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The future of distribution (part I)

FUND MANAGERS AND THEIR DIGITAL PRIORITIES

Digital's role in fund distribution's future

FUND MANAGERS SEE TECHNOLOGY AS CORE TO THEIR BUSINESSES AND DISTRIBUTION MODELS IN THE YEARS AHEAD, ACCORDING TO A SURVEY BY *FUNDS EUROPE* AND CALASTONE. HERE, WE ASSESS THE FINDINGS.

THE RISE OF cryptocurrencies such as bitcoin in the public imagination is paralleled in the funds industry, where an appreciation of how digital assets offer the potential to increase distribution ability is growing. While many aspects of this nascent market are not yet fully understood, asset managers can already see the benefit of digital assets and the technologies underlying them, such as blockchain.

Digital assets provide not only a new investment asset class, but a new and more efficient means for fund managers and their clients to access existing asset classes. This includes both traditional and alternative investments.

In research sponsored by Calastone, *Funds Europe* surveyed asset management professionals to assess how the industry's distribution models may evolve. We looked for insights into how the drivers for fund distribution would change in the next few years.

The findings show which geographic markets are expected to grow in importance to fund providers and how product demand may shift. We also discover how firms expect to utilise distribution technology as a result of the profound digitisation process taking place in funds.

Three factors

Currently, 'client communication and engagement' is the biggest driver of asset managers' distribution

43% of respondents to our survey think that fund managers will set up their own wealth management businesses in order to engage more directly with customers.

69% of asset managers who selected client communication/engagement as a top-three driver of distribution strategy say this has immediate importance. 31% said it would be important to them in the future.

61% of respondents who selected digital as a top-three driver of distribution say it will be important to them in future – up from 39% who say it is currently important.

51% of a cohort who commented on advice felt advice is important to all clients. However, some felt receiving advice would be dependent on assets under management.

Source: Funds Europe. Respondent numbers vary.

NEW HORIZONS - Digital assets provide a more efficient means for fund managers and clients to access existing asset classes.

strategies, with 69% of people that selected this answer highlighting this as a top-three factor. But this drops to 31% in the future (fig 1). The number of respondents was 69 and 30, respectively.

'ESG' ranks second when the number of asset managers that selected this option is considered. Eighty-six responded in total, with 52% citing this as a current factor and 48% saying it is a future factor.

'Digital' had the third-highest number of respondents, at 71, with 39% saying this was a current factor, but this rises to 61% of that number who cite digital as a future driving factor for distribution.

Demands surrounding data come through strongly in the survey generally, and so 'market intelligence/data' had the fourth-highest number of respondents (jointly with 'Costs'). The result was roughly half-and-half, considering this a current and/or future factor.

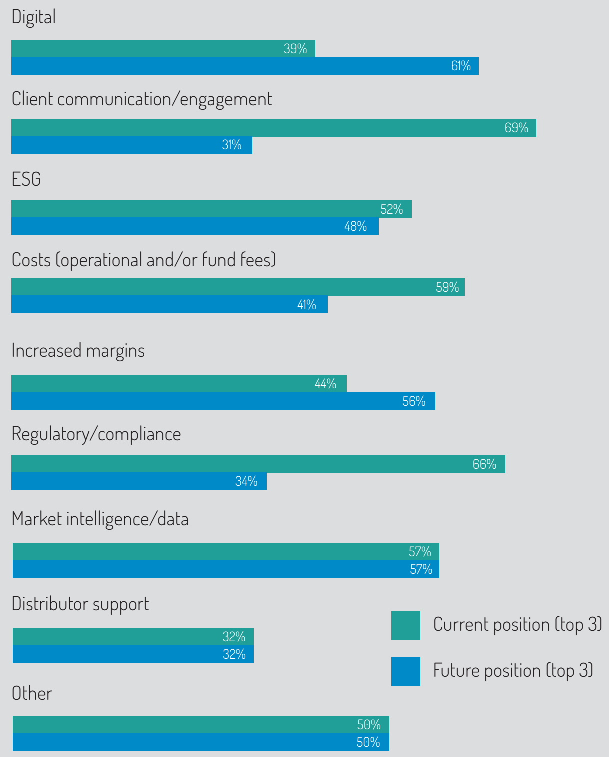
Finally, as low-cost passive strategies grow in popularity and active asset managers are forced to justify fees or lower them, 'increased margins' are likely to become a significant factor in fund distribution strategies. Of the asset managers who selected this option, 44% did so as a top-three factor now, versus 56% in future. This suggests fund distribution will have to become cheaper and, as a consequence, perhaps less complex and more fluid than it is today.

