RBC Investor Services

Searching for the new "modus operandi"

2023
Asset & Wealth Management Survey

Content

> "Whether to build, buy or outsource is a key decision as managers implement their change agendas."

Currencies are in USD unless otherwise indicated

Foreword

The global asset and wealth management industry is facing a diverse change agenda. Driven by new regulation, volatile markets, evolving technology and a range of operating model choices, the complexity confronting this sector is vast and increasing. So, how are today's asset and wealth managers charting their course for change?

The 2023 Asset & Wealth Management Survey, conducted by RBC Investor Services in partnership with Ignites Research and The ValueExchange, draws on the views of managers from across Canada, the US and Europe. Based on the online survey responses of 265 managers and validated through extensive follow-up interviews, this report presents a picture of how asset and wealth managers are building and executing on change within their firms, including the top 10 themes gleaned from the feedback.

We hope you find the report informative.

Rajiv Nambiar
Head of Global Market Services
& Business Development

What managers said

67%
forecast growing demand for fixed income (63% for ETFs)

67%
anticipate higher demand for equity ETFs, ahead of fixed income

59%
expect higher private asset demand among HNWIs (45% for retail)

51%
foresee a contraction in the crypto market (17% anticipate growth)

24%
are currently using key performance optimization tools

54%
plan to realize operational change via in-house development

26%
view ESG as the top priority in Europe (10% in Canada)

2%
see skills shortages as a driver of operational change

#1 Fixed income roars back—but not so fast!

Recent interest rate increases have given money owners the opportunity to channel investments back into the debt market. Faced with continuing rumours of a banking crisis and global recession, institutional and retail investors alike are returning to debt as a haven from what may be troubled times ahead. According to the survey, more than two-thirds of managers (67%) expect higher demand for fixed income securities over the next three years as investors seek safe and liquid returns.

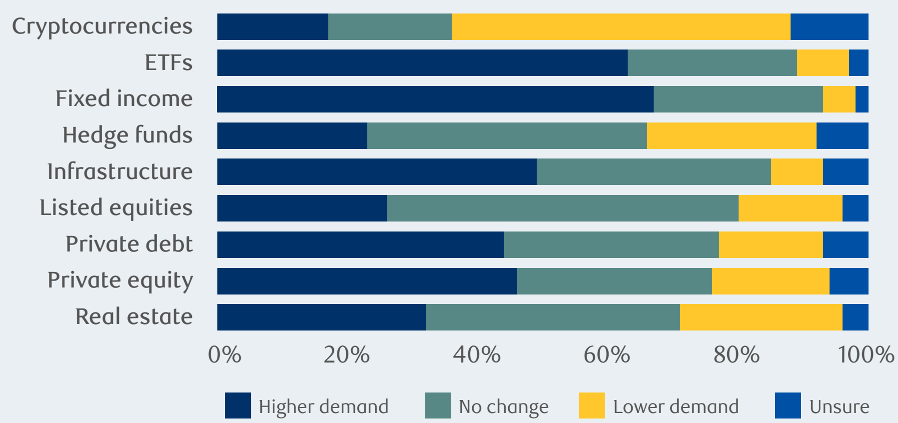
But fixed income is only part of the story. A total of 63% of managers forecast higher demand for exchange-traded funds (ETFs), and a similar proportion of European and Canadian managers (65% and 62% respectively) expect growing demand for infrastructure investments (37% for US managers).

2/3
expect higher demand for fixed income assets

63%
expect higher demand for ETFs

Demand for ETFs & private assets remains strong

How do you expect investor demand to change over the next three years for the following asset classes?



CANADA

Canada favours infrastructure and fixed income

Infrastructure and fixed income look to be the engines of Canadian portfolio growth going forward. Approximately 62% and 58% of Canadian managers respectively expect growth in these asset classes over the next three years, reflecting key dynamics that are playing out in this market:

- Active managers face pressure to demonstrate value by providing investors with access to unique sources of return. Unable to plough yet more assets under management (AUM) into equity markets, managers are turning to reinvigorated bond markets and burgeoning infrastructure funds as they look to add returns to their portfolios, preferably with limited correlation to stock markets.
- With large investors (more than $25 billion of AUM) far more infrastructure-heavy than their smaller, fixed income-heavy peers, it seems likely that complex infrastructure investments will remain the exclusive domain of the "big boys." But this is not the whole story as 78% of Canadian wealth managers see demand growing for infrastructure investments within their wealthy client bases going forward.

Despite uncertainty in a post-COVID environment, Canadian managers are also particularly optimistic about the real estate market with 58% expecting demand growth over the next three years. Perhaps this is not surprising given that Canada's pension funds—particularly the largest—own much of the country's top office and retail properties.

UNITED STATES

Rising interest rates put fixed income ahead of private assets in the US

Private markets have enjoyed strong growth since the global financial crisis[1] as low interest rates, liquid credit availability and rising valuations triggered a significant increase in capital towards private equity and private debt securities. However, this tide may now be starting to ebb. As interest rates have risen in 2023, so has the cost of capital, dimming interest in alternative assets and increasing the potential returns of other, more liquid asset classes.

In this context, investor demand for fixed income is surging in the US, with 67% of managers forecasting demand growth for this asset class in 2023, compared with 23% for listed equities. As interest rates have returned, the relative trade-off between highly liquid public debt and illiquid private securities has become more apparent. If returns of around 3% to 5% can be gained from both markets, why not avoid the complexities and liquidity limitations of private equity, and opt to buy bonds? Such a reallocation appears to be more pronounced in the US than elsewhere based on the market's unrivalled depth and liquidity.

EUROPE

Infrastructure fills the ESG gap in Europe

If one theme dominates the European investment agenda in the survey, it is ESG (environment, social and governance). Given significant regulatory change in 2022, this topic is now paramount for everyone from portfolio managers to back-office operators. Not only have infrastructure funds enjoyed growth over the last decade and demonstrated resilience during the pandemic, but they are also increasingly tied to the world's ability to meet the United Nations' Sustainable Development Goals (SDGs) as projects seek to source a combination of public and private funding. With 65% of European managers expecting to see growth in demand for infrastructure investment over the next three years, the ESG element of investment in energy transition, decarbonization, waste and the circular economy is presenting new opportunities to the investor.

Demand for infrastructure lags in the US*

Europe	65%
Canada	62%
US	37%

*Proportion of responsess

1 McKinsey & Company, Global Private Markets Review, March 2023

#2 Are ETFs driving an end to stock picking?

The world appears to be moving away from equity stock-picking towards ETFs, driven by market pressures, provider supply and taxation differences. The survey found that direct equity exposure will remain relatively flat, including the expectation of a net 10% growth in investor demand over the next three years (see Theme #1). At the same time, more than two-thirds of managers (67%) expect growth in demand for equity ETFs over the next 12 months.

