# Reality reimagined:

## Asset management opportunities & risks 2020

kpmg.ca/assetmanagement

# Transformative times

The events of 2020 have put Canadian asset managers on alert. And though the industry has shown its trademark resilience, homegrown leaders continue to feel the pressures of mounting competition, consumer shifts, and the rippling impacts of a global pandemic. To that end, the 5th annual Canadian asset management industry opportunities & risks report reveals a sector amid ongoing transformation – both to navigate years-old challenges and to serve customers in the emerging new reality.

Industry outlooks may have dampened in recent months, but the start of the year looked very different. 2020 launched on a note of optimism as the World Economic Outlook report published by IMF in January projected global growth to rise from an estimated 2.9% in 2019 to 3.3% in 2020.

The pandemic has turned this optimism on its head. Over a third (40%) of Canadian asset managers have a somewhat more pessimistic outlook for their organizations than one year prior, while over a third (40%) are equally concerned for the health of the Canadian asset management industry. While it's tempting to pin these attitudes on the pandemic alone, the reality is that the industry is equally aware of ever-present risks to its growth, such as increasing competition, the continued push for lowers fees, and uncertainty over how global events (e.g. the US election, trade wars, potential stay-at-home orders, and the continuation of government support programs and liquidity measures) may bring further uncertainties to the field. We'll explore the factors in greater depth throughout the reports to come.

**91 PERCENT**
of Canadian asset management organizations had a business disruption plan before the pandemic

"The reality is that Canadian asset managers are dealing with a lot of uncertainties right now stemming from market volatility, geopolitics, competition, and evolving customer demands during the pandemic," says James Loewen, Partner and National Sector Lead for Asset Management at KPMG in Canada. "It's the perfect storm, but there's also a sense among the community that they'll pull through."

| | Significantly more pessimistic | Somewhat more pessimistic | About the same | Somewhat more optimistic | Significantly more optimistic |
|---|---|---|---|---|---|
| My outlook for my organization compared to this time last year is: | 6% | 34% | 34% | 20% | 6% |
| My outlook for the Canadian asset management industry as a whole compared to this time last year is: | 14% | 51% | 31% | 3% | 0% |
| **Total** | **10%** | **43%** | **33%** | **11%** | **3%** |

**83 PERCENT**

plan to increase annual investments in digital technologies and cyber security over the next five years

## Making the shift

Change is a familiar state for the asset management community. Long before the pandemic spurred demand for virtual services and interactions, many Canadian asset management players were already in various stages of digital transformation. The pandemic may have caught them off-guard, but it did significantly accelerate many of their plans; and this is likely the reason that even though outlooks are generally less positive than in our 2019 report, over a third of Canadian asset management firms remain confident (if not more so) in their ability to adapt to rising digital demands.

That confidence may be tempered, but it exists. The domestic market has already seen improvements in recent months, and there are opportunities to be had for asset managers who can guide their clients through troubled times.

"We've done quite well in Canada when it comes to managing through the pandemic, and that includes financial institutions and asset managers alike," says Loewen. "True, there's still a wait-and-see attitude when it comes to embarking on new projects or larger initiatives, but those cautious attitudes are to be expected right now when everyone is still wondering what will happen next with the pandemic."

Fifty-one percent of Canadian organizations will not pause their ESG considerations until the economy returns to normal.

## Opportunities in the new reality

Obstacles abound for Canadian asset managers, but there are reasons to remain optimistic. Though the risks of market disruptions, competition, cost challenges, and industry regulations are real, they are balanced by opportunities to reach new customers, benefit from emerging innovations, launch timely responsible investment themed impact or ESG funds, or play a leading role in the new, post-pandemic reality.

"Anybody who doesn't look at a period of instability as an opportunity for growth isn't looking hard enough," says Joseph Micallef, National Tax Leader, Financial Services. "Now is the time to hone your competitive advantage, whether that's through acquisition of weaker players, the products you're putting out there, the way you conduct yourself with integrity, or the levels of service and value you're able to provide your clients despite everything that's going on."

Moreover, the days ahead hold opportunities for those with strong balance sheets and access to raising capital and can take advantage of those capabilities in what has become a buyer's market.

These are extraordinary times, but Canadian leaders have a reputation for being resilient. In the series ahead, we'll explore how 2020 has reshaped the asset management community and how Canada's asset management players are adapting to build customer loyalties and drive smarter operations from the front office and back.

2020 may be shaping up to be one of the most transformative years on record, but insights from this year's report show an industry willing and prepared to adapt.

**29 PERCENT**

of Canadian organizations anticipate that up to 20% of their workforce will continue to work outside of the office for the long-term

## TOP ORGANIZATIONAL **OPPORTUNITIES**

**63%** Increased penetration of existing client base
*(+16% from 2019)*

**63%** Enhanced operational use of technology
*(-1% from 2019)*

**54%** Launching new product types/services
*(+9% from 2019)*

**46%** Focusing on distribution channels and client needs
*(+6% from 2019)*

**37%** Cost-reduction initiatives
*(-6% from 2019)*

## TOP ORGANIZATIONAL **RISKS**

**60%** Push for lower management fee environment
*(+17% from 2019)*

**54%** Increasing complexity of regulation and cost of compliance
*(-10% from 2019)*

**46%** Cost challenges and squeezed profit margins
*(+1% from 2019)*

**43%** Cybersecurity risks
*(-5% from 2019)*

**43%** Intensified competition and consolidation
*(+7% from 2019)*

## Anticipated long-term impacts of COVID-19

**37 PERCENT**
How their employees work (permanent work from home, recruitment, etc.)

**31 PERCENT**
Further consolidation among the biggest companies as a result of large drops in AUM

**17 PERCENT**
The way in which new investors are sourced and pitched

# Shifting gears on digital transformation

Digital transformation was on the asset management industry's radar long before the pandemic. In 2020, however, the near-overnight move to remote working and hybrid teams accelerated the shift.

