CEOs face dual spectre of euro debt and regulation

The fund management industry is adjusting to different challenges as the European debt crisis enters a chronic phase, writes Yasmine Chinwala

Chief executives of fund management companies have a bullish outlook for their businesses, despite flat economic growth and the constant spectre of eurozone debt and increasing regulation, according to the annual Financial News CEO Snapshot Survey.

This year, 33 European fund chiefs with nearly €4 trillion of assets under management took part in the survey in March and April, which gauged their views on the health of their sector.

The eurozone debt crisis ranked first of eight macro themes whose impact on the industry was of greatest concern to fund management chief executives, while regulatory intrusion topped the list of worries for their own businesses.

The same two themes ranked top in last year’s survey.

Yet 70% of respondents said they had a bullish outlook for their firm over the next 18 months, and another 15% said they were very bullish.

Mike Karpik, head of Europe, the Middle East and Africa at State Street Global Advisors, said: “Last summer there was a real fear about the survival of Europe, and there are still concerns about the global capital markets. I do not think the survey results mean that we are raving bulls.”

Robert Higginbotham, head of global institutional services at T Rowe Price, agrees the bullish sentiment is comparative. He said: “I would not confuse that response with a sense that ‘Hey, the world is now fine and we are back rocking again’. I think it is simply a sense that we are making progress, that we are coming out of a bad place and that the world is normalising to a different place than it was before. It is a relative judgment, not an absolute one.”

The industry has switched from acute crisis management mode as Europe has entered a chronic phase, which presents different challenges. Andrew Wilson, head of Emea at Goldman Sachs Asset Management, said: “There is a sense that the worst is behind us. The problems aren’t over, but we’ve been sitting on our hands too long, and it is now time to do something. People are looking for solutions.”

This is where a more bullish perspective comes from. Higginbotham said: “We are in one of the structurally most attractive long-term bull markets in terms of demand for our product. States, institutions and individuals are going to need what we do for the next 20 to 50 years – and that excites me.”

After eurozone debt worries, survey respondents ranked a crisis of confidence second and a rise in protectionism as the third most worrying macro theme, moving up from fifth place in last year’s survey.

Campbell Fleming, chief executive of Threadneedle Investments, said: “While many jurisdictions are welcoming and open for business, it does not feel like that here in the UK. Political factors are a big risk, especially if governments start to shift much more towards a protectionist approach.”

Higginbotham said it was typical behaviour to become introverted in an attempt to solve problems, but added: “There is a huge opportunity to solve Europe’s financial problems by looking outward and becoming more competitive in the global market place. As long as we are morbidly obsessed by our internal problems in Europe we will not spot the bigger prize, which is Latin America and Asia over the next 10 to 30 years.”

At company level, the biggest concern was regulation, which scored an average of 2.5 out of a maximum three, particularly the complicated layering of regulation from different jurisdictions.

Karpik said: “The differences between US and European regulations provide a lot of complexity, not only for the business but for our clients too and we do not see it letting up any time soon. To use an American analogy, we’re in the third [out of nine] innings of a baseball game. These things tend to go in long cycles and will provide a lot of challenges for the asset management industry in general.”

A full five years on from the start

Continued on page 2
Nurturing the fragile shoots

A rally in equities has boosted growth expectations, but a more solid recovery hinges on macroeconomic policy, writes Peter Davy

The Financial News CEO Snapshot Survey shows confidence returning slowly but surely as managers expect modest, but welcome, growth. Last year, against a backdrop of the Greek election crisis, more than a quarter of asset management chiefs feared the industry could shrink by up to 20%. Those fears have receded.

Now, just over 80% expect growth in terms of net new business in the next 18 months, with 75% of those surveyed forecasting growth of up to 10% compared with 43% expecting that level of growth last year.

The sunnier outlook is underpinned largely by strong growth in equity markets, albeit with recent wobbles, say fund managers. With the FTSE 100 recently touching 13-year highs and the Dow Jones hitting a new record, investors are returning to the market.

