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Three Ways to Rethink Operating Models for a *New Investment Reality*

Fast-changing macro and market landscapes are creating ever-greater urgency for asset owners to transform how they manage portfolios to achieve their return targets and other investment goals. These shifts have important ramifications for operating models as well.

"Asset owners are looking to right-risk, right-source and future-proof their data and operating models as they rethink their front-to-back investment processes."
Rohan Singh, Global Head of Asset Owners, Asset Servicing and Digital, BNY Mellon

Themes shaping future operating models

Challenges faced by asset owners

- Low interest rates impacting yields
- Geopolitical instability and trade tensions
- Rising regulatory changes
- Economic uncertainty compounded by the pandemic

INCREASED
outsourcing of data, middle office and risk performance and analytics capabilities

ADVANCED
data analytics, technology and digital needs

GROWING
allocations to higher yielding assets (e.g., Alternatives, Digital assets)

GREATER
integration of ESG mandates in portfolios

Three ways to rethink operating models for a new investment reality

1. Use new technologies and data tools to remain agile
2. Follow best practices in connectivity and data truth for risk management
3. Strike the right balance between in-house and outsourced operations

In short, this shift is momentous as operations teams within asset owners grapple with the changing investment paradigm.

Within each suggested approach is the need for a fresh look at data management and outsourcing – especially for asset owners with multiple custodians in multiple geographies. For example, they need to:

- Ingest timely custodial data across regions and providers
- Aggregate risk performance and analytics across all portfolios
- Optimize financials resources (e.g., collateral management) across providers and/or portfolios

To achieve this and accelerate operational and data transformation to empower shifting investment strategies, Singh believes it is key to have access to an investment book of record that enables a holistic view across all assets, as well as to have a single source of truth from a data management viewpoint.

"Asset owners have historically struggled with multiple data-sets from different vendors and sources," he explained. "Ultimately, since a total risk approach is not constrained by asset classes, it is paramount to have access to an integrated front office that offers seamless support for all instruments, allowing asset owners to make better informed investment decisions."

Market outlook at-a-glance

Macro Snapshot

- Relatively positive on the outlook for risk markets
- Continued expectations that most countries will reach pre-crisis levels of economic activity during 2021
- Two main risks: (i) the uneven course of recovery from COVID-19 given different approaches to vaccinations, and (ii) inflation, based on the emerging demand/supply imbalance

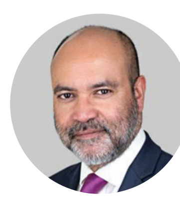
Investment Implications

– to be considered in the context of your varying return objectives (e.g., Central Banks vs. Pensions)

- Stay invested in equities and real assets – they won't perform as well as in 2020, but steady progress is likely
- Remain invested in fixed income – although not quite as much as historically given the inflationary scenario
- Volatility should rise and correlations fall, so good active security and manager selection more important than usual
- Increase exposure to alternatives – especially assets that offer some level of hedge against inflation and interest rate risks

Long-term Trends Shaping Portfolios

- Future regulation
- Technology
- Demographics
- The climate



Shamik Dhar
Global Chief Economist
BNY Mellon Investment Management

Accelerating Operational and Data Transformation

Against the backdrop of the current environment coupled with an uncertain near-term future, there are several key considerations that asset owners are contemplating when managing their portfolios going forward:

- Consider a total portfolio approach, to benefit from more effective and nimble decision making
- Embrace the hunt for alpha via greater appetite for alternatives and emerging markets while balancing the illiquidity premium
- Further incorporate ESG factors in strategic asset allocation and portfolio construction

Yet with every investment decision, asset owners also need to factor in a mix of elements, most notably the likely outcome, the level of uncertainty and the balance of risks. To further enhance returns on behalf of beneficiary owners, generating additional operational alpha becomes central to asset owner strategies too as they seek to extract maximum efficiency from operating models and future proofing.

1

Use New Technologies and Data Tools to Remain Agile

To tackle the challenges they face today, asset owners have increasingly moved from siloed, fragmented and multi-location investment models and operations to being focused on consolidating and rationalizing their technologies and platforms, as well as standardizing processes.

"The approach we have taken is 'controlled simplicity'. This involves cleaning up the operating model to transition from 'multi-local' to a global operating platform with standardized processes, where possible, and shared technology platforms and data-sets," explained **Marcel Prins**, Chief Operating Officer, APG Asset Management

This type of approach is essential for asset owners given the only way to manage an investment portfolio today and for the future is by adding more data sources, including alternative ones.

In line with this, there is also a need to consolidate performance management, both from the perspective of investment performance and risk management.

"This is part of our entire transformation journey, which enables us to create the right foundations for EPF to then start looking at advanced analytics, machine learning and artificial intelligence," said Ridzuan Wan Idrus, Head, Investment Operations, Employees Provident Fund (EPF).

The Malaysian pension fund has also been focused on streamlining its investment operations. "Besides the internal fund manager transactions that we have in our current front-office system, we are bringing the custody data into our front-office, so that we have a consolidated view," Idrus added.

