FINANCIAL AND BUSINESS SERVICES

ASSET MANAGEMENT: NEW MODELS FOR A NEW AGE

ABSTRACT

Two of the four worst bear markets of the past 100 years rocked the world of investing over a short span of just seven years in the last decade. They side-lined the conventional investment wisdom on risk and returns.

The ensuing monetary easing by central banks on both sides of the Atlantic have further served to weaken the link between market prices and their fundamental value drivers. Trust has been the main casualty.

In order to restore it, asset managers have since been re-engineering their business models so as to become their clients' trusted advisors. This white paper highlights the salient nature of the changes.

To hasten their pace, a new set of digital tools are coming to the fore. The tools are being pioneered by a new generation of start-ups, focused on embracing digital technology and driving disruptive innovation to streamline operations and improve efficiencies to meet profound regulatory and infrastructure changes.

This FinTech drive also has the backing of regulators and governments. Dassault Systèmes, the **3D**EXPERIENCE company, with a history of innovation in regulated industries, has shown how technological innovation can help institutions to gain differentiation.

As part of its drive to bring transformation to the Financial Services sector, for the second consecutive year, it recently hosted the "3D FinTech Challenge", a global immersive technology initiative.

The 6 finalists, selected from over 50 high calibre FinTech start-ups globally, were framed specific challenges around long-standing investment management problems. Their outcomes show how digitization can potentially reshape aspects of the asset management industry as it seeks to rebuild trust with its clients.

The challenges were set by asset management professionals who provided a detailed analysis of the challenges their industry faces and they pinpointed the areas where improvements are vital.

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1. FROM RISK TO UNCERTAINTY

In the last decade, risk failed to generate returns. Millions lost billions. The 2000s are now remembered as a 'lost decade' due to reversals in five distinct areas of investing:

- The correlation between asset classes turned asymmetrical during different market phases: low in the upturn, high in the downturn. Overall, the correlation between most asset classes went up.
- The risk return characteristics of most asset classes became time varying. They became hard to ascertain except over extended periods.
- Risk models based on past events proved more a therapy than a barometer: the past was our best guide to the future, until it was no longer so.
- There was no 'free lunch' with any asset class: macro risks stemming from the debt crisis or globalization were overwhelming the stock-specific risks.
- For long incidental, liquidity moved centre stage as a direct result of the credit crunch. The Lehman collapse showed all too vividly how market values can tumble when liquidity dries up—irrespective of the intrinsic worth of the underlying assets.

In sum, clients discovered that they no longer managed risk, they managed uncertainty. The first relied on the probabilities of expected returns, the other on guesswork. Unfortunately, these observations on the last decade are just as valid in the present one.

Notably, the last four years have been the most volatile in the history of equity markets. Price fluctuations of 4% or more in intra-day sessions have occurred six times more often than they did on average in the previous forty years. Extreme spikes in market volatility and asset class correlations have been common. The price-earnings ratios have no sensible anchor points currently.

Unsurprisingly, few players in the investment value chain—asset managers, fund advisors, pension consultants—have emerged from the crisis holding their heads high. This reveals new urgencies, as much as old weaknesses. As one pension plan put it, "For much of the last decade, asset managers spent a lot of time worrying about almost everything but their clients. We were as far away from them as the man on the moon."[1]

The 2008 crisis was a watershed. It showed that without greater engagement, clients' hopes will always run ahead of reality. It forced asset managers into making a concerted effort to understand, anticipate and meet the needs of their clients.

[1] Investment Innovations: Raising the Bar, Principal Global Investors / CREATE-Research 2011 Survey