Promise of the East

Although Europe and the broader developed economies dominate asset managers' key distribution markets for now, it is perhaps not surprising that the focus is set to shift more towards emerging markets.

Respondents in our survey highlighted the UK as the most important market (35% of them were UK-based), with 77% of them indicating that inflows from that country are currently the most significant (fig 2). Northern Europe and Switzerland were the two highest-selected areas next, with 71% and 69%, respectively. Fig 2 shows how these fall in future, and so looking ahead, the data shows a notable shift eastwards, where demographic trends and industrialisation are producing a growing middle class with spending power. As a result, 80% of people that selected India believe that country will be the most

1. What would you say are the key factors driving your distribution strategy?



Source: Funds Europe/Calastone

"WHILE MANY ASPECTS OF THIS NASCENT MARKET ARE NOT YET FULLY UNDERSTOOD, ASSET MANAGERS CAN ALREADY SEE THE BENEFIT OF DIGITAL ASSETS AND THE TECHNOLOGIES UNDERLYING THEM."

important geography for their funds in the future. However, Asia had a higher number of respondents and the result indicates that flows will grow from 47% now to 53% in future.

For many European firms, these important markets in the East will be hard to reach and the industry would benefit from utilising digital methods to penetrate these countries. But firms need to be mindful that the ever-developing Asian funds industry is witnessing a digital revolution of its own, which will mean competition from domestic and regional managers in those locations.

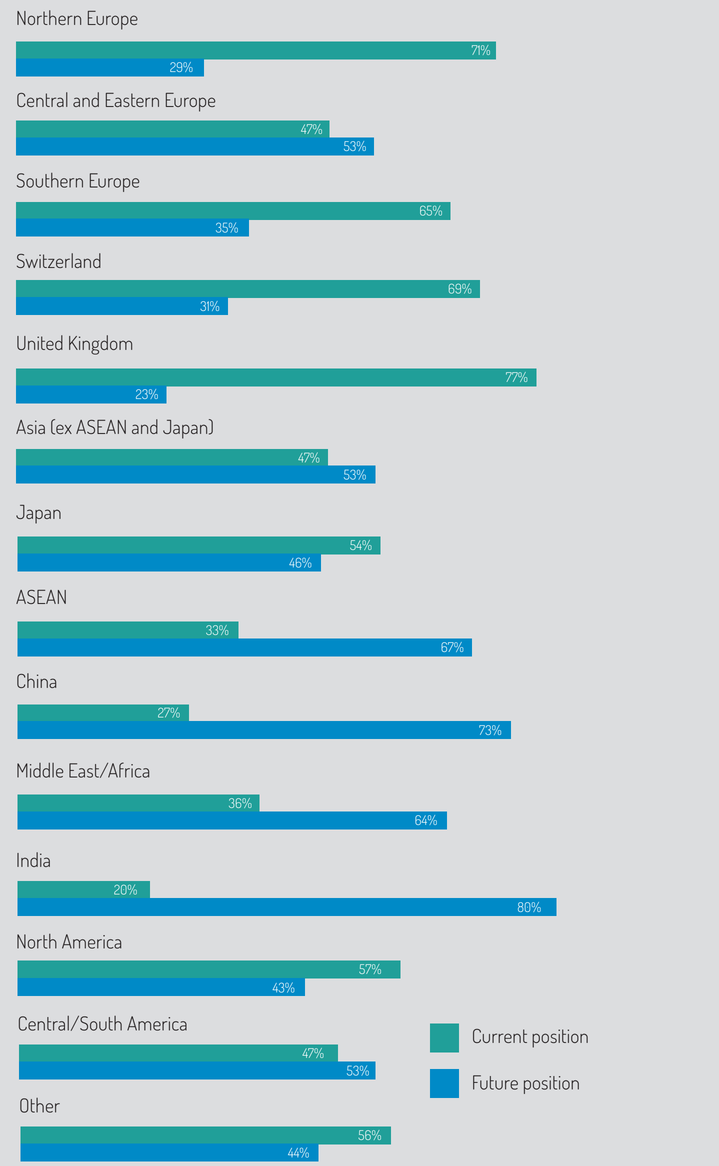
Other emerging areas of the Middle East and Africa, Central and Eastern Europe and Central and South America are also going to become more important for asset managers' flows in future, though overall, these geographies were selected by fewer respondents. The UK, meanwhile, sees a comparative drop-off in importance: just 23% of those who selected it as either a current of future location for flows said it would be in the future.

