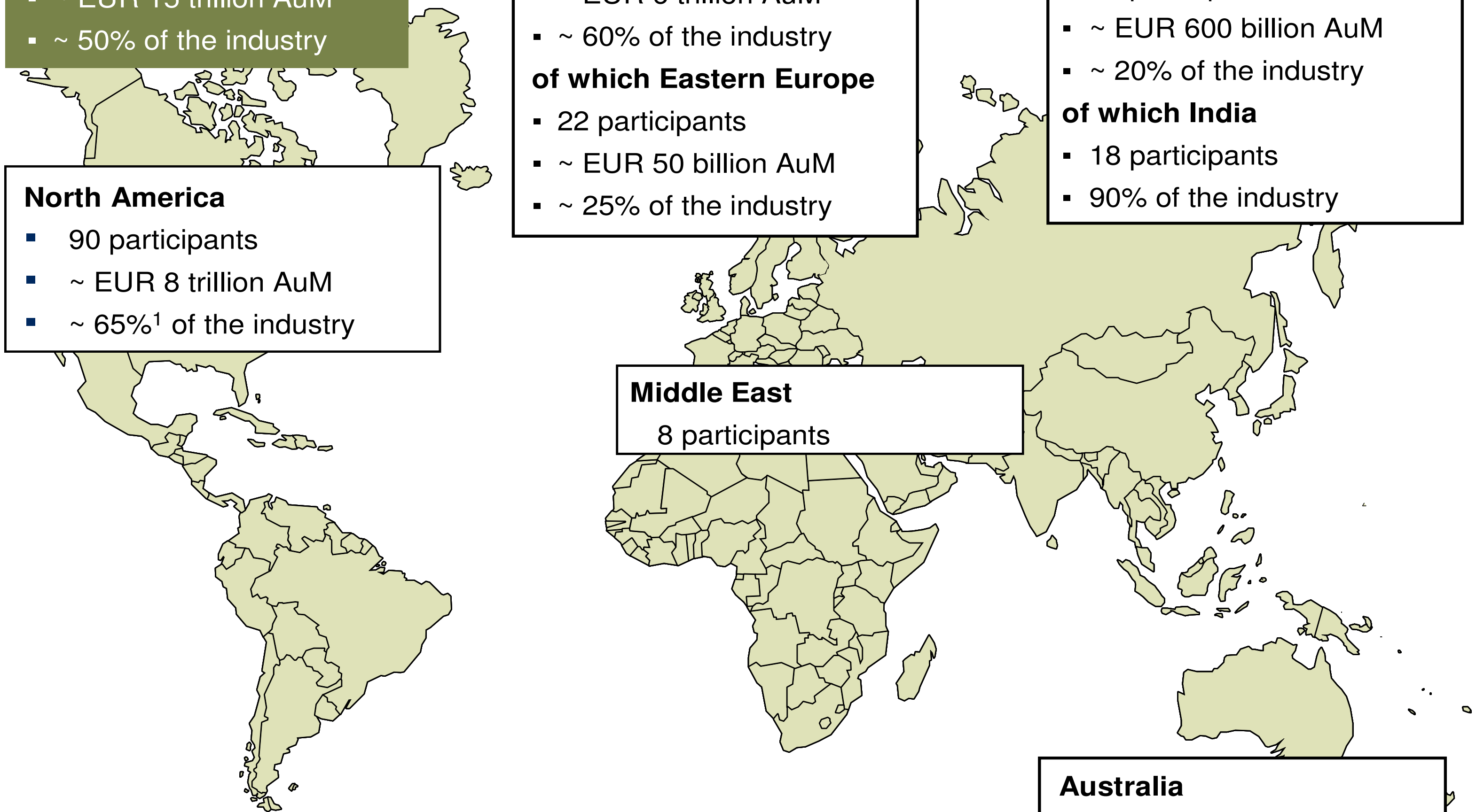
Structural shifts shaping the future of Asset Management

Discussion document

April 26th, 2010

McKinsey&Company

Key inputs in today's presentation come from our annual global Asset Management benchmarking survey



Global
- 288 participants
- ~ EUR 15 trillion AuM
- ~ 50% of the industry

Europe
- 119 participants
- ~ EUR 6 trillion AuM
- ~ 60% of the industry

of which Eastern Europe
- 22 participants
- ~ EUR 50 billion AuM
- ~ 25% of the industry

Asia
- 64 participants
- ~ EUR 600 billion AuM
- ~ 20% of the industry

of which India
- 18 participants
- 90% of the industry

North America
- 90 participants
- ~ EUR 8 trillion AuM
- ~ 65%[1] of the industry

Middle East

8 participants

Australia
- 7 participants
- ~EUR 200 billion AuM
- ~ 20% of the industry

Talent management
- 39 participants

Hedge funds
- 18 participants

SOURCE: McKinsey Asset Management Survey 2008

Key messages

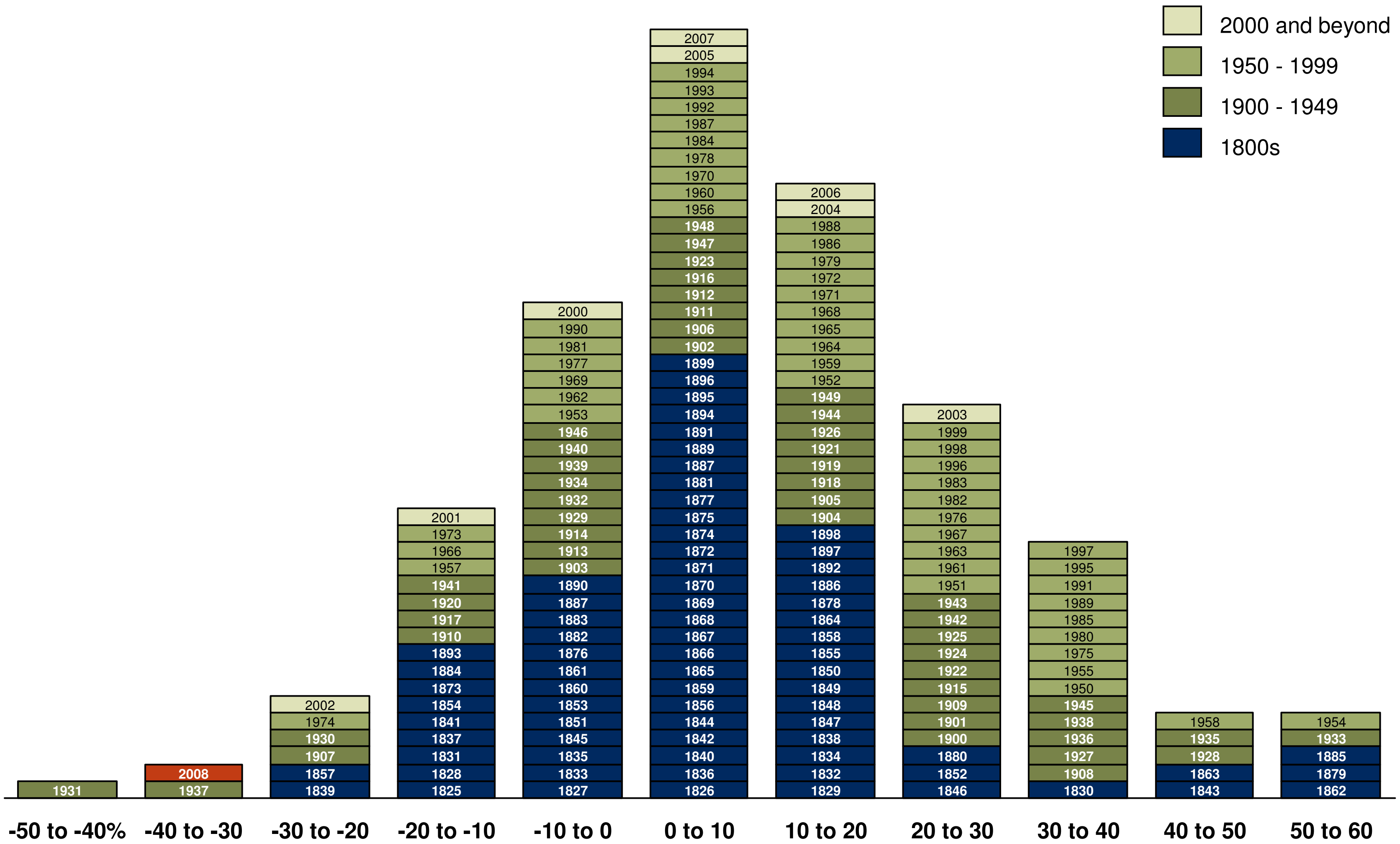
1 **2009 marked a decade low in AM margins**

2 Excellence in business management, not just investment management, is now required for firms to build a robust operating model

3 Looking ahead, despite a lot of uncertainty, the asset management market can be an opportunity-rich environment for firms that can capitalize on 5 structural shifts

2008 experienced the second largest S&P contraction in its 180-year history

Distribution of yearly index performance, 1825-2008

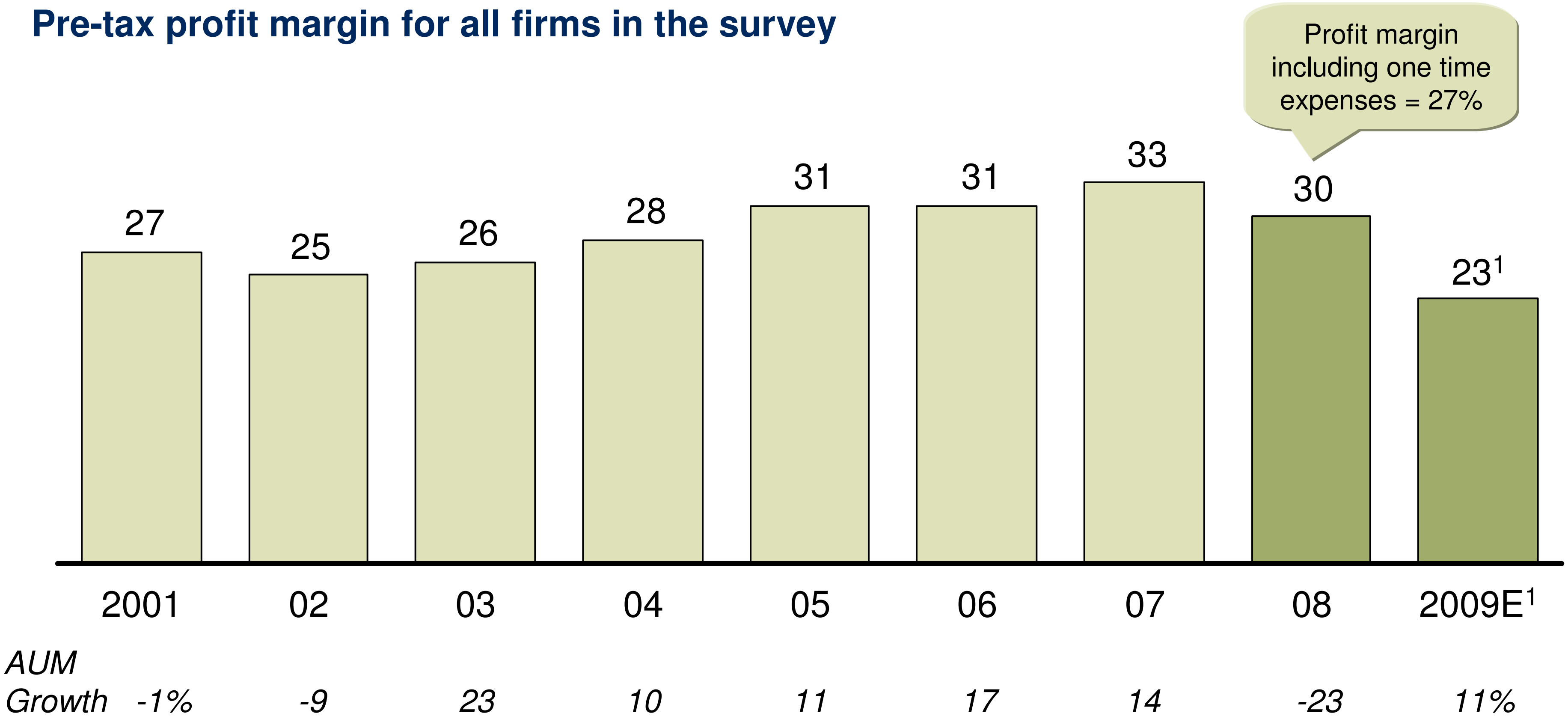


SOURCE: Value Square Management, Yale University

The crisis triggered an end to a 5-year growth cycle for the asset management industry, driving profit margins down in 2008 and 2009

