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Global Asset Managers

Beyond the Bounce-Back

Industry revenues have been largely shielded by aggressive policy actions. But growth will slow, and competitive pressures accelerate. To win, asset managers should drive growth (EM clients, private markets, solutions), take share with ESG, and sustain Covid-related productivity for >10% savings.

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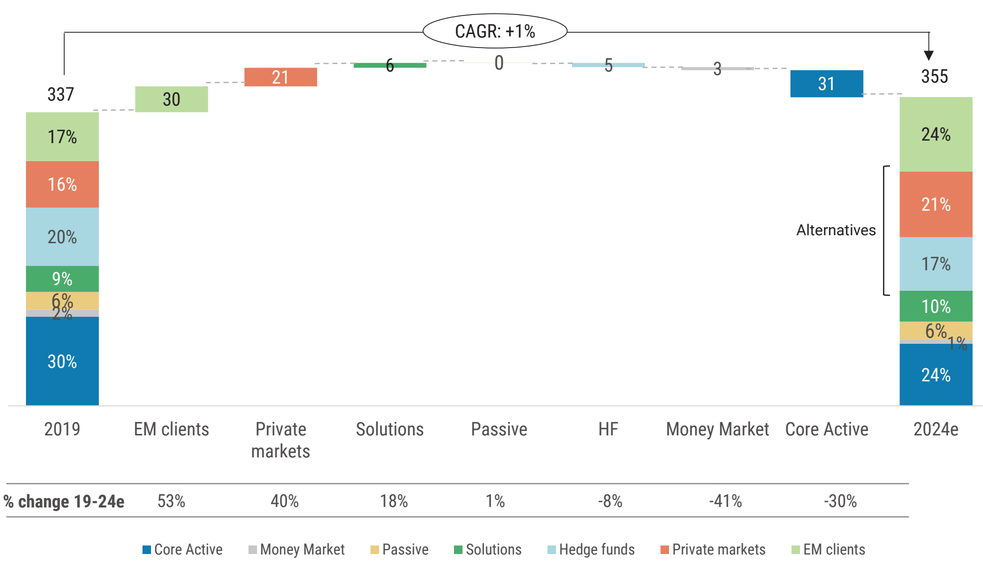
Executive Summary

- Aggressive policy actions by global central banks mitigated impacts on financial markets and stemmed deeper effects on the underlying economy, implicitly sheltering asset management revenue pools.
- In a V-shaped recovery, structural trends, including fee pressures and demographic trends impacting flows, will remain intact; indeed, they are likely to be accelerated by the pandemic.
- We see early indicators of core active flows improving since March, along with better active equity performance. We think this will accelerate the chasm between winners and laggards, as the former are already widening the performance gap. Our overall view for core active is unchanged — passive incursion and fee pressures will drive material fee pool compression, though the intensity of the shift could moderate for some.
- The crisis brought ESG even more to the forefront of industry discussions as performance (and flows) have proven resilient through the downturn. We expect adoption to accelerate and focus to broaden (to include the social responsibility element of ESG), serving as a competitive advantage for early movers. However, as ESG matures, we expect it to become a capability used across strategies, rather than a long-term fee pool driver.
- We anticipate that key growth zones relevant before the pandemic — emerging markets clients, private markets, and solutions — will remain intact. Of these, private markets appears most likely to benefit from a V-shaped recovery, as high levels of dry powder provide flexibility to take advantage of new investment opportunities as well as to support struggling portfolio companies.
- The crisis proved the viability of remote working, challenging conventional wisdom and paving the way for more radical changes to operating models. We estimate that structurally embedding efficiency gains revealed by the crisis could deliver 10-15% in cost savings. Taken to the logical extreme, we see the possibility of a fully "virtual" manager, which we believe could operate at a 40% lower cost base vs. traditional managers. While such an extreme transformation would introduce a number of operational and strategic risks, we suggest firms reorient their perspectives and look at the fully "virtual" manager as the "zero base" upon which to build back better.
- Finally, technology will play a pivotal role in enabling operating model changes, not just a transition to flexible and remote working. One area we would highlight where we see asset managers at least five years behind banks is in the adoption of API (Application Programming Interface). We think this is a key path to closer connectivity to distributors as well as an opportunity to streamline data infrastructure and reduce operational costs.

Exhibit 1:

Global Revenue Composition – Base Case, 2019-24e, USD BN



1. Private markets AuM includes dry powder

Source: Oliver Wyman analysis

Although the pandemic has dampened near-term growth, structural trends remain intact.

While the pandemic brought a sharp and painful recession, swift action from central banks buoyed financial markets. This, combined with early indicators of a V-shaped recovery, leads us to believe that asset management industry revenue pools will be relatively sheltered from the steep declines many expected in March. Key structural trends, including downward fee pressures and an aging population negatively affecting inflows, will remain intact; indeed, they are likely to be accelerated by the pandemic. On net, our expectations are more muted compared to last year, but we still see an overall positive trajectory for revenue and AuM pools through 2024.

Pressures on core active expected to continue, but the intensity could moderate for top performing managers.

Pressures facing active managers remain intense. We think the segment will continue to be challenged by rotation into passive as well as by accelerated churn, favoring players demonstrating strong alpha. However, early indicators point to some moderation in the intensity of the shift to passive — at least for some players. Anecdotal evidence from our conversations with managers points to a "better" crisis in terms of flows for those able to demonstrate relative performance. Additionally, mutual fund flow data from April and May are encouraging for the active segment overall, showing either a reduction in active equity outflows (e.g., US-domiciled funds) or even reversal to inflows (e.g., EU-domiciled funds) vs. prior years.