That transformation underpins much of this year's report. Nearly two-thirds of Canadian asset managers (63 percent) believe their organization can benefit by enhancing their use of technology across their front, middle and back offices, a number that aligns with the 64 percent of business leaders who saw the same potential in 2019. Equally telling is that 77 percent of this year's respondents anticipate their annual investments in digital technologies will increase over the next two years, and 83 percent see that investment continuing to grow over a five-year horizon.

The motivations behind digital transformation are mixed. For some, it is a means to unlocking operational efficiencies and managing to margin after years of fee reduction pressures, reaching virtual customers (Generation D), or staying compliant with ever-evolving industry regulations. For many, the accelerated adoption of tech for front, middle, and back-office operations has only been made more imperative due to pandemic-related implications.

"At some level, digital transformation almost always starts with cost reductions," says Chris Farkas, Partner and National Management Consulting Leader, Asset Management, KPMG in Canada. "Even before the pandemic, asset managers reacted to investor fee pressure by looking closely at their operations to create a more efficient and digitally connected enterprise, front to back. They were asking where can they make client interactions smoother, where should they be located, what activities make sense for them to own versus outsource, what they could automate, and how they could use tools like machine learning or cloud to find cost-saving efficiencies and build scale."

Certainly, asset and wealth managers were already evaluating and implementing new and emerging technologies in some form or another. Yet with a growing demand for virtual services for Generation D, new client reform regulations and continued socially distanced interactions, those long-term initiatives have been condensed into more immediate mandates.

As Peter Hayes, Partner and National Leader, Alternative Investments, KPMG in Canada, notes, "There's likely always been an ask among organizations for more investments in technology, and now it's probably easier to access those funds because of COVID-19."

"If there's ever been a good excuse to invest in online capabilities and drive efficiencies," he continues, "this is it."

## Upgrades at every level

Digital transformations are picking up speed throughout front, middle, and back-office operations. And according to this year's data, the lion's share of investments are being made to augment client acquisition and retention functions.

When asked where short-term investments in digital innovations would have the most value in their organization, over a third of Canadian asset managers (37 percent) cited the development of sales and marketing/investor relations portals

on the front end, 29 percent cited upgrades to their risk and compliance functions in the middle office, and 34 percent focused on fund accounting capabilities in their back office.

By and large, there is a clear appetite for technologies with increased focused on the front office. Joseph Micallef, National Financial Services Tax leader, believes "getting the front-office strategy and investment right will inevitably foster deeper client relationships. Clients want to feel engaged and empowered in their financial planning and most importantly understand what their advisor is doing for them throughout the year to meet their financial goals. If interactions only occur via a client statement and no other touchpoints, then advisors shouldn't be surprised if those clients eventually leave." Thus, investments in digital channels and tools combined with one-on-one communications will inevitably translate into stickier client relationships and ultimately growth in the firm's bottom line.

"Every organization is trying to reach out through their online channels to create a more remote experience," agrees Hayes. "That was happening before COVID-19, and now we're seeing organizations racing to get those tech initiatives past the finish line or, in some cases, scrambling to fill in the gaps."

Progress on these initiatives varies given each organization's size, resources, and digital maturity. Nevertheless, each organization is aware of the need to transform, not only to address current operational challenges, but to position themselves in front of tomorrow's clientele.

"Pandemic or not, there is a need to create reliable and user-friendly online experiences to capture the younger, more tech-savvy segment of wealth creators who will be looking for asset managers that can interact on their level," Hayes adds.

## Opening the wallet

Any business transformation comes at a cost, and the pivot to digital operations and online services is no exception. Looking ahead, 63 percent of Canadian asset managers plan to increase their annual investment in digital technologies and cyber security over the next 12 months, and 83 percent plan to do so over the next five years.

Interestingly, though, over 57 percent of respondents say these tech investments are not directly motivated by the pandemic, compared to 37 percent who said they were. Here again, while the pandemic may have accelerated tech adoption to some degree, these initiatives were well underway before the events of 2020 took shape.

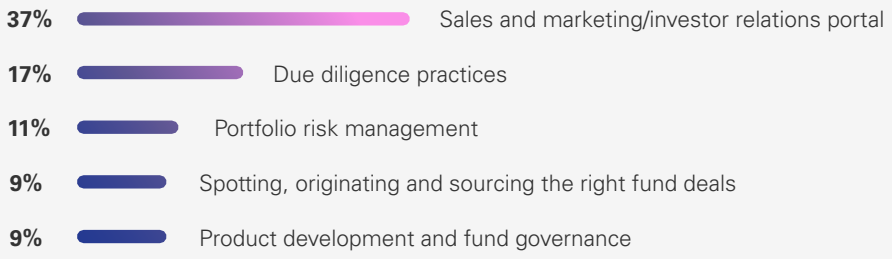
## A new angle on cyber security

Wherever there is talk of technology adoption, cyber security anxieties are never far behind. And in the race to acquire and enhance their digital capabilities, Canadian asset managers show due concern for the risks at their virtual doorstep.

"With the majority of workforces working from home, there are inherent security issues that arise with sharing data outside established security

### Short-term investment in the front office

As a result of the stay-home measures and an increased reliance on remote-working arrangements and digital technologies, what learnings have come about in terms of the activities in your value chain where front-office digital innovations and investments need to be made in the short-term?



networks, using personal emails and devices, or logging into third-party work software," offers Chris Farkas, Partner and National Management Consulting Leader, Asset Management, KPMG in Canada.