Naim Abou-Jaoude, chief executive of DWS Asset Management, said: “The rally on the equity markets is helping increase trust and confidence, and will help to grow the asset management business.”

This rally is in turn founded on government and central bank support through monetary policy. Quantitative easing, in which central banks buy government bonds, has pushed up prices for those bonds and therefore yields down, prompting investors to look at other products for better investment returns.

This is, according to Elizabeth Corley, chief executive of Allianz Global Investors, the single most important factor driving industry optimism.

She said: “It all hinges on macro policy at the moment. Quantitative easing is leading to collapsing yields on sovereign debt, and this is leading investors out of perceived safety assets to seek returns and yields elsewhere. It is almost an underpinning to the equity markets.”

This top line, however, hides a subtler story. First, confidence is fragile. The flip side of the strong link between the market and inflows that Abou-Jaoude identifies is that the growth could disappear with the rally. He said: “If the equity market remains at this level it will drive further growth, but if it drops by 5% or 10% that would just as surely drain the enthusiasm away again.”

And second, although survey respondents expect growth, the most popular choice was less than 5% growth, forecast by 45.5% of chief executives surveyed.

That can be explained by continuing weakness in economic growth, despite the performance of stock markets. Andrew Carter, who heads Royal London Asset Management, said: “We are still living in a period of reasonably slow growth, especially in Europe. Debt is still being paid down so there is growth in the asset management industry but not the 10% a year of the 1980s. It’s relatively flat.”

Low retail hopes

This underlying weakness is also reflected in chief executives’ expectations concerning different customer segments. CEOs surveyed rate institutional and high net worth clients similarly when it comes to their attractiveness as prospects for increasing assets under management, with both segments scoring an average of nearly two out of three. The main retail market scored an average of just under 1.5.

With so weak a recovery, the suspicion is that small investors don’t have the money to put away. Paul Abberley, interim chief executive at Aviva Investors, is firmly in this camp. He said: “Looking at Europe, the economic environment means the prosperity of individual savers is unlikely to be propelling growth going forward.”

This basic weakness could even affect the main potential growth area identified by managers: pensions. Cuts in public sector pensions, the decline of final-salary occupational schemes and, most recently, the introduction of auto-enrollment in the UK, forcing employers to contribute to a workplace pension, have sharpened the focus on retirement savings.

Defined-contribution pension products helping individuals invest to build up their pension pots are identified by CEO Snapshot respondents as the most attractive area for product development, given an average rating of 1.7 out of three in the survey. DC pension products also ranked top for last year’s survey respondents.

CEOs face dual spectre of cut

From page 1 of the financial crisis, the fund management industry appears to have made little progress on differentiating itself from banking, the primary target of regulators’ attention.

Fleming said: “There is a lack of joined-up thinking that is causing problems for investors and product and service providers. It is mostly down to the confusion about the difference between asset management and banking, and the political challenge of creating an environment where people are rewarded for saving and investing.”

One area where fund managers are facing a copy and paste of banking regulation is on pay. After regulatory intrusion, this year’s CEO Snapshot Survey respondents ranked restrictions on bonus payments as their second greatest business concern, moving up from eighth last year.

In March, the European Parliament’s Economic and Monetary
of growth

It is, according to John Fraser, chief executive of UBS Global Asset Management, a much bigger story than just auto-enrolment in the UK. He said: “The ageing of the population means the asset management industry is going to grow quite dramatically in all developed countries. Longer term, there’s also scope for growth in developing nations such as China, he says.

The opportunities here are not just for products to help with accumulation – the building of the pension pot – during savers’ working lives, but also for more creative ways of turning that pot into a regular income to live on in retirement, the decumulation phase. The latter is a growing area for Allianz, according to Corley, and Peter Schwicht, managing director at JP Morgan Asset Management, agrees. He said: “We need to be a little bit more imaginative about decumulation, rather than just leaving it to the insurance companies to find solutions.”