2001-09, percent

Pre-tax profit margin for all firms in the survey

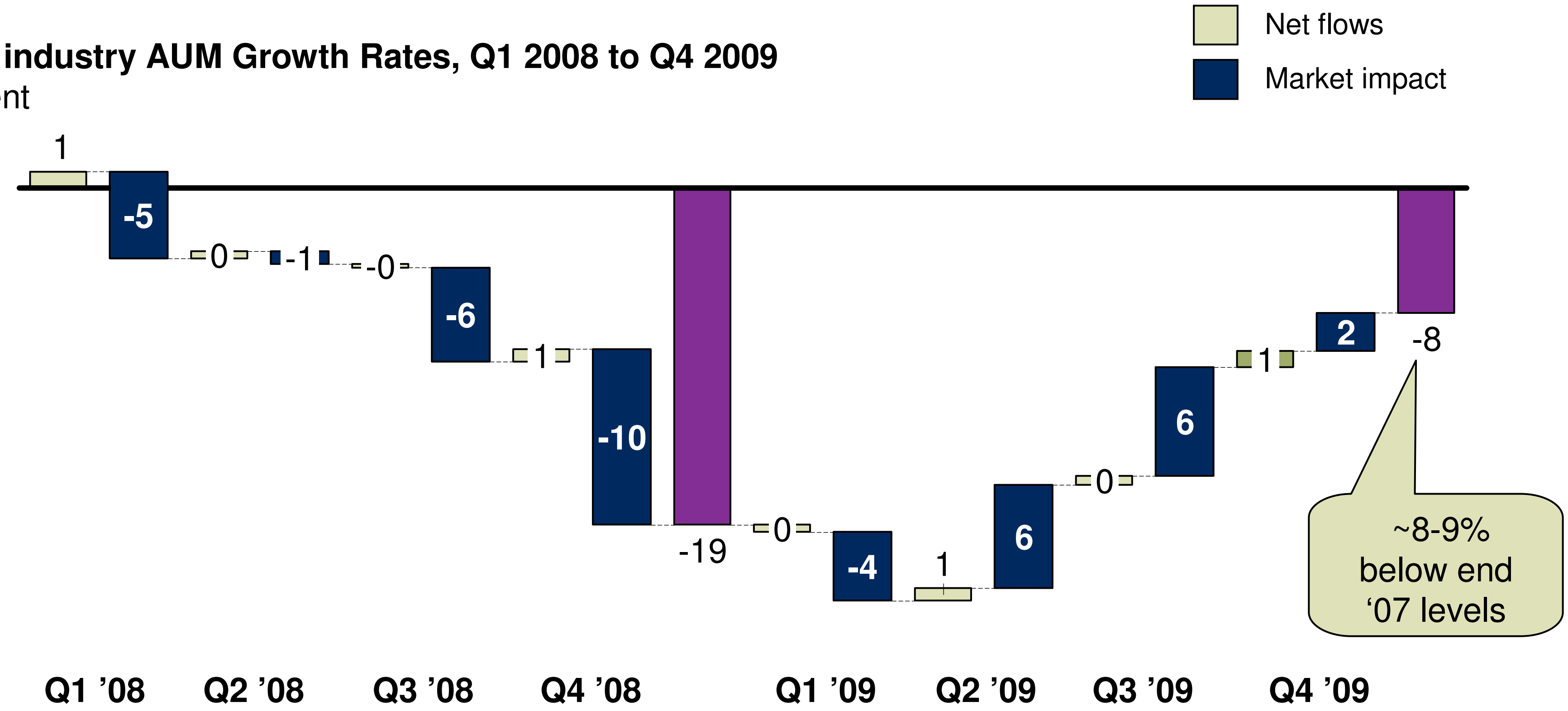


1 2009 represents EBITDA profit margin for the following publicly listed managers: AMG, AllianceBernstein, Artio Global Investors, BlackRock, Calamos, Cohen & Steers, Diamond Hill Investment, Eaton Vance, Epoch Investment Holdings, Federated Investors, Franklin Resources, GAMCO, Invesco, Janus Capital, Legg Mason, Pzena Investment, T Rowe Price, Waddell & Reed, US Global Investors, Virtus Investment Partners and Westwood Holding

SOURCE: 2009 McKinsey/USI AM benchmarking survey; SNL Financial

Despite a recovery beginning Q2 09, industry AUM remain ~8% below year-end 2007 levels

Total industry AUM Growth Rates, Q1 2008 to Q4 2009
Percent



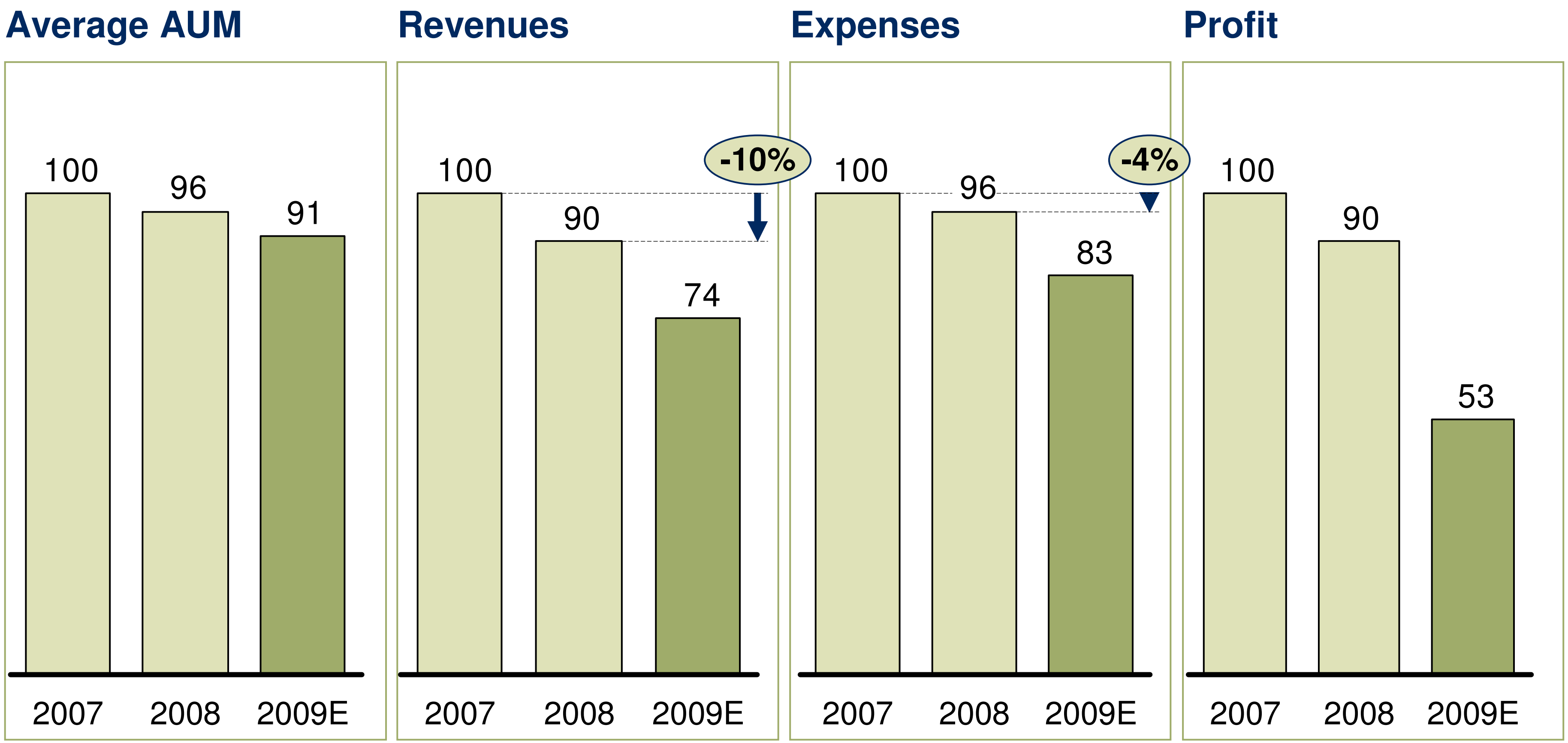
Indexed asset level 2007=100	96	96	90	81	78	83	89	92

Note: includes retail (MF and MMMF) and institutional assets

SOURCE: U.S. Federal Reserve, Flow of Funds Accounts of the United States

Most asset managers have struggled to realign their cost base to lower assets and revenues

100 = 2007 results indexed; '08 change in profits from same firms in both benchmarking surveys



SOURCE: McKinsey/USI 2009 AM benchmarking survey; McKinsey "Navigating the storm" survey; Analyst reports (Morgan Stanley and Barclays Capital)

Key messages

1 2009 marked a decade low in AM margins

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3 Looking ahead, despite a lot of uncertainty, the asset management market can be an opportunity-rich environment for firms that can capitalize on 5 structural shifts

Cost cutting accelerated in 2009

EXAMPLES

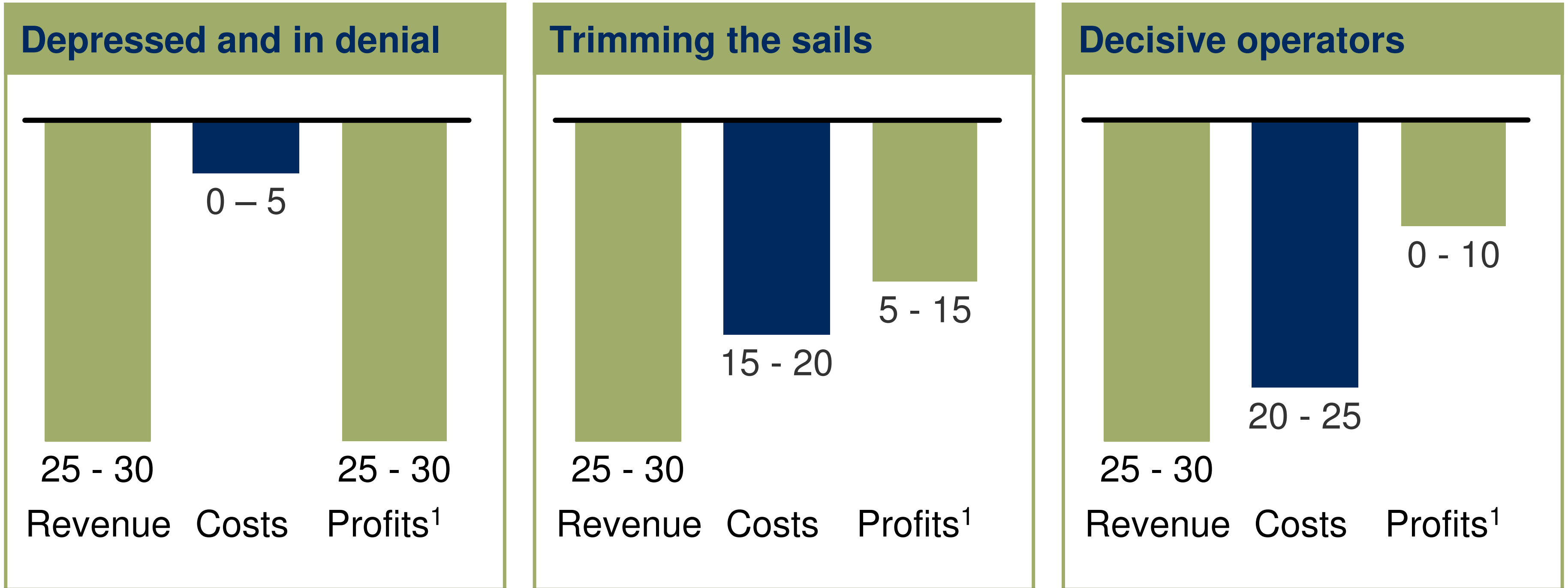
NOT EXHAUSTIVE

Company	Announced job cuts Percent of AM workforce	2009: competitors becoming even more aggressive
Russell Investments	~ 20	▪ Announcement to cut 20 percent of the workforce induced by full-scale productivity review end of 2008
AllianceBernstein	~ 12	▪ Potential additional measures considered if conditions worsen
F&C Investments	~ 10	▪ Reduction of ~ 80 jobs expected
Putnam Investments	~ 10	▪ Additional job cuts of 200 FTE announced in February 2009
Janus Go farther.	~ 9	▪ Expected job cut of 115 FTE
Schroders	~ 8	▪ Announced further cuts for 2009
Fidelity Investments	~ 7	▪ Additional reduction of 1,700 jobs announced in February 2009

SOURCE: McKinsey research, press clippings, annual reports

A handful of asset managers used the crisis to make meaningful changes to their operating model

Percent change from 2008 to 2009E



Depressed and in denial
- 28% of firms
- **<50% of group optimistic[2]**

Trimming the sails
- 35% of firms
- **69% of group optimistic[2]**

Decisive operators
- 13% of firms
- **83% of group optimistic[2]**

1 Mathematically derived average percent change in profits: Decisive Operators = 25% - 52%, Trimming = 47% - 52%, Depressed = 68% - 95%
2 Believe a mild economic recovery scenario following the crisis

SOURCE: 2009 McKinsey/USI AM benchmarking survey; McKinsey Navigating the Storm survey