Canadian asset managers are increasingly aware that the shift to remote working arrangements means elevated risks of data theft and corruption. As such, they are keen to the dangers of moving too fast on digital initiatives without the proper security controls in place.

The fact that cyber security fell several spots on KPMG's list of perceived risks for 2020 also deserves notice. This is not so much owed to a lack of focus, but the simple fact that Canadian asset management leaders have been working on cyber security for some time and feel adequately prepared for today's elevated risk environment.

"Cyber security is always a big risk, but it's also something we've been talking about for some time – to the point where firms have taken action and are just weary of talking about it," says Farkas, adding, "We have to remember that many firms have been making huge efforts in the last 10 years to fix and to prevent cyber attacks. So it's not a case of them caring less, but more a case that they're treating cyber security as table stakes at this point."

There is also the factor that many asset managers were already set up to work from home before the pandemic hit, and as such, organizations were already taking these risks into consideration.

Whatever the reason, it is promising to see cyber security remains high on the industry's collective conscience.

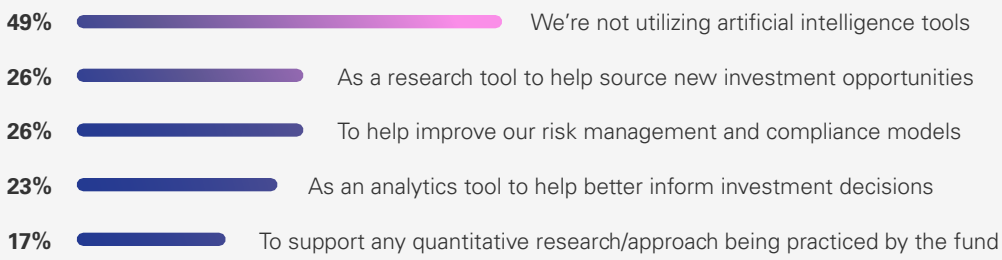
## Upgrading for the new reality

Not every employee will remain in a home office. Not every client prefers to interact through a screen. Nevertheless, much of the overnight digital transformations taking place today will likely stick well beyond the pandemic as Canadian asset managers ready themselves to do business in the new, hybrid reality. In the sections ahead, we'll examine how Canadian asset managers are adjusting to current and post-pandemic realities in other aspects of their operations, and the challenges and opportunities in their path.

### Machine learning/alternative data

For what purposes do you use machine learning/alternative data?

*(Respondents could only choose a single response)*




### Technology investments

Do you expect your annual investment in digital technologies and cyber security to increase, decrease or stay the same over the following time periods?

*(Respondents could only choose a single response for each topic)*

| | Increase | Decrease | Stay the same |
|---|---|---|---|
| 12 months | 63% | 0% | 37% |
| 24 months | 77% | 0% | 23% |
| 5 years | 83% | 0% | 17% |
| **Total** | **74%** | **0%** | **26%** |

# Same customers, new reality

It's little surprise that Canadian asset managers see the potential for growth among their existing clients. Between tightening markets, intensifying competition, and the customer recruitment barriers posed by a global pandemic, searching inward for new sales makes sense. Still, while 63 percent of respondents say "increased penetration of existing client base" is the topmost opportunity for their respective organizations, serving customers in the new reality is easier said than done.

**63 PERCENT**

of Canadian asset managers say increased penetration of existing client base (retail, institutional, fund of fund, and/or private wealth platform) is an opportunity for their organization

**84 PERCENT**

of Canadian CEOs overall are placing more capital investment in buying new technology

*KPMG's 2020 Canadian CEO Outlook COVID-19 Pulse Survey*

**80 PERCENT**

of Canadian CEOs will continue to build on their digital collaboration and communication tools

*KPMG's 2020 Canadian CEO Outlook COVID-19 Pulse Survey*

Selling new products or services among existing customers is a familiar strategy for the asset management industry; it was cited among the top five opportunities for Canadian asset management professionals in 2019. As such, the strategy is as much as a response to current limitations as it is to recurring challenges.

Says Peter Hayes, Partner and National Leader, Alternative Investments, KPMG in Canada, "The Canadian asset management market is fairly saturated, and it was like that before COVID-19. Firms recognize there aren't any huge client segments to go after, so a natural way to grow is to offer their existing clients a broader offering of products to gain their trust, maintain their loyalty, and generate better returns."

"The more firms can increase their value to their existing customers, the more those same customers will come to them first for insurance, RSPs, or other products down the road," he adds.

Increasing business among existing clients also tracks from a best value for incremental spend perspective, especially in a time where the need for growth is balanced by pressures to keep operating costs in check. Given the work and cost involved in obtaining a new customer, it makes more sense to direct some focus on clients who are already in the door and how to further penetrate their existing wallet share than it is to undertake an acquisition and integration exercise.

**26 PERCENT**

of Canadian asset managers use machine learning/alternative data as a research tool to help source new investment opportunities (23% to inform investment decisions)

## Sales limitations

For many asset managers, pinning growth on existing clients is symptomatic of the fact that traditional sales and marketing strategies don't apply in a global pandemic. Social distancing limitations and severe health risks have put a moratorium on face-to-face customer interactions, networking, and more traditional sales techniques, leaving sales teams with fewer means to "get in front" of future customers.

"Salespeople are social animals, and right now it's very hard to get out and 'press flesh' in an environment like this," says James Loewen, Partner and National Leader, Asset Management, KPMG in Canada. "There are far fewer business development opportunities than there were pre-COVID, so right now those sales efforts are being redirected online or refocused on existing business."