10%
net growth in investor demand for listed equities

67%
expect higher investor demand for equity ETFs

ETF investors cover their bases

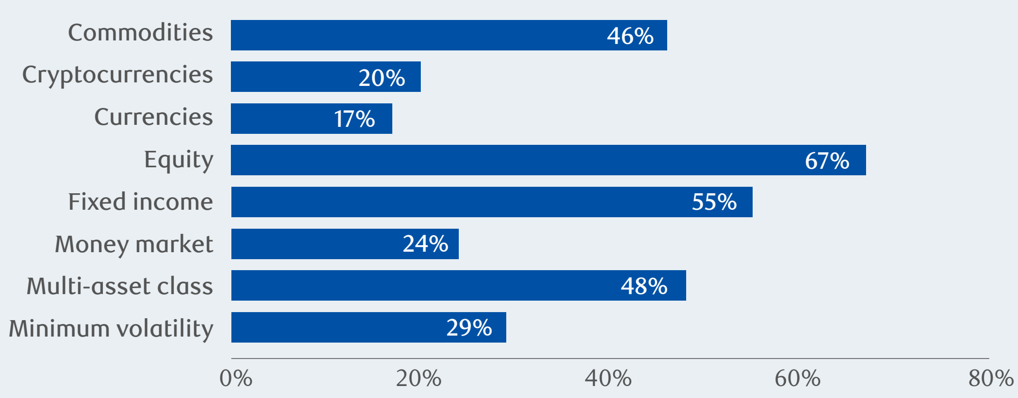
The survey results point to equity assets as the top driver of ETF growth in the near term. However, managers are also looking to fixed income and commodities as key ETF growth drivers (55% and 46% respectively). This may well be a reflection of the ETF market's longstanding reputation for ease of access, innovation and resilience, not to mention a potential response to recent volatility in the equity markets.

46%
expect higher investor demand for commodity ETFs

55%
expect higher investor demand for fixed income ETFs

ETFs have a longstanding reputation for resilience & innovation

What asset categories do you expect to generate ETF growth over the next 12 months?



CANADA

Transparency is a hot topic in Canada

Canadian investor demand for direct investments into listed equities also appears to be waning but not to the same extent as the US. A net 19% of Canadian managers are forecasting growth in demand for listed equities over the next three years, while more than half of respondents (54%) expect equities to generate ETF growth over the next year.

On the regulatory front, new transparency rules—known as Total Cost Reporting or TCR—were recently introduced requiring enhanced disclosure of costs for Canadian investment and segregated funds, including ETFs and mutual funds. TCR is intended to help ensure that investors understand the cost of advice, enabling them to assess and compare the performance of their investments. Scheduled to go into effect on January 1, 2026, the new regulation will apply to the first annual reports to clients covering the 12-month period ending December 31 of that year. TCR will result in substantially harmonized rules around the presentation of cost and fee information for securities, assisting investors in making informed decisions about their portfolios.

UNITED STATES

US investors are “outsourcing” their stock picking

A net 9% of US managers anticipate increased demand for listed equities over the next three years, while 72% expect equities to drive ETF growth in the coming year. Passive investments are clearly the structure of choice for “vanilla,” non-differentiating, investment strategies. A global phenomenon, this is likely being driven by two factors:

- First is the relative tax efficiencies of investing into ETFs compared to mutual funds. Index funds tend to have minimal turnover and, since investors sell their shares on an exchange, there is no requirement for the manager to sell the underlying assets and potentially incur a capital gain. This, combined with greater transparency and lower cost, has been sufficient to drive billions of dollars in liquidity out of mutual funds and into ETFs over the last few years.[1]

- The second factor relates to the changing role of advisors in the US. “Mutual funds are not bought, they are sold” and the advisor remains at the heart of fund sales today. However, as the fiduciary advisor model—where trailer-fees and commissions cannot be received by the advisor—continues to grow in popularity, it is becoming increasingly difficult to promote uncompetitive structures. In an age of cost transparency and paying-for-performance, additional growth is expected for ETFs due to their cost efficiency and ease of access.

It is not just about equity ETFs

We've witnessed tremendous ETF growth in recent years, reaching total assets of more than $9 trillion globally at the end of 2022, a 10-year annual average increase of 18%.[2]

One of the key advantages of this investment tool is the ability to provide investors with access and exposure to different strategies and themes. For example, if you invest directly into equities, you buy "equity-by-equity"—a cumbersome and expensive way to assemble a portfolio. On the other hand, if you invest in an equity ETF, you're acquiring a diverse portfolio of stocks, minimizing investment risk by spreading your investment among numerous positions and, at the same time, minimizing the cost of assembling the portfolio. It's as easy as buying a single stock!

The same applies to fixed income securities. As interest rates go up in today's volatile environment, we see that investors are increasing their allocations to fixed income. ETFs allow for easy access to a diversified portfolio of bonds. Commodities also offer the opportunity for investors to hedge against market volatility and, finally, multi-asset class ETFs provide a combination of the benefits of the individual asset classes that we've just been discussing.

ETFs deliver a wide range of options for investors to diversify their portfolios in an efficient and effective manner. This is resulting in a thriving ETF market, which is unlikely to decelerate anytime soon. For more information on how ETFs work, why they are so popular among investors and where this important investment tool might be headed, we invite you to read our thought leadership report, *A primer on ETFs*, which is available on the RBC Investor Services website.

Siu-Kei Chung
Senior Director of Business Development

Sheila Bowyer
Director of Business Development

1 ETF Education Channel, Mutual fund-to-ETF conversions: The wave of the future, January 27, 2023
2 ETFGI, ETFGI reports the global ETF industry gathered $856 billion in net inflows in 2022, January 12, 2023

#3 The quest for uncorrelated alpha continues

While the re-emergence of fixed income may come as no surprise, the expectation of significant continued growth in private markets is perhaps more notable with 45% of managers anticipating growing demand for private assets over the next three years. As a result of limited opportunities to deliver unique alpha in the public equity and debt markets over the past few years, investors have increasingly turned to private markets to "deliver returns that investors can't get elsewhere." For example, the world's three biggest private-markets firms, Blackstone, Apollo and KKR, today manage more than $2 trillion in assets, up from $187 billion in 2008.[1] In times of rising interest rates and a re-energized debt market, one might wonder how long such demand can be sustained.

Faced with rising rates, how long can demand for private assets be sustained?

Private assets under management*

2008	$0.2 trillion
2022	$2 .0 trillion

*Blackstone, Apollo and KKR

Wealthy investors are more bullish on private assets

The popularity of private assets appears to be strongest among high net worth individuals (HNWIs) as 59% of managers expect growth in demand—slightly ahead of family offices (57%). At the same time, a significant majority of wealth managers consider alternative investments to be either very important (47%) or important (36%) to their HNWI clients.