Across six key cost levers, "decisive operators" see much greater impact

	Trimming the sails		Decisive operator	
1 **Non-comp expense reduction**	▪ Renegotiate largest vendor spend	5-10%	▪ **Manage demand** through strong governance, incl. central visibility and transparent tracking across businesses / functions	30%
2 **Lean operations**	▪ Identify key pain points and processes that need to improve	5-10%	▪ Redesign and simplify **end-to-end processes across businesses / functions** such as account set-up, data management, and reconciliation	30%
3 **IT management**	▪ Look for savings opportunities in ADM[1] or delay select projects	10%	▪ Apply **lean principles to ADM and infrastructure** to shorten development cycle times and improve requirements gathering	30%
4 **Support function redesign**	▪ Top-down headcount reductions	10%	▪ Pool support functions into **shared services**	30%
5 **Workforce optimization**	▪ Reduce compensation based on market benchmarks	10%	▪ Optimize the workforce by **eliminating layers** and working within defined **spans-of-control**	30%
6 **Structural changes**	▪ Selectively consolidate some middle- and back-office functions	20%	▪ Refine footprint and **exit unprofitable markets**	60%

1 Application Development and Maintenance

By attacking all six levers, "decisive operators" can substantially reduce their cost base

Heavy impact
Medium impact
No impact

Where the impact is felt most

	Personnel	IT	Operations	Other Opex	Potential savings on addressable cost base (Percent)
1 Non-comp expense reduction	No impact	Heavy impact	Heavy impact	Heavy impact	5–30
2 Lean operations	Heavy impact	No impact	Heavy impact	Medium impact	5–30
3 IT management	Heavy impact	Heavy impact	No impact	No impact	10–30
4 Support function redesign	Heavy impact	No impact	No impact	Medium impact	10–30
5 Workforce optimization	Heavy impact	No impact	No impact	Medium impact	10–30
6 Structural changes	Heavy impact	Heavy impact	Heavy impact	Heavy impact	20–60
~Share of cost base	35–40	15–20	10–15	25–30	

1 Non-comp expense reduction – Market Data example

Typical savings levers

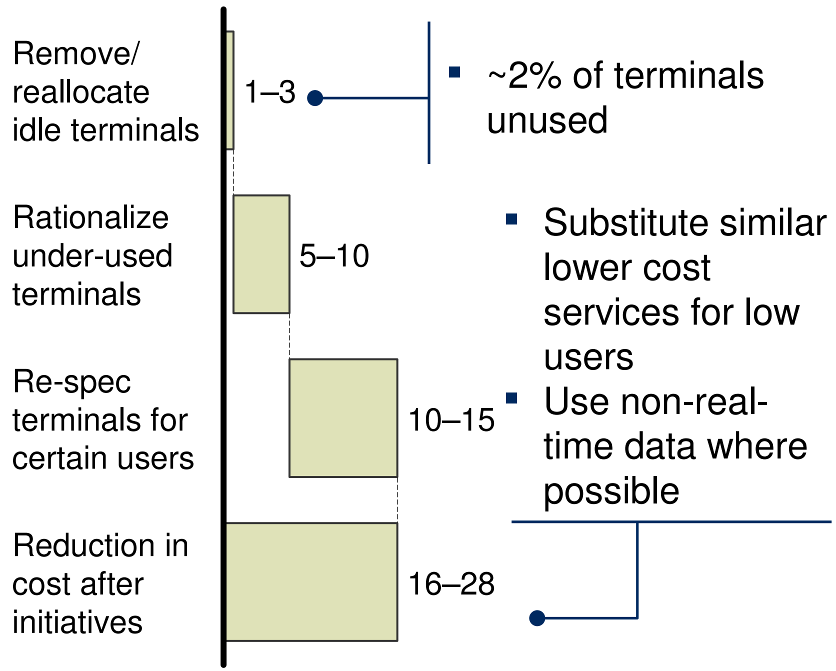
TCO approach

- **Vendor**
  - Consolidate vendor spend
  - Move to intranet based
  - Lower rates
- **Demand management**
  - Remove underused products
  - Downgrade low users
  - Eliminate unused add-ons
  - Identify substitutes
- **Compliance**
  - Ensure compliance
  - Publish internal benchmarking
- **Process management**
  - Monitor spend centrally and transparently

Case example

Total market data savings opportunities

Percent of total MDS spend base



Typical cost savings of 10–25%

2 Lean techniques across the value chain

Product development	▪ Install **lean requirements definition** process with a set of go / no-go points between Ops & Technology and the product groups before product launch
Investment management	▪ Improve **cycle time of innovation** and pre-trade investment ideas ▪ **Implement cost, quality and service** metrics to manage vendor performance
Asset management operations	▪ Implement **common workflows** to simplify process and reduce waste
Fund administration	▪ Optimize staff locations to **load balance and segment complexity** by asset type
Client Service	▪ **Consolidate redundant functional units** (e.g., transfer agency processing groups)

4 Finance redesign can drive 20–30% cost savings

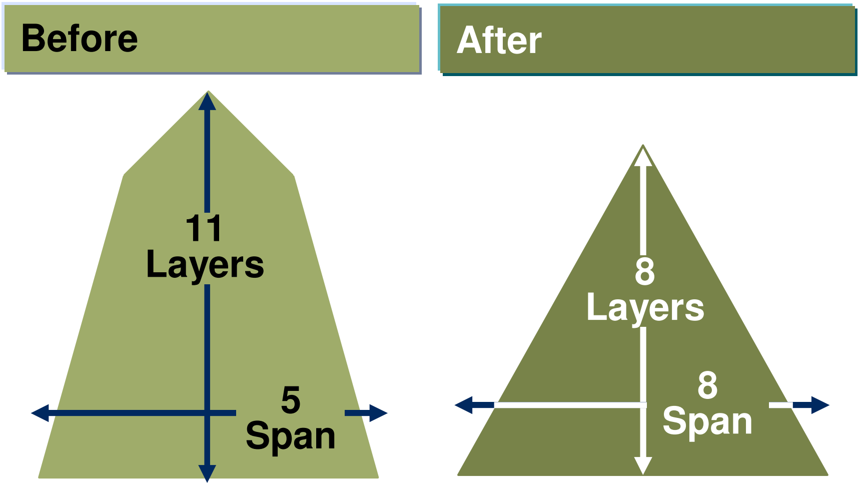
Organizational
Cost

Focus	Best practice	Typical savings
Operating model/ consolidation	▪ ~75% of finance activities conducted in shared services	4–5%
Organizational streamlining	▪ Min. span of control 5:1; dedicated finance support removed for smaller businesses	3–5%
Location strategy	▪ 30–40% of finance FTEs offshore or nearshore over 3 years	8–10%
Process redesign/ automation	▪ Redesign key finance processes to capture ~40% efficiency based on pilots launched in 8–10 weeks	8–10%
External spend management	▪ International operations reviewed by locally staffed auditors and billed at prevailing rates (e.g., Indian audit billed at rates 20–30% of Europe)	1–2%
Demand management	▪ Inventory of management reports scored on customer value-added ranking; 30% eliminated	2–3%

5 Workforce optimization – Spans and Layers

Optimizing Spans and Layers

- Reduce compensation costs by 10–20%
- Improve speed and agility
- Help create a stronger performance culture with clear accountability
- Clarify career paths and increase employee satisfaction and retention



Typical Spans and Layers process

- Align on **targets by area** and toolkit
- Identify areas with **low spans of control**
- Identifying areas to **delayer management**
- **Evaluate tradeoffs** and select the **desired end state**
- Develop **scorecards** to monitor progress

There are several success factors for sustained cost cutting efforts

Percent of respondents (total respondents = 2,994)

	What would you change next time in your transformation?	Response rank (1 = most popular)
1 **Set high aspirations**	▪ Set clearer targets	1
	▪ Set a higher aspiration	9
2 **Align the senior team**	▪ Spend more time developing and communicating a 'change story'	3
	▪ Have stronger alignment of the top management team	5
3 **Take a holistic approach**	▪ Focus more effort on creating a culture of change (ensure people resistant to change are engaged)	4
	▪ Gain more buy-in and personal leadership from the CEO	10
4 **Focus on business unit ownership**	▪ Spend more time engaging the workforce	2
	▪ Gain earlier 'success stories' to demonstrate the impact and potential	7
5 **Use disciplined program governance**	▪ Allocate more resources from the start	6
	▪ Better planning and preparation (e.g., be ready to integrate with organization, create a clear roadmap)	8

SOURCE: McKinsey Quarterly Performance Transformation Survey, July 2008

Key messages

1 2009 marked a decade low in AM margins

2 Excellence in business management, not just investment management, is now required for firms to build a robust operating model

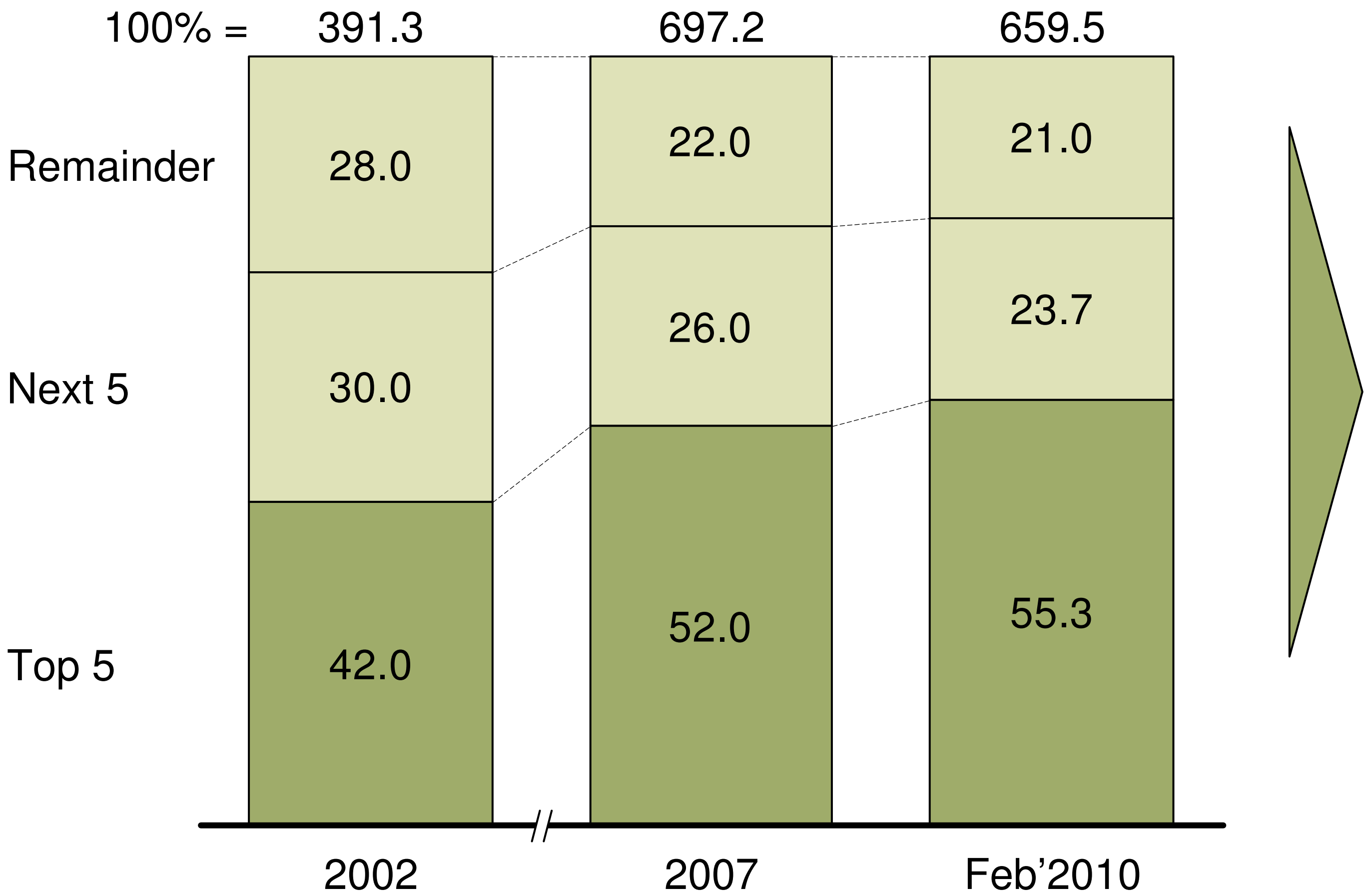
3 **Looking ahead, despite a lot of uncertainty, the asset management market can be an opportunity-rich environment for firms that can capitalize on 5 structural shifts**

There are a number of opportunities created by structural shifts that have and will continue to shape the future of asset management

1 **The industry is becoming increasingly concentrated and dominated by bank-owned players in Canada and “pure plays” in the US due to faster organic growth and acquisitions**

Recent market conditions have accelerated consolidation in the Canadian retail asset management market