The rise of platforms

Asset managers anticipate much more business with fund platforms in future as they move away from traditional distribution channels, such as IFAs and institutional investors, and embrace new ways to reach customers.

Fund firms in our survey generally attach significant importance to independent financial advisers, with 78% of those who selected IFAs – either as a current of future channel – saying this is an important channel to them at present. The most selected category was 'institutional investors', though the results suggest that these asset owners may become less significant. Whereas 70% of people selecting this

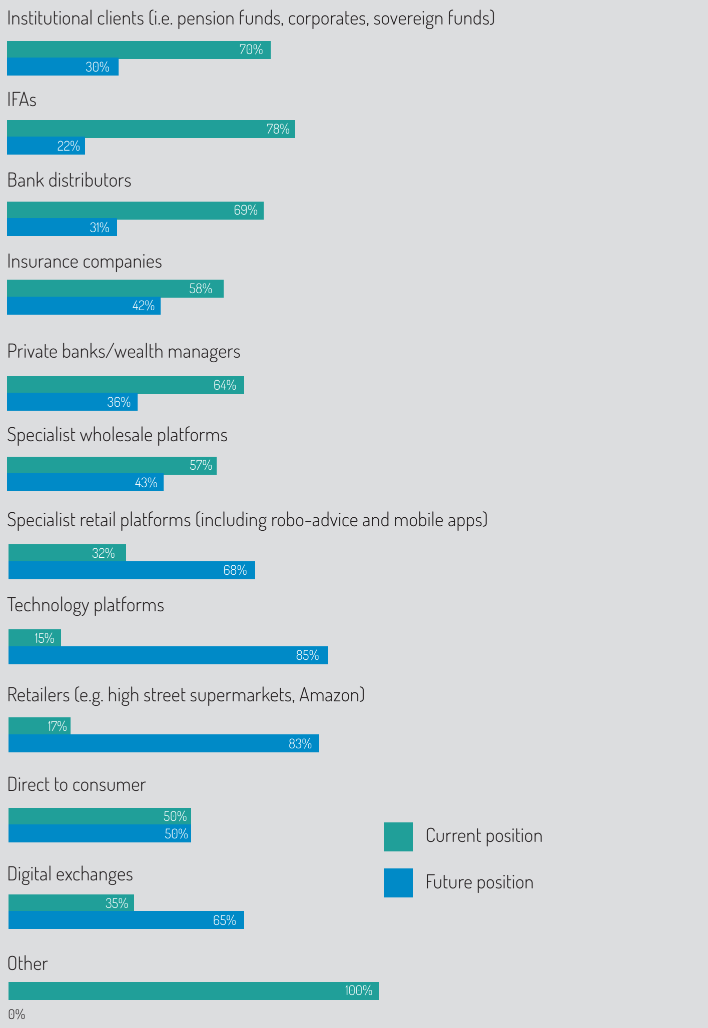
2. Where do your fund flows currently come from and where do you expect them to come from in the future?



Source: Funds Europe/Calastone

"FIRMS NEED TO BE MINDFUL THAT THE EVER-DEVELOPING ASIAN FUNDS INDUSTRY IS WITNESSING ITS OWN DIGITAL REVOLUTION."

3. What type of distribution channels/customers will be your primary targets?



Source: Funds Europe/Calastone

category said institutions were currently important, it falls to 30% in future as a primary target for asset managers' distribution strategies (fig 3). The asset management professionals who took part could select as many channels as they wished for this question.

Bank distributors (69%) and private banks and wealth managers (64%) are also a key focus and similarly see a fall in future importance.

Where we see a notable rise is in the importance of technology platforms. In the years ahead, and as distribution becomes more digital, the 85% of asset managers that selected technology

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platforms (or technology-driven fund platforms) as a primary channel for distribution give a strong indication that this channel will become much more important in the years ahead.