83%
consider alternatives to be an important HNWI offering

48%
anticipate higher demand for private assets among institutional investors

Wealthy investors in the capital preservation mode seem uniquely suited to private investments based on their long-term investment horizons and limited need for liquidity. As current or former business owners, HNWIs are generally comfortable with "company management" and willing to pay boutique managers for long-term performance that is not available elsewhere.

Nearly half of managers (48%) expect higher demand for private assets among institutional investors over the next three years. Significant private market investments in recent years have left many institutional investors with limited headroom to further grow this asset class at a time when the supply of high-quality and liquid investment opportunities appears to be declining. Could rising interest rates provide institutions with the opportunity to rebalance back towards public fixed income markets?

Democratization faces challenges

Beyond the appeal of private assets to HNWIs and institutional investors, the much-heralded "democratization" of retail markets looks more challenging, particularly if liquid assets begin to generate similar returns to private assets. Historically, investment in the illiquid and less-transparent private markets has not been particularly well-suited to retail investors as capital is tied up for extended periods of time without daily mark-to-market pricing.

Despite these challenges, a somewhat surprising 45% of managers expect demand for private assets among retail investors to grow over the next three years, ranging from a high of 45% in the US to 43% in Europe and 35% in Canada.

While the growth outlook for private assets across the retail space remains positive, views on the wider outlook remain divided. Certain hybrid (public and private asset) funds have seen significant growth in Europe. However, concern around how private assets can be packed successfully into more specific structures remains an obstacle in this space.

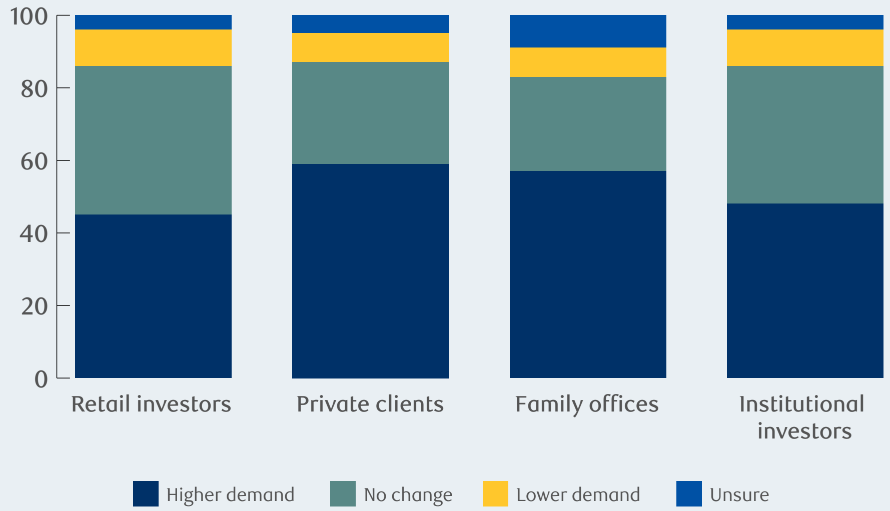
Canada lags on the democratization of private assets*

US	45%
Europe	43%
Canada	35%

*Proportion of responses expecting higher demand

Private assets will need to become more transparent & liquid for their appeal to broaden in the retail space

How do you expect investor demand for private assets to change over the next three years for the following investor profiles?



Private equity boutiques provide tailored HNWI offerings

I'm not at all surprised by the expectation of higher demand for private assets among HNWIs and family offices. Alternative investments have traditionally been popular with private investors as this asset class very much aligns with their attitude toward investing. Private assets provide diversification and the potential for higher returns. They also give wealthy investors access to exclusive investment opportunities, which they find particularly appealing. And alternatives offer certain tax advantages as well, including capital gain deferrals, not to mention opportunities for depreciation and amortization on real estate.

However, a recent development that I find particularly interesting is how private equity boutiques are increasingly tailoring their offerings to address the priorities of HNWIs. These specialist managers are synchronizing their business models with those of private clients and family offices, recognizing that wealthy investors have different priorities than, say, institutional investors. For example, the equity boutiques are developing investment opportunities that not only generate returns but also deliver on social issues and the "better good of the world" aspect—themes that are of particular importance to many private investors.

So, I would expect the allure of private assets to wealthy investors to endure, even in an ongoing environment of rising interest rates and volatile markets.

Sylvia Rizk
Senior Director of Business Development

1 The Economist, Private's progress, April 29, 2023

#4 Is crypto moving from winter to the ice age?

Over the past 18 months, demand for crypto currencies has scaled new heights and ploughed new troughs. While the collapse of FTX in 2022 and numerous scandals since have led many to question the future of this asset class, none of the failures appears attributable to the technology supporting the ecosystem or the nature of the securities themselves. Rather, fraud and mismanagement have dominated the headlines, giving rise to a divergence of views around whether crypto currencies can or should scale.

Fraud & mismanagement have dominated the crypto headlines

Regulation is driving crypto demand

While there is little doubt about the recent direction of crypto markets, the key question is what comes next? Overall, more than half (51%) of managers expect the crypto market to contract in the next three years and 80% of wealth managers indicate that crypto is not an important service offering to their wealthy clients. However, the survey results demonstrate strong regional differences in regulatory approaches to crypto, which tend to reflect similar differences in crypto demand:

- In Europe, where the European Union is working toward regulation of a new crypto asset market as part of their Markets in Crypto Assets (MiCA) plans and the UK is looking to bring crypto assets into the fold of regulated assets, demand for this asset class is surprisingly robust as 28% of managers expect to see growth in crypto demand. The expectation of higher crypto demand in Europe is primarily among large managers with AUM of more than $25 billion (35%), who are also expecting crypto to drive ETF demand.
- In North America, where crypto regulation has been more limited, only 13% of Americans and 12% of Canadians expect higher demand for crypto. Canada recently tightened regulations for crypto asset trading platforms, including the introduction of a pre-registration process. Early moves in the US to support a nascent crypto market appear to have been set back by recent initiatives that subject many crypto issuers to regulatory enforcement and make the longer-term outlook in the US unclear.

51%
anticipate lower crypto demand

80%
consider crypto to be "unimportant" to HNWIs

Europe is relatively bullish on crypto*

Europe	28%	Plan to make crypto part of regulated assets
US	13%	Heightened regulatory enforcement
Canada	12%	Tightening of crypto regulation

*Proportion of responses expecting higher demand

#5 Do cash, FX & SL represent missed opportunities?

Managers across all regions generally have a favourable predisposition toward alternative investments as a tool to optimize portfolio performance (72% are currently or planning to use this tool globally). However, a different story emerges on cash management, foreign exchange (FX) and securities lending (SL).

Cash, FX & securities lending appear to be misunderstood

Faced with growing pressures to drive returns, what role do active cash management, securities lending and FX play in helping to augment investment performance? The question is surprisingly divisive.