## Managing the new reality

There are ample reasons why Canadian asset managers are focusing inwards for growth, but the more important question is how. No doubt, the pandemic has forced organizations in every industry to adapt to a more digitally connected enterprise for their operations and client interactions, and asset managers are no exception. According to this year's study, 37 percent of Canadian asset managers are making short-term investments in digital innovations that will aid sales and marketing/investor relations portals, the most out of any front-office activity. Moreover, many firms plan to up their spending on communication and collaboration tools over the coming years, bringing artificial intelligence, machine learning, automation, and enhanced online service offerings to stay connected with clients and deliver greater overall value. The challenge has been bringing it all together, front to back, so that client and employee experience is aligned, and the operating model supports the services and response times promised to clients.

## Regulatory incentive

The pressure to take greater care of clients is also being felt from regulators. As Joseph Micallef observes, "Asset management industry regulators have returned to their pre-pandemic agendas with new priorities and perspectives, and are seeking to encourage recovery and growth and calling on asset managers to take greater care of their customers, according to KPMG global analysis."

With client reforms in Canada lacking clarity, he continues, firms need to understand how these will impact their front office to compete effectively. With potential change to Dealer product shelves in 2021, it's never been more important to work together with the Dealers to communicate key product features in a simple and scalable way to optimize distribution and minimize risk. At the same time, it's also key to determine which digital tools should be developed, purchased, or partnered with as asset managers re-imagine how they can serve their clients.

## Same customers, a new approach

The pandemic has imposed unique obstacles for client retention and acquisition. And as Canadian firms increase their focus on their existing clients for relief, it's clear that doing so will rely on technologies that can keep them connected, informed, and in touch with the needs of customers in the new reality.

> In many respects, asset managers need to be even more responsive and accessible than they were before the pandemic, and the only way you can do that effectively is through sophisticated digital tools and channels."
>
> – Joseph Micallef, Partner and National Tax Leader, Financial Services, KPMG in Canada

# The costs of doing business

Canadian asset managers have demonstrated their trademark resilience during the events of 2020. Even still, KPMG's asset management opportunities & risks survey reveals no shortage of obstacles on their radar.

The relentless pressure to reduce fees has risen to the top of our 2020 respondents' list of industry risks, rising three spots from our 2019 report. Specifically, 60 percent of Canadian asset managers believe the push for lower fees is a priority risk to their firm (+17 percent from 2019), and 71 percent say it poses equal risks for the industry at large.

The push for a lower management fee environment had been gaining momentum well before COVID-19 made headlines. Yet while it is a symptom of ever-increasing competition, there's no denying that economic anxieties are also motivating clients to reduce their investment costs.

"Asset managers recognize that their clients are looking for ways to soften the impact of a global pandemic on their investments, and one way to do that is through a break on fees," offers James Loewen, Partner and National Sector Lead for Asset Management. "When you consider the risks that retail or institutional investors are facing right now, you can understand that many are battening down the hatches."

"There's just more competition – more asset managers either offering the same or better returns that investors want for a much lower fee, which is driving this lower fee environment," says Chris Farkas. Partner, Advisory, Management Consulting - National Asset Management Leader, KPMG in Canada.

As concerns over market volatility and economic hardships mount, clients are more attuned to how much they are paying for their asset management services and the value they're receiving.

In their bid to balance out the impact of fee compression for traditional products, asset managers are turning to niche, bespoke investment products (e.g. alternatives) to attract higher fees.

"Asset managers can charge higher fees for alternative investments because they're a niche product generating true Alpha, but that means expectations are also higher. The performance has to be good, the asset manager's reputation has to justify the fees, and the investment has to actually deliver in terms of risk-adjusted returns," says Farkas.

What is vital now is a multi-year, pan-Canadian strategy to help our economy rebound and grow. We need to build on the best efforts of government to date, and enable the business community to normalize its role in driving economic growth, job creation and innovation.

## Help from on high

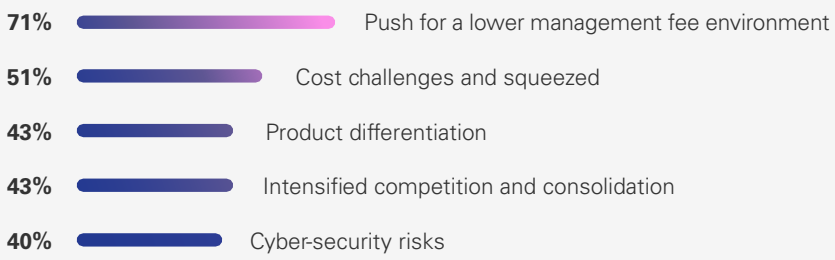
Since the onset of the pandemic, the federal government has wielded financial subsidy programs such as the Canada Emergency Wage Subsidy (CEWS) initiative to soften the financial impacts on homegrown businesses. 46 percent of Canadian asset managers believe these subsidy programs have already gone far enough to support their sector, but even with proposed extensions and enhancements on the way, Joseph Micallef, National Asset Manager Tax Leader, KPMG in Canada, suggests now is the time to talk longer-term strategies: "What is vital now is a multi-year, pan-Canadian strategy to help our economy rebound and grow. We need to build on the best efforts of government to date, and enable the business community to normalize its role in driving economic growth, job creation and innovation."

The path to economic recovery is long, but Canadians are not alone. As COVID-19 infection rates go up, and feelings of uncertainty follow suit, Micallef adds that it's important for governments at all levels to set businesses up for success and support the safe return of workers and customers if Canada hopes to achieve a broad and sustained recovery.