They are also looking at new ways to reach prospective clients through high street supermarkets or online channels such as Amazon, with 83% of those who selected this option saying they expected retailers to become a prominent distribution channel. Specialist retail platforms, including robo-advice and mobile apps, will also be a key target for 68%.

We have seen that just over three-quarters of those who selected IFAs said this channel was important at present. It falls to 22% in future. Perhaps this is related to assumptions that asset managers now make about the role of advice in the future of fund selection. From a list of statements about advice, we asked asset managers to choose their top three. Figure 4 shows that just over half said advice was "critical" to all clients for fund selection in the current investment environment. Some 49% also agreed that the level of advice would depend on the size of a client's assets. Interestingly, 42% of the asset managers said advice would likely be lifestyle-led rather than product-led.

Around a third (32%) of respondents believe that advice will remain the domain of high-net-worth individuals who can pay for it, while a fifth of the asset managers think that social media will play a larger role in fund selection.

On the whole, asset managers maintain that there is still a role for advice; just 14% said advice was a "red herring" and that more basic savings solutions were required.

When we asked asset managers how well served clients are with investment advice, we received a variety of opinions. Some noted that the cost could prevent clients from seeking advice in the first place, while low margins made it unattractive for the advisers. Others argued that advice ought be more flexible and more holistic to address clients' needs.

One respondent wrote: "More tailoring to people's unique circumstances than to financial outcomes – what are people looking to achieve? It may not always be having the most amount of assets in retirement or to pass on to heirs."

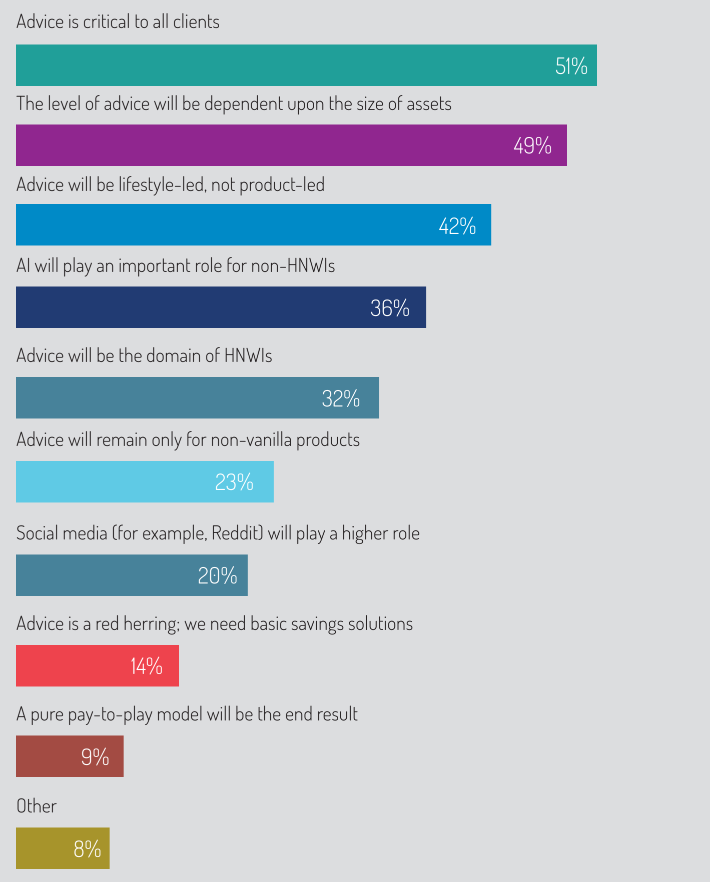
Another commented: "Advice hasn't changed sufficiently to meet clients where they are and how they prefer to engage," and added that the arrangement was "still very much adviser-led, rather than client-led".

Indeed, some asset managers noted that the quality of advice can be low, with profits rather than investor needs driving behaviour.

As the industry may be moving away from traditional distribution channels, we asked our respondents if they thought fund managers would establish their own wealth management arms to exert more control over the distribution process.