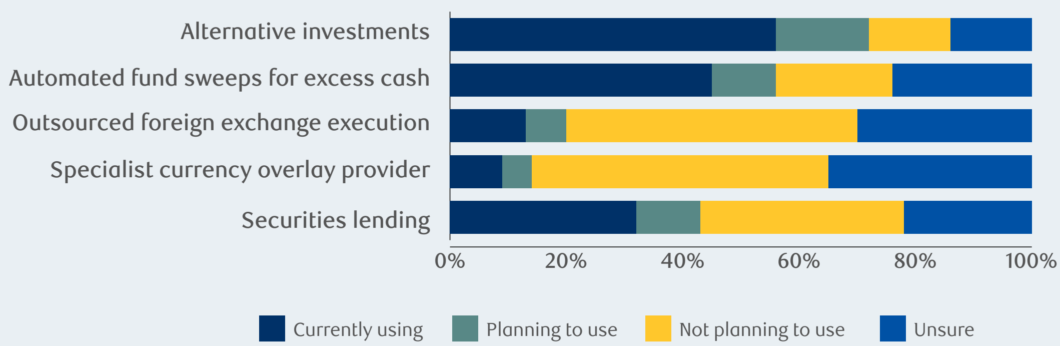
The survey indicates that cash sweeps are particularly prevalent among US investors but undervalued in Europe and Canada. FX best execution seems to be misunderstood across all regions as managers are generally more likely to track “cheapest-to-deliver” execution, while only 14% are focusing on the broader spread benchmarking and Transaction Cost Analysis. Meanwhile, views on securities lending range from “it needs to be prohibited” to “our program is fully indemnified and gives us only upside.”

With only 24% of managers currently using the key performance drivers (excluding alternatives and currency overlay) and a mere 9% looking to employ them anytime soon, this appears to be a missed opportunity. Often viewed as operational activities that reside far from the portfolio manager, cash management, FX and securities lending constitute valuable performance optimization opportunities for managers who employ them successfully.

24%
currently use key performance drivers

Performance optimization tools often reside far from the portfolio manager

What strategies is your firm currently using or planning to use to optimize performance?



Currently or planning to use performance optimization tools*

	Global	Canada	US	Europe
Alternatives	72%	77%	75%	68%
Cash sweeps	56%	23%	72%	39%
Securities lending	43%	23%	45%	50%
Outsourced FX execution	20%	27%	14%	33%
Currency overlay	14%	16%	17%	13%

*Proportion of responses

CANADA

Canada focuses on alternative investments

Canadian managers seem uniquely conservative in their approach to yield enhancement tools. The survey highlights that managers prefer to focus on their portfolio investments to generate returns, including minimal recourse to cash management, securities lending and FX solutions that have proven popular elsewhere over the last decade.

More than three-quarters of Canadian managers (77%) see the inclusion of alternative investment strategies as a key tool in providing a performance uplift to their investment portfolios today and tomorrow, including a striking 31% who plan to turn to this market in the near future. All other solutions pale by comparison, raising the question of how much additional performance is being forsaken in the average Canadian portfolio.

On the cash side, only 23% of Canadian managers see automated cash sweeps as a viable way of driving returns. This may be at least partially driven by managers' lack of access to intra-day information on cash balances, and recent increases in interest rates could provide the incentive to invest in this capability. Similarly, securities lending is a "black box" that 50% of Canadian managers seem unwilling to open (41% excluding wealth managers), generating surprisingly strong views among managers. Only 16% of the Canadian industry sees active management of FX execution as worthy of interest, perhaps given high CAD/USD exposures.

With relatively lower AUMs among Canadian survey respondents, are the benefits of securities lending and other optimization tools considered out of reach for mid-tier and small managers?

EUROPE

Europe embraces portfolio enhancement tools

Against a global backdrop of strong conservatism when it comes to portfolio optimization tools such as cash sweeps, securities lending and FX management, European investors appear to be uniquely engaged in this space. Although Europe lags on the use of cash sweeping compared to the US—perhaps due to the fact that cash accounts there have been remunerated for longer than they have elsewhere—Europeans lead in usage and ambition for securities lending and outsourced FX.

The diversity of currency exposures in Europe means that FX outsourcing gets almost four times more attention than it does in the US, albeit with only 33% of managers currently focused on this space. Usage of securities lending is also 30% stronger among European managers compared to the US, mainly among larger managers with more than $25 billion in AUM.

With over a third (37%) of the European market optimizing their portfolio performance through FX outourcing, cash management and securities lending, the value of these mechanisms is better understood east of the Atlantic but still has a way to go.

UNITED STATES

US managers lean into cash sweeps

As part of efforts to drive performance outside the core portfolio, US managers are unique in their use of automated cash sweeps to optimize performance, with 72% of respondents currently or planning to utilize cash sweeps. A likely legacy of the USD demand deposit account (DDA) structures, where cash balances are generally not remunerated, most US managers are comfortable sweeping cash out of their custody accounts to gain overnight interest on their balances.

Alongside cash sweeps, alternative investments are the only other significant driver of performance in the US, and this is at a level that is generally like other regions (75% current or planned use). Few other mechanisms, including securities lending and FX optimization, appear to have momentum among American managers. Given the vast scale of the domestic market, the limited current and planned use of FX overlays and outsourcing (17% and 14% of responses respectively) is likely due to a lack of FX risk to justify use of these optimization tools.

The fact that only 11% of the US market is looking to utilize performance optimization tools (excluding alternatives) in the near term does raise the question of how much efficiency could be gained from these tools.

Dialogue is key

Portfolio optimization tools continue to be employed by the world's most sophisticated asset managers and owners. What these managers and owners know is that outsourced foreign exchange execution and currency overlay strategies are contributing to increased operational efficiency, and securities lending can add significant risk-adjusted returns to portfolios. Ultimately, such performance optimizers enable portfolio managers to focus on their core competencies of asset selection and alpha generation, while working in the background to support performance.

Europe's higher usage of outsourced foreign exchange execution solutions is largely due to their multi-currency landscape and the need for a variety of geographically-targeted share class fund structures. The introduction of T+1 and ongoing event-driven volatility across the markets are likely to lead to a higher adoption rate going forward. Timely FX settlement will be critical in a T+1 environment and hedging against future exogenous market events is going to play a crucial role in risk mitigation.

S&P Global Market Intelligence estimates that securities lending is a $30 trillion global industry, supporting the overall health and sustainability of the capital markets system through the introduction of liquidity and price discovery. However, the somewhat polarizing results are not particularly surprising given past controversies and misunderstandings around this practice.

In the end, dialogue on the benefits and risks associated with performance optimization tools is key to investors' gaining full value from these tools.

Kyle Kolasingh
Head of Market Services Solutions

#6 Build, buy or outsource? That is the question

More than half of managers (54%) are planning to realize their operational change agendas via in-house development, while 34% are looking to deploy third-party technology and 12% will be taking the outsourcing route. The high level of in-house activity points to a significant volume of fragmented and non-standard operating models across the manager community. While many managers have historically relied on in-house builds for much of their platforms, a substantial number now seem to be dividing the operating model into two distinct parts to implement change within their firms.

