

Financial Services

Positioning for success – redesigning the asset management model

In response to challenging market conditions, asset managers should examine their operating models with an eye toward meeting demands from regulators and investors, growing assets, increasing investment performance and managing risk.

by Alan Fish and Lesley Keefe

Most asset managers have been battered by the global financial crisis and ensuing recession. But firms must balance taking defensive steps to curtail costs today with making focused offensive investments to provide for future growth. Surprisingly, perhaps, now is the best time for executives to prepare for the future by taking a hard look at their operating models and investing in some fundamental organizational changes.

Asset managers have long sought ways both to cut costs and to enhance functionality in their middle and back offices, with the goal of improving risk management while they grow in scale and global reach. Since the economic downturn began, however, cost pressures have dramatically increased. Meanwhile, the credit crisis has intensified the focus on risk management and compliance, particularly as industry executives prepare for expected regulatory changes from governments worldwide.

Essentially, investment managers face growing demands from all sides at a time when assets under management have fallen sharply. Clients want better performance, more information and greater portfolio transparency – and at lower fees. Regulators want more oversight and reporting, which imposes higher costs and further constraints. To meet these demands, firms must be able to get timely and comprehensive data related to their trading activity, portfolios and operational and investment risks.

Can asset managers really afford to invest in new strategic changes to their operations at a time when they have to do more with less? In fact, they can't afford not to. The increased demands make it more urgent for executives to realign their operations now, both to cope with the new environment and to build a strong base for renewed product growth and global expansion when the economy recovers.

However, in their efforts to streamline operations, firms should be careful to avoid quick decisions that involve long-term commitments to outsourcing, offshoring or shared services. Before making any moves, executives should first thoroughly assess

their current operations in light of their long-range business objectives. Their assessments should encompass the front, middle and back offices, looking not only at the technology infrastructure and applications, but also at the product set, people, skills and processes. Only then can a firm define a "target-state" operating model and formulate a plan for reaching it.

Defining the firm's future

Of course, every asset manager is constantly evolving as it innovates to meet market needs, changing its mix of products and asset classes and the people, skills and

technologies it requires to support them. Thus, it is important for senior management to step back and consider its long-term strategy, define a clear vision of where it wants the firm to be in two, three or even five years and take definitive steps to translate that vision into a program of activities. The vision should comprise goals for growth in assets under management, the firm's competitive position in particular asset classes and products, its ideal headcount and mix of skills and the geographical distribution of those people and skills.

The next step is to take a snapshot of the firm's "current state" operating model. This can be a challenge because management must commit to comprehensive analyses to get a sufficiently detailed picture, not just a broad outline. To draw this picture, the assessment team may need to interview people in all locations about what they do and exactly how each process works.

Management should assess the profitability of products and the cost of operational readiness, the balance of asset classes, each product and its competitive position, a complete roster of people and their skill sets and the strengths and weaknesses of each business unit. On the systems side, the assessment should include all manual and automated processes and workflows and the applications that currently support them.

With this snapshot in hand, executives can compare the current state with the target state and then pinpoint opportunities to make strategic investments for long-term competitiveness. They can identify the gaps they need to fill in the firm's product mix, people and skills and where the firm needs to update systems, expand capacity or automate processes. Executives should also consider how well the firm is prepared to meet increased regulatory requirements.

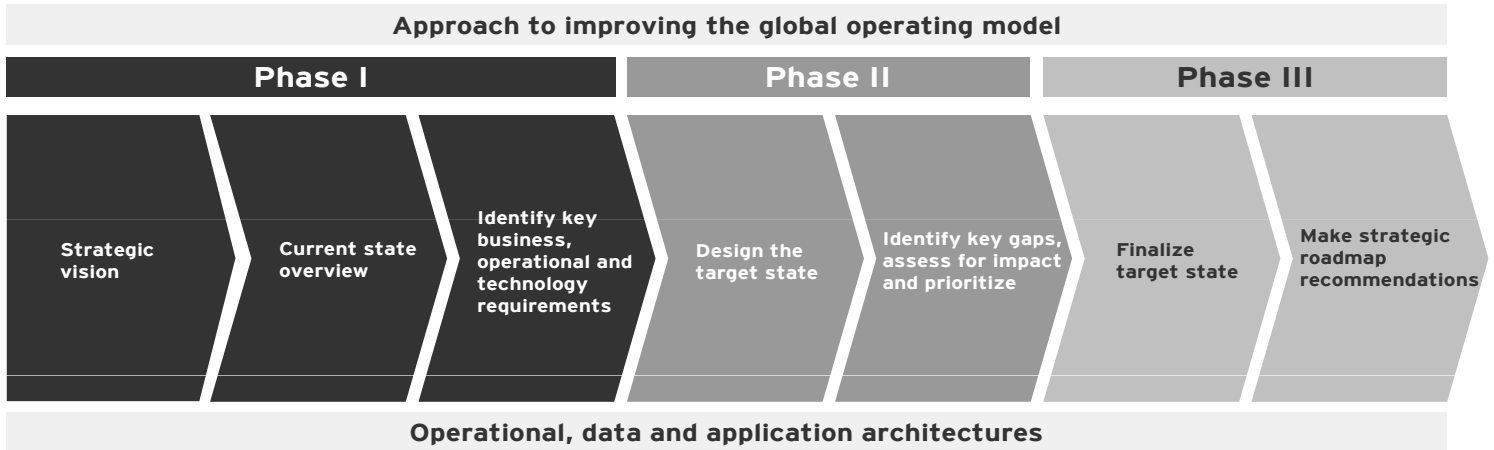
The top three factors preventing firms from achieving target operating models to date:

1. Management focus
2. Limited number of highly skilled resources
3. Technology limitations in business applications

Critical factors most cited as necessary for firms to achieve their business goals and objectives in the next one to three years:

1. Development of people skills and talents
2. Enhancing or maintaining an effective technical infrastructure
3. Innovative and profitable new investment products

Source: Ernst & Young Asset Management Global Survey of Operating Models and IT, February 2009



Allocating finite resources

Filling the gaps will likely require significant investments of management time and capital, so setting priorities is vital. These priorities will help managers turn the assessment into an action plan and a roadmap for getting the firm to its target state over a period of several years. To develop a logical and cost-effective operating model that will support the firm's goals over time, it may help to look at what other firms are doing, possibly through peer networking.

Because no firm has unlimited resources, the plan and the roadmap will necessarily include some tradeoffs between costs and desired outcomes, taking into account the people, resources and skills available to allocate to each project on the list. To ensure that they make the best decisions, executives should establish a formal governance structure to oversee the process. The right people, armed with the right information, should be making the choices about which projects the firm should fund and in what order they should be carried out.

Ideally, this group should include representatives from different parts of the firm at various levels. However, it should not be so large and cumbersome that it hinders the process. The real goal is timely and

effective decision-making by people who can continue to manage their assigned jobs at the same time.

The resulting target operating model and roadmap may well involve some mix of outsourcing and offshoring or the creation of shared-service groups within the firm. Ernst & Young's recent global survey on operating models indicates that many larger traditional asset managers have already moved toward this type of shared-service environment, particularly in their back offices.

Focusing on the middle office

However, our survey also indicates that many firms may find great opportunities for efficiency improvements and cost savings in the middle office. Focusing on standardizing and automating middle-office processes may be one of the most productive ways a firm can reach its target operating state and create the best conditions for outsourcing, offshoring or shared-service solutions.

Within most asset managers, a flowchart of the current operating model looks rather like an hourglass, with the middle office the narrowest point. Front-office portfolio

managers aligned by asset class funnel their trade information to the middle office, which then routes it to a variety of back-office accounting platforms that track the firm's institutional and retail client assets. The middle office acts as a point of convergence where the rest of the firm draws on information to support risk management, regulatory compliance, marketing and sales, client service and other functions.

Nonetheless, middle-office processes tend to be less standardized and automated than those in the front and back offices. This could lead to problems as regulators demand more timely and accurate reporting of positions and issuer exposures and clients seek more detailed monthly or quarterly investment-performance reporting.

For example, a regulator concerned about a particular issuer might ask a firm to report its overall exposure to that issuer, setting a 48-hour deadline for the information to be reported. To meet the demand, the middle office in one geographic location might need to pull data from dozens of different systems, global offices and departments, some of it in electronic form, but some not. In many firms, such information is maintained in a variety of formats in multiple business systems. However, the firm's report to the regulators cannot simply omit a position managed by

an entity in, say, Tokyo, just because the time difference makes it difficult for the New York office to normalize the data promptly.

Creating consistent processes and controls in the middle office and bringing to bear technology to enable further efficiencies make it easier to decide whether or not to outsource. To do this effectively, however, firms need to find the right data architecture, taking a close look at where and how trading activity, positions and related information are stored throughout the firm. The goal is to enable timely access to critical information as it flows to and from the front, middle and back offices.

Under today's volatile market conditions, asset managers need to handle the creation and stewardship of this data to allow standardized formatting, strict quality control, wide dissemination and instant access for the right people. Executives must clearly articulate a data strategy, assigning ownership responsibility for maintaining each type of data so that any individual piece of information need only be entered once, then enriched, in a format that all the firm's business applications can use.

Most often, the middle office will be the best place for that responsibility to reside. Ideally, it should be able to serve as a single source of data for all applications and platforms to draw on as needed, whether the data is stored in a centralized, application-independent data warehouse structure or in multiple physical locations.

This type of all-encompassing data architecture can indeed serve as one of the key foundational elements for a strategic initiative both to cut costs and enhance functionality in a firm's middle and back offices. A well-defined and managed data architecture, in turn, plays a critical role in developing an overarching operating model that is more rational and efficient across the enterprise – and, of course, more flexible.

By clearly articulating the vision, focusing and then mobilizing an organization's resources in support of a new operating model, a firm will heighten the capabilities of its people, processes, controls and technology and position itself for success.

Alan Fish is a partner in the Financial Services Office of Ernst & Young LLP. Alan is based in New York and can be reached at +1 212 773 6560 or alan.fish@ey.com.

Lesley Keefe is an executive director in the Financial Services Office of Ernst & Young LLP. Lesley is based in Boston and can be reached at +1 617 585 0925 or lesley.keefe@ey.com

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