ESG adoption should accelerate, but in the longer term it is unlikely to serve as a meaningful fee pool driver.

A combination of better relative investment performance and investors' deepening sense of purpose, (likely further accelerated by the wide-ranging societal impacts of COVID) could create a powerful tailwind for further client engagement on ESG investing. We expect this interest to generate near-term flow capture opportunities for early movers who have built credible offerings and purpose-driven value propositions. However, we do not expect ESG to be the sole preserve of active management or to develop into a major unique product category of its own. Rather, over the longer term, we expect ESG to be highly integrated into the risk and investment processes of most managers, becoming a widely adopted capability across strategies and product segments. As a result, while in the short term ESG is likely to create revenue opportunities for early movers, over the long term we do not see it as a meaningful incremental fee pool driver for the industry.

Private markets are most likely to benefit from a V-shaped recovery.

We see private markets as potentially the biggest beneficiary of our base case for a V-shaped recovery as headwinds ease, given concerns about the damage that corporate defaults could do to fund performance and prospects for future fundraising. We expect casualties. But we anticipate that a strong rebound in economic activity, combined with available dry powder to take advantage of new investment opportunities and support struggling portfolio companies, will limit the impact on overall performance. Meanwhile, a persistently low interest rate environment globally, and subdued outlook for returns from traditional asset classes, should feed ongoing client demand (as investors trade liquidity for returns). A more bearish economic outcome of a prolonged recession, however, could clearly change this optimistic assessment as portfolio losses become more pronounced, undermining investor confidence and shrinking any incremental investor demand.

The proven viability of remote working will push many managers to reimagine their operating model and leverage elements of a "virtual" asset manager.

Asset managers were fast and effective in moving to "work from home," challenging conventional wisdom. The industry has proven to be not only resilient from an operational point of view but able to operate at productivity levels close to (if not better than) before the pandemic. Our conversations with managers suggest that many are looking to hold on to efficiency gains revealed through the crisis — including widely using flexible work arrangements, reducing travel, and rethinking their location strategies, as well as spend on middle and back office. We estimate that managers who choose to structurally change their operating models to what has proven to work through the pandemic could see a 10-15% reduction in the cost base. Beyond this, we see an opportunity to go further to reimagine the asset manager operating model as an entirely "virtual" one. While this would require radical changes — e.g., moving to almost fully remote working, leveraging technology to a much larger extent (especially APIs), and fully reinventing business processes — the savings could be substantial. We estimate a virtual manager can operate at a 40% lower cost base vs. a traditional manager today. While we know of no fully "virtual" manager operating today, we think senior managements should look past the cost savings and efficiency gains forced upon them by the pandemic, to redefine their own "zero base" as that of a virtual manager, and figure out how to "build back better" from that point.

Messages from Our Proprietary Survey

Key takeaways from our meetings with senior executives of asset managers in the US and Europe with ~$12 trillion of combined assets under management

Although COVID-19 disruptions have resulted in a near-term drag on growth, managers do not expect fundamental changes to broader trends:

- There are near-term operational and business challenges to work through, but if the current recovery trajectory continues, asset managers have an overall positive outlook and expect to continue investing in growth, while aiming to hold on to productivity gains achieved during the disruption.
- Demographic trends in developed markets (e.g., retirement saving withdrawals) will be more exposed in the near term as inflows fall on the back of higher unemployment.
- Fee pressure remains top of mind across active and passive.
- Scale is as important as ever (for driving success in distribution, to fund technology investments, etc.); executives expect accelerated industry consolidation among small and mid-sized managers.
- The regulatory agenda is likely to shift focus to corporate resilience, which will play through in investment strategy design (e.g., incorporating leverage considerations into investment approaches).

Near-zero rate environment is expected to benefit private markets and outcome-orientated solutions:

- Investors are broadly in a better cash position than in 2008 and looking to take advantage of market dislocations.
- Near-zero rates, a major challenge for investor returns, are supporting demand for a broader range of risk premiums and solutions that can facilitate access to them.
- The private market growth story is likely resilient (thanks to the flexibility of dry powder to support existing portfolio companies and performance of existing funds, as well as investor appetite for new investments), although a prolonged recession could challenge this.

Managers still positive on the size of the onshore China opportunity, but access remains a perennial challenge:

- Executives continue to see a long-term need to grow and diversify the emerging market investor base (including China).
- Firms we interviewed expect geopolitical tensions to accelerate the pace of China onshore market development, and with it the case for global investor allocations to China.
- Many managers have made a cautious commitment to onshore growth; distribution access remains the biggest challenge, despite regulatory-driven transformation and professionalization of local asset management.

While ESG interest was rising before the crisis, it has been reinforced and accelerated by it:

- ESG is becoming mainstream and increasingly integrated into the investment process, although data quality remains a challenge for many managers looking to launch ESG funds.
- Thematic focus is evolving, with many firms expecting increased growth and demand for funds that take into account not only the environmental dimension but also the social responsibility element of ESG.
- Active managers that invest in building expertise and unique data sets to support ESG risk analytics can reap some short-term advantages, but ESG capability will be increasingly seen as table-stakes to winning new mandates.