Managers distinguish between client-facing and core system development

Managers rely on in-house development to provide competitive differentiation

The first part centres on the client experience—areas that typically provide managers with the ability to differentiate their offering from competitors, including investment research, product construction and allocation, product sales and distribution, and others. These areas are generally home to in-house change initiatives (see accompanying chart).

Managers are anxious to stay close to their "secret sauce." However, they must be prepared to take on the added responsibilities that come with developing and operating in-house platforms in today's increasingly complex operating environment. As one manager says: "Running your own platform can be a high-risk game. Unless you have strong processes and develop solid disciplines around documentation, then you'll really struggle."

54%
plan to realize operational change in-house

Managers rely on external providers to build efficient core systems

The second part of the operating model focuses on core operations—what the client doesn't see. This is the area where the most significant change is occurring. Since managers have minimal need to differentiate their core functionality, in-house development does not appear to be touching much of the central infrastructure. For example, effecting changes to the Investment Book of Record (IBOR) is the domain of third-party technology vendors and outsourcing providers (63% and 16% respectively). Trade management and cyber security are other parts of the core infrastructure where in-house change is not the norm, and managers are generally engaging outside providers (69% and 64% respectively).

79%
plan to rely on external systems for IBOR

Interestingly, client reporting appears to reside in the middle of the two extremes. Visibility of data is a common theme regardless of manager profile. As one manager commented: "60 years ago, the challenge was access to information. Now it's about managing access to the data."

Faced with growing and accelerating disclosure and regulatory reporting requirements, 43% of managers are looking to deploy third-party technology and 17% are taking steps to outsource the client reporting function. However, a significant minority of managers (40%) continues to favour the in-house development of client reporting, possibly due to the perception that third-party technology and outsourcing will be unable to provide the flexibility required to meet the unique reporting requirements of individual clients.

Niche fintechs have their limitations

As managers look to expand into new asset classes and markets, the deployment of third-party technology through niche fintech providers seems to be growing. Technological advances over the last decade have dramatically reduced the barriers to entry for fintechs, and it is now possible for managers to deploy standard, third-party technology with multiple providers at once as an alternative to in-house development or outsourcing these functions. According to one manager, niche fintechs provide "the latest technology that can help us solve specific problems."

60%
plan to engage external resources for changes to client reporting

That said, there are several factors for managers to consider in deploying third-party technology as part of an "open architecture" approach, including additional cost and work effort for:

- Vendor management
- Governance and oversight
- Resiliency and business continuity
- Cyber security
- Operating model integration
- Ongoing market and operational changes (e.g., T+1)
- System maintenance resources
- Data consolidation

Whether to build, buy or outsource the development of new or enhanced systems is a key decision as managers set out to implement their change agendas. It is important that managers carefully consider the impact on their operations as the choices taken will have significant implications throughout the change process and beyond.

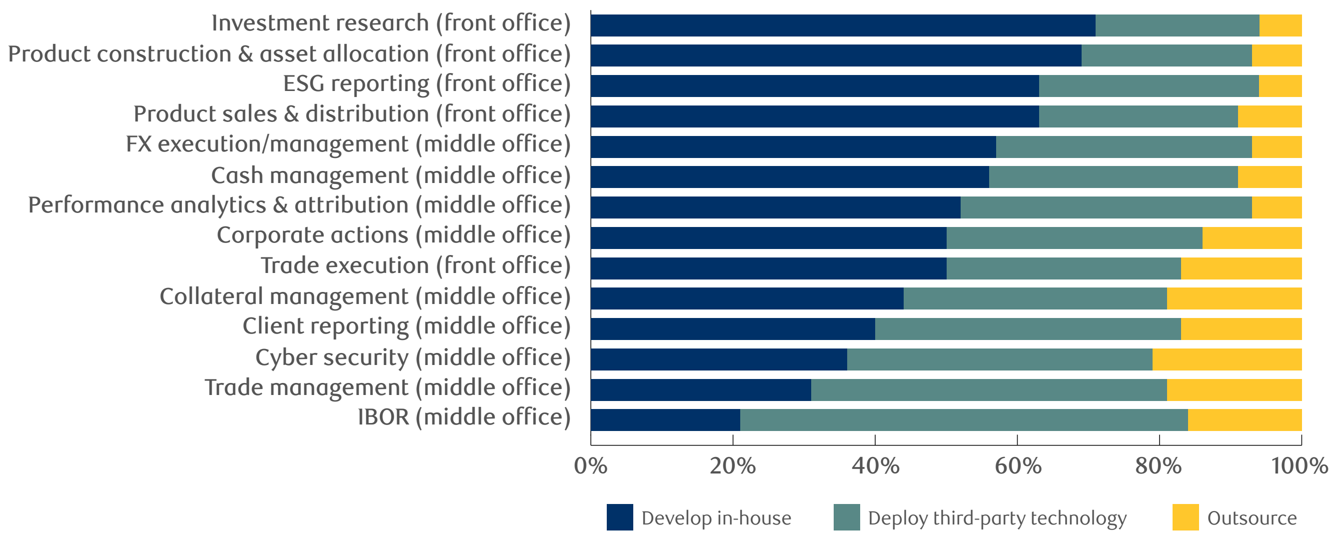
Where is T+1?

Among the busy investment agenda of Canadian and US asset and wealth managers, the transition to a shorter T+1 settlement cycle in May 2024 is conspicuous by its absence. According to a survey conducted by The ValueExchange earlier this year,[1] 61% of investment managers had not yet begun preparations for the move to a reduced settlement timeframe. The lack of momentum is of particular concern, given how loudly the clock is ticking.

Managers generally acknowledge that compliance with the regulatory operation rules for T+1 will require significant automation of the middle office. However, the pressing question remains: When will this work begin? And how will the required changes be implemented? Failure to comply could cause significant market risk and failing trades—not to mention regulatory breaches. It is critical for this initiative to quickly rise to the top of managers' project agenda.

61%
not yet started preparing for T+1

Out of the areas that will see change within your firm over the next three years, how will each change be conducted?*



*Proportion of responses

CANADA

Canadian managers differentiate between clients and process

A majority (65%) of Canadian managers plan to "go it alone" when it comes to technology, opting to develop internal systems on their own rather than using third-party technology (32%) or outsourcing to asset servicers (3%). While Canadians seem keener to build internal systems than their global counterparts, the reality of how this is happening is more nuanced as managers look to reduce costs and leverage the specialist skills of external providers.

In Canada, there is a clear distinction in method and partners between client-facing and process-centric technologies. In the case of the former—including areas such as product distribution and investment research—almost 100% of Canadian managers see the design of in-house software as a competitive advantage. By contrast, between 30% and 50% of managers, especially institutional managers, are prepared to entrust their core processing platforms (e.g., IBOR) to a software vendor or outsource to an asset servicer.