Some already have them, of course, and though most of the asset managers surveyed are not expecting a wave of new wealth management launches, a significant 43% said they expected fund managers to set up wealth

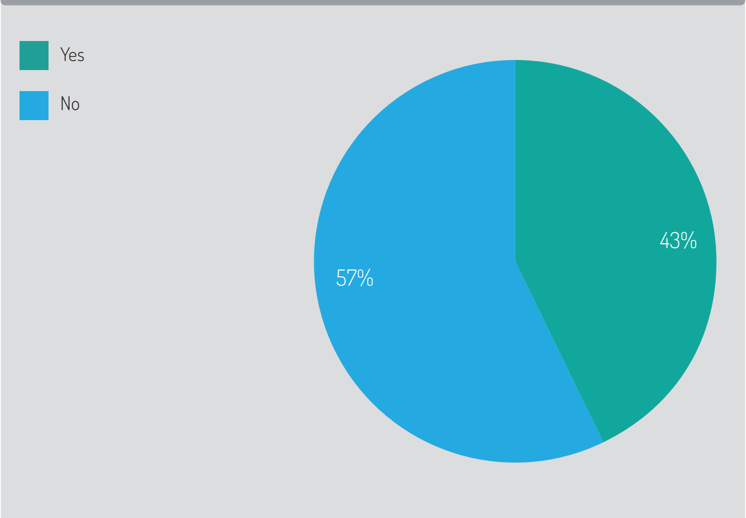
4. How important is advice to fund selection?



Source: Funds Europe/Calastone

"A FUNDS PROFESSIONAL WROTE: 'ADVICE HASN'T CHANGED SUFFICIENTLY TO MEET CLIENTS WHERE THEY ARE AND HOW THEY PREFER TO ENGAGE,' CLAIMING THE SET-UP WAS MORE ADVISER-LED THAN CLIENT-LED."

5. Do you anticipate that fund managers will create their own wealth management divisions?



"INCREASED TRANSPARENCY, BETTER CUSTOMER REPORTING AND A REDUCTION IN FINANCIAL JARGON WOULD HELP MAKE PRODUCTS MORE UNDERSTANDABLE TO POTENTIAL CLIENTS, SOME SUGGESTED."

management businesses (fig 5).

Conversely, some of our asset managers expected wealth managers to bring fund management in-house.

New customers

When we asked fund managers how the industry ought to connect with new customers, we received a range of opinions covering both technology and advice.

Further investment in technology would give customers a better digital experience, some commentators said, while greater efficiencies could help to reduce the cost of advice and drive better customer value.

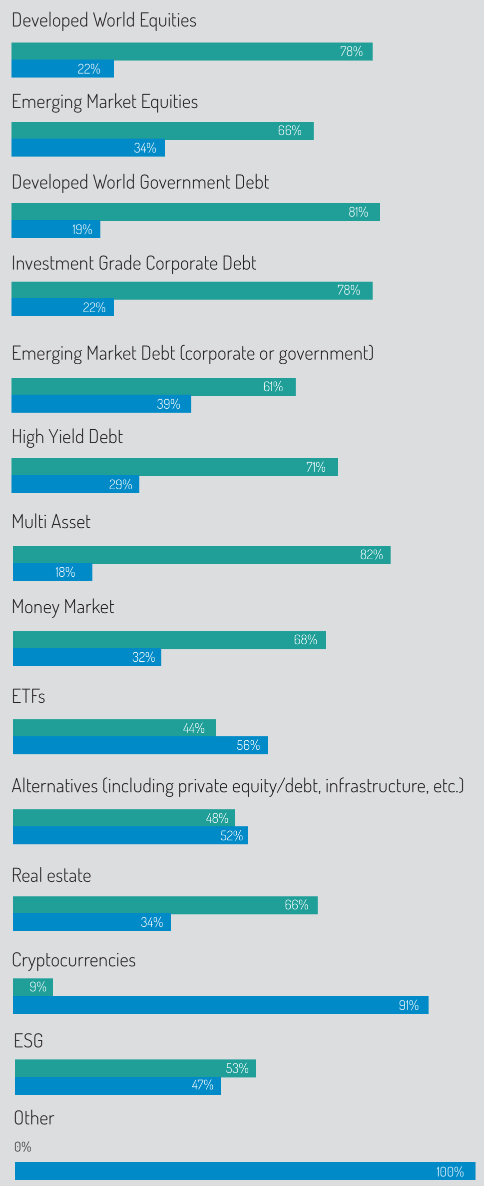
Greater education was a common theme among respondents, as asset managers identified the next generation of investors as a key source of flows for the industry in the coming years.

Making the customer experience better and stronger was another way that asset managers could attract new clients and capital.