A common end-goal for asset owners, is an open data-centric platform that offers best-of-breed capabilities across attribution models, portfolio construction and risk management within public and private asset classes.

Yet asset owners also need to be mindful of how quickly this can be achieved. Building such a platform in-house, for example, can take an asset owner several years, and can be very costly. There is a pressing need, therefore, to identify outsourced solutions to cut both cost and time-to-market to reach data and digital goals more quickly and at less cost.

2

Follow Best Practices in Connectivity and Data Truth for Risk Management

Another key role of data and digital is to ensure operating models are "fit for purpose" and can mitigate risks in an increasingly complex environment.

For many asset owners, a key challenge from the front to the back office is the consistency of data – which can be tackled by data management solutions to create a single source of truth and keep a centralized investment book of record. This requirement is now even more acute because of increasing real-time data expectations.

"We see asset owners wanting access to near real-time information and accurate start-of-day positions within their local market," said Mark McKeon, Global Head of Front to Back Solutions and International Products at BNY Mellon.

Identifying a single point of data truth is also the starting point on most projects for Jalal Faruki, Head of Securities Services and Custody, Securities Division, SNB Capital. "We then work backwards from there and try to propagate that data out to the different systems or different client interfaces that need to receive that data."

Sometimes this is based on a daily file exchange, while at other times it is based on more asynchronous processes happening in real-time. "The big challenge for us these days is client expectations are always growing in terms of how close to 'real-time' they get with that data," added Faruki.

EPF, for example, is in the midst of an implementation project for a data management solution. *"Moving forward we want to have a single source of truth of the code and copy of the data, the security masters and so on, taking from various data sources that we actually subscribe to,"* said **Idrus**.

This also helps to create transparency of risk exposure – by concentration, country and region, and asset class.

3

Strike the Right Balance Between In-house and Outsourced Operations

As a growing number of asset owners bring more of the management of their assets in-house, the need for global coverage while operating locally in certain markets adds to the complexity they face.

Talent is a critical pillar of a successful in-sourcing strategy. This relies on asset owners attracting and retaining individuals with the right specialist skills and experience to rethink how they operate today.

Other factors impacting in-house versus outsourcing considerations include the continued growth in alternative assets across private equity, real estate infrastructure, as well as the total portfolio approach gaining traction amid the move from traditional asset allocation to more of a risk-based approach.

For Trans-Canada Capital Inc, for example, the key to getting the outsourcing balance right has been to keep internal staff on value-added tasks that are core to the business. It can then outsource data management to external service providers which serve as an extension of investment operations – akin to being part of the team.

"With such a changing landscape, we now look to outsource some of the key functions that are not a value-added task for our people internally. For the back and middle offices, we look at what we can externalize, while still keeping our core value-added and nimble team." explained **Julie Pominville**, CFA, Chief Operating Officer, Trans-Canada Capital Inc.

An example of how the institution has implemented this, is the development of its collateral management system internally, while outsourcing key functions to external specialists who can ensure it keeps pace with a fast-changing regulatory landscape.

Creating an effective blend also comes down to collaborating with the right providers – which means ensuring the right data.

"It's incredibly important for INPRS to have open dialogue with our strategic service providers. I'm probably the greatest advocate for transparency… even with our strategic providers," said Alex Far, Director of Investment Operations, Indiana Public Retirement System (INPRS). "Sometimes this is created internally, but oftentimes it is by using a different platform, needing data from our custodian bank and making sure those parties are communicating effectively."

Operating Models in 2025

As the pressures from low yields, geopolitical tensions, macro uncertainties and regulatory reforms mount, asset owners have little choice but to embrace data challenges now. If they do not fix them, addressing the challenges they face will cost more and take longer.

For asset owners that want to pursue new approaches in a search for quicker and better outcomes, BNY Mellon has identified several themes and technological innovations that will shape operating models of the future:

- Asset owners will become ever-more active in managing their portfolios and, therefore, will drive **greater change and innovation across the investment industry**
- **Digital assets** are set to grow as asset owners assess and engage this new asset class
- **ESG** will continue to accelerate in terms of its role and influence within decision-making
- Significant advances will take place in **data, insights, technology and platforms**
- The focus will be on attracting talent to ensure asset owners have the r**ight tools and capabilities** to take advantage of industry innovations and new practices

"While asset owner objectives remain the same, the current challenges are forcing them to rethink how they achieve their targets and objectives. We expect to see significant advancements in data, insights, technology and platforms," said **McKeon.** *"For us, it's about delivering an integrated solution across the industry so that our clients have access to best-of-breed within a data-centric model."*

This need for asset owners to operate efficiently, quickly and transparently will only grow more acute as they strive to analyze, execute and monitor their portfolio decisions amid the far-reaching structural shifts and transformational trends shaping the investment landscape. Inevitably, how they integrate new technologies, more granular data, risk management tools and outsourced solutions will be a critical success factor.