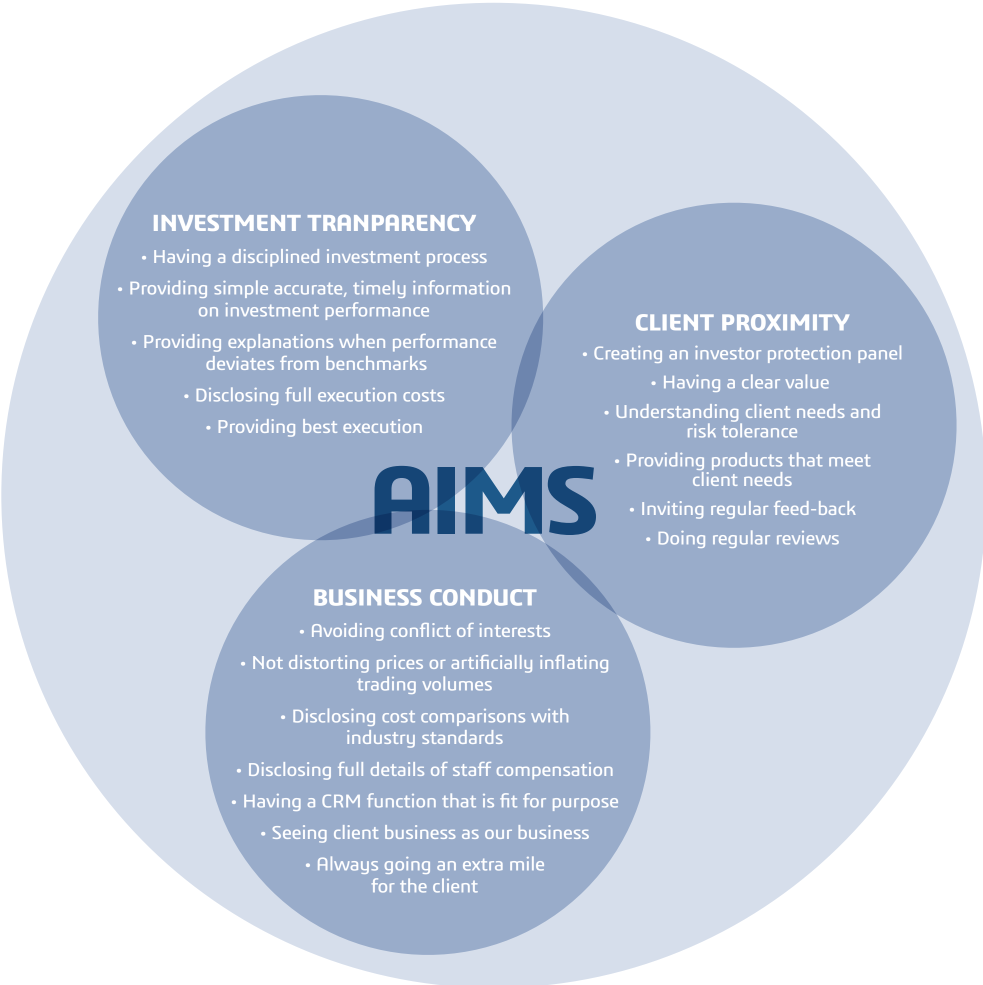
2. FROM A DISTANT VENDOR TO A TRUSTED ADVISOR

In the turbulent environment of the past five years, investors have had to walk a fine line between value investing and value traps. Similarly, asset managers have had to walk a fine line between product push and reputational risk.

To help strike that balance, more and more asset managers are aspiring to become their clients' trusted advisors: somebody who is in the client's inner circle of confidants; somebody who is open about the time period over which the expected returns can materialise and the nature of the associated risks.

Specifically, asset managers are attempting changes that fall into three distinct clusters (see figure), according to another previous survey.[2]

Figure 1. Best Practices that put the customer first



Improving client proximity

Aims to:

- Understand clients' dreams and nightmares;
- Sell products that clients need;
- Elicit regular client feedback and act on it; to avoid unrealistic claims about returns;
- Create in-house panels that protect clients' interests, via various checks and balances.

Improving investment transparency

Aims to:

- Rely on a disciplined investment process, providing accurate timely information, providing explanations when performance deviates from benchmarks, and disclosing all costs.

[2] Market Volatility: Friend or Foe? Principal Global Investors / CREATE-Research 2011 Survey

Promoting better business conduct

Aims to:

- Implement meritocratic incentives; to avoid 'me too' products;
- Avoid the artificial inflation of trading volumes and organise a Customer Relationship Management (CRM) function that is fit for purpose. Via CRM, clients want thought leadership that helps them to navigate the unfamiliar territory that investing is today. Asset managers must decouple marketing from thought leadership.

