Front-office viewpoint

The investment division: can technology drive transformational change?
Moving from incremental to transformational change in the asset management investment division

This paper examines the opportunities and challenges facing the asset management community in its pursuit of a scalable, capable and cost-efficient global operating model for the investment division and the technology to enable it. It also considers how existing solutions in the market are uniquely positioned to transform the way the business is serviced.

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Introduction

Asset managers continue to face pressure from investors and regulators to improve the reliability and efficiency of their businesses. In response, firms are making significant efforts to re-examine and improve the operating models that support these businesses, models that have often been in place for many years. This process still has a long way to go, especially in the investment division. But developments in front-office applications and technology provide an opportunity to review and reassess operations in this function, particularly when introducing a consistent, global, front-office-focused model. There is also a growing realization in many firms that this approach can generate much wider benefits across the entire business.

Technology now allows asset managers to develop front-office operating models that are not only cost-efficient but also capable, globally scalable and able to incorporate proprietary features. In this paper, we examine why, and how, asset managers are using technology to reshape their investment activities.
There are many reasons asset managers are increasingly transforming their front-office operating models and relying heavily on new technologies to do it. Some of the most important are:

- **Product evolution and geographical growth.** As asset managers focus on growth, front-office systems need to be able to support the development of complex new investments, such as multi-asset funds and structured products, while also supporting a global operating model in which assets are managed in multiple locations. Systems also need to handle a continuous process of fund rationalization and consolidation.

- **Cost savings.** Although the rebound in financial markets has pushed up asset managers’ operating margins, competition and fee transparency continue to put pressure on their underlying revenues. Profitability is also being squeezed by the upward march of costs in areas such as regulation and product development. In response, firms are looking for efficiencies in every area of their business.

- **Harnessing data.** While technology in itself rarely offers a source of differentiation, when used in conjunction with high-quality data it is increasingly seen as a core driver of investment decisions.

- **Reporting.** The demands of front-office reporting are growing as investors scrutinize how returns are achieved, and at what cost. With firms managing a broadening range of assets and strategies across a growing number of markets, robust technology is vital to consistent firmwide reporting and minimizing costs of reporting.

- **Risk management.** Consistency of the investment process and control over it is key. Over time, many asset managers have developed a mixture of custom and off-the-shelf front-office systems supplemented by spreadsheets and manual processes. Introducing more standardized, robust technology is seen as increasingly important to achieving standardization of process and effective governance and risk management.

- **Shifting decision-making.** In the post-crisis world, the historic decision-making dominance of the investment division has now been supplemented by others within the investment firm. Decisions on front-office technology are now as likely to be made by the business managers within an investment firm as by the fund managers themselves. Input from the investment division, while vital, is now only part of the picture.

These factors are stimulating a wave of front-office transformation across the asset management industry. We see no signs of this abating. If anything, the desire to upgrade investment capabilities is becoming stronger as asset managers pivot toward growth. There is a growing realization that front-office transformation can not only achieve cost savings but also help to achieve strategic goals for expansion.

What is driving the current wave of front-office transformation?
Why is technology so vital to front-office transformation?

Front-office restructuring is often triggered by the need to upgrade or replace existing technology. The goal is typically to establish a more streamlined platform with capabilities across a range of areas such as decision support, portfolio management, risk analysis, order management, execution and compliance.

Recent developments in functional coverage by technology vendors are further strengthening the case for front-office transformation. Today’s systems typically provide automated trade capture with minimal manual entry, and offer real-time risk analysis and compliance capabilities. They contribute to best execution by leveraging real-time analysis of liquidity and pricing, and by providing connectivity with fragmented sources of liquidity. They are also able to support multi-asset funds and other complex investments.

Technology vendors continue to develop new capabilities. One example is the ability to combine front-office portfolio reporting with back-office accounting data in real time, to produce an investment book of record (IBOR). An IBOR can eliminate many problems associated with an accounting-based data architecture, such as front-office teams needing to recalculate their start-of-day positions due to issues with quality of Accounting Book of Records data. An IBOR can also act as a central aggregation point that allows different users to view any type of data, for any portfolio instrument, at any time.

Following a big push from vendors, front-office software platforms also now offer good scalability. This includes the ability to handle multi-location, multi-jurisdiction portfolios and integrate acquisitions given the open architecture approach that a number of providers adopt. In recent years, a number of global asset managers have used the transformation of their front-office technology as a springboard for diversified international growth.
There is a clear trend of technology vendors supplying their front-office software within a hosted or managed environment. Simply put, this means that asset managers are paying for a service rather than buying an asset. This approach has a number of potential benefits for firms seeking to transform the performance of their investment divisions:

- One is simplicity. Hosted systems reduce the need for internal support, maintenance and administration. Changes due to market and regulatory requirements (e.g., MiFID and Dodd-Frank led to changes in collateral management processes) can be delivered to clients quicker. And they offer a standard architecture that makes upgrades and additional components easy to implement.

- Another benefit is focus. Internal technology specialists can focus on higher-value activities, such as developing front-office initiatives that provide a competitive advantage.