Client reporting sits in between these two extremes: 100% of Canadian wealth managers are looking to rely on external software vendors as key partners for client reporting, while nearly three-quarters of asset managers plan to engage a software vendor or outsource this function (43% and 29% respectively).

Given ever-evolving regulatory and client requirements, Canadian managers are anxious to avoid being left behind. However, one might question the extent to which their affinity for internal systems can be sustained over the longer term.

“

It is important to focus on what matters most

Managers are confronted with a growing range of regulatory and market changes that have a direct impact on their operating models. T+1 in North America, as well as ESG and the new Central Securities Depositories Regulation (CSDR) across Europe, are prime examples. This is an opportune time for managers to take a step back and consider solutions that cushion their firms from today’s increasingly complex operating environment, enabling them to focus on what they do best and what matters most—creating alpha for their Investors.

Historically, managers have leaned towards in-house solutions for their primary front and middle office functions. However, we are witnessing a gradual shift in this trend. Firms are increasingly recognizing the benefits of hybrid partnerships—including third-party technology platforms, outsourced service providers and a combination of both—to provide activities such as trade management, IBOR and trade execution. As the challenges associated with in-house solutions rise due to technology advancement, automation and the advent of cloud-based solutions, managers are looking to focus on their core responsibilities instead of building and maintaining complex solutions from scratch.

Today, we see robust “front-to-back” and “back-to-front” modular solutions that allow managers to partner with technology vendors, while retaining their exclusive strategies and models in-house. Leveraging the capability of advanced platforms is essential for scale and resilience, which are difficult to attain otherwise. Moreover, it is important for managers to consider the overall complexity and capital expenditure required to build in-house infrastructure, along with the challenge of finding and retaining expert resources to manage in-house systems.

New ways of thinking about current operational and regulatory challenges are worthy of managers’ careful consideration as they look to maintain a competitive edge.

Mathew Abraham
Associate Director of Middle Office Product

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1 The ValueExchange, Operationalizing T+1, March 2023

#7 Digitization is the ultimate change goal

The motivation behind operational change tends to be different for asset managers and wealth managers. However, the ultimate transformation goal is the same regardless of manager profile, and that goal is digitization.

Cost cutting often precedes true digitization

A large number of highly-fractionalized legacy platforms has resulted from the penchant of asset managers for in-house systems. In response, managers are looking to assemble the right system mix and, in turn, optimize connectivity across their operating models as the primary objective of their change agenda. Put simply: “The real focus is on cleaning up.” As a result, “cost reduction” is the top factor driving automation and operational change over the next two years, chosen by 31% of asset managers.

Asset managers focus on “housekeeping”— the precursor to true digitization

Managers’ road to digitization most often entails the “removal of touch points,” along with the simplification of platforms and processes. Such “housekeeping” or automation of manual processes is generally intended to bring about an environment of exception-based processing—the precursor to true digitization. As one asset manager highlighted: “The move toward fintechs would be much greater if it weren’t for legacy systems holding us back.” It is necessary to get the basics right and only then can asset managers turn their attention to artificial intelligence, machine learning and other exciting areas of digitization.

31% of asset managers focus on “cost reduction”

28% of wealth mangers focus on “new technologies”

What is driving operational change among different manager types?*

	Global	Asset managers	Wealth managers
Cost reduction	30%	31%	22%
Expanding into new asset types/markets	18%	20%	17%
New technologies	11%	7%	28%
Increased digital client expectations	10%	9%	11%
New regulatory requirements	10%	12%	11%
Consolidation	10%	12%	11%

*Proportion of responses

The advisor is king

Digitization has a different meaning for wealth managers where the financial advisor reigns supreme. As the gateway to private clients, advisors are the new battleground for wealth manager platforms. Managers are prioritizing their technology spend by focusing on "new technologies" (top factor driving operational change, including 28% of wealth manager responses) that enable the advisor role.

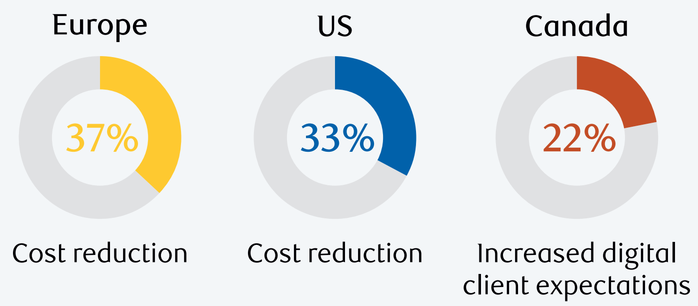
By automating Know Your Client (KYC) and client onboarding activities, for example, wealth managers are looking to optimize the advisory role and allow the advisor to spend more time developing relationships with investors rather than focusing on various administrative aspects of the investment process. Only in the US does investment in self-service technology appear to rival spend on the empowerment of advisors.

For wealth managers, digitization is key to advisor enablement

Canadian managers cut to the chase

While European and US managers are reducing costs in preparation for true digitization (regulation is also on the minds of Europeans), Canadian managers are looking to "cut to the chase" and focus on digitization in their quest for business growth.

Top operational priorities*



*Proportion of responses

What is driving operational change in the regions?*

	Global	Canada	US	Europe
Cost reduction	30%	13%	33%	37%
Expanding into new asset types/markets	18%	19%	21%	13%
New technologies	11%	16%	10%	11%
Increased digital client expectations	10%	22%	5%	9%
New regulatory requirements	10%	9%	7%	15%
Consolidation	10%	9%	10%	9%

*Proportion of responses

CANADA

Canadian managers are at the forefront of digitization

The Canadian operating model appears to be digitizing quickly with 22% of managers citing "increased digital client expectations" as a top investment priority for the coming year—the most popular factor to drive operational change. However, this is not necessarily the digitization that one might expect, particularly in the wealth and advisory space.

At the institutional end of the spectrum, cost reduction and standardization are the key drivers of digital transformation as Canadian asset managers move to standardize product roadmaps as part of their efforts to reduce bespoke processes and leverage the innovative capabilities of third-party providers. Digitization is also seen as a key enabler of alternative assets, providing out-of-the-box valuation, reporting and management tools to help short-circuit long and expensive learning journeys.

In the wealth space, discussion of digitization centres around the investment advisor. Almost universally, wealth managers are focusing their investment resources on the advisor, making the advisor's life as simple as possible (automating KYC, for example) and supporting value-added advice. For those wealth managers looking to expand their advisor networks across Canada, the ability to distinguish themselves through advisor-centric technology looks to be a core priority.