The trusted advisor role has come to the fore in the face of changing perceptions of risk. Many good investment products have not survived the resulting panic selling in the wake of the Lehman collapse. This much was evident in the mass early redemptions of hedge funds. The 24-hour news cycle has since conspired against value investing as well as time premium.

To avoid the prospect of another 'lost decade', asset managers recognise that they must undergo their biggest makeover yet, as they go from distant vendors to trusted advisors.

3. FROM ASPIRATIONS TO ACTIONS

It is one thing to talk about trusted advisors, quite another to be one. For most asset managers, it is a step too far. But it is happening via a number of baby steps in three notable ways.

Types of creativity

First, a culture of innovation is emerging, as revealed by the CREATE-Research/Dassault Systèmes 2013 Survey. It shows that innovation processes and their drivers have come under the spotlight. If focus is the silver bullet, the Apple iPhone is the role model.

Upping the Innovation Game in a Winner Takes All World

Such processes aim to promote three kinds of creativity:

- ***Provoked creativity*** based on a mandated approach that identifies a specific challenge or problem and invites creative solutions, akin to what task forces do;
- ***Unstructured creativity*** based on open-minded brainstorming without a set agenda in order to generate ideas without much regard to how they are connected;
- ***Eureka creativity*** based on real breakthroughs that deliver solutions that did not exist before.

Furthermore, under each type, the primary aim is to deliver better value to clients via products that are fit for purpose and engagement that is mutually beneficial.

By far the most common type of creativity at this nascent stage is provoked creativity. New challenges are being defined around deep-seated problems that need fixing. Teams are created to generate new ideas for fixing the identified problems and driving their implementation involving people, who have the necessary skills, expertise and credibility,

The underlying aim is to focus on the collective brainpower to tackle some long-standing issues so that the payback is immediate and visible. Today, blue sky thinking that delivers eureka creativity is the exception rather than the rule in asset management because of its cyclical nature. Picking the low-hanging fruit is a better option.

Sources of ideas

Second, and most notably, asset managers are looking at external as well as internal sources of ideas. Hitherto, competitors, regulators and academia have been the key outside influencers.

Now, the net is being widened to include start-ups unburdened by legacy thinking and legacy systems. In the process, they are taking on board the lessons of General Electric, as outlined by its legendary CEO and Chairman Jack Welch in 1988:

> *"At the beginning of the decade we saw two challenges ahead of us, one external and one internal. Externally, we faced a world economy that would be characterized by slower growth, with stronger global competitors going after a smaller piece of the pie. Internally, our challenge was even bigger. We had to find a way to combine the power, resources and reach of a large company with the hunger, agility, spirit and fire of a small company."*

Subsequently, a cross-industry IBM study showed that businesses that tap into external sources of ideas had a better innovation track record than those that were internally focused. [3]

[3] The Enterprise of the Future: Global CEO Study (2008)

4. FROM SURVIVAL TO GROWTH

Figure 2. A world class ecosystem engaged for success

This thinking, in fact, is what lays behind the 3D FinTech Challenge, now in its second year of operation As a first step, it gathered senior industry executives to frame challenges based on long-standing problems that needed to be addressed after a traumatic decade. It then opened up the application process to attract high calibre start-ups from around the world to deliver solutions that addressed these issues.

The 6 finalists were selected to apply their expertise towards solving the specific challenge that was set by the participating institutions. Mentoring support came from two sets of industry experts.

The first set comprised senior professionals from the asset management industry. Their task was to ensure that the selected start-ups came up with solutions that were not only pertinent to their industry but were also consistent with the art of the possible. The second set of experts provided legal, marketing, UI design, pitching and licensing expertise to help them to progress their businesses.

The 3D FinTech Challenge 2014

This was a seven-week immersive technology challenge. It aimed to identify, nurture and accelerate six high performing teams to deliver solutions that can potentially reshape the investment management industry.

Visit http://www.3ds.com/3d-fintech-challenge/ or @3D FinTech to find out more about the program

The six finalists were selected from over 50 high calibre applications and the challenges were set by leading industry executives. They benefited from master classes and on-going commercial mentoring from senior executives in the asset industry as well as Dassault Systèmes. They also received technical, marketing, legal and pitching guidance.

