NORTHERN TRUST

OPTIMIZING DATA IN A TRANSPARENT WORLD

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Transparency ranks as one of asset owners' and asset managers' top concerns,[1] but simply sharing more data between both sides does not always lead to better investment outcomes.

Instead, asset managers need to find a balance between fulfilling external transparency requests and protecting competitively differentiating knowledge, while asset owners need to find a balance between understanding what data they need to reach their investment and fiduciary goals and what data could lead to information overload.

A growing wave of data transmission, aggregation and analysis tools can help both sides find that balance and make transparency less of an operational burden and more of an opportunity to achieve their goals.

Three Key Takeaways

1. TRANSPARENCY REQUIRES CONTEXT, NOT JUST MORE DATA
2. THINK ABOUT WHAT QUESTIONS MORE DATA COULD HELP ANSWER
3. NEW TECHNOLOGIES CAN HELP MAKE TRANSPARENCY MORE MANAGEABLE

DEALING WITH NEW DATA

Greater transparency has been fueled in part by a new wave of disclosure laws bringing previously hidden or unknown costs and conflicts to light.

For instance, the Markets in Financial Instruments Directive (MiFID II), launched at the start of 2018, has significantly changed how managers disclose investor costs and charges such as trading and research fees. The regulation will likely push more trading onto online trading venues, as these platforms then take responsibility for reporting trades, as opposed to investment firms doing so for over-the-counter transactions. Managers are also adapting to new regulations by upgrading legacy technologies with systems that can automate pre- and post-trade data collection and reporting, such as trade quotes prior to execution.

For some firms, these new data requirements increase the need for better data analysis, as the raw data on its own may not tell the whole story.

For example, Russ Kamp, managing partner at investment consulting firm Kamp Consulting Solutions, recalls that at a firm where he was engaged with a blind principal bid trading strategy, the main cost associated with the strategy was trading the portfolio at the end of the day in one fell swoop. "It looked pretty expensive on the surface, when, in fact, by being able to simultaneously execute everything that we wanted to, it limited our expenses," he says.

Thus, as this experience suggests, managers need to provide more than top-line data on overall transaction costs. Instead, they need to share specifics such as how and why they incurred transaction costs, and new data management tools improve the ease of providing this specificity through customized post-trade reporting.

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WARNING: DATA DUMPS AHEAD

With transparency goals in mind, many asset managers do go beyond mandated disclosures, taking advantage of new technologies such as chatbots to answer client questions, automated reporting tools and AI-enabled data analysis platforms to provide more data and analytics to clients and prospects. But both sides need to be aware that doing so sometimes leads to overwhelming amounts of data for asset owners to manage.

For example, the rise of institutional data aggregation platforms—such as from eVestment and Informa, as well as investment consultants' proprietary databases—has in a way improved transparency, enabling asset owners and managers to conduct searches using hundreds of data fields on topics ranging from managers' key personnel to data on portfolio holdings. But, without context, users may find it hard to make sense of all that data.

"Asset owners can do a very specific search and receive a data dump," says Amanda Tepper, founder and CEO of Chestnut Advisory Group, a business development consultancy for asset management firms. "For example, if low P/E is a metric that matters to you, you can run a search with such parameters.

Asset owners are also asking for a significant level of detail in requests for proposals and, once firms are hired, in regular due diligence questionnaires. In response to each, asset owners may quickly end up with 200-300 page reports.

While sharing this information does make asset managers more transparent, simple communication of it is unlikely to be helpful to asset owners who hoped for a quick read and direct answer. It may help investors know where their exposures lie, for example, says Mr. Kamp, "but what do you do with that information?"

To avoid data overload, asset owners need to consider the purpose of the data they request and how that information would help them achieve their intended outcomes. For instance, a large asset owner may want to know more about the market impact of their trade orders so that they can mitigate how their transactions affect stock prices, but for very small investors with no market impact, such information may only complicate analysis.

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DETERMINING WHAT'S PROPRIETARY

Some asset managers also worry about oversharing data because they don't want competitors to gain too much insight. By revealing their investment selection criteria and operational tactics, even down to their day-by-day trades, others could copy their hard-built strategies or at least gain access to market insights that affect investment performance.

Mr. Kamp recalls that when he was leading the Invesco quantitative business, his team was cautious about divulging specifics of their investment factors and indicators lest larger competitors act on them. "The problem became disclosing enough to consultants so they would realize there are unique differences without giving away our insights," says Mr. Kamp. "It can be a difficult balance."

Still, asset managers' worries about losing their edge could be more of a temporary issue than a long-term reality, as market efficiencies usually erase advantages over time. "If you truly have an insight, full transparency can be harmful," says Mr. Kamp. "When you identify something that you think is unique, be it a data set, trading strategy, insight, the use of technology, whatever it might be, there isn't an endless capacity associated with that."

"The good and bad thing about capital markets is that they are very, very, efficient," agrees Ms. Tepper. "The factor gets out there and is eventually arbitraged completely out of the market. That's what managers are afraid of at the core of it."

Thus, managers need to weigh whether disclosing certain factors or other proprietary information would affect performance enough to outweigh losing opportunities to win and retain clients due to keeping information under wraps.

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DELIVERING THE RIGHT DATA IN THE RIGHT CONTEXT

Managers that do decide to disclose more data than mandated also need to think about how their clients receive that information.

Investors, consultants and other stakeholders often struggle to figure out precisely what data they need to meet their goals, so asset managers have a prime opportunity to work with clients on delivering the right data, rather than simply sending more data.

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For example, managers that can deliver performance reports that not only include raw data but also clearly benchmark performance and explain how certain factors and decisions led to the results can better serve their clients.

"There's an overreliance on data out there, and, ultimately, it's people behind all of this. It's emotions that drive markets and emotions that drive asset flows. So the manager needs to ask, 'Why are you asking that question? What is it you're trying to understand?'" advises Ms. Tepper.

Focusing on the most important data, whatever that means to individual asset owners, allows asset managers to spend more time helping owners drill down into the most important data that answers their key questions, allowing both sides to better meet their goals.

END NOTE

1 http://www.eiuperspectives.economist.com/sites/default/files/EIU_NT_The_Path-to-transparency-in-alternatives-investing.pdf