The lessons learned from COVID-19 will encourage a shift in operating models:

- Many firms are looking to hold on to efficiency gains revealed through the crisis — e.g., flexible work-from-home policies and a partial shift away from high-cost locations to optimize real estate costs, together with a permanent reduction in travel and physical marketing expenses.
- However, almost everyone we spoke to see in-person interactions as an essential component of their operating models and have said that a safe return to the office was a priority.

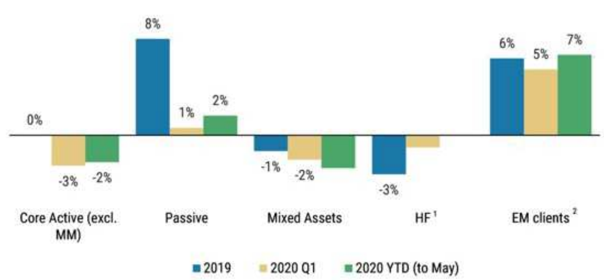
State of the Industry and Strategic Imperatives for Asset Management

Although aggressive policy actions have mitigated the immediate impacts on revenue pools, the pandemic and the recession will nonetheless leave a lasting impact on the industry.

Central bank actions buoyed global financial markets and implicitly sheltered the asset management industry.

The early days of Covid-19's spread across the globe saw lockdowns, collapse in economic activity, and a steep market downturn. Equity markets went into a near freefall in the early weeks of March, money markets faced severe liquidity challenges, and credit spreads surged. However, swift action by central banks to lower rates, flood the market with liquidity, and, again, "expand the policy tool set" stabilized markets quickly and led to a strong rebound. As a result, across core active and passive, investors reversed the initial panic that had led to outflows in March. Since then, flows have stabilized and investors have returned to riskier asset classes.

Exhibit 2:
Net Flows for 2019 and Early Months of 2020 (% of prior year AuM for given category)



1. Through May 2020
2. Onshore money of EM clients
Source: HFR industry reports, Broadridge, Oliver Wyman analysis

Asset managers were fast and effective in moving to "work from home," challenging conventional wisdom.

Within days, most asset managers in developed markets had 90% or more of their staff working from home. This happened even though such a setup was not part of their typical business continuity planning. While we observed occasional challenges in settlement cycles at the end of March, the industry overall has proven resilient from an operational point of view. On the back of some early settlement issues in March, some firms will reconsider their outsourcing agreements. Leaders will seek not only to apply the lessons learned to their business continuity management approaches but to "build back better." They will question multi-layered decision making processes in favor of greater delegation and flatter organizational structures to drive more agility.

Outlook for the industry for 2020 is only modest revenue pool compression, if markets remain calm.

In our base case, we expect that markets will remain broadly calm through year-end and flows will continue to recover. In response, we expect AuM to rebound and stabilize, reversing most of the sharp declines from 1Q. As a result, we expect revenues to decline only slightly (1-2%) relative to 2019.

Net inflows should be lower for years to come, but product shifts will support revenue pools.

The downturn in the real economy, with lower employment levels, will mute inflows from retail investors. In particular, this is likely to be felt in defined contribution pensions, where net inflows — already slowing in the US due to demographic-driven withdrawals — will be further buffeted as unemployment remains elevated and post-pandemic hiring struggles to reach previous highs. We also expect lower flows from Sovereign Wealth Fund investors, as many suffer from lower oil prices coupled with growing demands to support their domestic economies more strongly. Overall, this leads us to conclude that industry inflows will be muted up to 2024, with a base case forecast of 2.0-2.5% (vs. historical inflows of 3-4%).

On the flip side, aggressive monetary stimulus and sustained low interest rates will likely be a net benefit for the industry as investors shift their product mix into an even more barbell-shaped structure. On the one hand, cheaper core public market strategies (e.g., passive) will continue to gain share; on the other, we expect tailwinds for higher risk, higher return, and higher fee strategies (e.g., private markets, emerging markets, high-yield credit) as investors are forced to make meaningful allocations to maintain returns.

The pandemic will likely accelerate existing trends, forcing managers to take strategic decisions faster than they had anticipated.

The early months of the pandemic have provided a glimpse into the broader impact that it is likely to have. These implications will be far-reaching — from direct impacts on the economy to an acceleration of existing trends that will affect a variety of industries, including asset management.

Exhibit 3:

Underlying Trends Created or Accelerated by the Pandemic

Trend	Description	Impact on Asset Management
Geopolitical Tensions	• Decoupling of trade relationships between the US and China. • Strains on access of Chinese companies and investors to US financial markets and/or capital. • Potentially reduced role for the USD (in Asia) and growing role for the RMB (over the longer term).	• Accelerated development of onshore market in China. • Growing global investor allocations to China. • Continued access uncertainty for global asset managers in China.
Social Awareness	• Emphasis on sustainability and social responsibility. • Corporations taking a firm stand on ESG issues. • Growing transparency into firms' ESG metrics.	• ESG investing to mature and adoption to accelerate. • Near-term opportunity to capture share for those with a compelling offering and credible, purpose-aligned value proposition.
Social Distancing	• Acceleration of digitalization. • Acceleration of automation, including adoption of APIs. • Cross-industry acceptance of more flexible work arrangements.	• Reduced need for in-person sales and marketing events. • Quality of digital interaction channels a real differentiator. • Opportunity to realize efficiency gains from flexible working. • Tech driving products and solution development.
Regulatory Scrutiny	• Post-mortem central bank scrutiny of financial markets, including asset managers. • Accelerated scrutiny of/interest in privacy and security topics.	• Potential for incremental regulation (e.g., fund leverage, corporate balance sheet leverage, liquidity).