"We need to invest strategically in our recovery to get the most value for future investment, recognizing that some regions, sectors and workers will face greater difficulties for the foreseeable future," he says.

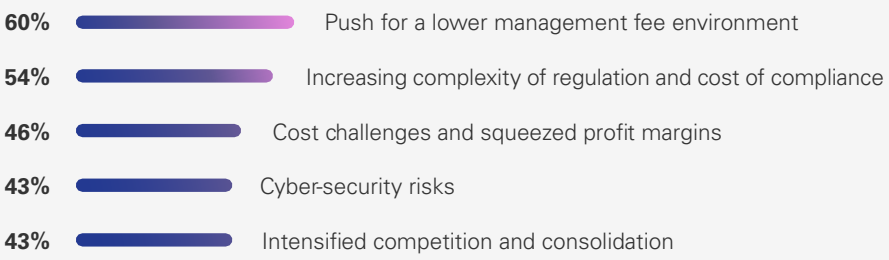
### What are the top 5 risks for Canadian asset managers?

*(Respondents were allowed to choose multiple responses)*




### What are the top 5 risks for your organization?

*(Respondents were allowed to choose multiple responses)*



"Much of the fee grind we saw over the past years was because people were moving money into passive strategies that didn't have many fees attached. We're seeing a shift away from that now as people realize that the bull market doesn't go on forever."

– Peter Hayes, Partner and the National Leader for Alternative Investments, KPMG in Canada

## Minding the bottom line

Cost challenges and squeezed margins are also on the minds of Canadian asset managers. In 2020, this concern was cited as the third-most pressing risk for individual organizations and second-highest risk for the asset management community.

For some firms, the pursuit of leaner, more cost-effective operations has meant simplifying product lines and merging funds, while for others, it's given way to outsourcing/co-sourcing partnerships.

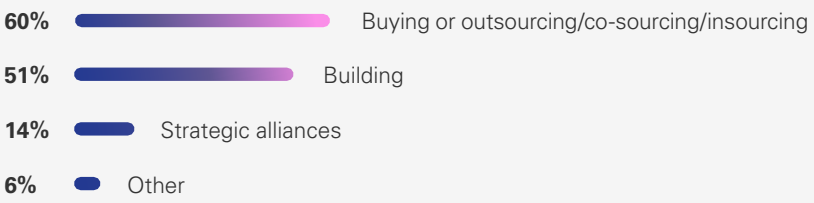
"Even some of the bigger asset managers who hadn't previously outsourced some of their back-office functions are doing so now, and at an accelerated rate. During a time of crisis, there is a tendency to focus on what you're good at, which is the investment management side as opposed to running a back office," notes Loewen.

For some firms, the pursuit of leaner, more cost-effective operations has meant simplifying product lines and merging funds, while for others, it's given way to outsourcing/co-sourcing partnerships.

The response to squeezing margins and cost challenges varies across the industry. As outlined in the earlier sections on tech investments and evolving business models, there is an underlying recognition that doing business in the new reality means being more agile, efficient, and open to collaboration.

How will you adjust your technology investment plan for front, middle and back office needs to accommodate the next two years?

*(Respondents were allowed to choose multiple responses)*



# Expanding products, embracing ESG

As client conversations turn to market trends, pandemic concerns, and ESG considerations, Canadian asset managers are evolving their product lines to match.

The potential growth from developing new products and services underscores this year's Asset management opportunities and risks report. Over half of Canadian asset managers (54 percent, +9% from 2019) believe doing so is an opportune strategy for their organization, while a significant amount (46 percent, +6 % from 2019) thinks the same to be true for the industry at large.

"If you look at the strategies amongst the big asset managers, you'll find a lot of them are looking at expanding into alternatives and low-cost betaproducts to the point where many players have gone down the route of partnering with hedge fund or private equity managers on the alpha side and looking into ETF style platforms on the beta side," observes Chris Farkas, Partner and National Management Consulting Leader, Asset Management, KPMG in Canada.

2019 also saw the asset management community make several billion dollars in moves towards liquid alts. This trend continued into 2020, with nearly every major Canadian asset management firm engaging in a liquid alt strategy of some type. In that same vein, low yields and a desire to pick up return in the fixed income space also drove demand for private credit products.

"Even before the pandemic, we saw a market that was very busy with private credit. That activity is continuing because a lot of individuals and businesses are looking for credit during the pandemic, and banks aren't going to be able to (or want to) serve everybody," says James Loewen, Partner and National Sector Lead for Asset Management, KPMG in Canada, adding, "Due to these factors, people are definitely looking at alternative lenders, and a lot of those strategies are done through funds."

Long-short type strategies are also proving popular in 2020, as are precious metals. The latter is a niche plays that tends to prove itself in times of higher market volatility and elevated concerns over inflation, which certainly describes the current economic climate.

This attention on alternatives and low-cost beta products is the evolution of the industry. On the alternative products side, the demand is fueled by investors who wish to be smarter about allocating their money and diversifying their portfolio; while on the beta side, the popularity is driven by individuals seeking low-cost ways of accessing market beta.

Clients are asking more sophisticated questions, requesting more detailed reporting, and applying greater scrutiny to ESG-labelled products. And as those ESG-related questions and concerns mount, the onus is on asset managers to have solutions.