Total mutual fund AUM
Cdn $ Billions, Percent

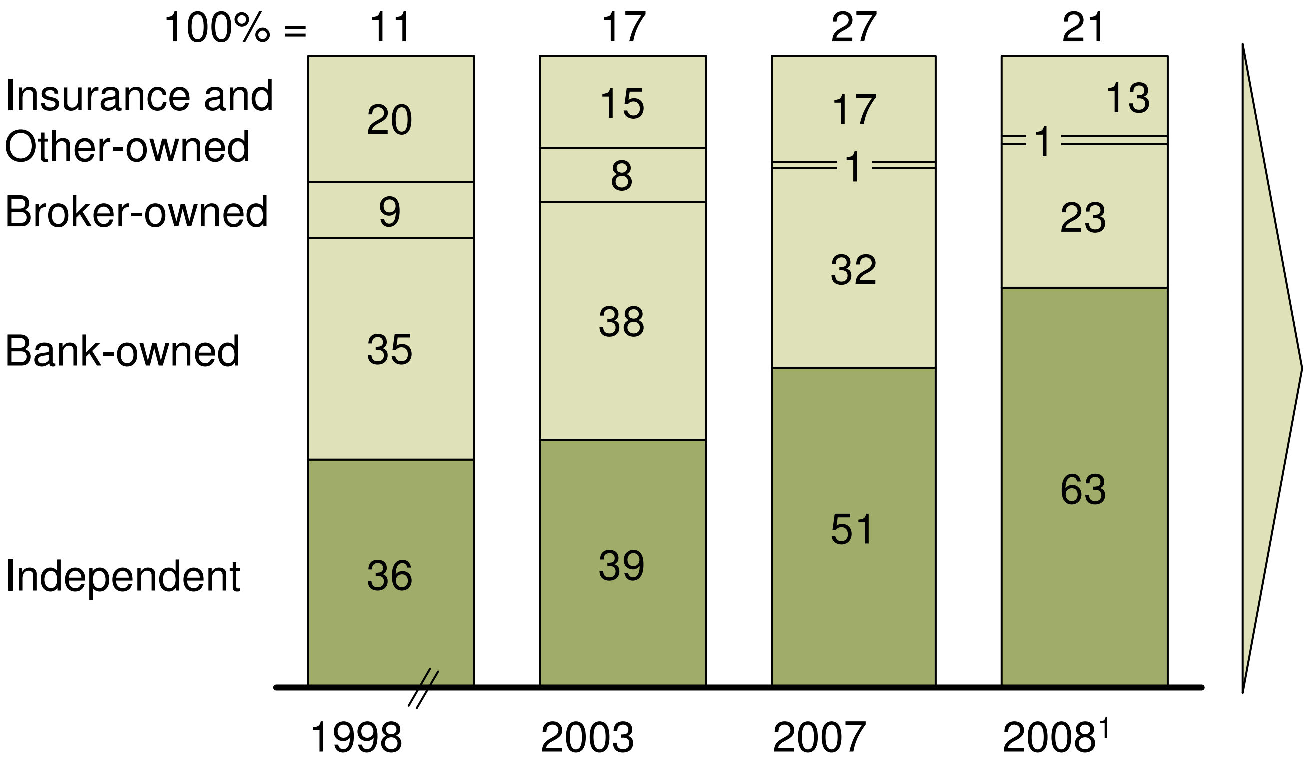


- The top 5 players have 55% of the market share, 13% more than they had in 2002
- In the past 2 years, the top 5 have increased market share by ~3%
- Distribution is key to gaining market share- all of the top 5 players have dedicated distribution

Source: IFIC Canada; CI Financial

In the US, the AM industry is more concentrated and dominated by independents that have gained share through fast organic growth and recent M&A deals

Asset share of top 50 US Asset Managers by Ownership
Percent, $ Trillions



Share increase from 2003 driven 10% by organic growth, 14% by acquisitions

SOURCE: Institutional Investor; SNL Financial; McKinsey

There are a number of opportunities created by the structural shifts that have and will continue to shape the future of asset management

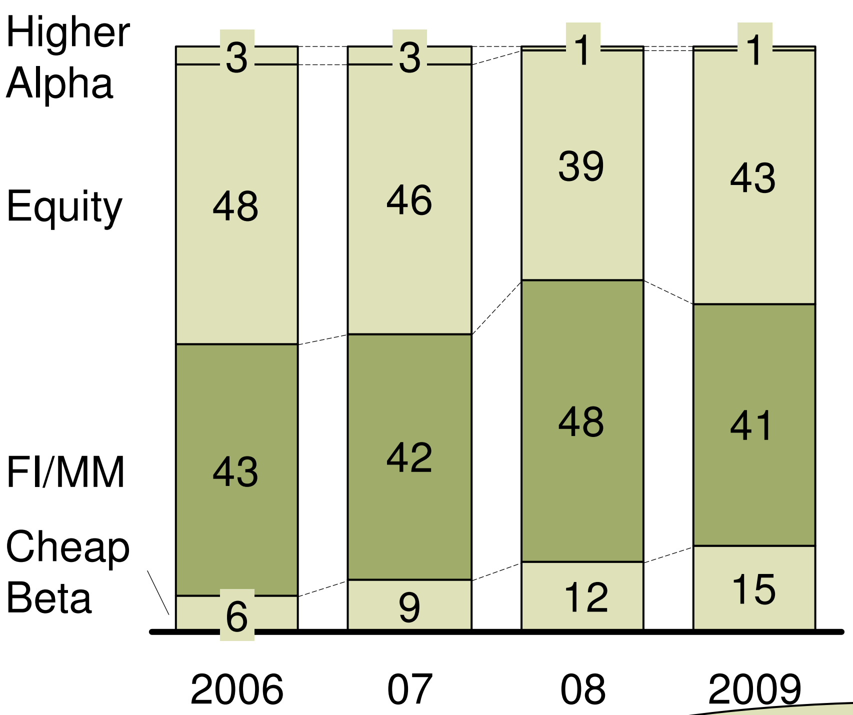
1. **The industry is becoming increasingly concentrated and dominated by bank-owned players in Canada and "pure plays" in the US due to faster organic growth and acquisitions**

2. **Secular shifts in allocations and investor expectations will enable those managers who can adapt to capture share and offset impact of deteriorating revenue mix**

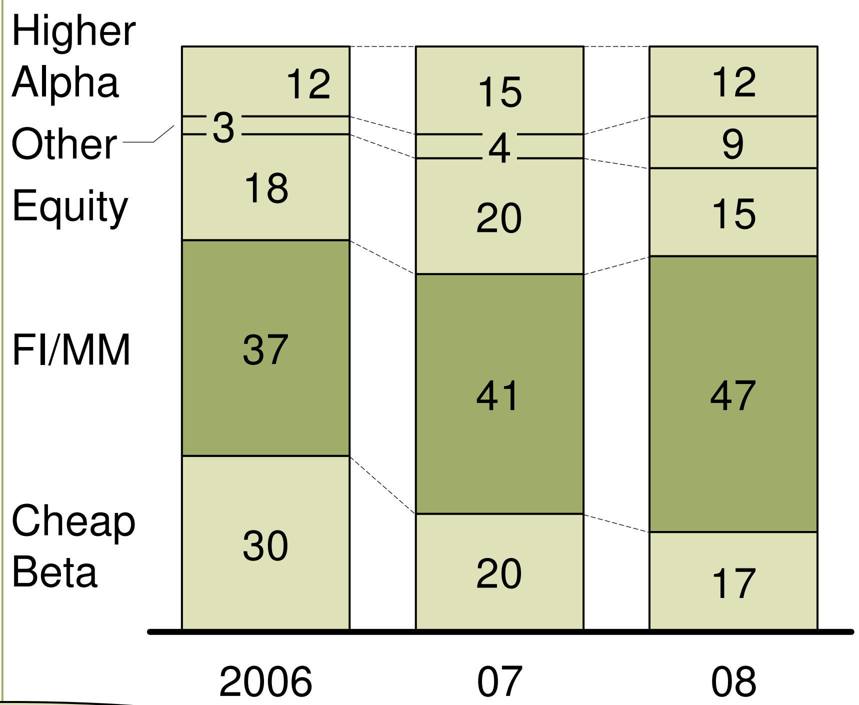
While 2008's dramatic shift in asset mix has started to reverse somewhat, overall revenue yields are unlikely to reach previous levels

Percent

Retail mix of assets



Institutional mix of assets

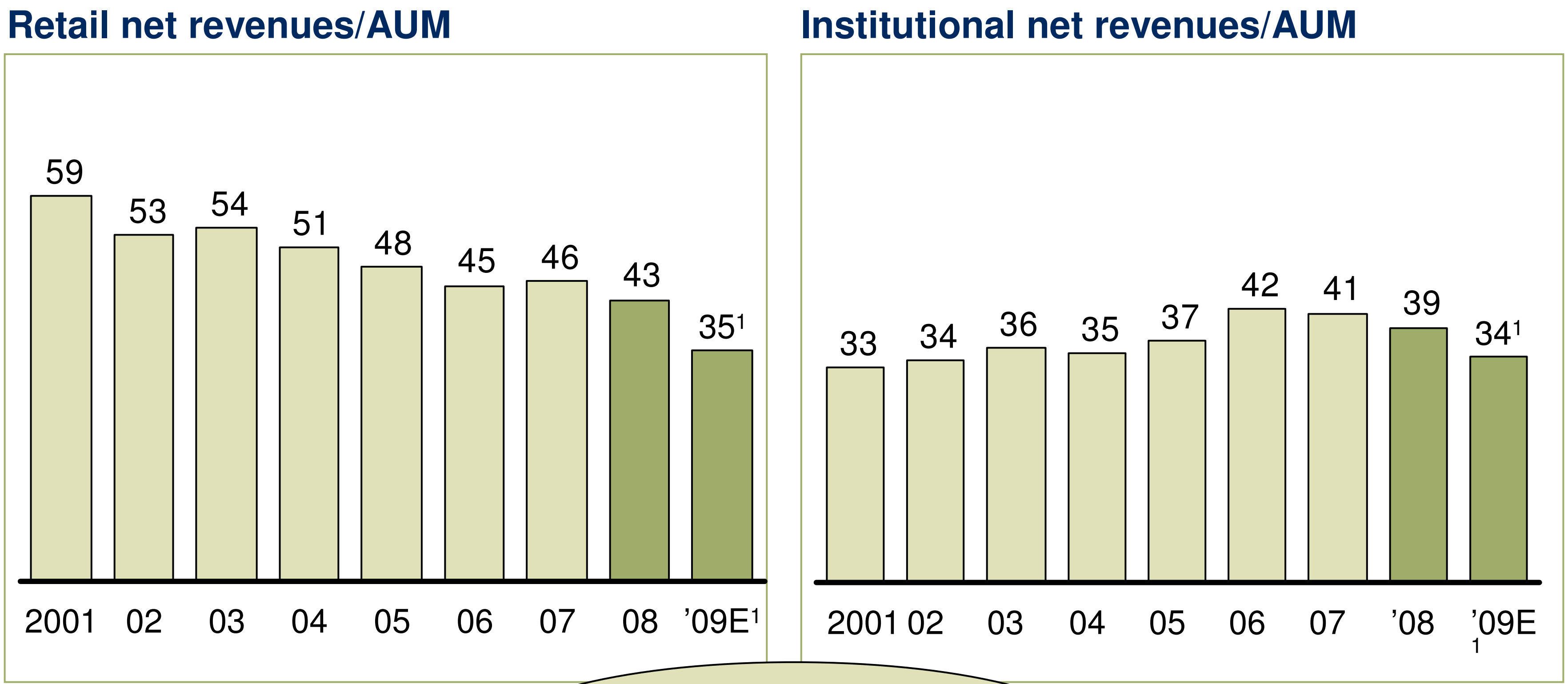


Shifts in asset allocation and declining yields could drive revenue yields lower by as much as 25% over the next 5 years

SOURCE: 2009 McKinsey/USI AM benchmarking survey; Strategic Insight Simfund MF (2008-2009 Retail); P&I

