mean)

Fig 9: Where will be funds industry focus measures to improve diversity and inclusion? (weighted mean)



> *"With three-quarters of FTSE 100 companies failing to report the ethnic make-up of their boards, investors are now calling on companies to take decisive action."*
>
> *ANDREW NINIAN, INVESTMENT ASSOCIATION*

On the second of these questions, respondents told us that measures to address age discrimination will be most prominent (fig 9).

Policies to improve cognitive diversity across the organisation were ranked by respondents in second place, representing steps to include employees with diverse perspectives and methods of problem-solving and processing information. Measures to address lack of opportunity linked to social background (2.77) or education background (2.76) featured in third and fourth positions respectively in the ranking order.

Alexandra Altinger, CEO of J O Hambro, noted recently that UK firms may pay a financial price for lack of boardroom diversity. She was commenting on the findings of a recent report by professional services group Company Matters, which concluded that women are outnumbered 16 to one in executive roles in AIM UK 50 companies.[10]

There is also a lack of racial diversity in UK boardrooms: only three out of 324 directorship positions in AIM UK 50 boards are held by directors who are black.[11]

Looking at the steps that the industry may take to encourage diversity (fig 10), 30% of respondents to this *Funds Europe* survey agreed that the funds industry ought to set targets for improved representation, with 9% saying these targets should be mandatory.

In contrast, a majority of respondents said that this is best achieved through a balanced set of measures designed to encourage more balanced representation across the industry (60%).

In February 2021, the Investment Association (IA) in the UK announced that it plans to issue warnings to FTSE 350 companies that fail to deliver improvements in boardroom diversity. This will include 'amber' warnings issued to firms that fall short of required standards on ethnic and gender diversity and more severe 'red' warnings for firms that demonstrate deeper fundamental shortcomings in this area.[12]

This builds on the recommendations of the Parker Review, published in 2017, which mapped out targets for directors

Fig 10: How should the funds industry encourage diversity?

on company boards from ethnic minority backgrounds.

In the first Parker report, from 2017, the Review made a series of recommendations and set a target for all FTSE 100 boards to have at least one director from an ethnic minority background by 2021 – 'One by 2021'.

A new Parker Review report published on February 5, 2020 found that 37% of FTSE 100 companies surveyed (31 out of 83 companies) do not have any ethnic minority representation on their boards. Representation on FTSE 350 firms was even worse, with 59% of companies (150 out of 256) having no ethnic minority representation.

Andrew Ninian, the IA's director for stewardship and corporate governance, observed that the UK's boardrooms need to reflect the diversity of modern-day Britain. "With three-quarters of FTSE 100 companies failing to report the ethnic make-up of their boards in last year's AGM season, investors are now calling on companies to take decisive action to meet the Parker Review targets," he says. "Those who fail to do so this year will find themselves increasingly under investors' spotlight."[13]

The funds industry also has work to do in addressing gender diversity. At the end of 2000, 14% of fund managers were women, according to data and analytics specialist Morningstar. However, at the end of 2019, this figure remained unchanged at 14%. There had been little measurable improvement in addressing this inequality of gender representation in money management teams.[14]

According to its February 2021 Diversity, Equity and Inclusion survey, Morningstar finds that only five of the 11 markets in which the survey was conducted have laws in place regarding disclosure on diversity policy that apply to investment firms – notably Finland, France, Norway, Sweden and the UK.

However, Canada, Denmark, Germany, Italy, Spain and the US still do not have disclosure laws on diversity policy.[15]

In May 2020, the Investment Association issued a diversity and inclusion statement, indicating that it aims to create a diverse and inclusive UK investment industry at all levels,

