The optimization imperative

Transformation of investment middle office

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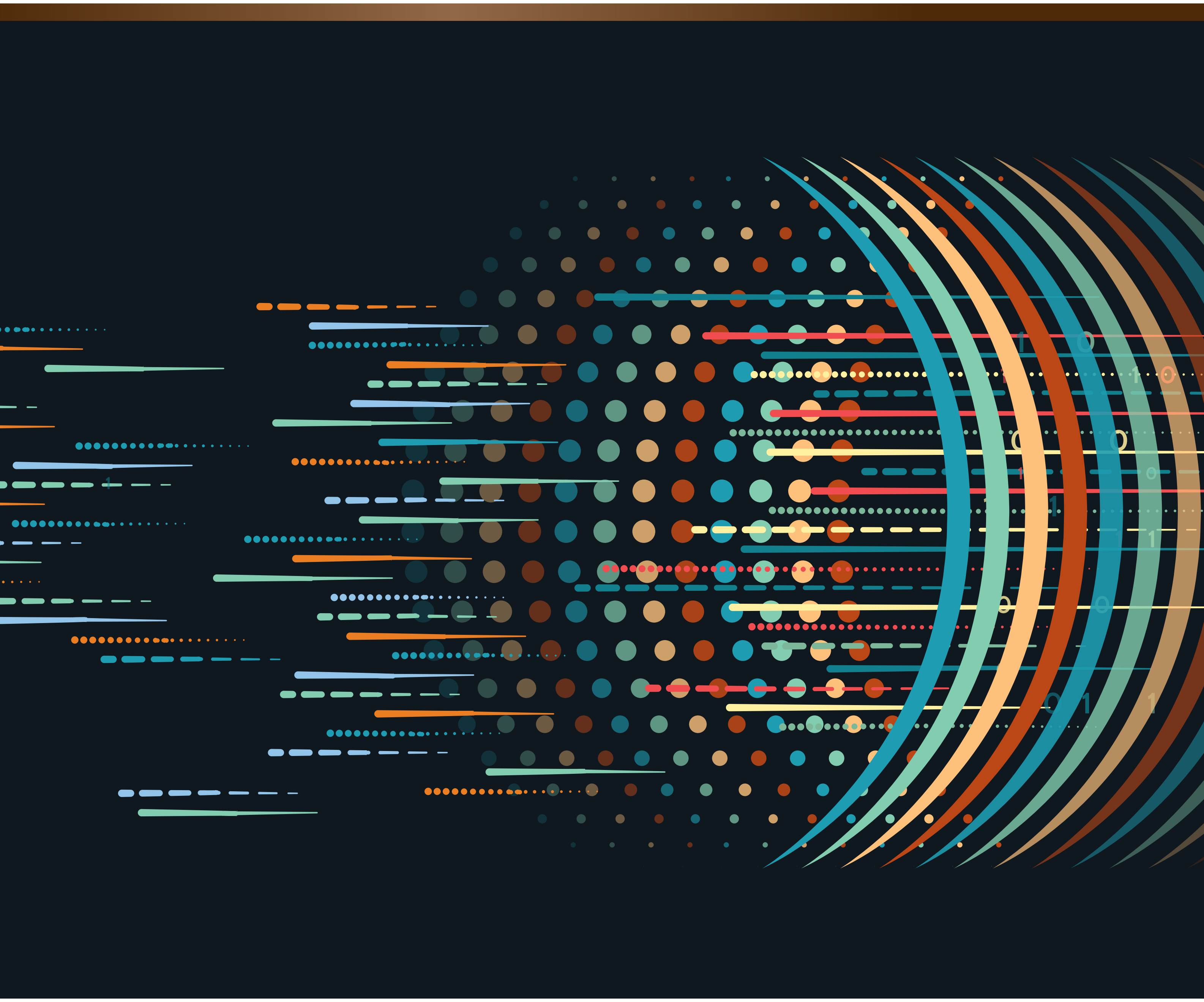

TABLE OF CONTENTS

In the ever-more competitive asset management industry, transforming and optimizing investment middle office operations is crucial. While there is no clear agreement on an ideal end-state model, given the varying needs of different managers, there is broad consensus about the potential to meaningfully improve the bottom line and better support evolving business strategies. We explore the need for change, potential options and key decision points to help asset managers choose their right path.

A competitive edge in a high cost, low margin environment

In a growing and increasingly complex market, asset managers are seeking to transform investment middle office operations to be more competitive. Global assets under management are projected to hit $145 trillion in 2025, nearly doubling from $84.9 trillion in 2016[1]. Rising costs, shrinking fees, industry-wide operating margin compression and resource constraints make charting a new path a priority.

Further adding to the challenge, asset managers are increasing allocations to private markets, which are projected to grow to $23.3 trillion by 2026[2], 1.7x their 2021 levels. These complex asset classes, typically with operationally sub-scale processes, place additional burdens on investment operations.

The strain on existing operations is enormous, making efficient, cost-effective and scalable solutions a strategic priority. Yet there's no one clear path to a target operating model – or even consensus on what a best-in-class model looks like.