## ESG on fast forward

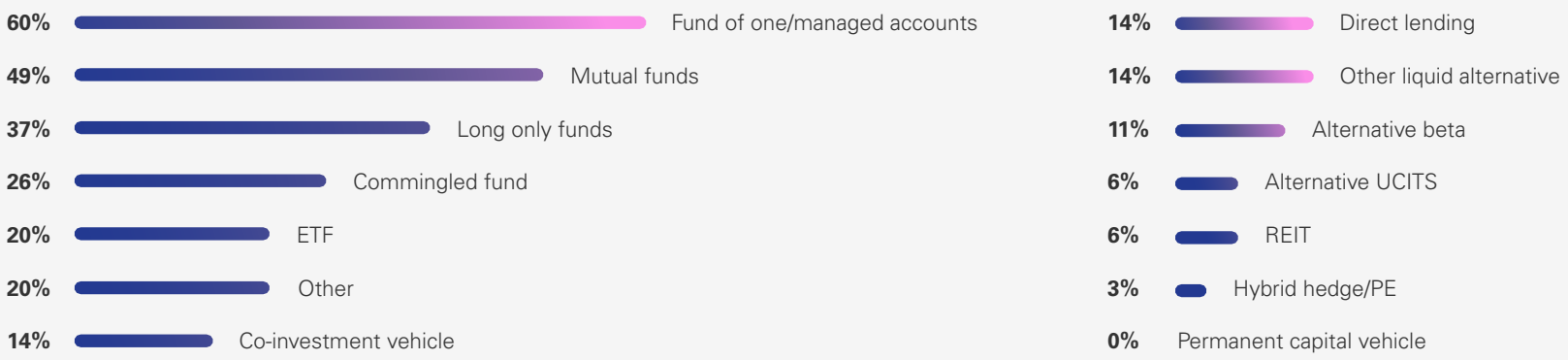
Despite market challenges, Canadian asset managers and investors are not hitting pause on their ESG strategies. Half of Canadian asset managers (51 percent) say their focus on ESG has not altered due to current economic conditions, while only 15 percent say their focus has moderately or significantly been shifted.

No doubt, studies have supported the idea that a focus on ESG drives financial performance over the long-term. As such, the debate over the cost of ESG outweighing the benefits has faded from the boardroom. If anything, the pandemic has amplified investor's interest in companies that are strategically embracing ESG, be it within their human capital management practices, inclusion and diversity strategies, or how their operations are making a tangible and sustainable impact.

"COVID-19 put a fine point on the things that matter most and drive value, and key differentiators from a corporate perspective," says Tania Carnegie, Leader and Chief Catalyst, Impact Ventures, KPMG in Canada. "This is of great interest to asset managers as they look for companies that are exceptional in creating a long-term value, and ESG provides a lens to help them do that."

The demand for ESG products and considerations is also being felt by asset managers. Investors are letting their values guide their decisions, in particular as the link between values and value has become more evident, and they are seeking asset managers who can accommodate. Similarly, clients are asking more sophisticated questions, requesting more detailed reporting, and

### Products offered by Canadian asset managers



**98 PERCENT**

of Canadian CEOs feel "moderate" to "very significant" amounts of pressure from their stakeholders to embrace ESG. Of those that felt "very significant" amounts of pressure, 49% say it is coming from institutional investors

*2020 KPMG Canadian CEO Survey*

applying greater scrutiny to ESG-labelled products. And as those ESG-related questions and concerns mount, the onus is on asset managers to have solutions.

"A common question I've heard from our asset management clients is, 'How do we develop products that enable us to meet our client's expectations for ESG products that meet their return objectives?' In addition, they also wonder, 'How do we do that in a way that's authentic, builds client loyalty and also help us attract new clients?" adds Carnegie.

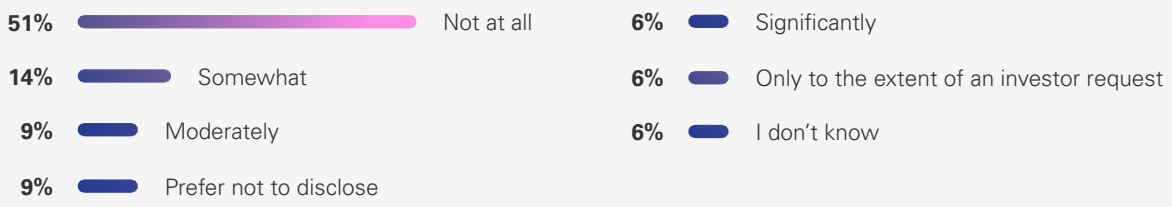
All told, investors are invested in ESG. They are eager to make a difference with their investments, and to learn more about the different strategies and products available to them. This presents a relationship development opportunity for asset managers who can provide investment options that drive returns and meaningfully address ESG risks and opportunities. This begins by taking extra time to understand each client's needs, hone their ESG investment goals, and come to the table with investment opportunities to match. Like anything else in this business, it's about keeping pace with expectations and learning and evolving with the Canadian market.

"Investors and asset managers alike recognize that companies that integrate ESG effectively and strategically are doing so to better understand and manage social, environmental and economic opportunities and risks – all of which creates long-term value."

– Tania Carnegie, Leader and Chief Catalyst, Impact Ventures, KPMG in Canada

Given the global effort to restart the economy, has your organization's focus on ESG considerations been put on pause until such time that the economy returns to the new normal?

*(Respondents could only choose a single response)*



# Evolving relations and operations

Agility is an asset in the days of COVID-19; and true to their resilient nature, Canadian leaders in our 2020 Asset management opportunities & risks survey display a willingness to revisit their strategies and partnerships to tackle the challenges of the day.

Methods of adaptation vary among Canadian asset managers. For over a third of our respondents, the path to growth and scale of operations is paved with mergers and acquisitions (M&A).

"M&A activity is certainly increasing in this space," observes James Loewen, Partner and National Sector Lead for Asset Management, KPMG in Canada. "There's safety in numbers, and in speaking with our clients there's a recognition that bigger is certainly better, especially when it comes to managing capital issues and surviving a recession that may take a while for the country to dig itself out of."