Source: Oliver Wyman analysis

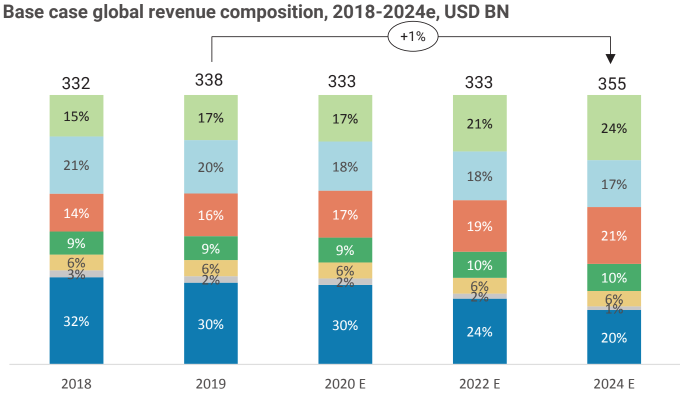
We expect to see a muted but overall positive trajectory for revenue and AuM pools through 2024.

In our base case, a V-shaped recovery, we expect global asset management revenue pools to grow modestly over the forecast period (~1% per annum), from $337 billion in 2019 to $355 billion by 2024. This scenario is based on a view that the recession will be sharp but short, with a relatively healthy recovery that begins in the second half of 2020 in most geographies. Under these conditions, we expect that AuM will first stabilize to 2019 highs, with growth subsequently accelerating from 2022 onward. Meanwhile, we expect continued fee pressures in strategies that are struggling to demonstrate added value versus lower cost alternatives.

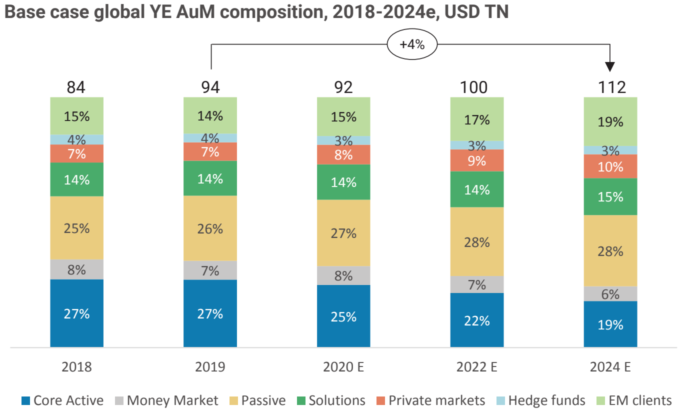
Exhibit 4:

AuM and Revenue Outlook Through 2024

Base case global revenue composition, 2018-2024e, USD BN



Base case global YE AuM composition, 2018-2024e, USD TN



Private markets AuM includes dry powder.
Source: Oliver Wyman analysis

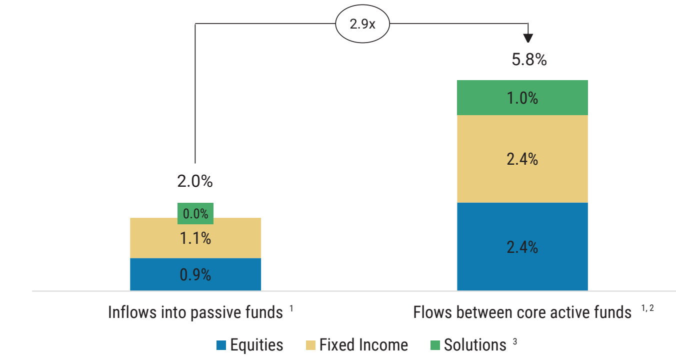
Structural pressures on core active should continue, but we think the intensity of the shift could moderate.

While our fundamental view is unchanged — passive incursion and fee pressures will drive material active fee pool compression in the segment — we are seeing early indicators of a moderation in the intensity of the shift. Mutual fund flow data from April and May are encouraging, showing either a reduction in active equity outflows (e.g., US-domiciled funds) or even inflows (e.g., EU-domiciled funds) vs. prior years. As a consequence, in the base case, we expect core active revenue pools to decline ~7% p.a. through 2024 (vs. the ~9% p.a. that we forecast in our report last year). However, we are also seeing an acceleration of competitive pressures — flows from active-to-active are 2.9x vs. net flows to passive — which is favoring players demonstrating alpha, as well as scale in product breadth and distribution access. Indeed, we expect to see the crisis reinforce the chasm between winners and laggards, as the former widen the performance gap and see "lift" from outperformance, as is typical during crisis periods.

Exhibit 5:

Flows Between Funds (Inflows into Passive vs. Flows Between Core Active Funds)

Flows between funds, 2018-2019, as % of the 2018 industry AuM



Source: Oliver Wyman analysis, Broadridge. Note: 1) Excludes other asset classes; 2) Relative flows between funds of the same asset class based on the evolutions of fund AUMs controlling for market effects; 3) Proxied using "mixed assets" in Broadridge.