Net revenue yields in retail and institutional AM have declined from their peak

Bps



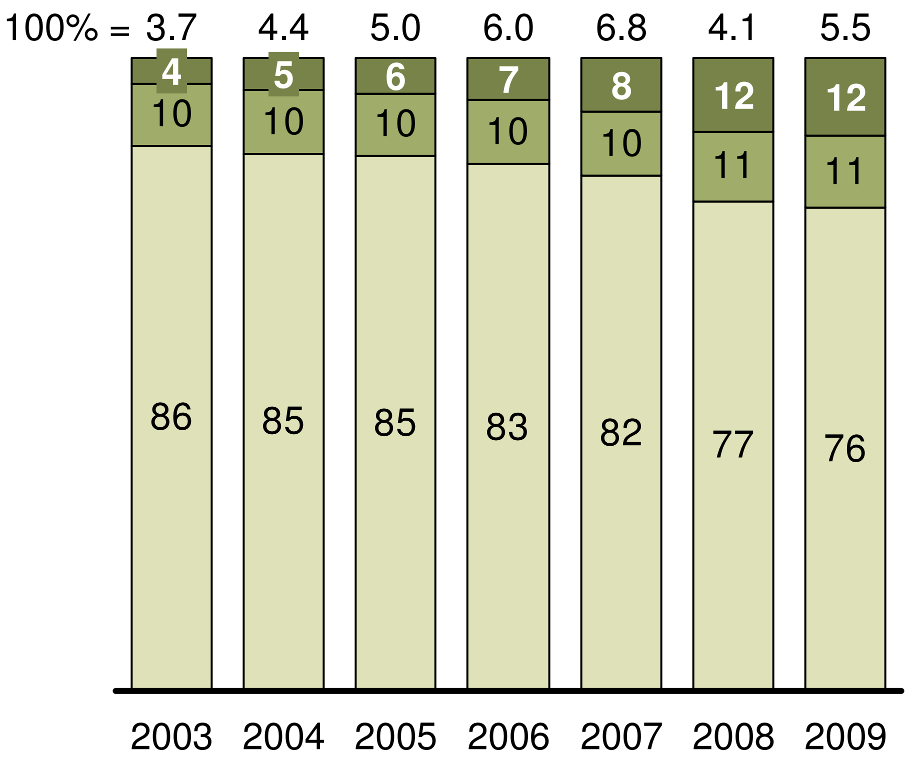
Decline due to lower revenue yields and changing asset and product mix

1 2009 based on publicly listed players only, Retail = Eaton Vance, Federated Investors, Franklin Templeton, Invesco, Janus, T Rowe Price, US Global Investors and Waddell & Reed; Institutional = Affiliated Managers Group, AllianceBernstein, Artio Global Investors, Calamos, Pzena, and Virtus Investment Partners

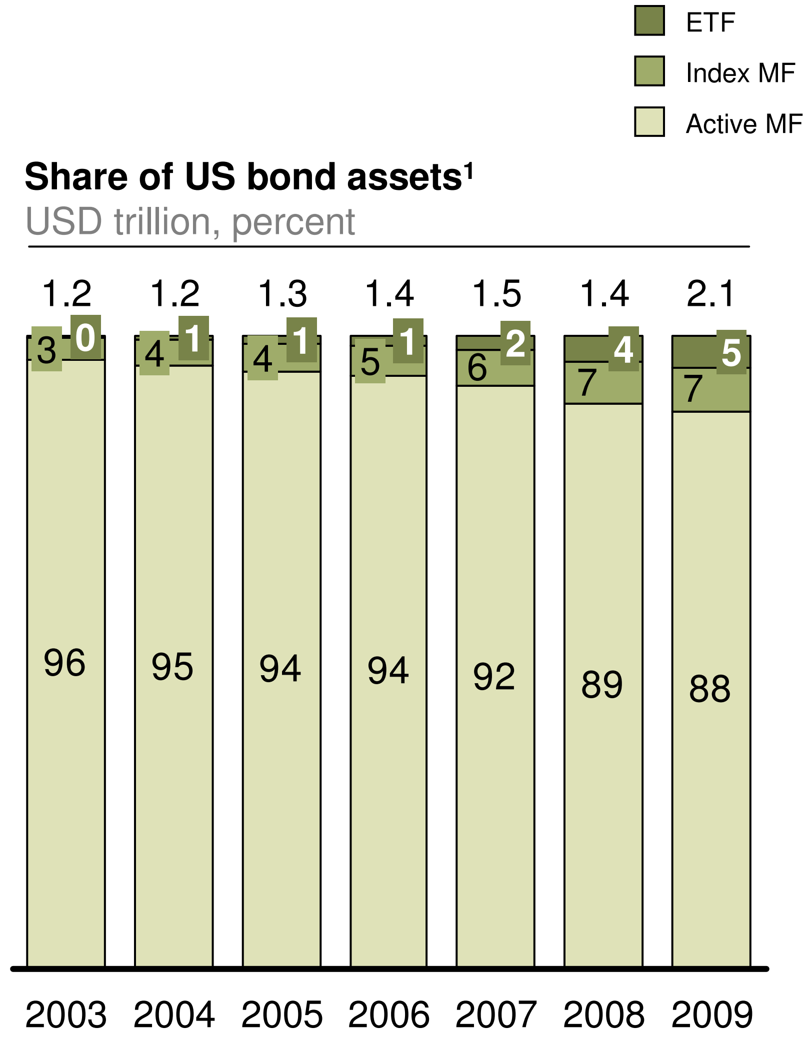
SOURCE: 2009 McKinsey/USI AM benchmarking survey; SNL Financial

In most developed markets, share of low priced ETFs and index funds has grown rapidly

Share of US equity assets[1]
USD trillion, percent



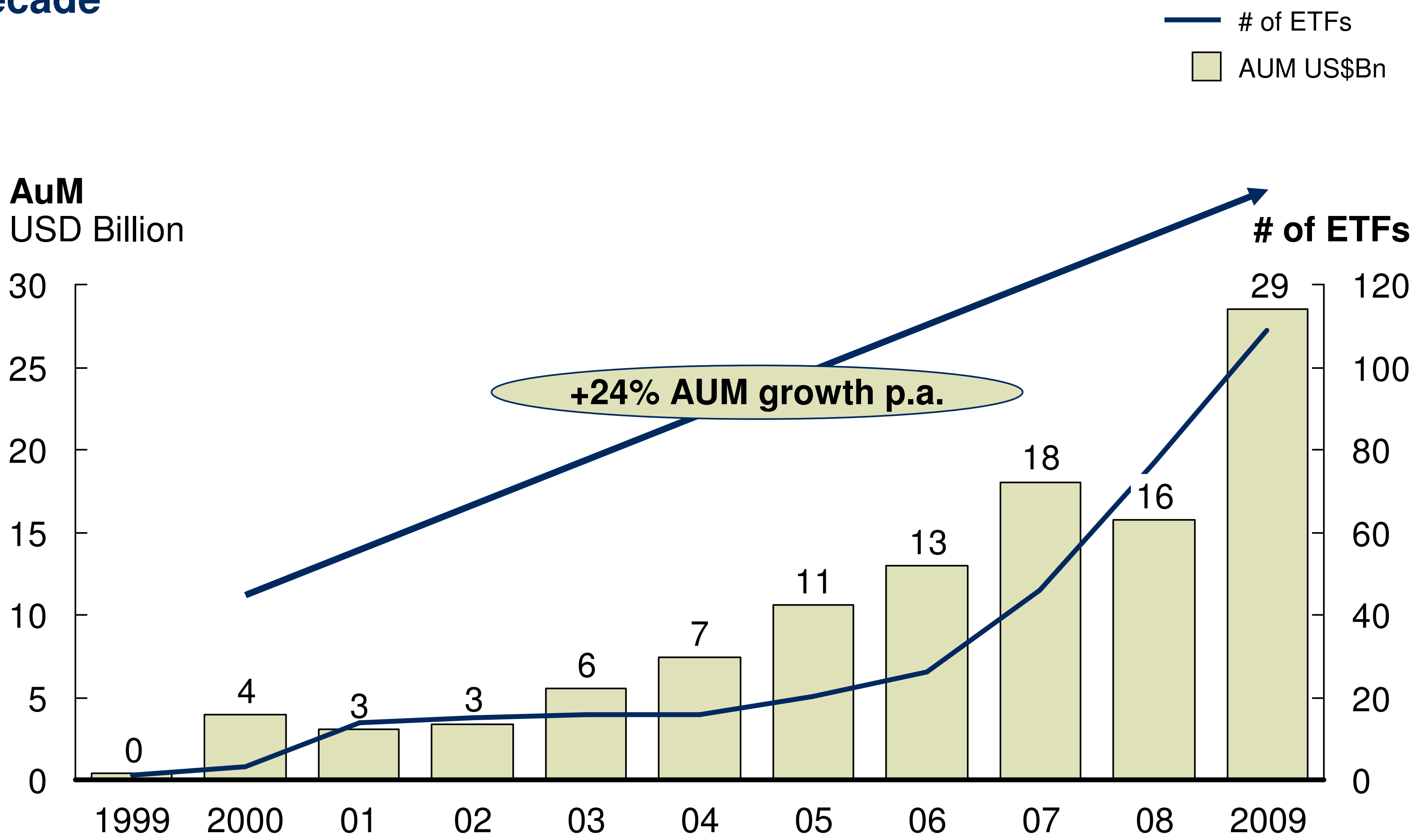
Share of US bond assets[1]
USD trillion, percent



1 Excludes fund of funds and closed-end funds. ETF assets include both open-end and UIT vehicles and active as well as passive ETFs. There were $80 million in active bond ETFs and $58 million in active equity ETFs at year-end 2009.

SOURCE: Strategic Insight Simfund MF

In Canada, ETFs have also experienced explosive growth over the past decade



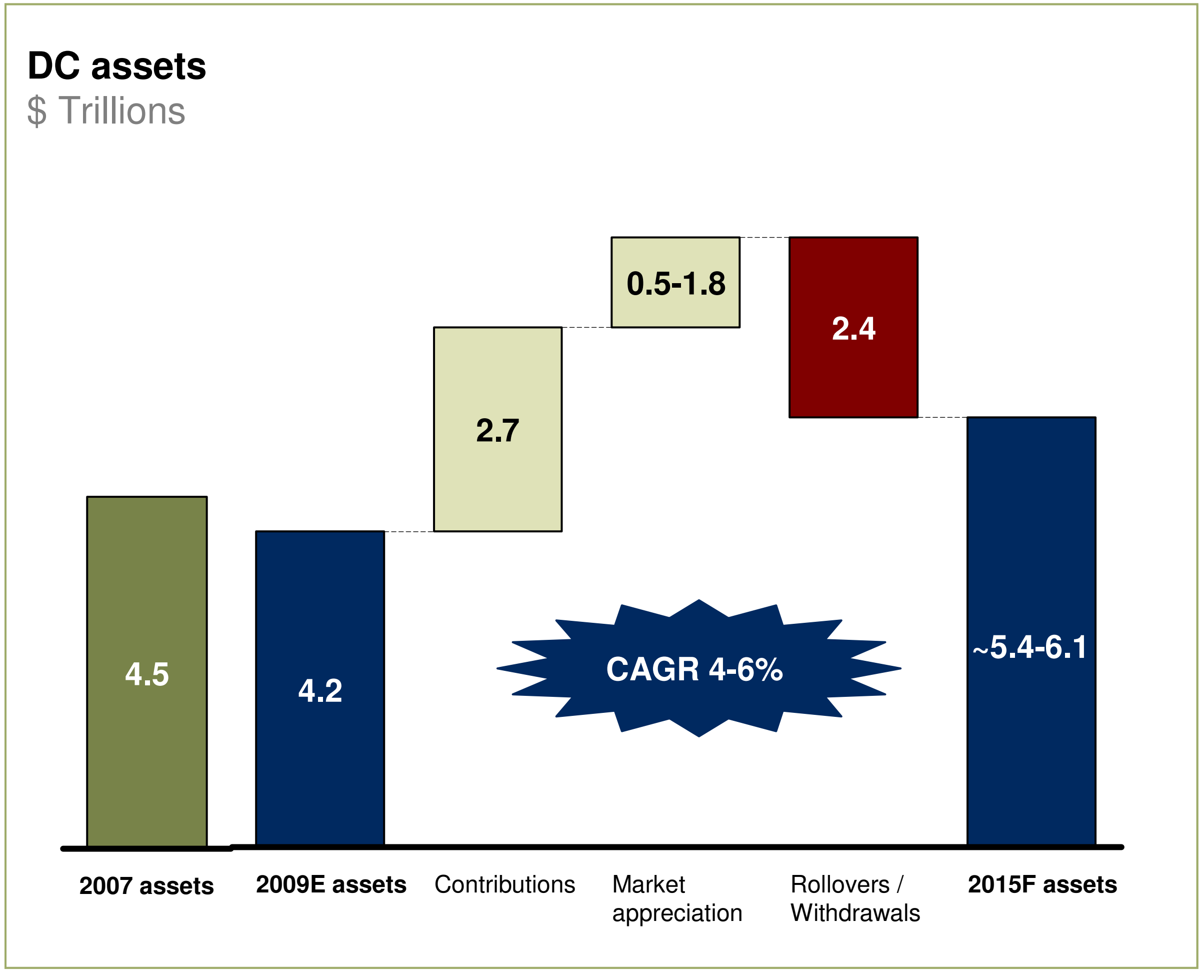
There are a number of opportunities created by the structural shifts that have and will continue to shape the future of asset management