The justifications for M&A activity extend beyond mere survival. In addition to strengthening a firm's resolve during times of disruption, asset management partnerships open doors to new markets and global opportunities, as well as help to expand value chains, and quickly add new service or products to their mix. Moreover, as a majority of Canadian asset managers seek to embed new technologies and digital capabilities into their organization, many are turning to third-party partnerships to help accelerate their digital transformations.

Granted, M&A activity was healthy before the pandemic. Small to medium-sized firms and alternative players were positioning themselves as sub advisors for larger firms well before COVID-19 made headlines.

"Even before the pandemic, we saw a number of small or mid-sized players out there looking to be a sub advisor for a number of different managers," says Loewen. "Now, we're seeing even more alternative managers emerging in the marketplace, because that's what tends to happen when there is volatility and dislocation in the marketplace. As a result, there's more opportunities for those smaller firms to provide sub-advisor services for those managers."

The increasing complexity of regulation and cost of compliance is cited as the second highest risk facing Canadian asset management organizations (eighth for the industry).

## Help from afar

Outsourcing activity is alive and well within Canadian asset management industry. Nearly two-thirds of Canadian asset managers are seeking to bolster their digital transformation by outsourcing, co-sourcing, or insourcing with partners that can provide the technologies, capabilities, or experienced required to meet their growth objectives. Moreover, over a quarter of Canadian respondents to our study (26 percent) believe the industry can benefit from

increasing their outsourcing activities to better manage asset services, cash management, investor services, marketing, regulatory and tax reporting, and other traditional functions.

"There's so much outsourcing going on right now, be it to augment operations or build on to a firm's core activities," notes Joseph Micallef, Partner, Tax – National Tax Leader Financial Services, KPMG in Canada. "We saw outsourcing activity growing years before pandemic, especially among the back-office, but now it's almost a necessity to stay competitive or manage the demands of the day."

## One step ahead

While some client-facing services are being entrusted to outside firms, a bulk of outsourcing activity is focused on middle to back-office operations. In particular, a growing number of firms are entrusting specialty shops or other third parties with their regulatory reporting. Considering over half of Canadian asset managers (54 percent) feel their organization is at risk from the increasing complexity of regulation and the rising costs of compliance, this uptick in external compliance-based partnerships makes sense.

"A lot of asset managers in Canada invest outside our borders where they're subject to a whole slew of global and country-specific regulations. These are costly and time-consuming to stay up with, which is why it can be advantageous to bring in extra regulatory and compliance support," notes Peter Hayes, Partner and the National Leader for Alternative Investments, KPMG in Canada.

Regulatory pressures have also spurred outsourcing activity. And with Canadian client reforms lacking clarity (e.g., know your client (KYC) and know your product (KYP)), it will be critical for firms to understand how these will impact their front office in order to effectively compete while at the same time determining which digital tools should be developed, purchased, or partnered upon as they reimagine how they are serving their clients and staying compliant with the regulations.

The events of 2020 have motivated regulators to take their foot off the pedal in regards to some of the customer relationship management (CRM) measures that were in the 2020 pipeline. Still, it won't be long for regulatory agendas begin picking up speed and pose costing risks to fund managers of all sizes.

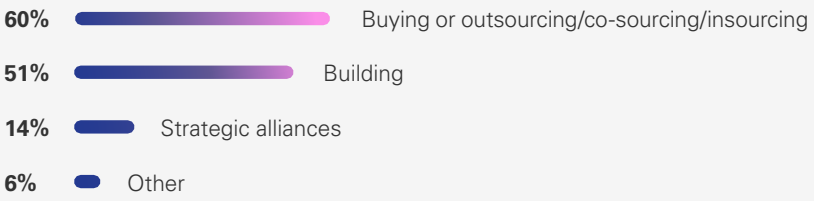
With a bird's eye view of the country's regulatory environment, Hayes notes, "Overall, Canada has a friendlier regulator than most, and we do have initiatives to try to decrease regulatory burden and redundancies. Nevertheless, it's all net-net and there will be more to comply with every year."

## New models

Adaptation is "business as usual" in the Canadian asset management. And as the section on digital transformation makes clear, the upticks in M&A activity, outsourcing moves, and business model shifts are all motivated by a common desire to keep speed with clients, stay on top of compliance, and exceed stakeholders expectations in a time where nothing can be taken for granted.

How will you adjust your technology investment plan for front, middle and back office needs to accommodate the next two years?

*(Respondents were allowed to choose multiple responses)*



# Making way for the new reality

As the impacts of a global pandemic come into focus, the question in boardrooms is clear: What comes next? Responses vary among our 2020 asset management opportunities & risks study participants, yet there is a common understanding that managing human capital and day-to-day operations won't likely return to "normal" in the new reality.

## Enter: The hybrid workplace

Much has been said about the work from home (WFH) revolution. Still, what does the shift to remote "offices" and hybrid teams look like for an industry that trades in interactive investment and research teams, responsive client service and long standing personal institutional relationships? This question is top-of-mind for Canadian asset managers, over a third of whom anticipate that the most significant long-term impact of COVID-19 on their business will be how their employees work – be it through permanent WFH settings, in-office arrangements, or a combination of both.

As virtual and physical offices collide, organizations are challenged to find common ground. As Joseph Micallef, Partner, Tax - National Tax Leader Financial Services, KPMG in Canada, notes: "While most respondents have ranked how employees work as the most significant impact, it's important for firms to develop policies and processes to maintain operational effectiveness in the long term. Moreover, as innovation can often suffer as a result of remote working, it's critical that management experiment with out of the box ideas in regards to collaboration to foster creativity."