Given each organization's unique blend of priorities and objectives, a one-size-fits-all solution or approach is unrealistic. Truly impactful transformation is likely to be complex, particularly for an established asset manager. Fortunately, there are tried and true ways to tackle the problem, starting with a look at common challenges and prior industry experiences, and an emerging set of leading solutions to consider.

73%

of asset managers cited the increasing cost of operations as a reason to seek solutions that enable scale and efficiency[3].

1. PWC - Asset and Wealth Management Revolution, 2017

2. Preqin Alternatives in 2023

3. Cerulli Associates - Asset Managers Turn to Outsourcing Providers for Operating Model Sustainability, 2022

Contributors to the problem

There is significant commonality in the challenges asset managers face:

1. The need to support multiple ageing systems that were added on over time, often sub-optimally integrated and heavily customized. These are increasingly difficult to maintain or evolve.

2. Webs of manual and fragile operational and data management processes that were built to compensate for system capability or integration shortcomings and support business strategies.

3. Vertical one-off solutions, both systems and process related, that have been put in place to solve specific problems that innately are not scalable or extensible.

4. More complex and diverse asset classes, creating investment portfolios that demand a global support model with expert technology and operational flexibility.

5. A heightened regulatory environment with implications for ongoing adjustments to investment operations.

6. Demands on talent, as driving and executing change must be constantly balanced with simultaneously supporting day-to-day operations.

Contributors to the problem

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As investing increasingly crosses borders, timeframes compress and complex structured products arise in response to investor demand, siloed and fragile infrastructure comes under increasing pressure. Older technology can be difficult to update and day to day processing often requires multiple layers of manual reconciliation across systems. While human capital can pick up the slack, that can introduce additional risk into the process. It also diverts important resources from more value-added work and can lead to retention issues.

Global operations support requirements paired with regional, functional and batch-based systems result in a costly and inefficient model. This fragmentation results in investment data copies, reconciliations and inconsistencies that impact the efficiency and performance of the investment teams in managing their strategies, liquidity and risk.

This is all set against a background that is anything but static: regulatory obligations continue to intensify, the pace of technology change is relentless and risk (such as cyber risk) is on the rise.

It's no wonder then, that asset managers are looking for solutions and partners to help them navigate these challenges. As they work through their options and decisions, they will also need to embrace the transformation they are undertaking and be prepared for the substantial effort required to be successful.

Three key transformation decisions

For most asset managers, an optimized state includes seamless systems and front-to-back data integration, with comprehensive asset class support that is configurable, extendable and scalable.

Arriving at that state requires working through a series of key decisions based on organizational needs and desired outcomes. An asset manager intent on driving transformation will want to consider these questions carefully, since the decisions taken significantly influence the future route.

Order Management Systems (OMS)	*Single OMS*	*Multiple OMS*
Service Model	*Insourced*	*Outsourced*
Platform Solutions	*Software Provider*	*Service Provider*

Order management systems (OMS)

The ability to optimize investment middle office operations is substantially impacted by the front office's technology strategy. As OMS providers have steadily expanded support for complex asset classes and global markets, they have also extended their capabilities to support a growing number of post trade activities. OMS capabilities have become a core consideration for the middle office, with the potential to significantly affect the flexibility and transparency of workflows, ability to integrate with market partners and the front office, and the provision of quality, timely investment data.

- Institutions that opt for a **single OMS platform** for front and middle office tend to be focused on simplicity and connectedness. Asset managers should carefully analyze whether one OMS can support all desired asset classes, transactions and lifecycle events, and what alternatives are needed to close any gaps.
- Institutions that leverage **multiple OMS platforms** are usually selecting best-in-breed solutions to address front office investment team needs. For the middle office, multiple platforms can create cost and complexity due to duplicative platforms and functions, disparate workflows and significantly greater complexity in managing investment data coming from multiple sources.

Service models

The perennial question of whether to keep services in-house or outsource to a third party is complicated. An insourced solution gives the asset manager total control and can help to achieve desired efficiency levels and operational alpha. However, the manager must then maintain the technology, constantly integrate systems with clients and partners, and adjust operations as the market evolves. As a result, many have set up operations in high value, low cost locations, but this approach offers finite upside while increasing organizational complexity and adding management overhead.

Given the potential downside and increased complexity, outsourcing is increasingly on the table. In 2022, nearly one-third of investment firms looked into outsourcing their middle office – up from 17% in 2017[4]. By outsourcing, the asset manager can rely on a partner's global scale to handle essential investment operations functions. This allows the manager to focus on their own strategic priorities and benefit from managed technology, shared risk and the ability to convert from a fixed to variable cost business model.

Platform solutions

Since outsourcing investment operations has moved beyond the historical lift-and-drop approach, asset managers are largely choosing between platform solutions in the marketplace.