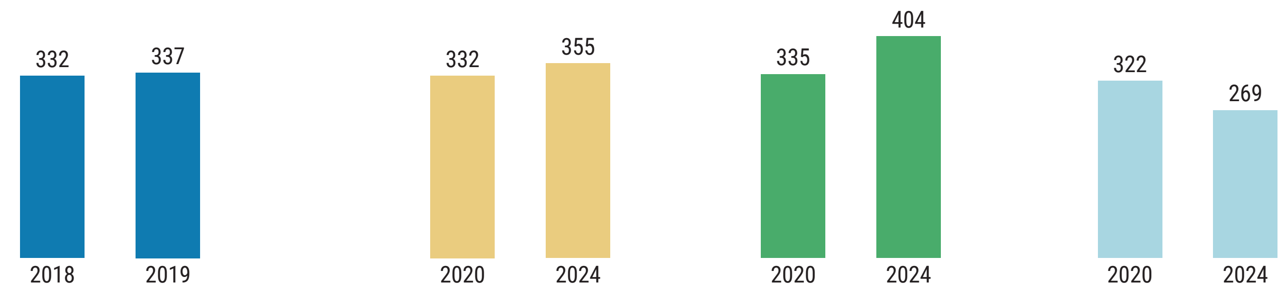
We see substantial downside risks to the industry's trajectory from uncertainty around global governments' ability to contain the pandemic.

Embedded in our base case is a degree of optimism, supported by the type of recovery we experienced in May and June, and incorporating expectations that a potential second wave of the pandemic will be better contained and more manageable than the first. However, the virus spread and vaccine development are the key variables that underlie our alternative scenarios. There is substantial downside risk that the pandemic will not be brought under control soon, and that this will drive a double dip in the global economy, with a subsequent prolonged recovery period. Under such a bear case, we forecast that it would take more than five years to return to AuM levels seen in 2019, which, when coupled with accelerated fee pressures, will result in revenue pools declining (~20% over 2019).

On the flip side, in the bull case we assume that the worst is behind us, with reopening ushering in a faster normalization of economic activity than in the base case. Under such a scenario, AuM levels do not experience declines, even in 2020, and stronger inflows cause fee pressures to abate for the industry (vs. the base case). Under this scenario, revenue pools continue to grow and are ~20% higher vs. 2019 levels.

Exhibit 6:

Scenarios for Industry Revenues, 2024e, USD BN



	Base	Bull	Bear
Macroeconomic Narrative	•2nd wave occurs in Autumn with a modest spike in cases •Vaccine is broadly available by 1H21 •DM economies recover to 4Q19 output by 4Q21	•Number of new cases continue to fall •Vaccine available in select markets before 4Q20 •DM economies recover to 4Q19 output levels by 1H21	•Number of cases rise as economies try to reopen •Vaccine is not available until 1H22 •Double-dip in global economies
Industry 2024 YE AuM (USD TN, '19-'24 CAGR)	112 (4%)	126 (6%)	86 (-2%)
Fee pressure and product mix effects ('19-'24 CAGR)	-3.0%	-2.5%	-3.8%
Industry Revenue (CAGR '19-'24)	1%	4%	-4%

Source: Oliver Wyman analysis

Achieving Growth in a Post-Covid World

Making investments into growth zones and ESG capabilities will be key to sustaining topline performance.

Growth zones remain pivotal through the recovery.

Given the relatively contained impact of the recession on many investors, we anticipate that key growth zones relevant before the pandemic — emerging markets clients, private markets, and solutions — will largely remain intact; in some respects, we think they will be accelerated. We expect the revenue pools related to these three zones to grow at an average of 7% p.a. through 2024, to 55% of aggregate industry share. For comparison, all other parts of the industry are expected to contract at ~4% p.a.

However, in a bear scenario private markets are most exposed, as a prolonged recession could test the resilience of private market portfolios. Managers will increasingly face difficult decisions around how to work through portfolio companies whose balance sheets will be stressed to the breaking point, risking a surge in "zombie" companies that could sap returns (and investor patience) for years.

Success in capitalizing on these growth opportunities will require investments even through the recovery, which, from our conversations, many managers are already making. For example, to tap into net new money flows, many are committed to growing their onshore China business as restrictions on majority foreign ownership are being relaxed. Meanwhile, to tap into the private markets opportunity, private markets managers began to fundraise actively (and, in many cases, successfully) as soon as we had passed the immediate trough in financial markets. Traditional asset managers have also continued looking to build out private markets capabilities — organically, through acquisitions, or both. We expect more of that. Finally, to capitalize on the solutions opportunity, investment in technology and data will be key to delivering value-added analytics and packaged products.