Savings conundrum

Whether these opportunities will have a great impact in the near term is debatable. Again, it comes down to the state economy. Michael Green, head of American Century Investments’ international business, agrees that “the privatisation of long-term savings” through DC pensions will underpin strong growth in the industry, but adds that it is unlikely to precede a convincing economic recovery.

He said: “You are relying on individuals to make those long-term savings but the economic climate means they don’t have the excess capacity to do so. You have to wait for the European economy to recover sufficiently so people feel they can save as well as survive.”

After DC pension and traditional active products, CEO Snapshot survey respondents rated smart beta, diversified growth and corporate loans highly for new product development, all of which point to investors’ search for alternative sources of return. Strong equity markets point to a preference for traditional active products, which scored an average rating of 1.6 out of three, compared with just 0.5 for index-tracking products.

Jonathan Compton, founder and managing director of Bedlam Asset Management, said: “It really is developing into a stock-pickers’ market for the first time since about 1969.” He believes the returns will come.

Higginbotham said: “We have our message across in the political space, but also for more creative ways of turning that pot into a regular income to live on in retirement, the decumulation phase.”

“Clients paying active fees want to see real active management.”

Dyson believes the market is at a crossroads: “We are probably in a period where there will be more polarised results than we’re used to. It might add up overall to a balanced picture, but there will be plenty of winners and losers within that.”

euro debt and regulation

Affairs Committee voted in favour of adding a clause to UCITS V capping fund managers’ bonuses at 100% of salary, just as bankers’ bonuses were capped under the Capital Rights Directive IV. Such a move, if it is included in the final draft, could come into effect from the end of next year at the earliest and would fundamentally change how fund managers are paid.

A bonus cap of 100% of basic pay was also in an early draft of the Alternative Investment Fund Managers Directive but dropped out of the final version. However, AIFMD does have rules on deferral, clawbacks, types of instruments that can be used for compensation, and a requirement to have a compensation committee for all but the smallest managers.

Higginbotham said: “We have spent five years telling everybody that we are not banks. But through the Capital Requirements Directive, the Alternative Investment Fund Managers Directive and UCITS V, it should be patently clear that we have not landed a single punch.”

GSAM’s Wilson agreed there was a lot of engagement between the industry and regulators and policymakers, “however, the people making the decisions and pushing the regulatory agenda are politicians and it is still fashionable to hold up the financial services industry as a source of evil. It is a big challenge to get our message across in the political dialogue.”

Chief executives responding to the CEO Snapshot Survey rated conflicts of interest as the top item of focus for regulators over the next 18 months, followed by misleading marketing and soft commissions.

Ann Doherty, head of asset management at Affiliated Managers Group, believes that pressure on fees will squeeze active managers offering little better than index-like returns, leading to a split in demand for passive products on one side and truly active products on the other. He said: “Clients paying active fees want to see real active management.”

Dyson believes the market is at a crossroads: “We are probably in a period where there will be more polarised results than we’re used to. It might add up overall to a balanced picture, but there will be plenty of winners and losers within that.”

As you use more collateral in more ways, are you optimizing it fully?
Market overcrowding concerns

The chief executives responding to this year’s CEO Snapshot Survey appear to agree on one thing – there are too many funds and too many fund management firms.

Eighty-two per cent of survey respondents think there will be consolidation in terms of the number of funds, while even more at 88% think there will be consolidation of fund management companies. All but two respondents believe there are too many funds in the market, and 27% think there are more than twice as many as there need to be. When it comes to fund management firms, nearly half of survey respondents estimate there is overcrowding of up to 20%.

Julian Ide, chief executive of Old Mutual Global Investors, said: “We all know there are too many funds around.”

But the timing of any market consolidation is difficult to predict. John Fraser, chief executive of UBS Global Asset Management, said: “We’ve been saying we will see consolidation for about 10 years now and been wrong. I am more sceptical about it now.”