- Using a **software provider solution** maximizes the investment in the OMS platform and looks to drive front to back efficiency through systemic integration and cohesiveness. In this model, platform vendors layer operational resourcing and expertise onto their software licensing to manage many investment functions performed on the platform for their clients. While in its nascent stages, most major OMS providers are developing and deploying this model. It deepens their relationship with their client and allows the client to access the software provider's knowledge, expertise and capabilities in running the system.
- The **service provider solution** is more mature in the marketplace and prevalent among institutions with multiple OMSs or those with a preference to diversify across multiple providers. This model lets an asset manager leverage chosen investment platform(s) while accessing the service provider's infrastructure to support their business. They gain technology, market connectivity and operational expertise.

In either platform solution, there is a high degree of interdependence between the manager and provider. As such, while integration and end-to-end connectivity are critical, the intangible quality of cultural and strategic 'fit' can often determine success or failure.

4. Funds Europe - Outsourcing: Why Asset Managers are Rethinking Operating Models, 2022

The right fit makes the difference

In any outsourcing model, the end-to-end alignment across people, process and technology is complicated. While difficult to have certainty about and measure, it is often a key determinant of success.

Beyond a clear vision of what they want to achieve, the asset manager must be ready and willing to change. By adapting and fully leveraging the new operating model and platform delivered with their chosen provider, the manager will realize the greatest benefit. Similarly, the provider must fully understand their client's priorities and requirements, be able to flex accordingly and execute on their promises to support the manager's business efficiently and at scale.

While processes need to be well established and based on best practice and market convention, they must also be flexible enough to support diverse asset classes, investment strategies and operating requirements. Technology is the key to unlocking scale, but it must be adaptive and interoperable to accommodate varied and evolving investment strategies and support a client's desired outcome.

A growing case for the service provider solution

The pendulum appears to be swinging towards service provider platforms, in large part driven by their adoption of, and investment in, cloud and managed data services.

Previously, outsourcing investment operations to a service provider necessitated duplication of investment data records by the manager and provider with each performing reconciliations, data mapping and data translation to keep their processes operating in alignment. Employing cloud-based, shared data infrastructure simplifies the manager-and-provider operating model tremendously. It enables co-ownership and collaboration on a single source of truth without having to utilize a single operating platform for front, middle, and back office processing.

With the right service provider, managers realize the benefits that accrue from their global scale and operational footprint, connectivity with street-side counterparties, and ongoing investment. At the same time, the manager retains choice and optionality for their investment front office capabilities.

A service provider's ability to be agnostic to a manager's front office systems and flex technical and operational configurations to complement their retained capabilities unlocks maximum potential for the manager. In a recent study, 73% of asset managers cited rising operational costs as a reason for seeking solutions that enable scale and efficiency[5], making the service provider option particularly appealing given the operational and cost efficiencies that can be achieved.

5. Cerulli Associates - Asset Managers Turn to Outsourcing Providers for Operating Model Sustainability, 2022

A service provider with a difference

As one of the leading providers of securities services capabilities with a strategic focus on technology, J.P. Morgan is uniquely positioned to support clients with its Investment Middle Office Service suite. This combines a sophisticated and scalable operating model with dedicated operational experts and a cloud-native data management platform – Fusion by J.P. Morgan. This proprietary platform is a data technology solution which effectively positions managers to outsource their investment middle office operations to J.P. Morgan and achieve a greater depth of capability and operational support than is possible with other service or software platform providers.

Data from multiple sources can be seamlessly integrated and normalized into a single investment data backbone that delivers the benefits of scale and reduced costs, along with the ability to more easily unlock timely analysis and insights supporting use cases across the investment lifecycle. Importantly, clients retain flexibility and choice in front office technology selection, with full optionality to utilize whatever OMS configuration is best suited for their business.

Operationally, J.P. Morgan leverages proprietary asset class processing engines from its trading businesses and provides access to a deep global talent pool of investment operations expertise that provides a truly distinctive offering.

The modular structure to the platform and services allows managers to opt in or out of services to meet their specific needs, with J.P. Morgan offering a full suite of front-to-back capabilities. Regardless of the configuration, the asset manager receives scalable, fit-for-purpose services and can leverage the firm's broader capabilities and investments in technology, regulatory oversight, banking and staff.

The competition for talent is real, and even the most streamlined operating models require expert practitioners to deliver the promise of a target state operating model. As one of the leading global bank with operations across multiple business lines, J.P. Morgan successfully attracts and retains top talent to deliver solutions, affording them tremendous ability to flex and grow with their clients.

Returning to that intangible 'fit', J.P. Morgan nurtures a culture of innovation supported by thoughtful leadership. We work closely with our asset manager and asset owner clients to understand their objectives and maintain open dialogue to stay connected, keeping the relationship - not just the data - in sync. For asset managers seeking a competitive edge, it is a collaboration that can yield positive results.

Scan QR code to view a cloud-native data management platform Fusion by J.P. Morgan

Choosing the right route to support future success

Every firm has their own unique set of requirements, but it's clear that efficient investment middle office operations are increasingly critical as investment strategies become more complex and diversified. Recent technology innovations give managers additional choices, leading many to take a fresh look at what optimizing their operations could mean. With a clear view of their objectives, a thorough evaluation of the options, and the willingness to tackle change, each firm can identify their right road and reach their destination with the right mind-set and partner.

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