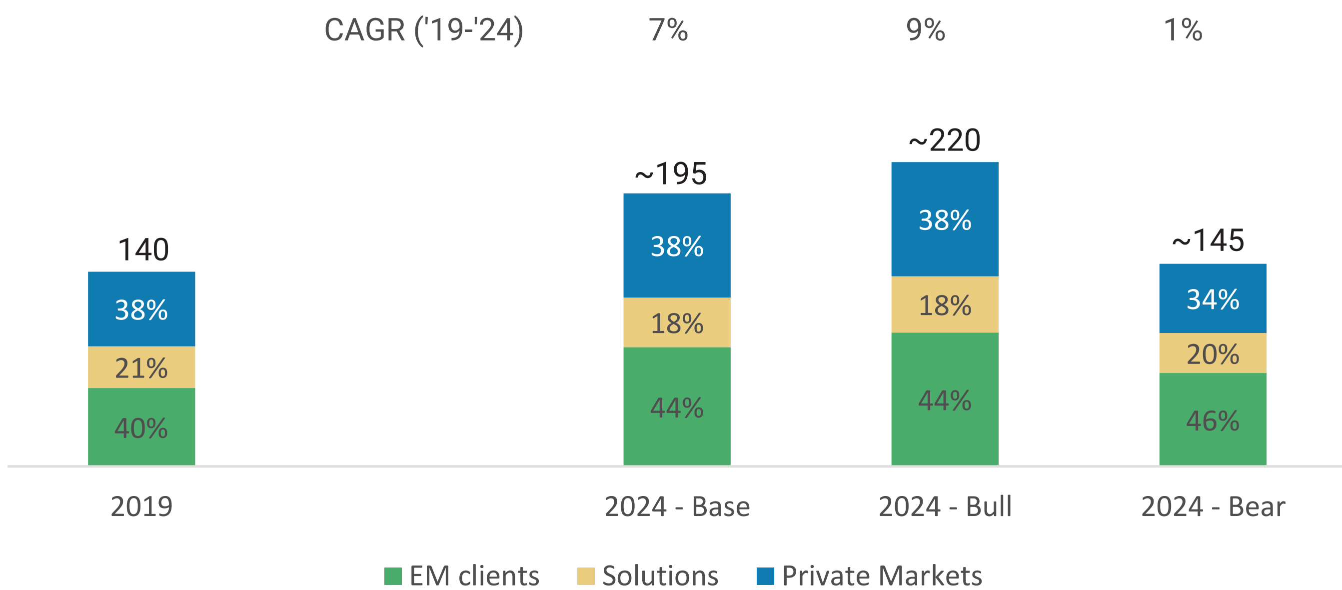
Exhibit 7:

Outlook for Industry Growth Zones

Growth Zone	Base Case Outlook	Bear Case Downside Risks
EM Clients	**Sound fundamentals in net new money** • Inflows from this segment may slow in the short term, but we expect a strong rebound — ~10% AuM CAGR between 2019 and 2024 (vs. ~2% from clients in developed markets). • Decline in global interest rates pushing new clients from bank deposits into asset management products. **Onshore China is a major growth catalyst** • Coordinated actions by the local regulator and industry to drive professionalization of the onshore market. • Expect greater domestic and global institutional investor participation.	**Flows at risk in a prolonged global recession** • Prolonged economic impact in EM countries struggling to contain the pandemic. • Slower wealth accumulation and less cash available to invest into AM products. **Geopolitics challenges access to China** • West-China geopolitical tensions hit the ability of foreign financial institutions to operate and/or scale onshore presence.
Private Markets	**Potential beneficiary of V-shaped recovery** • Substantial amount of dry powder being deployed to take advantage of market dislocations. **Persistently low rates feed demand** • Search for yield amidst near-zero interest rates to drive investor demand for illiquidity and other risk premiums. • Opportunity from opening access to private markets to defined contribution (DC) pensions (although hurdles remain).	**Prolonged recession tests portfolio resilience** • High levels of leverage and exhausted dry powder push many private market managers into the uncharted territory of a true economic downturn, which many managers have not experienced. • Surge in "zombie" companies active in sectors most hit by the pandemic, impacting returns of existing funds. • Future fundraising is curtailed as investors rebalance stressed portfolios and reassess risk-return attractiveness of private markets post fees. • Additional regulatory headwinds (e.g., leverage restrictions on corporations) impact buyout market.
Solutions	**Search for more diversified risk premiums core to demand** • Traditional 60:40 and income-orientated strategies challenged by near-zero interest rate environment. • Investors need solutions to structure exposure to an optimized range of return sources to achieve goals. • Technology enables delivery of customized solutions for smaller clients. **Helping clients manage ESG obligations** • Institutional investors increasingly make social commitments while retaining fiduciary responsibilities to end-clients — an opportunity for ESG leaders to produce bespoke solutions to balance ESG obligations.	**Inflows at risk from a prolonged recession** • Inflows are reduced substantially as volatility pressures on public market returns. • Mounting unemployment and household economic strain lead to lower discretionary spending and falling defined contribution (DC) pension allocations (e.g., target date funds). • As some demand growth is contingent upon providing investors access to higher-risk strategies, overall solutions demand dampened as demand for these strategies (including private markets) declines in the bear case.

Source: Oliver Wyman analysis

Exhibit 8:
Outlook for Growth Zones in Base vs. Bear Case



Source: Oliver Wyman analysis

The crisis should accelerate acceptance for ESG and be a source of differentiation, but not necessarily profits.