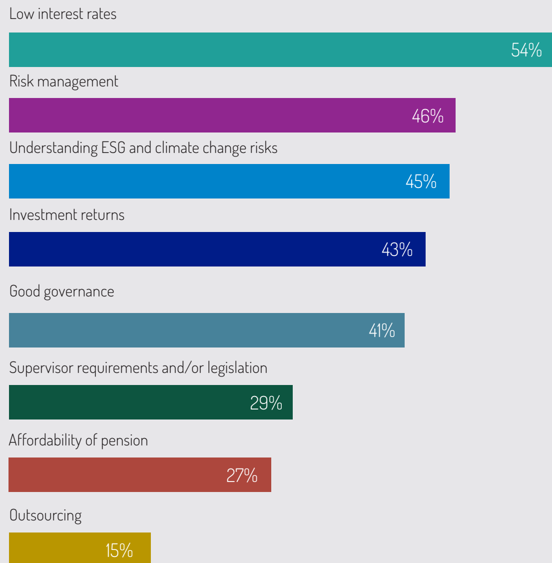
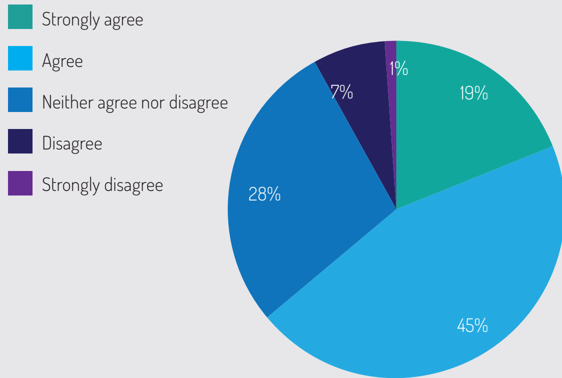


Fig 12: How much do you agree with the statement, "Pension funds should pay more attention to alternative investments in their search for yield"?



> *"Successful businesses create an environment where people want to work, where they feel challenged, able to use their talents, and valued."*
>
> *THE INVESTMENT ASSOCIATION*

including within the Association's own employment structure. "Successful businesses create an environment where people want to work, where they feel challenged, able to use their talents, and valued," it says.[16]

This will include steps to attract, develop and retain talent from a wider pool – recognising that minority groups and women are under-represented in the industry, especially in senior positions. It also aims to promote a change in corporate culture, taking action to address the gender pay gap along with practical guidance to promote ethnic diversity and LGBT representation.

Pension fund governance

When asked to identify the major challenges confronting pension funds boards in the current investment climate, 54% pointed to the current low interest rate environment as their top priority (fig 11). More generally, almost half highlighted a broad focus on risk management (46%), including investment risk management, regulatory risk and asset servicing risk. In the context of the preceding discussion, it is significant that 45% of respondents highlight ESG and climate change risk in their top three priorities.

Pension funds have traditionally held fixed income instruments as a key component of their asset allocations, providing the diversification and stable cash flows required to match their obligations to retirees. But when bond yields are close to historic lows and equity returns are highly volatile, this presents challenges for pension funds in satisfying their return expectations, meeting funding levels and safeguarding the cash flows required to meet obligations to scheme members.[17]

Given the magnitude of fiscal and monetary stimulus that leading economies have experienced during the past 12 months – and in the longer term since the 2008 financial crisis – investment boards remain wary of inflationary pressures and watchful regarding the potential formation of asset price bubbles in equity, commodity and

real estate markets.

Reacting to this set of challenges, almost two-thirds of respondents said that alternative investments provide an attractive option for pension funds in the current investment climate (of which 19% said they agreed strongly). In contrast, just 8% of respondents said they disagreed with this statement (fig 12).

Recent evidence suggests that pension boards must give careful consideration to governance and engagement considerations associated with their investments. In the UK, trustees of defined benefit, defined contribution and hybrid schemes are required by law to compile annual Implementation Statements which detail how their engagement policies as shareholders (including how they have exercised voting rights) have been fulfilled.

However, a March 2021 study by Dalriada Trustees and Minerva Analytics found that only one-third of asset managers surveyed were able or willing to respond effectively to information requests from pension funds regarding how they engage with investee companies. Out of 43 asset managers analysed in this study, nearly 30% provided no information at all and 40% of managers said there was no information to report.