The Challenge differed from other FinTech accelerator programs in that Dassault Systèmes did not take equity in the start-ups. It also encouraged collaboration between teams and ensured they gained exposure to the FinTech communities in both New York and London.

The winner of this year's ***3D FinTech Challenge*** was Prophis, which helps enterprises identify relationships and derive exceptional value and insights from their "medium data". The runners up were Heckyl, which provides real time financial information discovery and an alert platform, analyzing millions of online data sources and open data sets.

The composite challenge for the start-ups was:

> *How can asset managers improve customer experience and trust via the activities listed in Figure 1 **"Best practices that put the client first"**?*

The number of activities involved is extensive and the overlap between them is inevitable. Start-ups were able to cover some of them more than others. But theirs was a bold attempt to provide solutions that can potentially enhance the customer experience to enable the end user to regain trust.

5. FROM CONCEPTS TO SOLUTIONS

Common themes

Before looking at the solutions put forward by each start-up and their linkage with the best practices outlined earlier on, it is worth setting out two common points that emerged from their deliberations:

- Web-based platforms will demystify the craft of investing: Digitization holds revolutionary potential but its impact will be evolutionary owing to client inertia and brand power. Even so, over time, it will bifurcate the industry into nimble players and dinosaurs. Outsiders will challenge the incumbents and drive change. Most of the low-cost commoditized products (e.g. money market funds, ETFs) will migrate to the web. The early adopters will include high net worth investors, young employees (saving for retirement) and retirees (investing their saving nest eggs). The migration will disrupt the business models of active asset managers and fund intermediaries alike. Competition will intensify. Over time, DIY educational tools will be available for high-level activities such as asset allocation, portfolio construction and stock picking. .
- Customer experience will be a key differentiator: Those managers who offer web-based products, as well as those who prefer to use the traditional sales channels, will be forced to improve their customer experience by enhancing the quality of activities mentioned in the three areas in Figure 1. The experience encompasses diverse activities ranging from simple, accurate timely information at the low end, to frequent investment reviews at the high end.

Specific solutions

Six start-ups delivered solutions at the end of the seven-week immersive period. The nature of solutions and their potential impact are described below. The start-ups are listed below, highlighting how their solutions are linked to one of the best practice clusters outlined in Figure 1.

Closir – improves investment process through better investor relations

For asset managers and other investors, the solution provides a digital bridge with the companies in which they invest. It is the only cloud-based tool enabling companies and their investors to connect and engage with one another directly. It provides investors with direct customised access to, and objective qualitative intelligence on, the entire spectrum of companies in their portfolio.

It dramatically reduces the need to rely on a multiplicity of sources, most of which depend on third party information. Above all, the tool helps those who engage in high conviction investing and/or shareholder activism to enhance their investment results.

www.closir.com
info@closir.com

DATA-NEXT – SaaS for asset managers to automate the investment process, analytics and compliance

Previously hedge fund managers, wealth managers and family offices have relied on disparate applications to obtain functionalities in the separate areas of client proximity, investment transparency and business conduct. This significantly increases running costs via multiplicity of locations.

In contrast, relying on cloud technologies, this integrated platform recognises the interdependencies between activities in front, middle and back offices and delivers their seamless delivery. Not only does it save time and resources on client engagement, it also delivers accurate timely information to investors in ways that enable them to understand how their portfolios are performing and whether rebalancing is essential.

www.data-next.ch
@data_next_eu

Heckyl – drives insights from the vast amount of information affecting share prices

www.heckyl.com
@heckyltech

Heckyl, the runners up in the 3D FinTech Challenge 2014, provides real-time news and data analytics, based on data from over 1.5 million sources of structured and unstructured data. The analytics aim to discover patterns in seemingly unrelated data sets so as to provide actionable insights that matter in the better management of funds in real time.

It provides investors with an enhanced understanding of the risks and opportunities associated with their strategies so that they can take corrective actions when necessary. It also saves time when seeking information that matters for portfolio construction, stock selection and periodic rebalancing. It empowers individual investors with information hitherto available to only a few market participants who traditionally enjoyed the prime mover advantage.

PensionMandate – delivers predictive intelligence on manager selection

www.pensionmandate.com
@pensionmandate

This solution seeks to identify, filter and extract a large volume of real-time data and predict the pace and content of manager selection activity. Current service providers largely rely on news stories that tend to be more speculative than predictive.

