Speaking of Alpha

# Positioning APAC Asset Owners for Growth: Technology, Services and Operational Transformation

A conversation with Lucy Chen, Peter Sherriff & Clayton Issitt

STATE STREET

**APAC asset owners are increasingly looking to build scale, either through mergers, expanding into new geographies and asset classes, or delivering low fee returns and flexible investment options for their members. The focus on outcomes is forcing a rethink of the technology and services required to make better informed and timelier investment and allocation decisions.**

**Lucy Chen**
Head of Alpha℠ Services Delivery
Asia Pacific, State Street

**Peter Sherriff**
Director of Product Strategy,
Asia Pacific
Charles River® Development

**Clayton Issitt**
Head of Alpha℠ Client
Solutions Asia Pacific,
State Street

## State Street's Lucy Chen moderated a discussion with Peter Sherriff and Clayton Issitt on the changing landscape for asset owners in the region, and how they're looking to improve and scale their operating models.

**Lucy: The APAC Asset Owner landscape is very dynamic, with participants experiencing growth organically as well inorganically through M&A. What are some of the operational implications of this growth?**

**Peter:** As funds grow their membership and assets, they typically look to external managers for expertise in diversifying into new asset classes and geographies. This can stress the scalability of their operating footprint by requiring new processes.

For example, geographic expansion means having to manage corporate actions across multiple countries, which adds new challenges including the need for timelier data. Organisations can attempt to manage the increased workload internally or adopt a combination of technology and outsourced services.

**Clayton:** Diversification increases both transaction volumes and complexity, but hiring operations staff with the requisite skills to handle these requirements is difficult. In APAC, it's generally very expensive to hire a relatively commoditised middle office skill set, so it's not a cost-effective way to build a scalable organisation that's also capable of acquiring and integrating other funds.

**Lucy: You have touched there on the timing implications of employing external managers and the operational challenges associated with this. How does this play out in the day-to-day investment process?**

**Peter:** Funds that employ external investment managers typically see a lag between accounting and custody data ranging from 2 to 5 days. This is no longer acceptable from either a regulatory or stakeholder perspective. Indexation, or using a proxy to gauge expected exposure, is one approach used to compensate for the time lag, but it's a blunt instrument that can leave asset owners with unwanted exposures, especially in volatile markets.

The early days of the pandemic in Australia is an example where funds that didn't have timely views of holdings and liquidity were significantly disadvantaged when government mandates suddenly allowed member redemptions. Many funds lacked the ability to model redemption scenarios or identify whether they had adequate liquidity to service redemptions.  With sizeable investments in illiquid mandates that couldn't be sold quickly and cost effectively, some funds were forced to sell public assets into rapidly plunging markets.

**Lucy: Closing the timing gap would seem to require sourcing, aggregating and managing large volumes of data which would understandably be a significant challenge for many APAC asset owners today. How can service providers help clients adapt their operating model to help address this?**

**Clayton:** On the service model side, utilising a co-sourced model with a shared Investment Book of Record (IBOR) can provide complete visibility at every step of the process. This includes acquiring and ingesting data from each manager, building positions from the transactions, applying corporate actions and pricing, reconciling the data, and performing post-trade investment compliance to generate the whole of fund view.

Clients gain a full, auditable view of what is being done, without the burden of doing it themselves, along with operational scale that only the very largest asset owners and managers can achieve. It's a marriage between IBOR technology and human services. Robust technology enables this capability set for the asset owners in a way that requires less overhead than current middle and back-office systems.

This does require human expertise, especially for data governance and corporate actions processing. On the low end of the complexity spectrum, superannuation funds with internal investment capabilities investing solely in Australian assets need only process domestic corporate actions, and the events are fairly spread out across time. In Japan by comparison, there tend to be semi-annual peaks of activity due to market conventions for dividends resulting in workload spikes. It's unfeasible to scale up a corporate actions team that can validate and process data fast enough to enable portfolio managers to make timely dividend reinvestment decisions.

**Peter:** Another benefit of outsourcing is that custodians and fund administrators already have relationships in place with the majority of asset managers and systems to receive that information and process it efficiently. Leveraging that flow to feed a new process is relatively straightforward and doesn't require a costly new technology stack to onboard additional asset owners. This enables a delivery mechanism that is scalable, repeatable and cost effective, and reduces the 2 to 5 day time lag.

To Clayton's point, because IBOR is on a shared platform, everything completed on a client's behalf is transparent, visible and real-time. There's no delay or additional integration incurred from moving data around between different data silos and systems.

