

Resilience in asset management: Persevering in challenging markets

Transcript

NARRATOR: Welcome to the industries podcast series, where Grant Thornton shares information through an industry-specific lens about the most important business issues of the day.

MICHAEL PATANELLA: Hello everyone and welcome to our asset management podcast relating to resilience in asset management. My name is Michael Patanella. I'm the National Managing Partner of our Asset Management group for Grant Thornton. And I have the pleasure today of speaking with David Allen, who is our asset management luminary relating to this topic. Hi, David. I wanted to give you the floor here to see if you can give us just a little bit of your background before we get into some questions.

DAVID ALLEN: Sure. Good afternoon, Michael, and thanks for inviting me to join today. As you mentioned, my name is David Allen. I started my career actually on Wall Street in the '90s as an options trader and eventually I kind of got bit by the energy bug. I moved upstairs to help a number of asset managers think about how they wanted to restructure and monetize energy assets after the fall of Enron. And then in the second half of my career, I've been more of an investor, both on the private equity and private credit side and also personally as an investor in some really interesting energy transition and fintech opportunities over the last 10 or 12 years. I've advised funds like Apollo and BC Partners and CBRE investment Management, and I'm really honored to be a luminary with Grant Thornton assisting you and the asset management team in navigating some really interesting but uncertain times ahead.

MICHAEL PATANELLA: That's great, David. What a pleasure to be here and working with you. And you mentioned it, right? We're in very challenging times right now and there's been a lot of different turmoil. It's come, it's gone. There's been some flashes of greatness and then in some cases disaster. Can you talk maybe and just give the audience just a high-level overview of some of the broad challenges that different firms are having right now?

DAVID ALLEN: Sure. I'd be happy to. This is by no means an exhaustive list, but as you alluded to, Michael, some of the headwinds that we face or just crosswinds that we face right now certainly relate to inflation. And it's not just input cost inflation and commodity inflation. It seems to slowly be wage inflation and the stickiness and persistence of inflation, I think, is greater than a lot of the pundits thought it might be or hoped it might be.

That has also impacted the cost of technology. It's impacted the tightness within the labor market and it's also had some sort of knock-on impacts as well in the interest rate market. So as the Fed tries to use its tools to try to tamp down inflation, we get kind of a double whammy of higher interest rates and more volatile and uncertain interest rates as you can see in the term structure of the interest rate curve, where near-term rates remain a lot higher than longer-term rates.

So all of these present real challenges for committed capital and I think they also present challenges for sort of conventional asset managers like banks and mutual funds and insurance companies who as you probably have noted have been hung by the challenges of trying to finance through public market debt and bank loans, a lot of the M&A that had been popular and more robust prior to the pandemic hitting.

So that mid-2020 period is really what catalyzed all of this and what started all of this. The opportunity to deploy capital during dislocations was kind of limited. It seems like in the last 10 or 15 years, 20 years, these crises present these dislocated markets. But the time period of dislocation seems to be shrinking with each crisis that we're presented with. And so where we're left right now is in a market where valuations seem relatively well-bid where cost and inflation pressures are making it harder for a lot of private equity, private credit, hedge funds and banks to pencil out of a profitable asset management business. And so they're really starting to think very critically about where they can save on cost, where they can automate or digitize, and how to use outsourcing effectively.

MICHAEL PATANELLA: Yeah, that's right. And I think when you when you talk about resilience and when you look at your business model and the different areas, whether it be, looking at outsourcing, which is something I'd like for you to touch upon, how will we and asset managers taking the compliance, administration, marketing, all the different areas and looking at them from both an employee retention standpoint, profits are coming down for asset managers, and looking at all different aspects of your business now both in the short term and long term, it's challenging. Maybe you could touch a little bit about how firms are using different strategies during these times.

DAVID ALLEN: Sure, happy to give that a try. So again, one of the things that the pandemic on leashed was this period where a lot of us in asset management are under a much more critical microscope right now in terms of how management fee income is being spent, how efficient asset managers are being in their fundraising and also in the structuring of the products that they're offering.

And so to the extent that they can use technology and bring that to bear to automate and create more efficiencies in certain more manual or sort of traditional grunt work processes, that's obviously time and money well spent. To the extent that they could leverage themselves

as fundraisers and investment relations people and bring in some third-party marketers or outsource certain pieces of the IR function, again, ones that lend themselves more to automation, asset managers are certainly trying to do that. But I just want to highlight that as always, there's a very delicate balance between trying to be thoughtful and efficient in bringing technology to bear and in bringing outsourced business services or managed services to bear as we procure them from professional services firms versus the other side of it is, losing control.

And I think that striking that balance is going to be very, very fund-specific. It depends a lot on the age and vintage and legacy of your asset management firm. It depends a lot on the regulatory regime that you operate under either here in the United States or globally. So it's not just as simple as deciding, OK, I'll take this relatively easy-to-outsource process and bring in a new vendor. There are obviously some other considerations.

MICHAEL PATANELLA: Absolutely, David. And we help clients within our asset management group make these transitions. We find that a lot of times it's how you approach it with your teams and it's a little bit of a culture change that you have to go through and as you said, it's not as simple as just dollars and cents. There's a very large people aspect to it.

There are certain areas of a business where you can decide to maybe not make a certain change. Maybe technology could be possibly one of them, you may be competitively disadvantaged if you don't do that. But you mentioned regulatory and when I think of things that you absolutely need to really address, I think of cyber risk and what that can do to an asset manager if they do become vulnerable, something that maybe shouldn't be put off. Can you talk a little bit about cyber, some of the reality of it that you've seen and then also if there are any other type of must-do changes where you must deploy capital at this time?