The business development teams in asset houses currently rely on information and anecdotes that are not always corroborated or analysed in a user-friendly manner. This solution, in contrast, taps into a vast amount of information cost effectively, analyses it systematically, and generates predictions in ways that convert a laborious activity into a simple tool that identifies sales leads and makes informed pitches.

Prophis Technologies – transforms the client experience via “Proteus-Client Executive” product

www.prophis.com
@ProphisTech

Prophis Technologies were the winners of the 3D FinTech Challenge 2014. Their solution helps asset managers transition to a more advanced business model that transforms the client experience via two core functionalities: first, innovative, visual communication regarding investment strategies and fund performance; and second, timely accurate reporting and real-time responding to queries from investors.

The central aim of the product is to improve the business brand via investment transparency and enhanced trust. It enables account managers to review and query their clients’ portfolio in real time from any location; respond to questions and use visualisation to tell the stories behind performance in a more impactful manner.

PraireSmarts – educates investors on downside risks in their portfolios

www.prairiesmarts.com
@PrairieSmarts

This tool calculates, simplifies and explains financial risk at the individual security level as well as the portfolio level. The old risk models failed miserably in the two big “fat tail” events in the last decade. Based on cloud computing, this tool aims to provide estimates of downside risk that are superior to the conventional VAR and volatility measures.

The underlying philosophy is that investor trust can be best regained via an open honest dialogue on measures of risk as well as its management, its time dependency as well as its randomness.

6. CONCLUDING REMARKS

The 2008 crisis has left client needs unaffected in some ways but profoundly changed in others. The deliverables they want in this decade will remain the same as before but their tools will have to change.

Clients will continue to demand consistent returns, backed by service quality, and a value-for-money fee structure. No change there.

But they want a step-change in the tools that are deployed. Ex post outcomes have rarely matched ex ante promises.

An important element of service is now about getting closer to clients so that their needs are identified and delivered. This can be achieved by empowering the customer through technology innovation.

By embracing technology, the investment industry has the potential to build respect and trust where it has for too long, been broken. By delivering diversity and personalization to an increasingly demanding customer base, technology will improve the customer experience and enable the end customer to be master of their own financial destiny.

For asset managers, the latest crisis has proved a concealed opportunity to tackle things that have long conspired against customer interests.

The 3DFinTech Challenge is an important initiative in accelerating this process. Through a series of baby steps, it aims to enable asset managers to make giant leaps via external collaboration over time.

About CREATE-Research

www.create-research.com

CREATE–Research, a UK based think tank, specialises in the future trends in global fund management. It works with prominent partners to publish much annual reports on prospective challenges and potential responses in the industry. The reports often appear as series of feature articles in the Financial Times, Global Investor, Financial News and IPE. Professor Amin Rajan, CEO also writes for these papers regularly.

About Dassault Systèmes

http://www.3ds.com/industries/financial-and-business-services/3d-fintech-challenge/

At Dassault Systèmes, we are committed to helping companies put their clients at the heart of the innovation process to deliver powerful outcomes that transcend mere products and services. Delivering customer focused outcomes is the cornerstone of our 3DEXPERIENCE® platform which is built on the solid foundation of nearly three decades of collaboration with our global customers in 12 industries.

Our Investment Management solutions leverage the3DEXPERIENCE® platform to drive outcomes specific to the industry and are easy to use and deploy. With proven reductions in implementation time, our solutions deliver real business value faster and with much less complexity than traditional approaches.

To find out more, please visit 3ds/com/financial-services or contact us at DS.Financial-Services@3ds.com

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Our **3D**EXPERIENCE® platform powers our brand applications, serving 12 industries, and provides a rich portfolio of industry solution experiences.

Dassault Systèmes, the **3D**EXPERIENCE® Company, provides business and people with virtual universes to imagine sustainable innovations. Its world-leading solutions transform the way products are designed, produced, and supported. Dassault Systèmes' collaborative solutions foster social innovation, expanding possibilities for the virtual world to improve the real world. The group brings value to over 170,000 customers of all sizes in all industries in more than 140 countries. For more information, visit **www.3ds.com**.

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