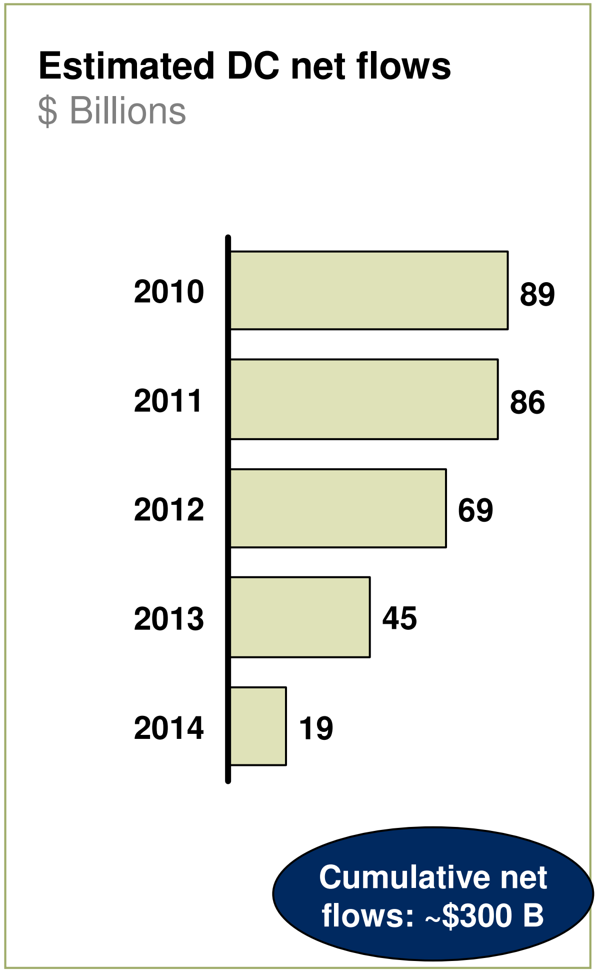
1. The industry is becoming increasingly concentrated and dominated by bank-owned players in Canada and “pure plays” in the US due to faster organic growth and acquisitions

2. Secular shifts in allocations and investor expectations will enable those managers who can adapt to capture share and offset impact of deteriorating revenue mix

3. Proven resilience of qualified funds and a reinvigorated push towards open architecture demands a targeted DC strategy

DC assets likely to return to '07 levels by 2011 and approach $6 T by 2015

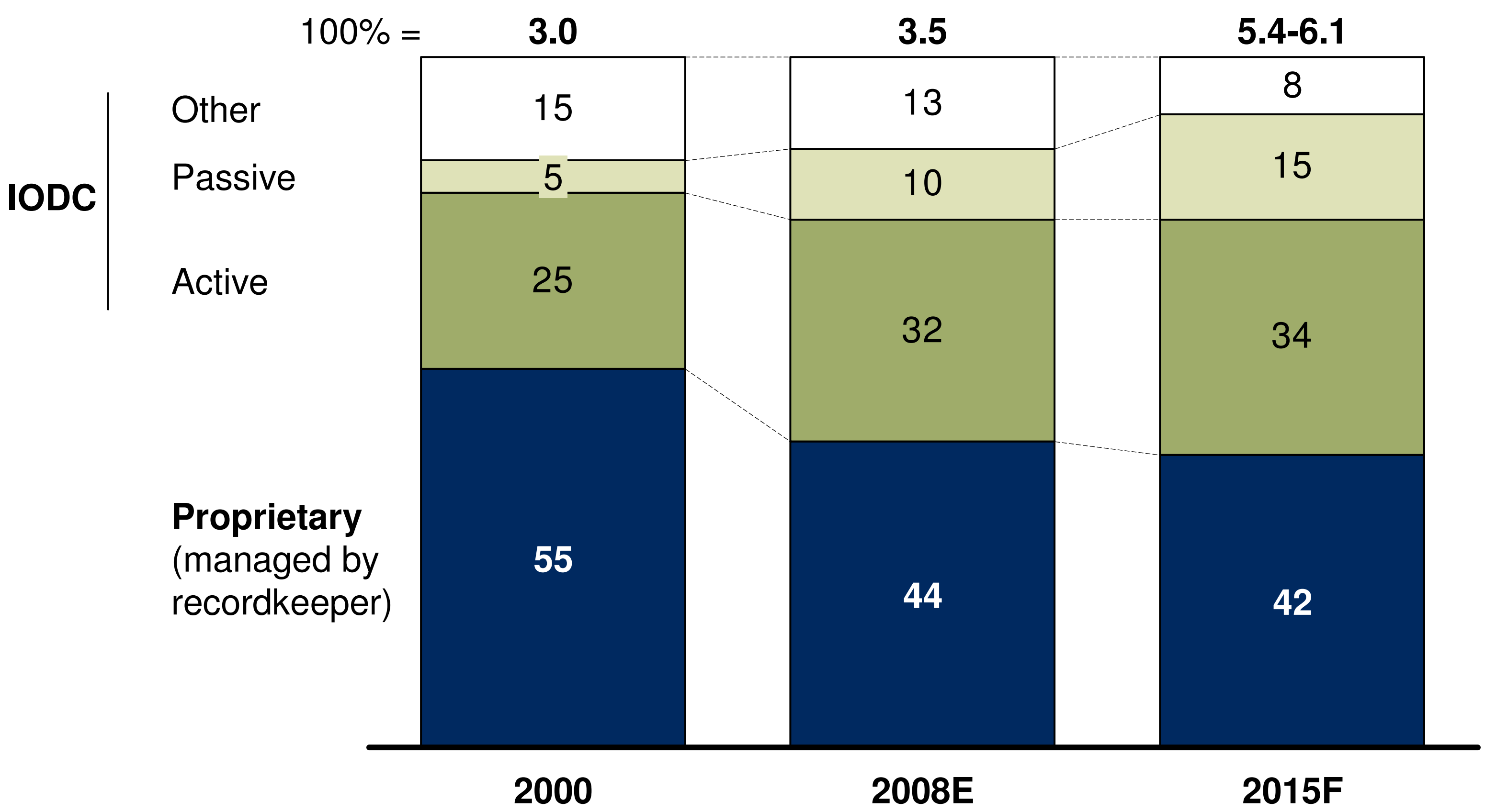




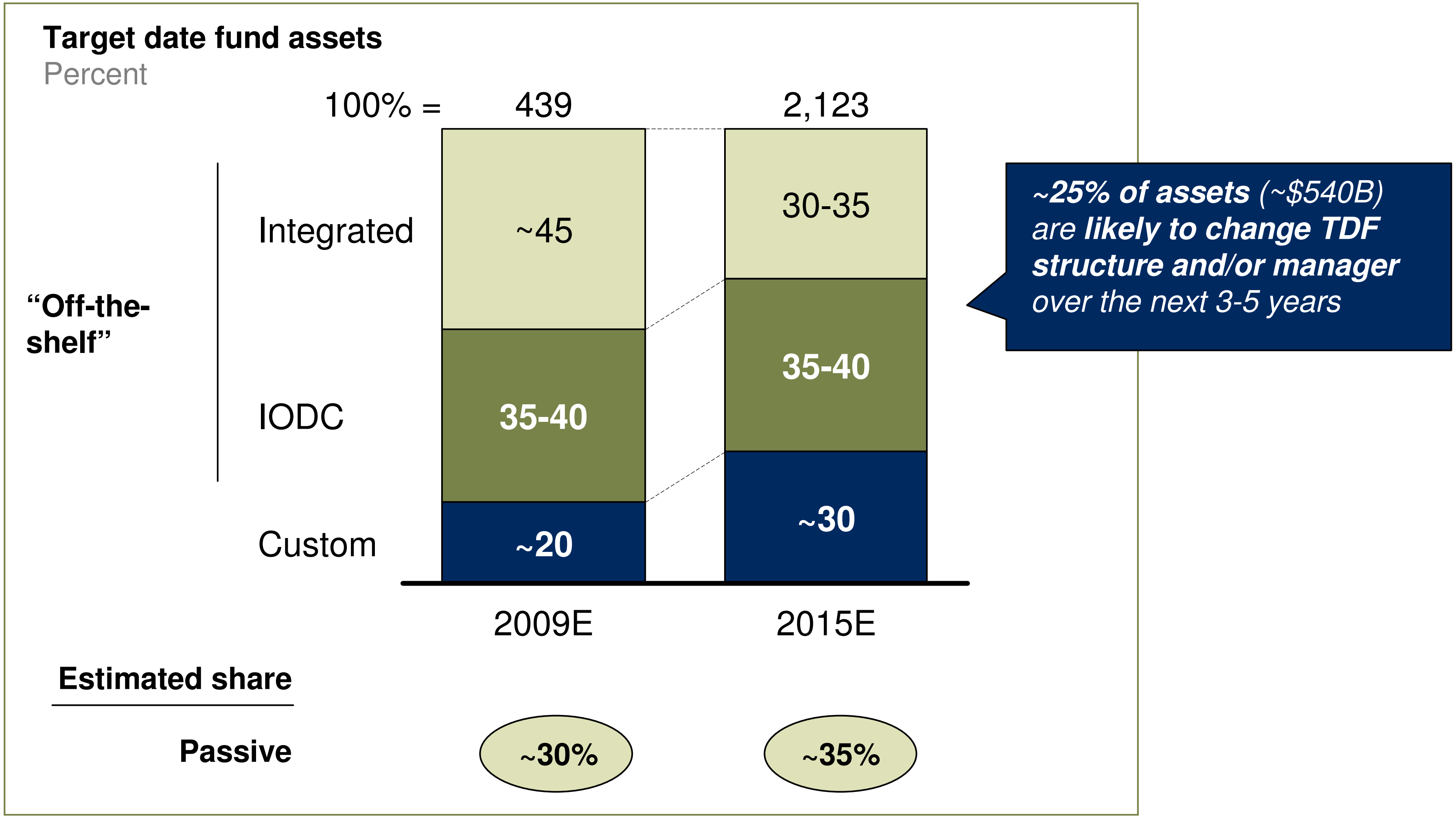
SOURCE: ICI; American Benefits Council; Vanguard; J.P. Morgan Asset Management

Crisis reinforced shift to open architecture and by 2015 IODC players will control ~50% of the market

DC assets managed by type of investments
Percent, U.S.$ Trillion



This shift to open architecture and the growth in customized solutions will create opportunities for IODC managers



SOURCE: Casey, Quirk/PSCA Target date fund survey; McKinsey

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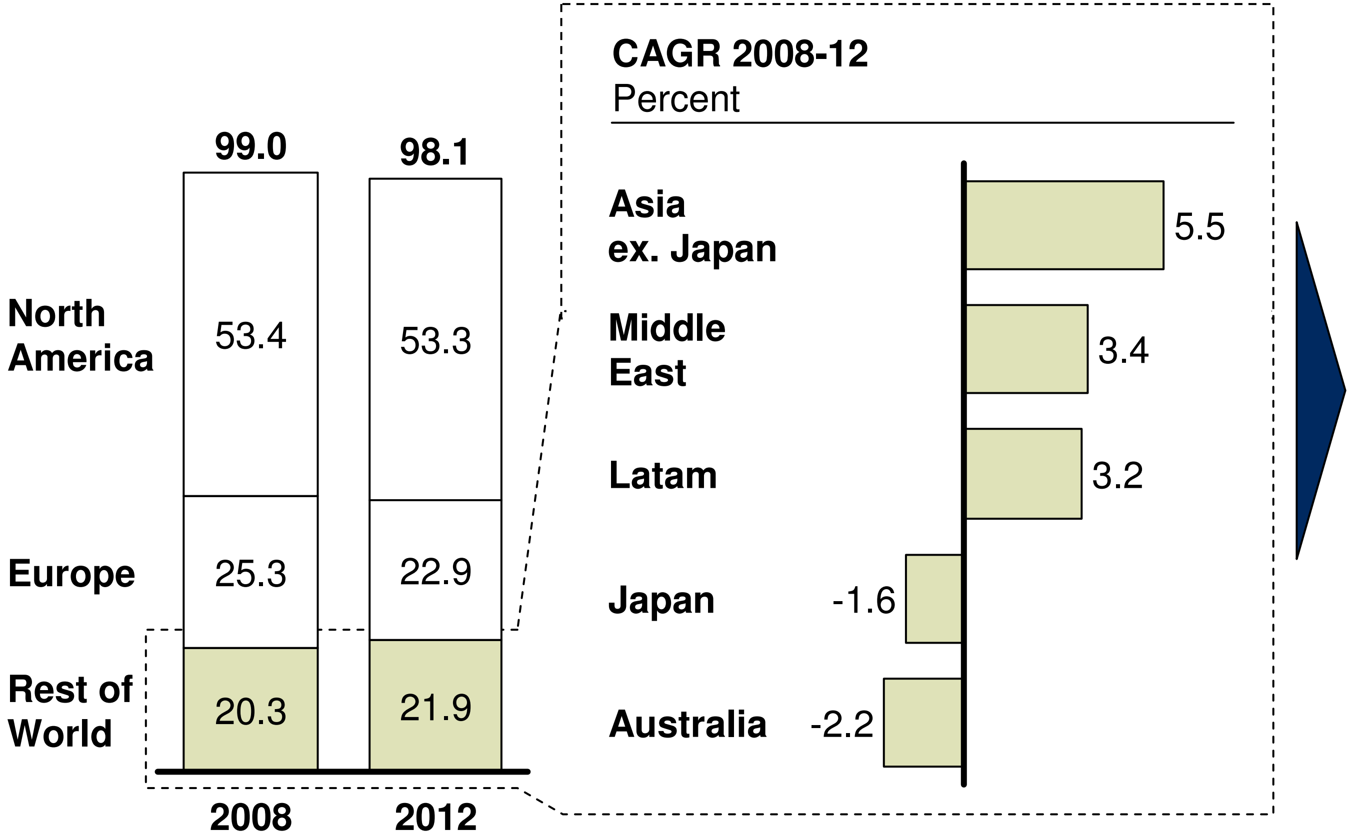
3. **Proven resilience of qualified funds and a reinvigorated push towards open architecture demands a targeted DC strategy**