UNITED STATES

Major US managers are cutting their way to growth

The impact of portfolio changes is driving a varied approach to technology and transformation among US managers. A striking 45% of top-tier managers (AUM of $25 billion or more) are driven by cost reduction as their core priority to effect technology change—far ahead of the 19% focusing on new client growth. Heavily exposed to the shift toward passive investments, major US asset managers are having to radically reshape their cost bases and infrastructures to drive scale. They are being required to transform vast mutual fund factories into agile ETF platforms, for example.

And top-tier US managers are doing this with relatively little use of technological innovation. Only 6% of these managers cited the use of new technologies as a priority in their transformation plans and a similar proportion cited the digitized client experience as a key factor. The automation of existing, legacy platforms is likely the top priority in this space.

Mid-tier US managers are leveraging technology to empower growth

By comparison, mid-tier US managers ($1 billion to less than $25 billion in AUM) are pressing ahead—mostly. Generally freed of legacy technology, 27% are focusing on expansion and stealing market share—almost entirely to the exclusion of cost management—and 18% of managers are using new technologies to support growth as they look to leverage machine learning, artificial intelligence and specialist fintech solutions to build platforms that are fit to scale in a world of passive and alternative investments.

Yet life is not entirely carefree for mid-sized managers. Regulatory change, including increased reporting requirements and T+1, is a powerful burden for 18% of these managers as they struggle to increase the sophistication of their platforms and data management to remain competitive.

EUROPE

Cost containment and regulatory change are motivating the European agenda

Whether it be ESG, anti-money laundering, best execution or shareholder rights, the significant volume of regulation hitting European managers is unique, and it is the most-cited driver of transformation in the region. According to one European manager: “We hardly have time to think now because of the onslaught of new regulations.” Beyond the direct cost of regulatory implementation, the indirect costs of change are also ballooning—a priority for 37% of European managers. People and processes in client reporting, compliance monitoring and performance attribution stand out as major spending requirements.

Dealing with regulatory change is expensive and time-consuming. However, this burden is not equally shared. For mid-tier managers with AUM of $1 billion to less than $25 billion, 27% of investment projects are driven by regulation (4% for top-tier managers with AUM of $25 billion or more), leaving these managers at a potential competitive disadvantage around the ability to prioritize growth projects and digitization initiatives. While larger managers generally have the bandwidth to implement innovation and regulatory change concurrently, smaller firms have fewer resources for anything other than regulatory compliance. Expansion is certainly not a factor in the less than $1 billion segment.

Is innovation only for the “big fish” in Europe?

Re-platforming, big data, SaaS, regulatory technology, agile distribution, machine learning, artificial intelligence and robo-advisory are relatively scarce in Europe and remain the exclusive domain of larger managers.

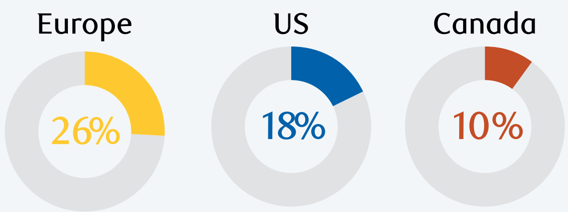
New technology is a factor for only 11% of European managers, including no focus at all by smaller firms. Improving the digital client experience is considered a driver for only 9% of European managers and all are in the top tier. The burden of legacy technology is still overwhelming for larger managers; however, they are at least able to drive transformation through their own in-house client experience initiatives, and by offloading areas such as IBOR, collateral management and client reporting to software vendors and asset servicing providers.

How are smaller firms able to compete? Ostensibly, mid-tier European managers ($1 billion to less than $25 billion) appear to be doubling down on their core competencies and leveraging partnerships for everything else. Focusing on what differentiates them today, these managers are redefining traditional manager-vendor boundaries by moving the outsourcing line further than ever. For example, they are using third parties for investment research, along with product sales and distribution, and trading—traditionally part of the in-house realm. The mid-tier operating model is becoming highly specialized.

#8 ESG regulation matters—a lot

Approaches to the core ESG (environment, social and governance) theme vary significantly by region. ESG is an existential priority in Europe, where 26% of managers currently view it as the top investment priority. US managers are beginning to put ESG at the top of their agenda (18%), while Canadian managers see ESG as "no more than a couple of pages in the marketing deck" (10%).

ESG as the top priority*



*Proportion of responses

ESG regulatory reporting requirements*

Europe	Mandatory
US	Discretionary
Canada	Discretionary

The lesson from ESG appears to be clear: It is a top priority in Europe, where regulation is the driving force. However, in the US and Canada, where ESG reporting is discretionary, demand appears slow to catch up, particularly in the wealth space where 40% of managers deem ESG to be unimportant.

40%
of US and Canadian wealth managers deem ESG unimportant

ESG requirements are outstripping the availability of data

In-house teams create hidden risks for investors

The lack of coherent ESG market demand is creating a supply problem. In many cases, "our ESG requirements are outstripping the availability of data," driving managers of all profiles to build ESG capabilities on their own, including internal teams of analysts to satisfy client demand (64% of respondents currently have internal teams in place and 13% have plans to do so). As several managers highlighted, the in-house approach significantly limits the comparability of ESG across different funds or managers, creating a further obstacle to scale and hidden risks for investors.

77%
have internal ESG teams in place or plan to build them

CANADA

ESG isn't a big deal in Canada

Canada is unique in the lack of importance it currently places on ESG as a pillar of investment activity. Despite Canadian pension funds leading the world in the importance they place on ESG reporting (80% track and report investments this way today), only 20% of wealth managers and 48% of asset managers are currently able to report on ESG performance. Owing to a collective lack of pressure from regulators, investors and service providers, Canadian managers not only lag their US and European counterparts on ESG reporting, but they also appear to have the least ambition to move ahead in this space tomorrow. Anecdotally, ESG is "just not a thing yet" in Canada.

By contrast, philanthropy (i.e., legacy giving) is considered more important to the mature investor base that supports much of Canada's market today, while ESG is generally in greater demand by the younger investor.

EUROPE

ESG is inescapable in Europe

Following significant regulatory change, including the Sustainable Finance Disclosure Regulation (SFDR), along with pressure from leading asset owners, European asset managers are required to begin reporting their ESG credentials as part of 2022 annual statements. The impacts also trickle down into the European Union's Markets in Financial Instruments Directives (MiFID) and the Insurance Distribution Directive. According to the survey results, ESG is a uniquely core and present-day obligation for 70% of European managers. As one manager commented: "There's no way out anymore."

Ongoing discussion continues around the value of ESG reporting. Some see ESG as a distraction that is crowding innovation and costing the industry: "We'd much rather be focusing on driving investment returns." Others highlight that ESG and returns are no longer incompatible: "You can now find plenty of ESG investments that actually drive the portfolio." Regardless, this market change has created unexpected gaps and opportunities.