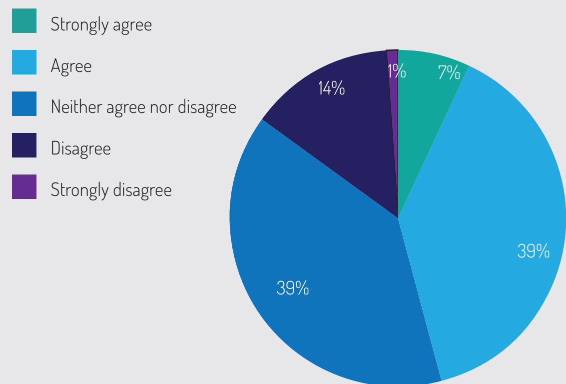
David Fogarty, director of Dalriada Trustees, commented: "As trustees, we need to show to members what action we are taking in terms of engagement on assets we govern on their behalf. Yet we are in a position where we are receiving insufficient information from the asset management community. We are seeing managers marketing funds for their ESG credentials, but they are failing to provide clear evidence of the actions being taken."[18]

The UK's minister for pensions and financial inclusion, Guy Opperman, said recently that it is "totally unacceptable" that fund managers are "unable or unwilling" to respond to information requests from pension funds.

Faced with these challenges, *Funds Europe* asked

> *"We are seeing managers marketing funds for their ESG credentials, but they are failing to provide clear evidence of the actions being taken."*
>
> *DAVID FOGARTY, DALRIADA TRUSTEES*

Fig 13: How much do you agree with the statement, "The custodian is the ideal party to act as a governance partner for pension funds with independent reporting"?



respondents, "Is a pension fund custodian the ideal party to act as governance partner in assisting the pension fund with independent reporting?" The balance of opinion (fig 13) was in support of this statement, with 46% saying that they agreed and 7% agreeing strongly. This substantially outweighs the 15% who disagreed with the statement.

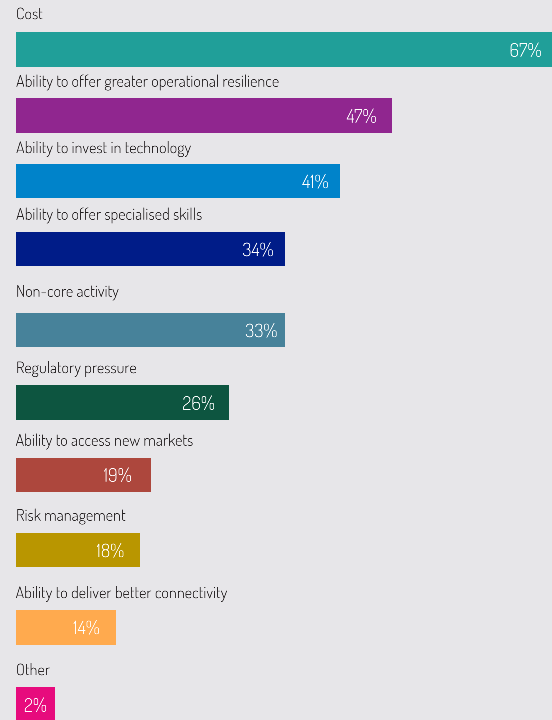
Significantly, however, a sizeable percentage (39%) were agnostic about this proposal, with no strong opinion for or against.

Service outsourcing

Building on this theme, the survey asked respondents to identify which factors will be the primary drivers of outsourcing across the asset management industry (fig 14).

The response was unequivocal. Cost pressures will be the dominant factor (67%). Companies will aim to reduce their headcount, technology and maintenance expenditure – and more generally to translate fixed into variable cost through outsourcing.