4. **Emerging markets and Sovereign (Wealth) Funds will continue to represent one of the largest sources of global assets over the next five years**

Revenue pools in the developed AM markets will be flat through 2012; largest pockets of growth are in emerging markets

Revenue pools, EUR billions

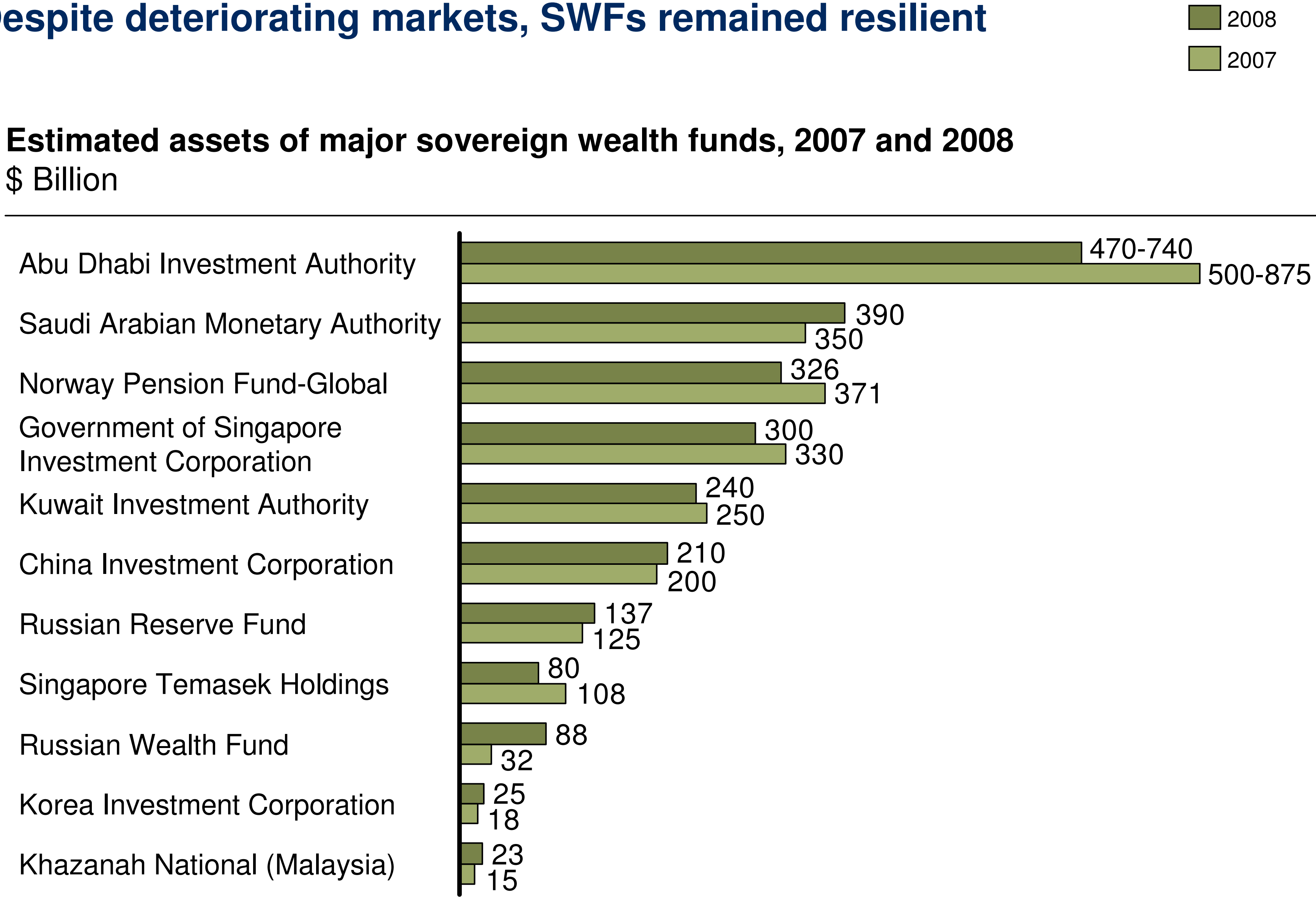


- **Assets likely to recover earlier, however both North America and Europe are under price pressure**
- **Emerging RoW countries are offsetting lower growth of developed countries**

SOURCE: McKinsey Asset Management Practice

Despite deteriorating markets, SWFs remained resilient

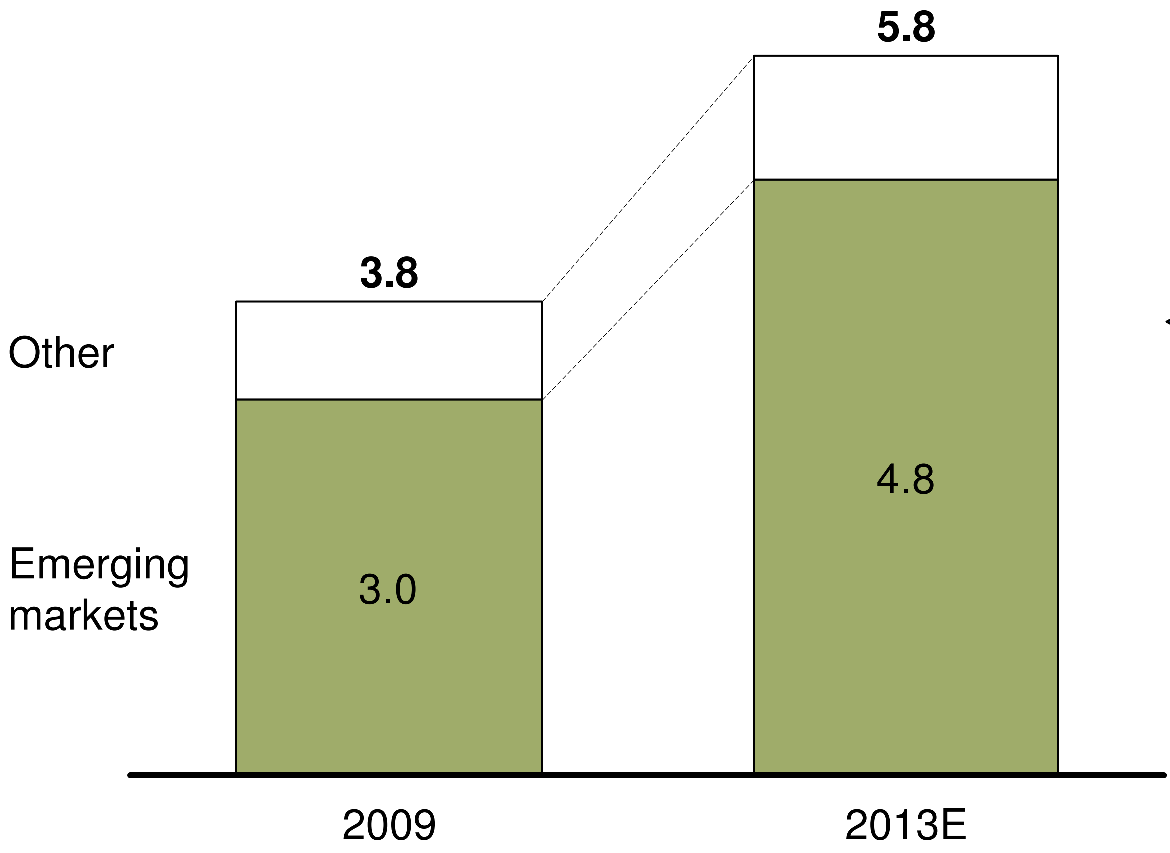
Estimated assets of major sovereign wealth funds, 2007 and 2008
$ Billion



SOURCE: Press releases; interviews; McKinsey Global Institute analysis

By 2013, Sovereign wealth fund assets could be equivalent to half of the current institutional AUM

Sovereign wealth fund assets, 2009 and 2013
$ Trillion



Q3 2009 institutional AUM is ~$9.5 T

SOURCE: International Monetary Fund; Sovereign Wealth Fund Institute; McKinsey Global Institute analysis

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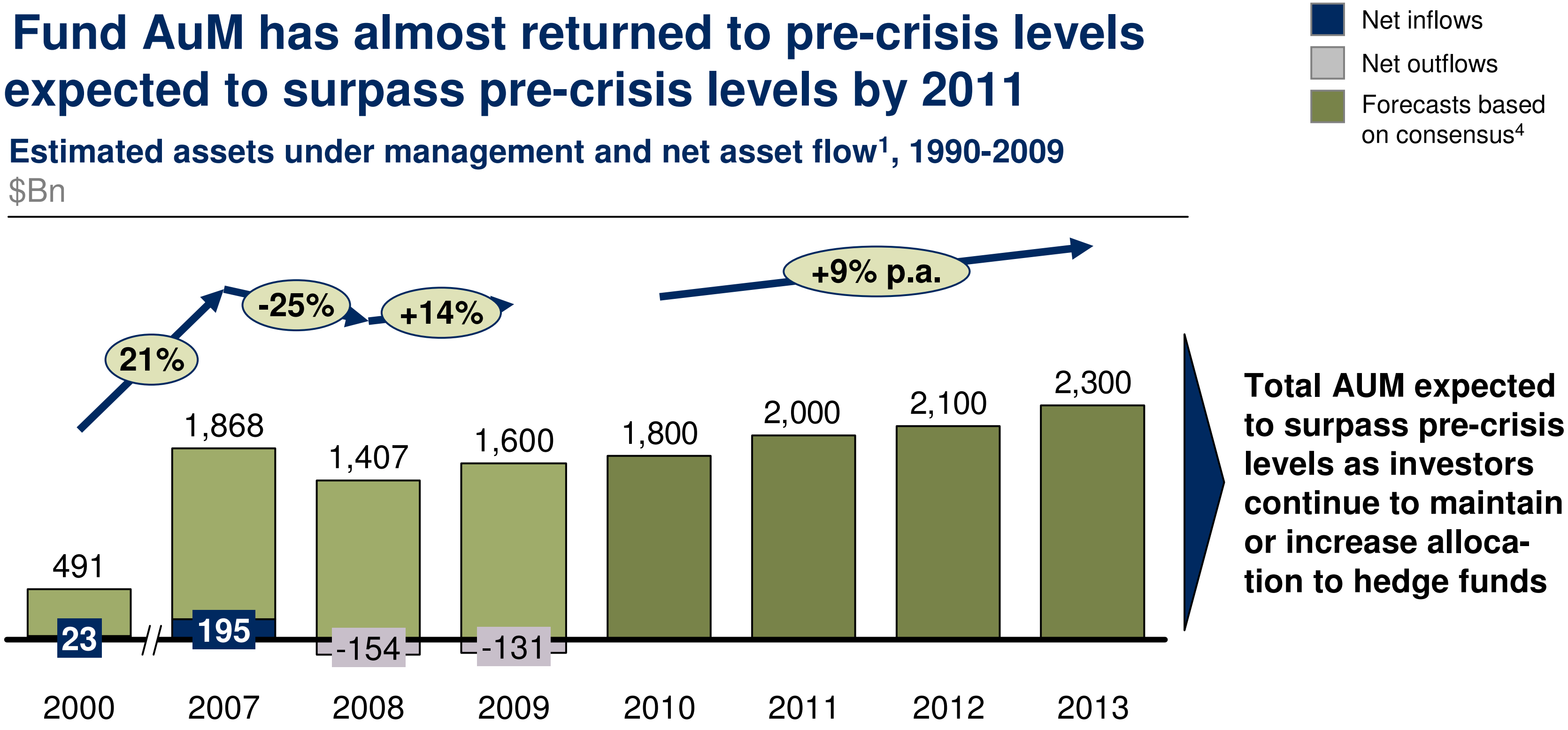
5. **Alternative asset classes will continue to gain market share as investors continue to seek diversification and uncorrelated returns – however, at reduced fees and with increased transparency around reporting and performance**

Hedge Fund AuM has almost returned to pre-crisis levels and is expected to surpass pre-crisis levels by 2011

Estimated assets under management and net asset flow[1], 1990-2009
$Bn



Total AUM expected to surpass pre-crisis levels as investors continue to maintain or increase allocation to hedge funds

