Peter Cherecwich is the EVP and Head of Global Funds Services for Northern Trust. This is an executive whose duties provide exposure to issues of custody, fund accounting and distribution for everyone from hedge and private equity funds to corporate and public pensions, foundations and endowments. In the course of research for an upcoming Forbes Insights survey (sponsored by EY), we had an opportunity to toss a handful of questions Pete’s way:

Bill Millar: What are some of the most pressing challenges and opportunities facing the global asset management industry?

Peter Cherecwich: Overall, this is an era of opportunity for the industry – we’re in growth mode. But in terms of challenges, if I had to choose perhaps the top three, I’d say the most forceful is fee pressure, followed by complexity and then distribution. Then I’d add: regulatory issues play a role in all three.

Millar: What is happening with regard to fees?

Cherecwich: The simple answer is that investors do not want to pay as much. There is competition for their business. There are index instruments who in some cases are outperforming managed products – for lower fees. But markets [often] move in cycles and today you see active managers able to say: ‘look, pay our fees, and we will beat those index [funds] by an even greater margin.’

Also, I think one of the key drivers of fee pressure is political. An active funds manager might in certain cases significantly outperform the index, generating returns well in excess of their fees. But the focus is on that fee: it’s such a large number. Of course it’s justified, given the returns, but [stakeholders and other relevant observers] see only the size of the fee.

As for its overall impact, as a custodian and administrator, one thing I can assure you: fee pressure rolls downhill. When an asset manager is making less money, they turn to their custody, data and tech advisors and say: “we need to reduce these fees.”

Millar: What about complexity?

Cherecwich: Complexity begins with opportunities: not just emerging markets but also new instruments like exchange-traded funds and alternative investments. There are so many new products and strategies.

Then there are the differences between [traditional] 40 act funds and collective investment (CIF) funds. Some investors prefer the assurance of the 40 act funds but CIFs have [significantly] lower cost, and still are governed well. Regulators are still having a look, but asset managers have to decide whether to offer one or the other or both. The product mix is changing.

Another key driver is regulation – which is everywhere. Dodd-Frank, for example, [introduced] form PF for hedge fund managers, requiring extensive reporting and disclosure on fund activities and holdings. [In the EU] there’s the alternative investment fund managers directive (AIFMD), again affecting hedge funds, real estate, PE managers, and others in the E.U.

There is also [the foreign account tax compliance act] forcing funds to figure out if any of the investors are non-U.S. citizens – a result of the [Swiss banking] tax evasion controversy – where compliance is incredibly complex and expensive. To avoid a [punitive] tax, funds have to double-check every single investor. Then in the UK, there are new client money rules where there can be no [co-mingling] of investor cash.

Millar: How are regulations impacting the industry?
Cherecwich: The goal is greater security for investors – which seems to be happening. But the question is whether investors are paying too much as a result, because regulations are adding significantly to the cost of asset management.

[What is] interesting is how some of these regulations work to cross purposes. One goal is to prevent firms from growing too large, which concentrates risk. But the cost of compliance with so many regulations confers advantage to larger and larger firms. A good example, part of AIMFD, [driven] by the Madoff [debacle], requires custodians/depositories to make sure a fund manager’s assets are not “lost,” and if they are, write a check to cover. Essentially, insurance.

So today, an investor, ultimately, is now looking to the custodian or the depository for security. But that requires additional due diligence checking. So it becomes harder and harder for fund managers and custodians to work with anyone other than a [name brand] prime broker. So instead of spreading the risk around, here the rules tend to concentrate the risk.

Millar: What about distribution?

Cherecwich: Rule changes, the rise of technology-driven competition, new products – they’re forcing firms to reevaluate where and how they reach the market. Where this gets really interesting is when you look globally, as countries are looking at what types of products are appropriate for their markets.

For example, there are UCITS products, domiciled in Luxembourg or Ireland, that are distributed in Asia. Countries like Taiwan or Hong Kong get to take a really close look at such products in terms of fit for purpose. But if there’s a local product, that is getting reviewed and approved more quickly because, face it, it is in these countries’ best interest to build up the local industry. A local product needs a local trustee, a local accounting agent – and that means local employment.

Meanwhile, countries like Taiwan have rules requiring a minimum number of people on the ground. You cannot always just distribute from afar, you need a local presence. All of these forces and opportunities are playing a role in how firms approach their distribution.

Millar: What does all of this mean for Northern Trust?

Cherecwich: All of this leaves firms needing to figure out ‘who’ they are and ‘who they want to be’ in this industry; which products, delivered how, to which markets? Overall, it’s creating a tremendous new marketplace for service providers.

Think about it: say you’re an asset manager with 500 on staff and 200 are back office. If you outsource the back office, there are now fewer people to manage, fewer who need bonuses and less capital on people and systems.

Or perhaps you’re a fund manager and you want to use a new instrument, a total return swap (TRS), to get access to, say, an emerging market. You want to execute several of these [trades], but you do not have the systems in place to manage a TRS. So do you invest in the needed systems? Do you track it on a spreadsheet – for just a few trades? Or do you tell your portfolio manager “no, we can’t use these?”

If you work with someone like us, even if you have only one or two trades like this, you do not have to pay the full cost of the [needed] infrastructure. Or if you’re entering a new market, you don’t have to work quite as hard on understanding local distribution. This gives you [speed to market], flexibility and scalability. And it is forces like these that are driving a massive uptick in outsourcing. Let’s just say: we’re keeping busy.

About the Contributing Author:

I’m a freelance business writer, researcher, roundtable facilitator and speaker – a unique combination of journalist and practitioner. That’s over 30 years writing about risk, finance, taxation, business strategy, the role of the CFO and technology coupled with practical Wall Street experience at firms like Euro Brokers, Drexel Burnham and E.F. Hutton. Are you a fan of arcane business books? I’ve written or collaborated on over 20 including Financial Innovations (Harper Business), Enterprisewide Risk Management (Financial Times), Global Treasury Management (Harper Business) and The One to One B2B (Currency / Doubleday). I’ve also authored or edited over 2,000 articles for trade publications such as Business International Money Report, Finance & Treasury and Risk alongside contributions to The Economist and the Financial Times. As a ghost writer, I’ve collaborated with three New York Times best selling business authors (so far). Also worth noting – I’ve been telecommuting since 1988.