Middle-Office Outsourcing Trends for Asian Asset Managers

Transaction Services

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Asian asset managers are expanding their investment footprint, driving increased trade volumes and diversification into new asset classes, strategies and geographies. In order to pursue these opportunities while meeting client demands for transparency, they are turning to dedicated providers of middle-office services to manage complexity, create new products, enter new markets and comply with evolving regulatory demands.

As the Asia Pacific region continues to expand its share of world GDP, the asset management industry in Asia ex-Japan and Australia is expected to double assets to $4 trillion by 2015.[1] New pools of investment capital are rising in pension funds, insurance companies and sovereign wealth funds. China will likely be a principal engine of this growth, with Korea also continuing as a considerable market driver. While assets under management in the region do not approach those of well-established markets in North America and Europe, Asia is expected to become one of the world's most significant regions of growth for the asset management industry.

As Asian economies grow, financial intermediation is migrating from banks to capital markets and the economic culture is shifting from one based on savings toward one based on investment. While pooled investments have thus far been concentrated in large institutional structures, a growing middle class and an increased reliance on funded pensions are laying the foundation for a growing retail investment industry.

Asian asset managers, in tandem with global asset managers, and in partnership with world-class custodians and fund administrators, are creating more complex, non-standard portfolios that include securities in multiple asset classes, over-the-counter derivatives and ETFs. Institutional investors are showing increased interest in private equity and hedge fund vehicles. Further compounding this complexity are rapidly evolving technologies for trading and portfolio construction, steadily rising demands for portfolio and investment process transparency and new regulatory requirements for monitoring and reporting.

New Operating Normal

Meeting these challenges has given rise to a host of new investment services needs — a "new operating normal." Amid unprecedented volatility, investors need new methods for managing risk and for establishing suitable control frameworks. They want their asset managers to reduce costs, increase transparency and apply greater focus to risk management. To comply with these requirements, managers are looking to third-party middle-office providers to deliver robust administrative and operational support, better access to and more efficient use of data, scalable services to accommodate growth, comprehensive global connectivity to resources around the world and reporting capabilities that are both broader and deeper throughout the investment life cycle.

Simultaneous to this transformation, the Asian asset management industry is steadily globalizing. Global asset managers want to offer their services to the rising pools of investment capital in Asia. Asian asset managers likewise want to deliver their services in multiple markets and are well positioned to understand local investment preferences and market nuances. To achieve this, asset managers need industry-leading administrative services for each market

[1] Estimate of Citi Securities and Fund Services, cited in Reuters, "Asia's Asset Management Industry Seen at $4 trillion by 2015," October 24, 2011

in which they invest or offer products. The footprint of their geographic expansion will vary depending on the global reach and range of services offered by their service providers.

To meet the needs of expanding Asian asset managers, middle-office service providers must undertake the full range of middle-office services — portfolio accounting, performance and risk measurement, post-trade compliance, voluntary corporate actions, trade processing, investor reporting, data management, reconciliation, derivative services and collateral management — in a manner consistent with local, regional and global requirements.

While the early days of middle-office team lift-outs and the "rebadging" of staff might well have been termed "outsourcing" aimed at simple cost reduction, the future of third-party middle-office service provision aims at managing highly sophisticated technological and operational functions. Investors and asset managers are increasingly relying on middle-office outsourcing providers that deliver a full array of services including specialized expertise in multiple strategies, asset classes and geographies; a global network of offices that offer deep local expertise and service offerings that can be customized to meet the needs of investors and managers. Importantly, these solutions should be delivered from within a unitary data and account relationship management platform that enhances operational efficiency.

Different asset managers are responding to this changing market in unique ways. Some are consolidating multiple service relationships with a single provider so as to streamline their business globally, bundle cost savings and reduce the governance burden of monitoring multiple providers. Other managers are going in the opposite direction, creating relationships with multiple vendors to achieve best-of-breed service provision in each global market, diversify risk and foster healthy competition among their service providers.

The future business model will be flexible, allowing managers to work with multiple entities including third-party middle-office administrators, information technology and business processes (ITO/BPO) in an integrated manner. It will also provide for more innovative production, allowing the use of variable-cost models to market test new products as well as the use of outsourcing to mitigate risk. Third-party middle-office services have clearly evolved from a cost-centric exercise to one focused squarely on the timely and accurate delivery of information in growth enabling ways.

This set of modular and scalable capabilities should address every aspect of the post-trade workflow, enhancing the in-house capabilities of clients, integrating with third-party back-office providers, streamlining post-trade operations in a single, transparent platform and reducing operational risk through automated straight-through processing.

The Rise of Asian Asset Management

While it is impossible to predict how the asset management industry will evolve in the diverse and dynamic Asian region, the macro trends driving asset growth are similar to those that have been seen in the United States, Europe, Australia and other regions — increasingly elaborate regulatory and control frameworks, the further development of funded retirement structures and greater reliance on complex alternative investments that include derivatives, exchange-traded funds and sophisticated risk hedging.

Likewise, the provision of third-party middle-office services in Asia is evolving rapidly. Local asset managers appear keen to engage the services of global players that deliver best practice and efficiency, while at the same time accommodating the unique challenges of individual markets.

In a region as varied and diverse as Asia, leveraging a single country platform and services may not be the most effective strategy. Each country in the region has its own requirements in terms of market personality, language and culture and regulatory approaches. Asset managers are similarly diverse, with their own ideas about investment decision processes. While most Asian asset managers appreciate the benefits to be derived from evolving local systems to a global standard, this migration may take some time before it is fully realized.

To accelerate implementation of global standard systems and processes, it may be an auspicious time for Asian asset managers to embrace the scalable solutions offered by leading third-party service providers. In so doing, they can take advantage of a unique opportunity to influence the evolution of global best practices that accommodate local nuances. Investors today can seize "first mover" advantage, working with the large service providers that will progressively shape the administration landscape and establish client delivery standards that will endure for years into the future.

The fragmentation of the Asia Pacific market is expected to diminish over time. Market nuances may become less challenging as systems are enhanced and best practices evolve among regional market participants. Investment administration outsourcing will facilitate this, as investors come to appreciate the accelerating investment in systems and resources that they will face in order to mitigate risk and achieve a strong control environment with best practice services.

The current relative growth in Asia provides an excellent opportunity to influence large-scale service providers that are building systems attuned to local market requirements. Over time, the Asian asset management industry will enjoy the productivity benefits that come from greater standardization and more coherent system infrastructure. Leading providers of third-party administration are playing an invaluable role in driving this evolution, to the benefit of investors and managers alike.

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