For funds, it is easy enough to make a case based on the numbers. According to the European Fund and Asset Management Association, there were 35,372 UCits funds in Europe at the end of last year, with assets of €6.295 trillion. Compare that with the US market, which has 7,596 mutual funds with assets of $13.045 trillion, according to trade association Investment Company Institute.

Even allowing for 10 separate big markets in Europe, the choice for investors is overwhelming. Inès de Dinechin, chief executive of Lyxor Asset Management, said: “It means nothing to an investor to have so many, particularly when we are speaking about an increasing globalisation and passporting to allow products from one country to be used in another. There’s real overcrowding.”

However, she added that consolidation will not happen quickly. On the one hand, there are undoubtedly strong drivers pushing for a more concentrated industry. Principal among them is regulation. Ide said: “The fixed costs of running asset management businesses are very high and are rising as a consequence of regulation.”

The Retail Distribution Review in the UK is one recent example that is pushing consolidation in the wealth management space.

Fees squeeze
At the same time as costs going up, fees are under increasing pressure due to regulation as well as disappointment over lacklustre returns and a shift towards more cost-efficient passive management.

Jonathan Compton, founder and managing director of Bedlam Asset Management, said: “The squeeze on fees is never-ending. Every firm should be budgeting for the average management charge they receive to halve over the next five to seven years.”

All this momentum pushes for economies of scale, and there have been signs of consolidation in the industry. A few big-name mergers have been announced and the number of UCits funds did decline over the past year to 35,572 at the end of December compared with 36,106 a year earlier.

But that is a decline of only 2%. Lack of clarity on rules governing fund closure have been a considerable hurdle. Campbell Fleming, chief executive of Threadneedle Investments, said: “It is much harder to close a fund than to open one. We have only recently had some clarity on the tax treatments of fund closures. The European Parliament recently found that an in-species distribution from one fund structure to another is not a taxable event.”

Ann Doherty, head of asset management clients in the investor services division at JP Morgan, said she expects to see more asset managers reducing the number of funds they offer. She said: “There is not the same pace of opening funds and asset managers are being more considered. You can actually see programmes of rationalisation in place now. At least there is now clarity on what you can actually do to close funds.”

Uneven spread
Another contributory factor is that overcrowpacity is patchy. While there are too many funds of certain types, managers argue that some areas are actually under-served.

Magnus Spence, managing partner at Dalton Strategic Partnership, said: “There are too many funds, too many average funds and too many that underperformed their indices. In certain areas, though, there is a paucity of funds. In multi-asset funds, for instance, there is a
M&A ambivalence rules the day

Joe McDevitt, head of Pimco’s London office said it is often hard to find an incentive to close struggling businesses where they are part of a wider financial group. He said: “It is hard to know what exactly would trigger a wholesale move to offload asset management firms.”

Limited impetus

Likewise Robert Harris, chief executive at Majedie Asset Management, said: “Industry operating margins remain quite high so there is limited impetus.”

At the smaller end of the scale, there are benefits that can outweigh the attraction of economies of scale. Boutiques such as Majedie, which has about £7bn of assets under management, are “deliberately small”. Restricting the size makes it easier to conclude nimbly since they do not come up against liquidity constraints, argues Harris.

He said: “M&A might seem attractive to those firms who see themselves as asset gatherers, but such a strategy is very unlikely to be driven by a desire to perform better for existing clients.”

Spence agrees: “Our industry is generally best served by having a vibrant and entrepreneurial community of funds and fund managers. As you get larger, your probability of outperforming an index tends to decrease.”

Perhaps the most significant barrier to consolidation in the number of fund management firms is the challenges of cultural integration of staff. Paul Abberley, interim chief executive at Aviva Investors, admits it may be a cliché to say that people are an asset management firm’s key resource, but it is the truth. He said: “The second-hand value of the desks and chairs isn’t really very much.”

Rosenberg, chief executive of the London branch of Cardano, said: “It is a talent-based business, and many of the characters in this market are frankly antisocial. They aren’t herd species, and they just don’t go in big teams. So, you have on the one hand this driver to consolidate the cost base but on the other hand you have a lot of talented people who are a huge barrier to any form of consolidation.”