First, there is a difference between the rules that target regulated institutional investors and those for unregulated family offices. While the former is obliged to be fully ESG-transparent (74% of managers with AUM over $25 billion are already ESG-compliant), the latter remains largely untouched by ESG rules (only 27% are ESG-friendly today). This leaves family offices more agile and able to focus on other areas of the portfolio. Second is the difference between active and passive investments. Few ETF structures currently offer ESG transparency, and active managers are finding themselves uniquely able to offer investment reporting that has an ESG angle. In this context, ESG is a premium offering that has yet to make its way into the passive world.

While Europe is advancing towards ESG standards faster than other regions, much work still needs to be done to build a robust ecosystem that supports this new lens on performance.

UNITED STATES

ESG is a growing priority in the US

Sandwiched between Europeans' fervent focus on ESG and Canadians' relative indifference is the US market. Nearly 20% of US managers are prioritizing ESG investments over the next two years, making it the top industry priority. As demand from institutional investors for greater ESG disclosures escalates, the largest US fund managers are clearly most strongly focused on this new competency—ahead of the 6% of mid-tier managers ($1 billion to $25 billion in AUM) who are ESG-focused today.

ESG competency is being built using all possible solutions. Nearly 70% of top-tier US managers (more than $25 billion in AUM) indicate that they have established their own analyst teams for ESG and begun using a range of third-party data sources. By comparison, mid-tier US managers seem significantly less invested in exploring market solutions, with 83% preferring to rely solely on in-house competencies as they service demand for ESG transparency in their products.

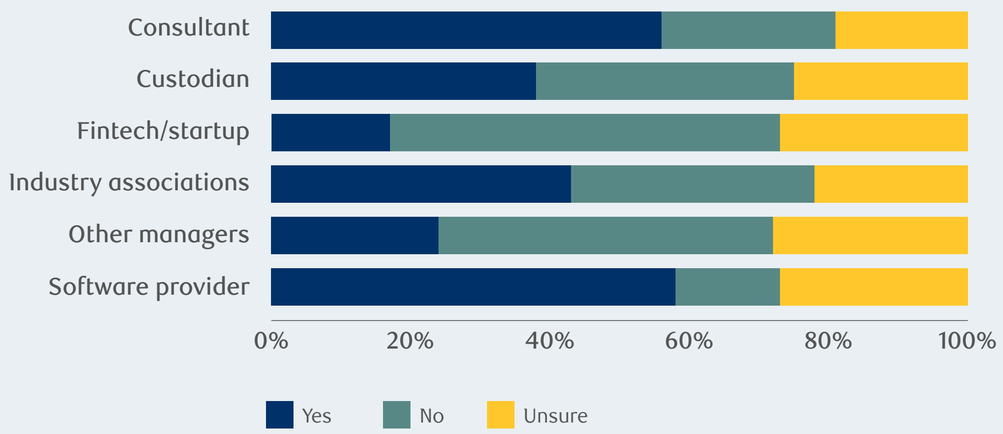
#9 Consultants & industry bodies are key partners

Many managers continue to depend on their core software providers and custodians to effect change (58% and 38% respectively). However, the high volume of new and updated regulation—especially around reporting but also across the entire operating model—is driving 56% of managers to seek out external consultants as core partners in change. This is particularly prevalent in Europe where regulation is a significant burden. Operational risk reduction is a key factor in using consultants, not to mention the benefit of having the de facto "stamp of approval" from one of the big-four consulting firms.

56%
look to consultants as change partners

There are benefits to a big-four consulting firm's "stamp of approval"

Do you expect to engage the following external partners to work on your operational change projects over the next two years?



EUROPE

A collaborative approach is taking shape in Europe

Also of note is the substantial role that industry associations seem to be playing in the face of regulatory complexity, particularly in Europe where 59% of managers rely on this group to assist in bringing about change (43% globally). At the top end of the market (AUM of $25 billion or more), 57% of European managers are looking for industry associations to help drive and shape regulatory developments. At the other end of the market (AUM of less than $5 billion), those unable to afford consultancy support on new regulation often utilize industry associations as a proxy for specialist advice (80%). Either way, industry associations are a preferred, "top-three" partner for all profiles of investors in Europe, highlighting a new, collaborative approach to change management.

Europe embraces industry associations*

Europe	59%
Canada	41%
US	29%

*Proportion of responses by region

Large & small European managers embrace industry bodies*

$25 billion or more	57%
$5 billion to $25 billion	38%
Less than $5 billion	80%

^Proportion of responses based on AUM

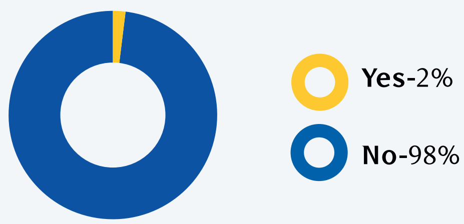
#10 Is there really a skills shortage?

The asset and wealth management workforce is undergoing significant change as the baby boomer cohort—architects of the current infrastructure—retires. Key human resource dependencies, including skills shortages, are emerging across various operational functions. However, managers appear to be overlooking this important change. Only 2% flagged “shortage of the right talent” as a top driver of change. This is generally consistent across all regions, business types and regardless of manager size.

Who is going to keep the lights on?

Based on the lack of urgency around current skills shortages, one might wonder who will lead the charge to develop the investment management infrastructure going forward?

Is “shortage of the right talent” driving operational change within your firm?



Respondent profiles

This report is based on the online survey responses of 265 asset and wealth managers, conducted in early 2023 and complemented by a series of one-on-one manager interviews.

	Total	Canada	US	Europe	Other
Location	265 (100%)	43 (16%)	137 (52%)	72 (27%)	13 (5%)
Business type					
Asset manager	52%	49%	42%	75%	38%
Wealth manager	30%	30%	42%	7%	23%
Asset owner	8%	14%	10%	1%	8%
Service provider	10%	7%	6%	17%	31%
Size (based on assets under management)					
Less than $1 billion	21%	40%	21%	11%	23%
$1 billion to less than $5 billion	12%	25%	7%	14%	-
$5 billion to less than $25 billion	14%	21%	12%	14%	15%
$25 billion or more	53%	14%	60%	61%	62%
Role					
Financial advisor	30%	14%	51%	4%	10%
Executive	14%	30%	8%	15%	10%
Business development	14%	2%	10%	22%	40%
Investment	10%	5%	11%	13%	-
Client service	9%	9%	8%	10%	10%
Finance & administration	8%	21%	5%	8%	-
Operations	7%	19%	2%	11%	-
Legal/risk/compliance	7%	-	4%	13%	30%
Technology	1%	-	1%	4%	-

About RBC Investor Services

RBC Investor Services delivers asset servicing solutions to Canadian asset managers, asset owners, investment counsellors and other financial institutions. Part of Royal Bank of Canada, the country's largest bank and one of the top 10 globally,[1] we focus on safeguarding the assets of our clients and supporting their growth.

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1 Based on market capitalization as at April 30, 2023