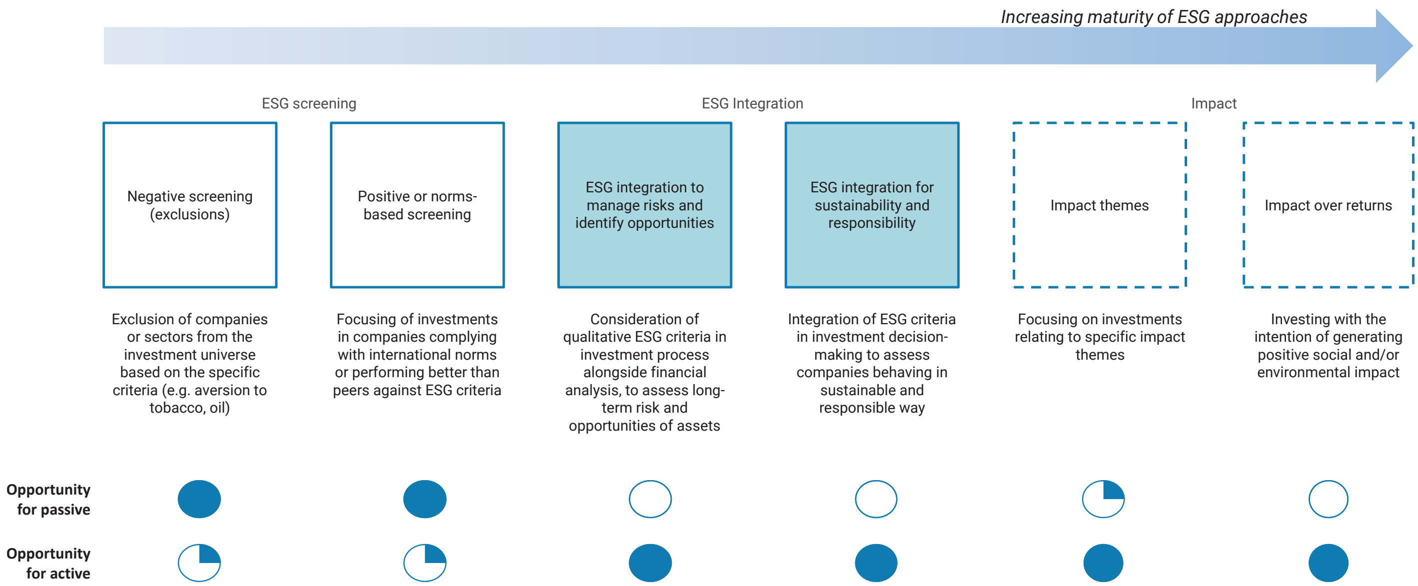
Looking forward, we expect the combination of performance and purpose to create a powerful tailwind for further investor engagement on the ESG topic. In Europe, penetration of ESG is relatively deep, and it is already broadly embedded in institutional investors' fund selection criteria. Within the next five years, we expect this to expand across geographies and for integrated ESG capabilities to become a minimum requirement for winning business/requests for proposals (RFPs). Additionally, our conversations with managers point to increased product innovation and a broader focus to introduce more social responsibility–focused strategies to supplement the environment- and climate-related ones that have dominated until now.

In the short term, early movers can leverage ESG to differentiate offerings and capture flow. As illustrated in Exhibit 9, opportunities will lie in driving maturity of ESG approaches, including (1) ESG integration into risk and investment decision making, (2) greater adoption of impact-driven investing, and (3) investments in proprietary ESG methodologies. We already saw evidence of ESG driving meaningful market share shifts among active managers in 2019 and early 2020, which we expect to persist as the focus and public awareness on the topic broadens.

Finally, while it may be more natural for active managers to take the lead in responding to demand, we do not expect ESG to be the sole preserve of the core active segment. Passive providers with the ability to create bespoke solutions have already demonstrated success in winning flows; they will be able to prove themselves in ESG as well. Indeed, over the next 2-3 years, we expect ESG to be highly integrated into the risk and investment processes of most managers, becoming a widely adopted capability across most strategies and product segments. As a result, while in the short term ESG is likely to create revenue opportunities for early movers with credible offerings and track records who can satisfy increased investor interest, over the long term we do not see it as a meaningful incremental fee pool driver for the industry as a whole.

Exhibit 9:

Maturity Spectrum for ESG Investment Approaches



Source: Oliver Wyman analysis

Options to 'Build Back Better'

Proven viability of operating in a remote working environment will push managers to reimagine their operating model more structurally.

Adopting lessons learned from remote working through the pandemic could release 10-15% in savings.

In shifting to remote working, managers' operating models proved highly resilient. Many not only maintained productivity levels but found ways to make improvements (shorten decision making times, create additional capacity for portfolio managers to spend more time with clients, increased reach though digital marketing events). These experiences challenged the conventional wisdom that teams need to be in one location (typically a high-cost location to attract the best talent) and that, as a corollary, salespeople need to spend as much time as possible in the same room with their key clients.

We expect that managers who choose permanently to adopt into their operating models what has proven to work through the pandemic will be able to realize 10-15% in cost savings over a 3- to 4-year horizon. First and foremost, this will require a wider adoption of flexible work arrangements, both to accommodate demands from employees and to capitalize on cost saving opportunities that come with a smaller physical footprint and a team that is less concentrated in high-cost financial centers. Second, managers will need to reconsider their sales and marketing approaches to incorporate more virtual touchpoints and to think more critically about the value of travel in a post-pandemic world. Finally, we expect many to review their support model: In a world where more teams are working virtually, functions that sit next to the front office will be less important, creating an additional impetus for scaling of shared services, greater adoption of outsourcing, and/or near-shoring to lower cost locations of less critical functions.

How far could this be pushed? We think operating at a 40% lower cost base is possible for "virtual" asset managers.