- The third benefit is cost. The majority of hosted systems require lower up-front investment and licensing costs. They are often charged by usage and require less in-house support. And they offer potentially significant reductions in technology staffing, which often comprises 10% or more of an asset manager’s headcount.

Technology vendors have also worked hard to reassure their asset management clients – and especially investment divisions – about the security of proprietary data, intellectual property and identifiable investor information. Despite natural caution over sharing this type of data with a third party, we see this as a receding issue. Vendors have put strong safeguards in place, and most asset managers have been entrusting similar investor data and commercially sensitive information to back-office administrators and hosted sales platforms for years.
Hosted front-office software is provided by a range of specialist vendors, including BlackRock Solutions, Bloomberg and Charles River Development. The buyers of hosted front-office technology include international asset managers, small and mid-sized firms, and insurers’ in-house management arms.

In our experience, a range of firms can benefit from implementing a consistent front-office model across markets, geographies and business units. However, larger firms typically have the greatest scope to simplify technology; we have seen the implementation of a hosted platform lead to dozens of other front-office systems being decommissioned. Large asset managers may also have the opportunity to leverage other investment in shared centers of excellence. Finally, big firms are most likely to have the budgets and skills to take on major transformation programs.

It is unrealistic to think that a large multinational asset manager can rely on a single technology platform to support all of its investment activities. Even so, the open architecture of a number of systems allows firms to selectively integrate internally developed platforms and to connect directly with service providers in the middle and back office. This gives asset managers the opportunity to significantly improve efficiency and scalability in the investment division while retaining valuable in-house systems and making full use of middle- and back-office outsourcing.
How does technology broaden the reach of front-office transformation?

The flexibility and capability of current systems show that technology designed for the investment division is spreading its wings across the asset management value chain. By developing functions such as performance attribution and client reporting, front-office providers are beginning to duplicate existing arrangements that asset managers may have with other service providers.

As they aspire to service a greater extent of asset management operations, front- and back-office service providers are beginning to compete head on. We have even seen examples of asset managers opting to insource some processes from third-party administrators after making major upgrades to their front-office technology.

Developments like these illustrate the impact that front-office transformation can have on the whole of an asset manager’s value chain. Because activities in the investment division touch on most aspects of an asset manager’s operations, changes to technology and operating models tend to be felt throughout the business. This means that improvement or restructuring in the front office can quickly evolve into more wide-ranging business transformation.

The resulting improvements are not confined to technology. Strengthening capabilities in the investment division makes it easier to make enterprise-wide improvements in areas such as risk management, client reporting, product development, compliance and settlement. The resulting impact can be a step change in capabilities across the whole operating model. There can also be significant opportunities for firmwide cost savings as a result of streamlined technology, staffing reductions and process efficiencies.
How can asset managers maximize the benefits of transformation?

The potential benefits of front-office transformation may be significant, but success cannot be taken for granted. Poor execution can leave asset managers struggling to justify the investment they have made. So what are the key features of successful front-office transformation?

In most cases, the answer does not lie with the technology. The market-leading systems are capable of delivering a range of benefits throughout the value chain and across business lines and geographies. Instead, it is usually an asset manager’s own ability to manage the change that holds the key to maximizing the benefits of transformation.

In our experience, one key to success is to recognize that, while transformation may begin with technology, it is only one aspect of effective change. To optimize the benefits of simplification, consistency and centralization, upgraded systems need to be matched by changes in areas such as process, products, third parties, governance and organizational change. The resulting upheavals to staffing and organizational structures need careful management, under the same sort of monitoring and central oversight as any other major business change.

A second key to success is to consider the process of transformation from an enterprise-wide perspective. Scope for complementary improvements in the middle and back offices needs to be factored in from the start. This not only helps firms to leverage new technology beyond the investment division; it also makes it easier to review existing outsourcing arrangements and identify opportunities to rationalize third-party relationships.

A third important feature of success is to avoid viewing the introduction of new front-office technology as a one-off event. Tight, well-drafted service level agreements are vital, with operational management of the combined service overseen by a steering group with representatives from the business, technology staff and external providers. Firms also need to maintain a sustained focus on their wider goals of business transformation, not just on implementing changes to technology.

Taking this kind of holistic approach helps firms to improve global oversight, risk management and reporting; to optimize their distribution of resources; to maximize the effective use of shared service centers; and to reduce headcount and other associated costs.
Conclusion

Developments in technology are providing asset managers with an unprecedented opportunity to restructure their investment divisions. Solutions now available in the marketplace have the potential to transform front-office operations, especially for large organizations with the greatest scope for simplification, rationalization and centralization.

In our view, the key to success is to look beyond the technology and beyond the investment division. Firms that take an enterprise-wide view of front-office-led transformation and its potential benefits will reap the greatest rewards.

While recognizing that every firm has its unique circumstances, we believe this is an ideal time for transformational change that starts in the front office. In the current atmosphere of market optimism, the industry is increasingly focused on asset gathering, expansion and entering new markets. At the same time, regulatory pressures, while substantial, are becoming part of business as usual.

There may never be a better moment to use technology as an enabler of transformation in both the investment division and the wider business, and for that transformation to deliver a step change in asset managers’ capabilities, performance and long-term growth prospects.
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