Increased transparency, better

"ASSET MANAGERS SHOULD EMBRACE THE GREATER FOCUS ON ESG INITIATIVES TO REACH NEW CLIENTS, PROVIDING MORE NUANCED INVESTMENT STRATEGIES."

6. Please indicate your current product ranges and how you anticipate that these may change over the next few years.



Source: Funds Europe/Calastone

customer reporting and a reduction in financial jargon would help make products more understandable to potential clients, some asset managers suggested, while branching out to new markets would help reach underserved customers.

Asset managers should also embrace the greater focus on environmental, social and governance (ESG) initiatives and products among customers to reach new clients, providing more nuanced investment strategies that better match the beliefs of end-investors.

Finally, better and more stable fund performance could help convince customers to ditch passive index-tracking vehicles for actively managed funds, some argued.

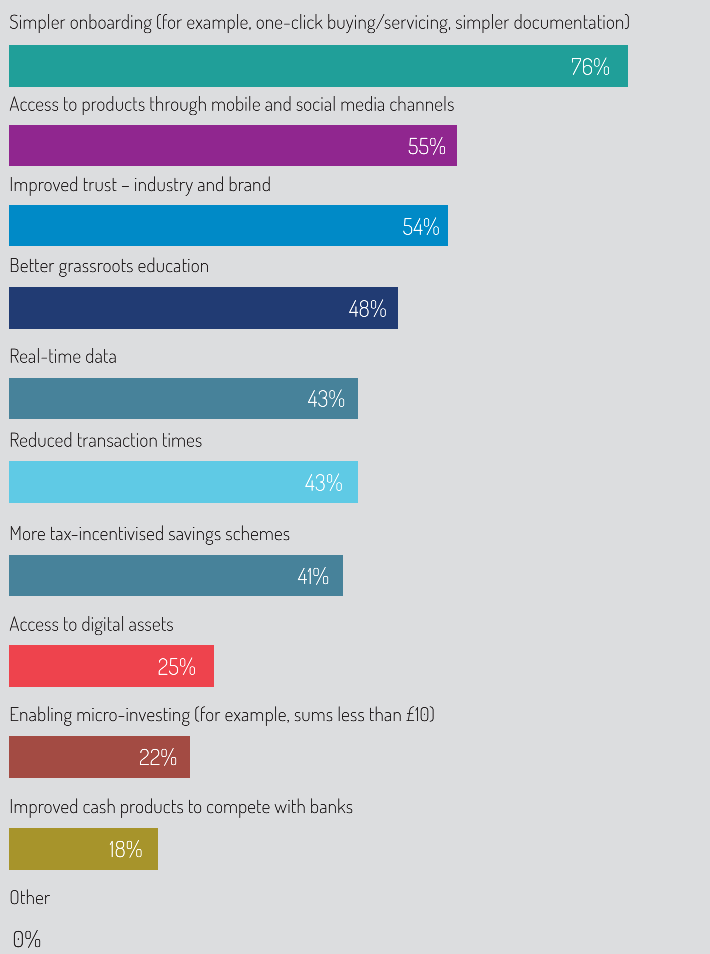
Cryptocurrencies, alternatives and ETFs

As asset managers change the way they think about their distribution strategy, they are also changing the products they offer. We asked those taking part in our survey how their product lines look now, compared to how they expect them to look in the future.

For the time being, our respondents are largely focused on conventional and traditional asset classes. For instance, of those who cited developed world government debt, 81% say the asset class is a current feature of their product ranges – but this plummets to 19% in the future (fig 6).

Similar falls are seen in other major asset classes, such as investment grade

7. How do you believe the industry can improve accessibility for existing and new investors?



Source: Funds Europe/Calastone

corporate debt (from 78% to 22%). Multi-asset is one of the more popular products among asset managers currently, with 82% of those who cited it saying that they offered such strategies. But this sees a similar drop to 18% in future.

In the future, a greater focus on new, more innovative strategies and asset classes seems likely. Some 91% of asset managers in our survey said they believe cryptocurrencies will be an area of focus for them, up from 9% currently, a shift that presumably reflects the disruptive influence of digital currencies. However, only a small number of asset managers selected this category.

Meanwhile, just over half of respondents (56%) that selected ETFs as being in their current or future product ranges said they would be offering ETFs in the future – up from 44% currently.