Flow as % of prior year-end balance 5.1 13.3 -8.3 -9.3

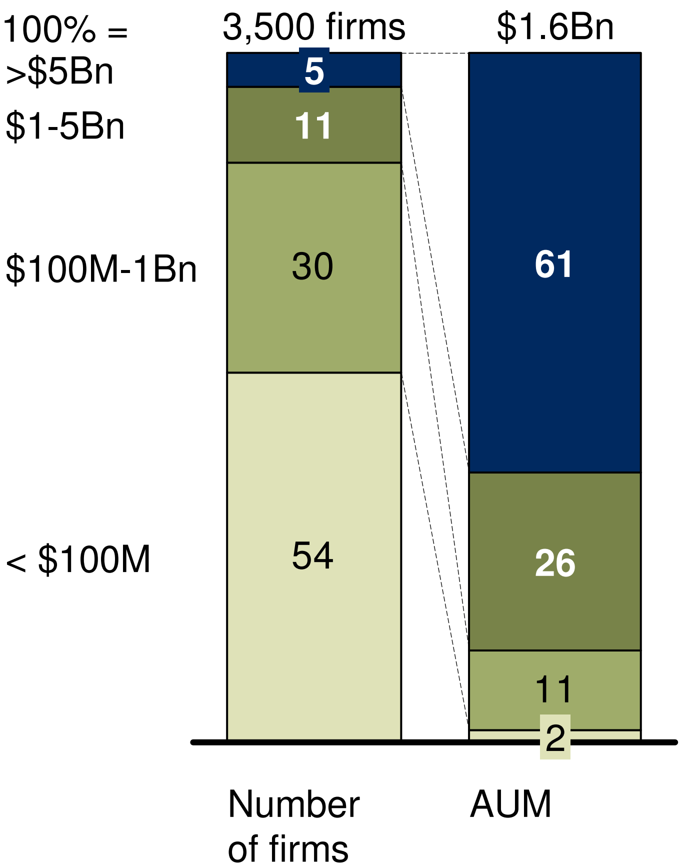
- **Performance drove ~$320Bn of AUM growth;** on average, funds returned 20% in 2009[2]
- **Net outflows across all major strategies;** long/short equity, relative value and event driven strategies each suffered ~10% net outflows in 2009

1 Excludes funds of funds
2 HFRI Fund Weighted Composite Index
3 Range of estimates exists, e.g. Hedgefund.net estimates 2009 year-end assets to be $2.04 tn vs. 2007 year-end figure of $2.86 tn
4 McKinsey Global Institute estimates based on economy consensus scenario – GDP growth resuming mid-2010

Hedge Fund assets are concentrated in largest funds, many of which are multi-strategy

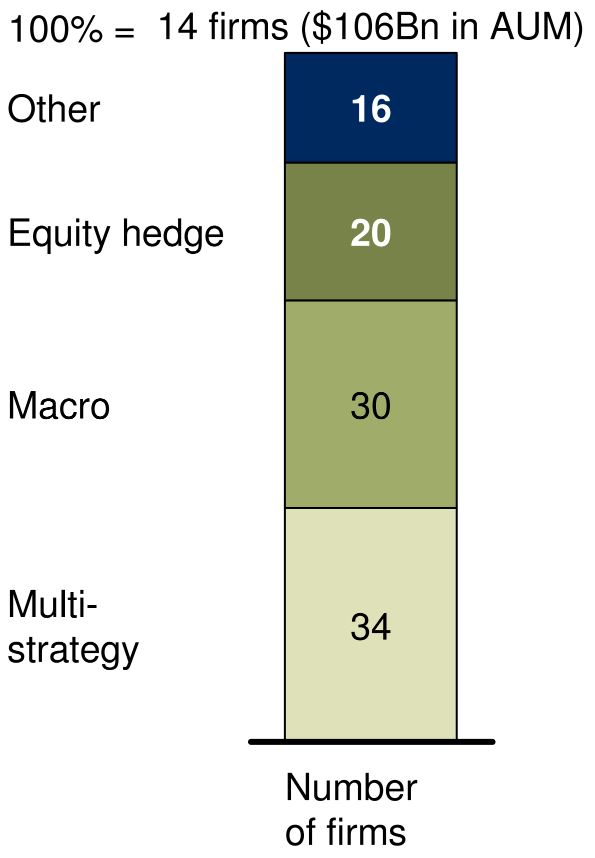
Concentration of assets under management by firm size[1]

Percent ($Bn), 2009



Firms with >$5Bn by strategy

Percent, 2009



- Banks catering to larger funds will have significantly more **scale advantage**
- Catering to larger funds will likely necessitate **cross-product capabilities** as over one-third of funds with >$5Bn in assets are multi-strategy funds

1 Excludes funds of funds

SOURCE: HFR; Eurekahedge; McKinsey analysis

Strategic questions for asset managers to address

A How will you ensure that the **costs cut out over the past 18 months do not creep back**, such that you can ensure that you have **materially changed your operating model?**

B How well positioned is your firm to deliver **net new assets in excess of market appreciation**? Is there alignment (and resourcing) around the 4 to 5 big asset flow categories (e.g., DC, SWF, Retail) over the next 3 years?

C What are the **major changes in client demand** (e.g., LDI, retirement solutions, volatility and risk management), what are the implications for secular asset allocations and is your firm carving out a leadership position?

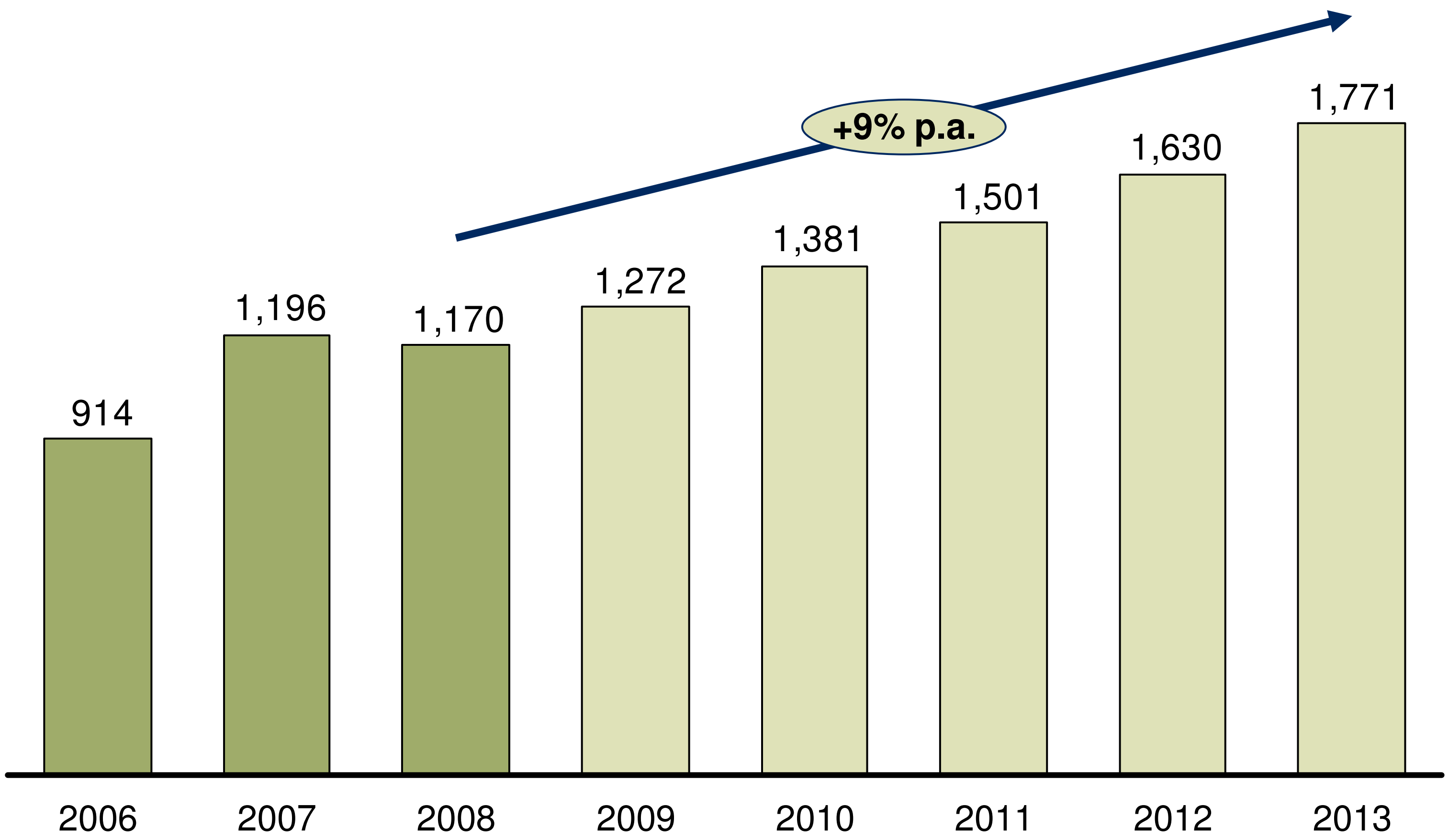
D How is your **firm organized, resourced, and compensated to go after big 'strategic' opportunities** (e.g., BU vs. corporate funding, products vs. sales, multi-boutiques vs. integrated) and what needs to change to improve execution?

E How will **bank/insurer-owned asset managers need to position themselves differently to clients vs. pure plays** to differentiate and now that pure plays are dominant, how will they distinguish themselves?

Appendix

The Australian DC market is expected to grow at 9% per annum for the next 5 years

Australia DC AUM (2006 – 2013)
$ Billion

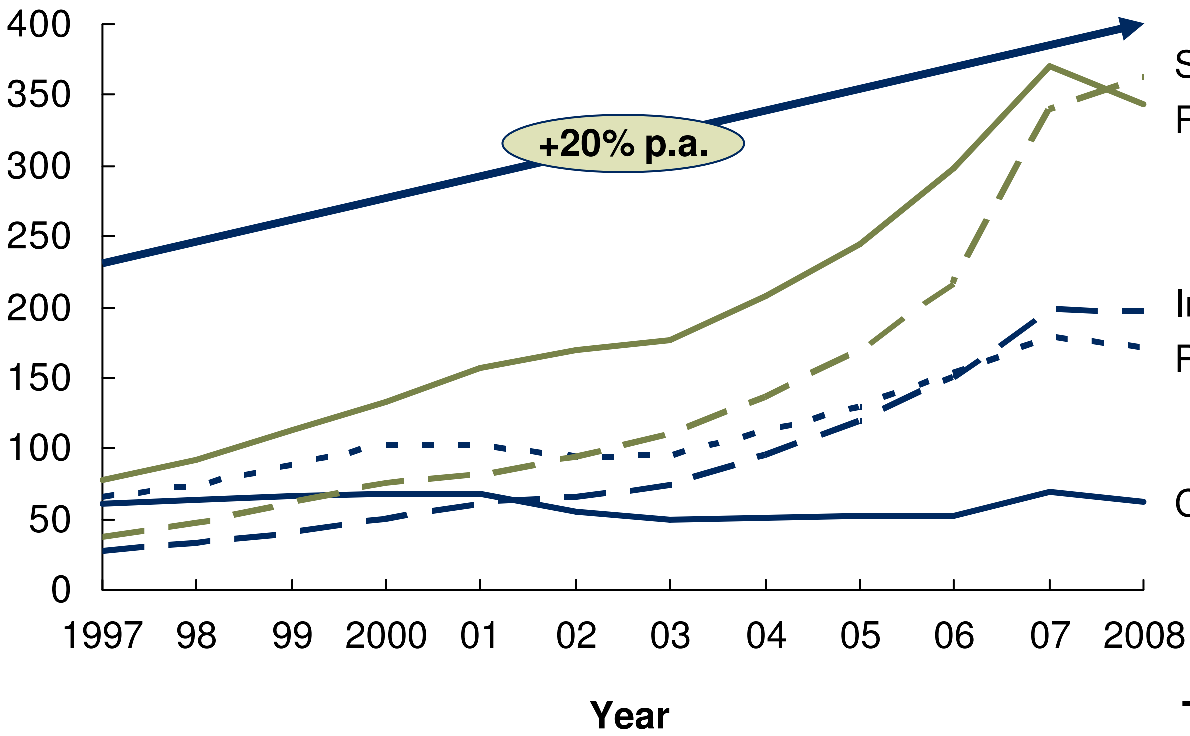


SOURCE: McKinsey Retirement Practice; APRA; IBIS reports; team analysis

The Retail, SMSF and Industry segments have grown the fastest, however the Corporate segment has stagnated

AUM by segment over time

Assets, AUD Billion



	1997-2008 CAGR	2008 Market share, %
Small/SMSF	23.3	31.9
Retail	14.4	30.3
Industry	19.8	17.4
Public sector	9.1	15.0
Corporate	0.2	5.5
Total	**23.3**	**100.0**

- The SMSF[1] and Retail plans account for almost 2/3rd (62%) of the market
- Current DC business is focused on the corporate segment, which has not grown over time

1 Self Managed Super Funds are limited to a maximum of 4 participants; tend to be higher net worth individuals

SOURCE: Australian Prudential Regulation Authority