Peter Davy

It has been a strong year for fund management sector mergers and acquisitions. Schroders’ acquisition of Cazenove Capital and Royal London Asset Management’s purchase of Co-operative Asset Management are part of a wider uptick in M&A activity. Corporate finance boutique Imas puts the value of transactions announced in the first quarter in the fund management industry at 90% of the total for the sector in 2011 and 2012 combined.

Kevin Pakenham, founder of specialist advisers Pakenham Partners, expects this to continue. His firm’s figures show the number of transactions worldwide has been steadily increasing since 2010, when it touched a low of 138. That increased to 153 in 2011 and 189 in 2012. Pakenham expects a similar increase in deals this year, driven by rising markets.

He said: “There’s always a relationship with easy money conditions, strong equity markets and the level of transactions.”

Despite this buoyant backdrop, respondents to this year’s CEO Snapshot Survey have mixed feelings on M&A. While a higher percentage, 42% this year compared with 35% last year, said they are not interested in acquisitions, more are actively pursuing a strategy of growth by acquisition – up to 15% of respondents from 3% last year. Nor has respondents’ risk appetite for M&A increased markedly since last year, with 79% saying they felt the same about M&A as a year ago.

Mike Karpik, head of Emea at State Street Global Advisors, believes the rapidly evolving regulatory landscape and sluggish economic growth have increased the challenge of big acquisitions. He said: “Given how difficult it is to integrate these businesses as well as the clouded regulatory environment, I think the appetite for large M&A is pretty cold right now.”

A third of survey respondents said they were open to acquisition ideas as an acquirer. Karpik added: “As the industry begins to focus on client needs in the market environment, there is more likely to be a market for building up capabilities with deliberate and targeted acquisitions.”

Survey respondents also submitted lower estimates for the fair valuation of the European asset management sector, which is counterintuitive given the brighter outlook overall for the industry.

Last year, almost half put the fair value of the European asset management sector at eight to 10 times earnings before interest, taxes, depreciation, and amortisation, 24% said 10 to 12 times ebita and only 16% gave a valuation of less than eight times ebita.

This year, a third offered a valuation of eight to 10 times and 30% said less than eight times ebita.

Dan Mannix, chief executive of boutique RWC, said: “There is definitely a trend that the gap between acquirers’ and sellers’ expectations is coming down. Increasingly, smaller, single-manager businesses believe there is value in a larger group absorbing them, to allow them to continue to operate their business. It is particularly acute in businesses that are subscale and lack diversification.”

According to Fred Hansson, partner at Imas, valuations for most deals are being driven by the need to make a return to 50bn-€1bn, leaving 3,201 firms at the end of 2012.

At the larger end of the scale, while there have been assets for sale, buyers are wary. Mike Karpik, head of Emea at State Street Global Advisors, said: “The challenges of large scale acquisitions have definitely gone up, given the regulatory landscape and the general uncertainty. I think all European bank-owned asset managers – bar two – have tried to sell their asset management business in the last few years, and unless I am mistaken most have not managed to sell.”

Jam-packed: the industry is swamped with funds and fund management firms
Renewed confidence drives hiring up

If you use collateral around the globe, do you have a global view of it?

Peter Davy
Returning confidence among fund managers is also opening wallets, according to this year’s CEO Snapshot Survey. Unsurprisingly, respondents expect to increase spending on regulatory compliance by 81% in the next 18 months. However, in contrast to last year, more than half also expect spending increases in sales and marketing and international expansion.

Vanguard is not the only asset manager looking to Asia. Andrew Wilson, head of Emea at Goldman Sachs Asset Management said: “In terms of where we have hired, 20 of the last 30 hires across GSAM were in India and Singapore. We now have a team of a dozen research analysts who provide investment grade and emerging market research.”