**Lucy: From an investment teams perspective, having this up-to-date view of exposures across the whole of fund seems to offer a number of benefits. Can you briefly highlight some of these, particularly with regards to the evolving regulatory environment?**

**Clayton:** An expanding asset mix typically adds new geographies and currencies. Using a few proxy currencies to model exposures doesn't really provide an accurate or useful view of risk. Asset owners must be able to "look-through" to each external manager for an accurate view of underlying currency exposures, supporting better informed hedging and neutralisation of unwanted exposures. In essence, IBOR can be thought of as an "exposure book of record".

The ability to look-through a complex security is key to helping organisations understand risk in their portfolios. For example, a fund holding a Unit Investment Trust (UIT) will see a single line item in their accounting book of record (ABOR), priced in local currency. But that UIT can consist of a global basket of different asset classes priced in multiple currencies. Leveraging existing integrations with asset managers via a custodian and fund administrator enables asset owners to determine what actually comprises a UIT and align that with their internal view of holdings.

Additionally, with asset owners now subject to Uncleared Margin Rules (UMR), efficiently managing margin and collateral workflows likewise depends on a timely view of holdings and cash. In the front office, traders require visibility into what counterparty to select, what Credit Support Annex is in place and realistic pre-trade margin estimates. Back-office teams also need to know what assets are available and cheapest-to-deliver as collateral.

For an asset owner with multiple outsourced fund managers, the organisation can get far better terms for the entire fund when all external managers are on the same collateral management and negotiation agreement instead of each fund manager negotiating terms off their far smaller book of business.

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**Peter:** Emerging regulations such as **Portfolio Holdings Disclosure** in Australia require funds to report at least one level beyond that UIT so that members have greater transparency into what their fund is invested in. Fund administrators have integrations in place to support look-throughs, and established relationships with most of the asset managers these funds allocate to, either as external managers or as UIT investors. By outsourcing this capability to an administrator, funds can leverage those integrations to achieve faster access to their holdings because the information is available earlier in the trade lifecycle.

From a technology standpoint IBOR needs to support the disclosure regulations and the tax and structural aspects of UITs.

The single currency investment/return of UITs make them very popular vehicles and convenient to manage from both an operational and accounting perspective. By enabling transparency and granular views of holdings, IBOR enables firms to perform meaningful risk assessments on these assets.

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**Lucy: You talk about the ability to look-through a complex fund structure to understand the exposure to different asset types of the whole fund for example. Typically, in these situations cash can present challenges, can you discuss some of these?**

**Clayton:** Even mid-sized funds can have complex fund structures with cash potentially located in multiple accounts. A manager may have to leave 5% of the portfolio in cash, based on regulations for that specific mandate, resulting in significant sums of idle cash across multiple managers and the fund itself.

Accurate, timely views of available cash from a whole of fund perspective is key to helping firms maximise yield from that cash.

Creating a cash forecast that incorporates known market events and internally sourced activity on plan members, including redemptions and inflows, provides funds with the information needed to make timelier decisions.

In contrast, a traditional custody account only provides a point-in-time view that is reconciled daily, often with a one-day lag, so it's not useful from a cash management perspective.

**Peter:** For those asset owners acquiring illiquid real assets directly without intermediation, they now need to manage larger, less frequent cashflows associated with these investments. In a traditional, shared infrastructure project, the asset owner as a limited partner would only be responsible for a share of the next payment. In contrast, an organisation backing a project on their own needs to provide the entire payment to fund the next project phase. Having clarity on real assets and cashflows, paired against member subscriptions and redemptions and other cashflows across the fund, enables smarter cash management and reduces unnecessary turnover to cover liquidity events.

As a fund grows through mergers and acquisitions, so does its member base, resulting in far larger bidirectional cashflows. Without an intra-day view of cashflows, organisations have a harder time putting cash to work without adversely impacting markets or missing opportunities.

**With an accurate and complete start of day view of their holdings, cash and exposures, asset owners have a whole of fund view, improving their ability to identify risk exposures and concentrations, ultimately improving their investment process.**

**Lucy: Lastly, as an organisation, how are we helping asset owners evaluate, reshape, transition and scale their operating model to support growth and ultimately better serve their members?**

**Peter:** We are continually looking for ways to deliver value to our clients and see the Investment Book of Record as central to operational transformation and helping to close the information gap.

With an accurate and complete start of day view of their holdings, cash and exposures, asset owners have a whole of fund view, improving their ability to identify risk exposures and concentrations, ultimately improving their investment process. It's no longer adequate for funds to operate with a two day or longer information lag.

**Clayton:** The combination of modern, scalable middle office technology and human services is an increasingly compelling proposition for asset owners looking to grow their internal investment capabilities, diversify into new assets and geographies or offer differentiated options to their members whilst still meeting their regulatory disclosure obligations. Our scale and global footprint enable asset owners to benefit from an outsourced middle office that also provides clients with transparency and auditability across their investment operations.

State Street Corporation
One Lincoln Street, Boston, MA 02111

www.statestreet.com

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