The growing interest in alternative strategies is reflected in our survey. Of the 100% that selected this category, 52% planned to offer these strategies in future, with 48% indicating that they have this capability now. Such strategies have played an important role in portfolios in the low-rate, low-growth environment that has characterised the post-Global Financial Crisis investment landscape.

It's worth noting that the relatively small jump for ETFs and alternatives – both major areas of development for traditional fund houses – may be linked to the relative maturity of these products and strategies. It is digital assets such as crypto, which still face technical and regulatory hurdles, that are the most notable emerging asset class.

Improving accessibility

If there's one major change that digital assets and their corresponding technology can bring to asset management distribution, it is in improving access to financial assets, be they funds or underlying investments.

Survey respondents highlighted a range of actions that the industry can take to help new and existing clients to improve accessiblity.

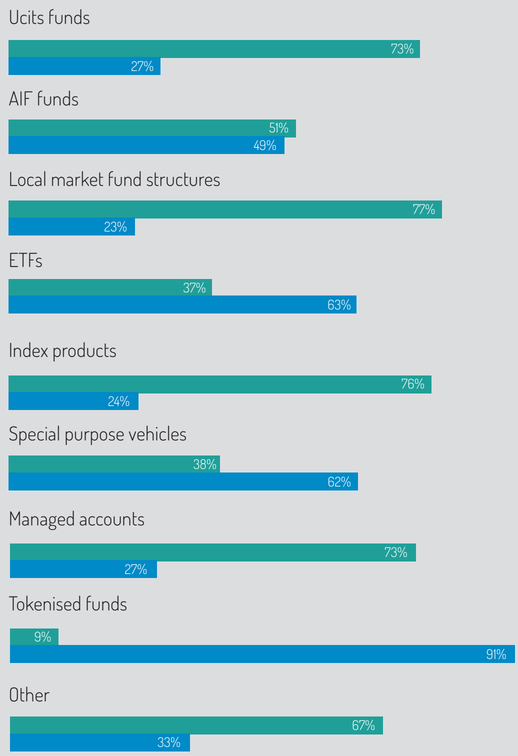
Chief among these was simplifying the onboarding process, backed by 76% of asset managers in our survey (fig 7). Quicker onboarding might include 'one-click buying' and making documentation processes simpler.

Firms also want to make products more available through mobile and social media, a tactic highlighted by 55% of asset managers.

A more general aspiration, cited by

"FUND MANAGERS WANT TO EXTEND THEIR INTERNATIONAL DISTRIBUTION REACH TO FAR-FLUNG REGIONS OF THE WORLD VIA A BROADER, PRIMARILY DIGITAL SET OF CHANNELS."

8. How are your investments currently delivered to clients and how might this change?



Source: Funds Europe/Calastone

54%, was to boost clients' level of trust in the funds industry.

As traditional asset classes potentially give up their dominance and new types of assets become available to a wider range of investors, the increased sophistication and digitisation of the asset management industry could see innovative structures come to the fore.

Fund managers in our survey mainly deliver products through EU-wide Ucits funds or local market structures (fig 8).

However, the evolution of blockchain and the acceptance of digital assets could lead to the emergence of new types of fund structures such as tokenised funds.

Our survey indicates a growing future usage of these products. The popularity of passive strategies and low-cost ETF vehicles, as well as the emergence of new types of actively managed strategies, means that 63% of asset managers who selected ETFs as a current or future range expect to offer them in future.

The message that emerges from the first part of our Future of Distribution Survey is that fund managers want to extend their international distribution reach to far-flung regions of the world via a broader, primarily digital set of channels – and it is the supranational scope of digital communications that makes this possible. **fe**

The *Funds Europe*/Calastone Future of Distribution Survey, conducted in Q2 2021, received 96 responses. The number of respondents to each question varies. All of those taking part were from fund management businesses. Respondents were given multiple choice questions. Some scores do not add up to 100% because respondents were allowed to select more than one answer/statement.

Key locations where asset managers work include:

• Australia	15%
• Luxembourg	5%
• Singapore	3%
• Spain	4%
• Switzerland	5%
• UK	35%

By roles, our survey cohort was:

• Management/C-level	27%
• Senior manager	23%
• Manager	12%
• Team lead	9%
• Vice president	9%
• Other	8%
• Partner	5%
• Regional manager	5%
• Owner	1%