Traditional asset managers adopting a "virtual" model will rely much more heavily on remote working and technology to power the business (as illustrated in Exhibit 10). We think that such a virtual player will be able to operate at a 40% lower cost base vs. a similar manager with a largely "physical" model. In this paradigm, nearly all staff will work remotely, with a very small physical footprint reserved for high-priority interactions. In distribution, a virtual player may choose to position itself as a pure product-provider, relying on intermediaries (that work like a network of partners and could include wholesalers, investment consultants, and neobanks or fintechs) to source, onboard, and manage client relationships; much smaller relationship/client service teams may focus almost exclusively on managing these strategic relationships. In this setup, brand will be less relevant, and as a result the cost of marketing and client events will drop significantly. The investment engine will look different as well, more akin to quant funds that exist today, with a much lighter touch of human involvement. Much of the research and risk analysis will become highly automated, with portfolio managers and their lean teams focused on generating ideas, sourcing data, oversight, and refining algorithms. Investment ideas will be implemented in separately managed accounts (with lower cost to operate vs. traditional fund wrappers) to become increasingly accessible to mass retail at lower fees. Meanwhile, trade execution as well as much of operations will be outsourced.

Technology will be crucial to powering the "virtual" operating model. The pace of advancement has accelerated, making it possible to do more with even smaller teams. Natural Language Processing techniques have progressed significantly over the last several years (especially with the arrival of BERT[1]), as has adoption of machine learning and alternative data, which are particularly important to making research less human resource-intensive.

A technology that remains widely underestimated and under-deployed is API. Compared to banks, we estimate that asset managers are five years behind banks in setting up open API portals and building out developer communities. Creating these capabilities will be key for the "virtual" manager as they will create a bridge between the manager and its distributors, as well as its custodians and other vendors that will power the middle and back offices.

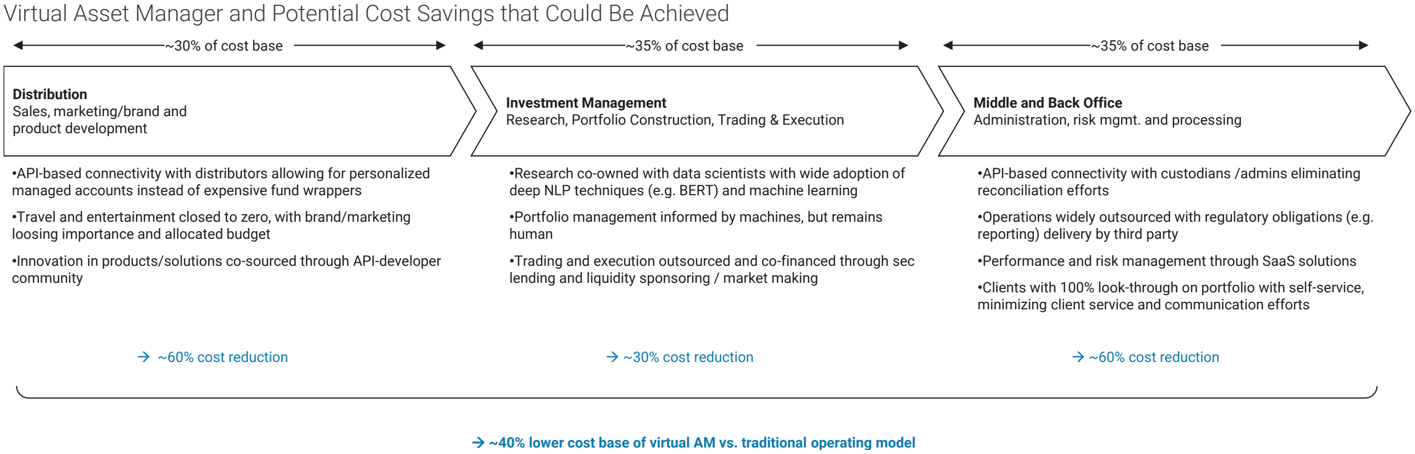
To be clear, we know of no fully "virtual" manager operating today, but we think it will turn into a viable and attractive option for many types of managers. First, it can be attractive for mid-sized asset managers looking to maintain profitability while conceding to incessant fee pressures. For insurance or bank-owned managers, a "virtual' model can be an attractive "utility model" to serve client franchises in the core businesses. Newer entrants, leading with technology, may see this model as a way to disrupt the industry and quickly gain market share (e.g., create active products that, from a price point perspective, can compete with passives). Others may want to reap first-mover benefits to achieve higher valuation multiples through a rerating more in line with technology-oriented businesses, with a further boost delivered from improved earnings power. Such a valuation multiple uplift would be particularly valuable if consolidation accelerates, as it would improve the relative position of such first movers.

Implementing a pure "virtual" model will not be without risk. Attracting talent and fostering a cohesive culture typically requires some sort of physical presence, and typically in a higher-cost location. However, we think senior managements should reorient their thinking by taking the virtual model as their "zero base" option on which to build features on top — the opposite of the usual approach of starting with the status quo and aiming to reduce.

1Bidirectional Encoder Representations from Transformers is a technique for Natural Language Processing (NLP) developed by Google

Exhibit 10:

Virtual Asset Manager and Potential Cost Savings that Could Be Achieved



Source: Oliver Wyman analysis

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Not-Rated/Hold	5	0%	0	0%	0%	3	0%
Underweight/Sell	553	17%	84	11%	15%	225	15%
Total	3,240		743			1483	

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