How is the Canadian industry adapting to the challenge of engaging the new hybrid workforce? The section on digital transformation examines how asset management firms are leveraging new and emerging tech to keep teams connected and innovated in WFH situations. Similarly, in the section on relations and operations, we discuss how ramping up remote work capabilities has also spurred M&A and outsourcing activity.

The pandemic may have caught Canadian asset managers by surprise, but it did not find them unprepared. 91 percent of respondents claim to have had a business disruption plan in place before the events of 2020.

**60 PERCENT**

of Canadian CEOs plan to reduce their office space

*(2020 KPMG Canadian CEO Outlook)*

Still, with nearly a quarter of Canadian asset managers anticipating a full return to pre-pandemic office operations, the more compelling question may be: How will physical office spaces adapt? Answers may lie within KPMG's 2020 Canadian CEO Outlook, wherein a significant majority of respondents (60 percent) indicate they are planning to reduce their office space, as well as anecdotal evidence among KPMG's clients which points to a desire to rethink traditional workplace functions.

As always, the name of the game is adaptation. And with regards to accommodating teams in the new reality, asset management firms are tasked with rethinking how their physical office spaces can be used to facilitate the needs of their occupants and their remote co-workers. That means layouts that can be reconfigured to support collaborative teamwork or connective technologies that enable virtual meetings and remote project management. It also means acquiring the "soft skills" that today's business leaders need to keep every member of a team engaged, productive, and feeling part of the team no matter where the sign in.

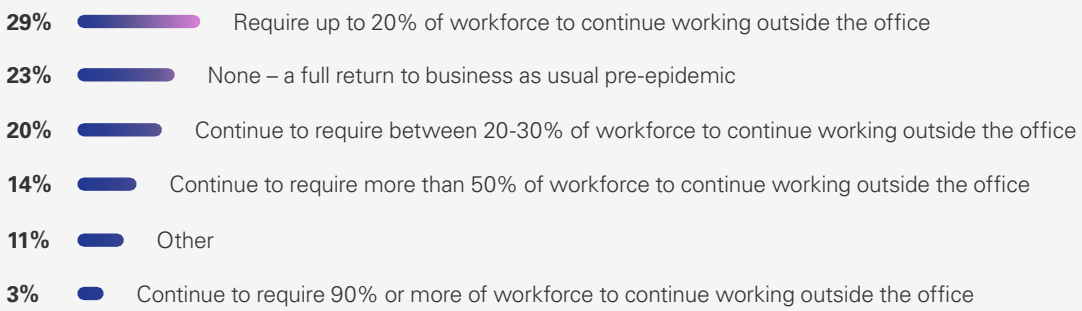
## Protecting the value chain

Managing the hybrid workforce is one challenge on the industry's horizon. So too, however, is extending the same considerations for the product manufacturers, advisors, sales team, and other partners who encompass an asset management firm's network.

It's not just employees who are working remotely; it's also the partners throughout the asset management value chain. Patchwork solutions and short-term fixes have helped firms manage delays or disconnects in their network throughout the pandemic. Still, long-term success lies in the ability to turn those band-aid solutions into permanent strategies.

With the stay-home measures, physical distancing, and safety concerns resulting in virtual workplaces being the new normal, to what degree will these operating practices be continued on a longer-term basis?

*(Respondents were allowed to choose multiple responses)*



**46 PERCENT**

of Canadian asset managers believe the federal financial subsidy programs have gone far enough to support the asset management industry throughout the pandemic (11 percent no, 40 percent not sure).

## Business as (un)usual

The fact virtually all Canadian asset managers had a business disruption plan in place before COVID-19 is promising. And although it's unlikely those plans took a global health crisis into full account, these business continuity plans played a significant role in the industry's ability to weather the storm.

"There have been no monumental collapses in the industry, and I think everyone was perhaps a little surprised by just how seamlessly and smoothly the industry has responded to the pandemic," says Peter Hayes, Partner and the National Leader for Alternative Investments, KPMG in Canada. "That likely speaks to the strength of the continuity plans that were in place."

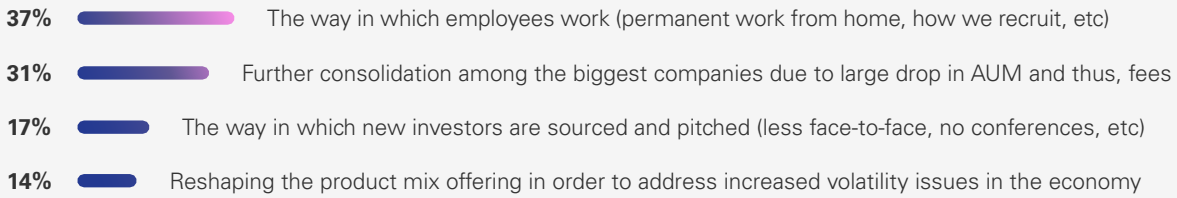
The best-laid continuity plans can only take asset managers so far. As the new reality takes shape, the ability to accommodate new attitudes and approaches to work will be the true test of resilience.

"What is vital now is a multi-year, pan-Canadian strategy to help our economy rebound and grow. We need to invest strategically in our recovery to get the most value for future investment, recognizing that some regions, sectors, and workers will face greater difficulties for the foreseeable future."

– Joseph Micallef, Partner, Tax – National Tax Leader Financial Services, KPMG in Canada

What do you think the most significant long-term impact will be for the asset management industry due to COVID-19?

*(Respondents could only choose a single response)*



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