Investment in product launches is also considerably up, with 49% of survey respondents now expecting spending to increase compared with 32% last year. Despite the recent focus on

06 CEO Snapshot Survey

Three quarters of chief executives say regulation will not lead to an increase in fees, writes Yasmine Chinwala

of all the items of regulation facing the asset management industry, the Alternative Investment Fund Managers Directive ranked top in terms of the cost of its impact, according to respondents to this year’s CEO Snapshot Survey.

AIFMD scored an average rating of 1.55 out of three, followed jointly by the Foreign Account Tax Compliance Act, the fifth iteration of the Undertakings for Collective Investment in Transferable Securities and the second round of the Markets in Financial Instruments Directive.

Ann Doherty, head of asset manager clients within the investor services division at JP Morgan, said: “AIFMD heads the list because it is on the minds of most asset managers right now. We are in the middle of an implementation phase. Firms are finalising legal agreements and people are thinking how much more it is going to cost. It is not a surprise that AIFMD has become more important, because it is also the dress rehearsal for Ucits V. Taken together, they will have a huge impact.”

More than half of survey respondents are at the stage of planning or executing changes to comply with AIFMD, however there has been a lack of clarity surrounding how the rules will be written into law at national level. European Union member states are required to apply AIFMD within their jurisdictions by July 22, but the Financial Conduct Authority had not published precisely how the rules will be applied in the UK or released application forms for authorisation just weeks ahead of the deadline.

Doherty predicts that next year the European Market Infrastructure Regulation will rank first for fund management chief execu-

Hiring for sales and marketing

In which of the following areas do you expect to increase headcount in the next 18 months?

- Sales and marketing
- Fund managers
- Client relations
- Risk management
- Compliance
- Analysts
- Corporate governance (of investments)
- Administration/back office

Source: FN CEO Snapshot Survey 2013

Three quarters of chief executives say regulation will not lead to an increase in fees, writes Yasmine Chinwala

Compliance pressure builds

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Tom Rampulla, head of Europe at Vanguard Asset Management, said international expansion was a big area of investment for his firm. He said: “For a long time we were primarily a US domestic company. Now we are expanding globally, which is a pretty big effort for us. There is a lot of opportunity in Asia and elsewhere.”

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the boardroom agenda

equity markets, fixed income continues to be interesting for many of the managers surveyed. Both Paul Abberley at Aviva Investors and Pimco’s London-based managing director Joe McDevitt, for example, are looking at less liquid fixed income products linked to real estate as a source for growth.

IT investment

Forty-six per cent of respondents also expect to increase spending on technology over the next 18 months. About half, 48%, expect no change, often because the big investments have already been made. Record Currency Management, for example, is at the end of a four-year investment in a new middle and back office system, according to the firm’s chief executive James Wood-Collins. As happened last year, a majority of 52% of respondents put front office systems as a high priority. The second most popular area for technology spend was online presence. This was a new category introduced to the survey this year. Greg Hobdon, group client director at financial sector communications specialist Living Group, said asset managers are taking an increasingly sophisticated approach to their online presence. He said: “There’s still some reticence in financial services, but they’re getting more confident.”

Many now are looking towards a “high touch” model that instead of just pushing out branding and corporate announcements on their websites, tries to engage with clients across a range of media and capturing data on their interests. It might mean, for example, that email alerts direct them to relevant analysis on the website and the homepage content is tailored to their interests – much as Amazon tracks users’ browsing and shopping history and tailors what that user sees online accordingly.

Peter Schwicht, managing director at JP Morgan Asset Management, said: “This is not about Twitter. It is about personalising the client experience. We are looking at how to get actionable intelligence to people, bringing the right content to them at the right time and in the right format.”

Allianz Global Investors has been making similar investments. However, according to European chief executive Elizabeth Corley, it is not restricted to customer-facing technology. Her firm also uses social media internally – for example, it uses Chatter, an online collaboration tool by CRM specialists Salesforce. She said: “We use social media for business reasons, not just external communication. You can get real-time socially networked enabled research conversations on stocks or topics going around the world. It’s brilliant.”

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