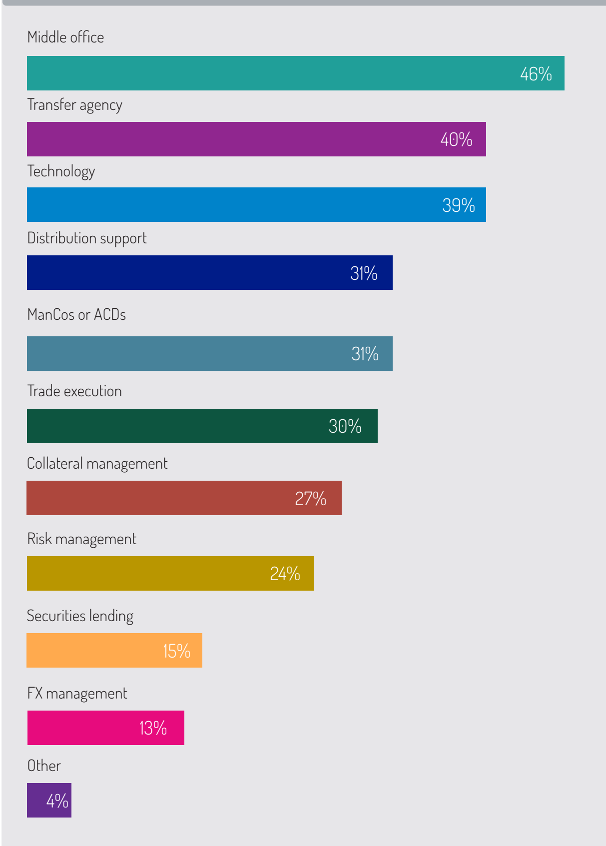
Survey results indicate that, in the wake of the pandemic, companies are also seeking to establish a higher level of operational resilience by



outsourcing services that they currently manage in-house (47%). Perhaps unsurprisingly, respondent firms will look to outsourcing partnerships to strengthen their technology capability and to access specialist skills that are not currently available internally.

The strongest acceleration in service outsourcing, respondents tell us (fig 15), will take place for middle-office services (46%). While asset managers typically wish to retain key functions in-house that feed their competitive advantage, they may be willing to outsource 'non-core' support functions to a specialist third-party provider.

One example may be for investment firms still



meeting their transfer agency requirements in-house to outsource this to an external specialist, either on a modular basis or as part of a bundled package from their asset servicing partner(s). The survey finds that buy-side firms may also outsource to meet their requirements for technology renewal and innovation.

Digital transition

According to Schroders' group chief executive, Peter Harrison, technology has been at the heart of his company's response to Covid-19, facilitating collaboration across business units and safeguarding business resilience. Even before the pandemic, this asset management group has been working to establish an infrastructure for 'unhindered flexible working', helping teams to cross-fertilise ideas within the company and for portfolio managers, analysts and traders to achieve the same working experience, whether working in the office, at home, or from a disaster-recovery site.

But where does the industry need to focus its attention to realise most gain from its investment in digital transition (fig 16)?

The need to invest in data management and analytics is the most pressing issue identified by respondents (85%). This is a wide-ranging category that embraces many priorities highlighted in this report. Additionally, respondents prioritised efforts to move to real-time (or near-real-time) investment operations and reporting (75%) and a need to improve connectivity between participants (66%). Improvements in cyber security (64%) ranked fourth in this list.

The ability to manage large data volumes and high data velocity is fundamental to a wide array of functions in the asset management industry – as an input to factor-based

Fig 16: The impact of Covid-19 has accelerated digital transition. Where does the industry need to focus investment? (Please select your top 3 answers)