DAVID ALLEN: Sure, there are several gating issues, I think, when institutional investors take a look at allocating to asset managers, and obviously they come up both hopefully during due diligence when one is looking to go through this sort of checklist of is this asset manager investing in institutional-grade operational infrastructure and certainly you mentioned cyber. It's probably one of the top things that institutional investors and LPs in general care about because the proliferation of attacks and ransomware is so common now, unfortunately, and the tools that we have to try to prevent and mitigate are still kind of rough.

So a big portion of this is policy and hiring the right CISO, not only at the asset company level, but also integrating that and coordinating that with the efforts at the portfolio company level. Many CISOs are looking for partners in that journey. They don't want to just install a piece of software. They want to be situationally aware, and so we constantly are looking for the best advisers that can help us get ready and prepared, not just as we go out and market and try to fundraise to show that we're ready and prepared. But God forbid if there is a breach or a threat

that needs to be mitigated, we want to know that we have a partner that's there to help us with that too.

So as the universe of surface area for bad people and bad actors to attack become wider and broader — and by the way, the pandemic certainly didn't help with that, as it promoted more remote work and communication over personal devices and a lack of archiving and reporting and monitoring — as that has all happened, I've noticed that this has become an issue that the SEC is more aware of and beginning to implement certain rules. But well before the regulators, the asset management companies themselves need to take a first-mover approach and make sure that they've put up their defenses as best they can.

MICHAEL PATANELLA: Agreed. And cyber insurance and how the insurance companies are looking at premiums really is dependent on the control environment and some of the procedures that the asset management firm is either having perfectly put together or lacks and is looking at very closely. So they're educating themselves, helping clients in a lot of different ways mitigate that through the asset manager. And as you pointed out, if it's private equity, some of the additional portfolio companies.

One area I'd like to switch to, David, is we talked a little bit about just asset management changing and from a revenue perspective as well, the overall returns and certain sectors of asset management are negative with people losing money. As much as we strive to make money all the time, these markets are very tough. And in doing that, talent at some point becomes very focused on the future. And deploying some of these different levels of capital in different areas of the business could keep individuals, and they're seeing that there's still a growth trajectory. Others will look at, maybe, competing firms, and compensation comes in, and there's definitely a shortage of overall talent. And keeping individuals when the carry isn't coming in or the returns aren't high from an incentive allocation, maybe for a hedge fund, I know there are a lot of different ways that asset managers have cleverly thought about this. And I thought maybe it would be a good question to see your view on how firms are addressing this and how the retention piece of asset management in this resilience environment is being handled.

DAVID ALLEN: It's really an excellent question because it's so existential to the asset management industry. Certainly in asset management, whether you're at an insurance company, a family office or a private capital fund, you must make money in order to spend money. It doesn't work the other way. So in times where margins are compressed, in times where exits are delayed, in times where you're not finding good value and feel like you're chasing, these are the stressful times where it becomes really difficult to kind of map out in a linear way, what should I do next?

However, one of the most important, the lifeblood of your team are the human beings that make up that team and especially recently the junior to mid-level folks are absolutely imperative to

have in seats and happy and doing good work and well rewarded. And so I've noticed that in an effort to recruit and retain the right kind of talent, it's really important to make sure that as mentors, as managers of businesses, we really help — it comes down to, Michael — something as simple as just spending the time to help a young person manage and plan their career.

What a lot of folks want to know, is what does advancement within the asset management industry mean? How many years will I stay as an analyst? How do I graduate into the associate program? Does that allow me to get deal carry, ever? Will there be a chance for me to get fund carry if I make partner, and what does making partner look like? What kind of deals can I work on? What kind of late-night, more boring work might I have to do? This should never be a surprise. If it's a surprise to your talent, then they're likely to wind up being disappointed and they'll leave.

And so, a) mapping out that course for them and helping get buy-in from them, that that's something that they're game to do is very important. And then providing them the professional training, but also just on-the-job mentoring. Again, COVID created arrested development around that because our junior to intermediate talent really does need that water cooler chat and that time in the office with management sitting down and helping them screen deals and look at data. So all of these things are really meant to align folks to performance, align compensation and set as to performance.

And I might add one of the topics that we talked about, which was outsourcing, that can be a helpful tool, too, if we can outsource some of the more mundane but automatable processes. If we can outsource some of the basic blocking and tackling to either technology groups or offshore it to groups that are able to do it for us a little more efficiently, it does take a little bit of pressure off of the domestic team and it allows them to focus on either fundraising or captive origination of new deals or structuring of new products for LPs that have very custom needs. And so again, in trying to do that, we sometimes find that we need liaisons like Grant Thornton to help us interact with that fund administrator, interact with that custom report writer, interact with that law firm or outsourced compliance group, again taking pressure off of the full-time folks that are on the desk.

MICHAEL PATANELLA: Yeah, I agree, David. And I think you make a good point — a couple of good points there. Going to your providers now during these more difficult times and asking what other clients are doing. At Grant Thornton, we have different forms to bring our clients together to have conversations about specific areas, that they may be in a changing environment within the organization. We also, to your point earlier about some of the younger individuals in their careers and at that next level we've taken upon kind of a journey within that group to bring individuals together and provide different levels of mentoring, which you'll be very much involved in, David, and helping to give that — and every company is different — but

helping to give some of the main themes of what it means for progression, what the other firms in their asset management group are doing and what trajectories look like.

Because not all companies take the time to do that, and some do a very good job of it. So it depends on what firm you're with and where your peer group is that you have communications. So that is something that we have rolled out and if anyone is interested, we'd be happy to give some more information. But with that, David, I'd like to thank you for your time, thank all the listeners and look forward to our next podcast with all of you.

DAVID ALLEN: Thanks Michael.

NARRATOR: Thanks for listening. Find out how Grant Thornton goes beyond expectations at [GT.com](https://www.gt.com)