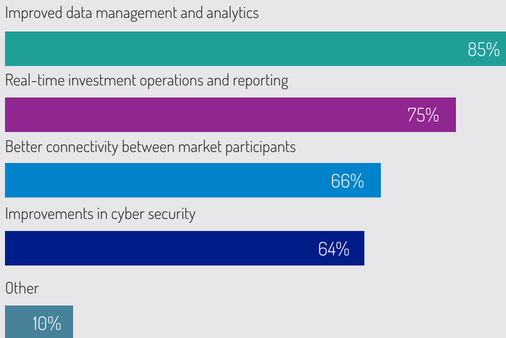
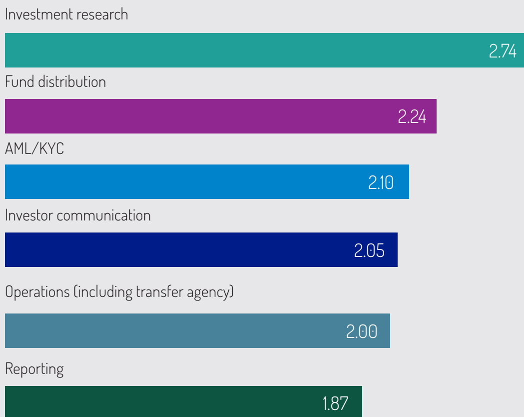


Fig 17: Which areas of digital transition are your highest priorities? (weighted mean)



and quantitative investment strategies, for example, or for conducting analysis of customer buying preferences as a driver for its product development and distribution strategy.

Another fundamental requirement in effective data management – the ability to accommodate data variety – is also becoming increasingly important. Investment teams are drawing insights from a wide range of alternative and unstructured data sets to inform their investment strategies. Beyond the investment decision, this expertise may be important, for example, when applying ESG screening to assets held in portfolio or received as collateral in secured finance transactions.

In the 'Other' category, respondents highlighted the importance of effective channels to support digital engagement with customers. In the context of remote working, a number of respondents prioritised standardisation of market practice around digital document signatures.

Several respondents also highlighted the potential

> *"The UK's minister for pensions and financial inclusion, Guy Opperman, said recently that it is 'totally unacceptable' that fund managers are 'unable or unwilling' to respond to information requests from pension funds."*

"The ability to accommodate data variety is becoming increasingly important. Investment teams are drawing insights from a wide range of alternative and unstructured data sets to inform their strategies."

benefits offered by blockchain in supporting centralised record-keeping, reconciliation and safekeeping across the investment value chain, including custody services.

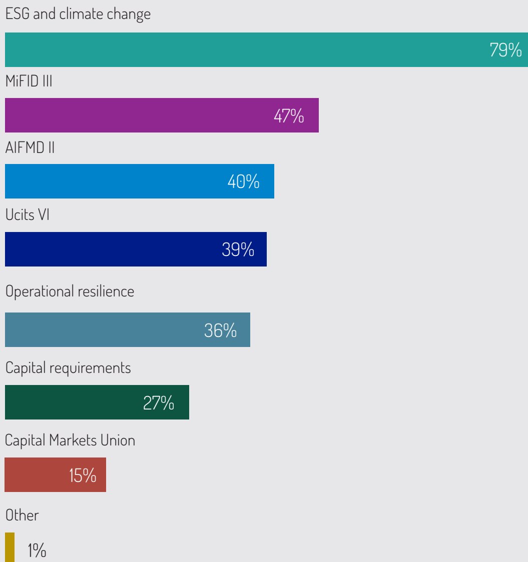
When asked which areas of digital transition are most important to respondents' firms, the survey finds that the highest priority is in digitalisation of investment research (fig 17). Asset management firms are seeking access to new data sources to support their investment decision-making, including alternative data sets to support alpha generation and to enable their ESG strategies.

Second in the rankings is the need to improve digital transformation in fund distribution – including digital transmission of fund subscription/redemption instructions, the ability to bring greater automation to anti-money-laundering/know-your-client (AML/KYC) verification and improved automation of fee and commission payments.

Alongside the sales component of the distribution function, key parties to the fund transaction may require a wider range of services including managing distributor agreements, rebate calculation and processing, support with compliance reporting, communicating data on distributor sales, and access to product information and fund documentation through a single point of access.

Many of these tasks have traditionally been manual

Fig 18: Which areas of the industry are likely to see tighter regulation in the next 3 years?



"The distribution and distribution support functions are benefiting from investments to improve digital engagement, improving STP rates and lowering operational risk, as well as delivering a better client experience to the investor."

and resource-intensive. The distribution and distribution support functions are now benefiting from investments to improve digital engagement, improving STP rates and lowering operational risk, as well as delivering a better client experience to the investor. This is vital to improve cost-efficiency and to meet the investment objectives of younger generations.

Regulatory drivers

We have reflected at multiple points in this report on the challenges and opportunities posed by regulatory adaptation as a driver for change in the funds industry.

To identify where this change agenda will have most impact, the survey asked the question, "Which areas of the funds industry are likely to see tighter regulation during the coming three years?"

Given the huge drive across asset management and asset owner organisations to meet their ESG targets, it is perhaps unsurprising that ESG and climate change featured at the top of the list, attracting over 30% more responses than any other answer (fig 18).

Respondents also highlighted the likelihood of potential reform to the MiFID directive.

The European Commission released a consultation paper in March 2020 soliciting public feedback on MiFID II and MiFIR (the Markets in Financial Instruments Regulation). The first part of this consultation paper addressed questions on the overall functioning of MiFID II and MiFIR, while the second section addressed a range of priority and non-priority issues raised by the Commission. Among the 'priority' issues were proposals to phase out paper-based investor information, along with ongoing steps to provide access for retail clients to a wider choice of transparent and affordable investment products.

More broadly, the Commission has put forward for public consultation the possibility of

"Among the priority issues were proposals to phase out paper-based investor information, along with ongoing steps to provide access for retail clients to a wider choice of transparent and affordable investment products."

creating an EU consolidated tape, an electronic data stream providing real-time exchange data (e.g. price, trade volumes) which is not limited to equity instruments. It is also reviewing plans to promote further unbundling of research and execution services and to deepen research coverage of the SME sector.

To preserve standards of investor protection, while maximising flexibility available to investors, the Commission has also sought feedback on the creation of a category of 'semi-professional clients' lying between the existing categories of retail or professional investor. The aim is to make it easier for high-net-worth and sophisticated investors, which may not currently fall within the professional investor category, to participate in the capital markets. Ultimately, this may lead to the creation of a tailor-made investor-protection regime for these 'semi-professional' clients.[19]

"The Commission has sought feedback on the creation of a category of 'semi-professional clients' lying between the existing categories of retail or professional investor."

The European Commission has also launched a review process regarding a potential successor to the Alternative Investment Fund Manager Directive (AIFMD). This, among other considerations, will assess the competitiveness of the AIF industry in Europe, the effectiveness of the AIFM passport, and whether there is justification to extend the AIFM licence to a wider category of fund managers.[20]

This also includes plans to clarify AIFMD rules on depositary services and depositary obligation. The Commission recognises the need to address a short supply of depositary provision in certain markets, particularly where there is a concentration of depositary services in smaller EU markets.

More generally, the European Commission continues to explore steps to align AIFM and Ucits Directives, including (i) potential for a single EU rulebook for Ucits and AIFM regulatory frameworks; and (ii) potential for a single licence for AIF and Ucits managers. **f**e

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Survey methodology

A total of 172 fund professionals participated in the survey, conducted online during February 2021.

Looking at the occupational breakdown of respondents, 30% indicated that they work in fund administration or asset servicing. A further 19% indicated that they work in fund manufacture.

In total, 17% of the respondents identified themselves as working in fund distribution, with platform services (8%) and market infrastructure (7%) the other key categories.

The balance of respondents ('Other') includes respondents working in legal services, software vendors, trade associations and private banks.

Most respondents are based in the major fund domiciles of Luxembourg (20%), France (17%), the UK (15%) and Ireland (10%).

Any commentary in this report relating to survey results, or wider analysis of the industry, is that of *Funds Europe* and does not necessarily reflect the views of CACEIS.

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CAMRADATA ANALYTICAL SERVICES LIMITED
5TH FLOOR, 80 LEADENHALL STREET, LONDON EC3A 3DH
TEL: +44 (0)20 3327 5679 FAX: +44 (0)20 3327 5693
EMAIL: CONTACT@FUNDS-EUROPE.COM

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