INDEFI

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PERSPECTIVES

EUROPEAN SUB-ADVISORY: A LAND OF (FALSE) PROMISES?

Over the past five years, sub-advisory has become a central feature of the European open architecture market. This model offers many benefits to fund distributors that are looking to control an increased share of the value chain and are simultaneously grappling with increasingly tighter regulatory constraints[1].

While AuM growth has indeed materialized for asset managers, it has taken an unexpected turn as new products have outweighed existing mandates. These recent market developments also tend to play into the hands of global asset management leaders that properly leverage the growth within the sub-advisory channel.

Keeping all of this in mind, we have to ask – five years after the sub-advisory fever took hold of European distributors – is it time for a reckoning?

Open architecture assumptions – true or false?

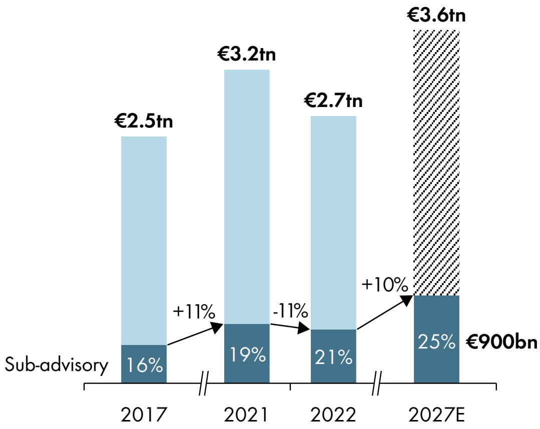
Many asset managers are building their European businesses based on the assumption that open architecture will expand, and distribution networks will open to third-party products. While there is some truth to this idea – it is only half of the story.

- Funds have been growing in proportion to European household savings during the last decade. However, the Covid period – to some extent – and recent interest rate hikes have nevertheless demonstrated that risk-free return-free investments are still a natural choice for many Europeans[2]. Old habits die hard.
- Fund flows are departing vertically integrated fund distributors. In most European markets, new channels have gained market share to the detriment of traditional banks and insurance networks. Winners include "independent" advisors and wealth managers (IFAs/RIAs), restructuring and consolidating fast under the aegis of private equity money, and online platforms and fintechs. It's important to note that these vertically integrated distributors nevertheless remain in control of the lion's share of managed savings (60% to 80% typically across the continent).
- European Union regulation has not yet taken a clear stance as to whether the dis-imbricated production-distribution model in asset management should prevail (refer to the never-ending debate on a potential ban of inducements, or heightened ESG requirements, that do not exactly make third-party outsourcing easier).

1. Indefi, "Fund selection units upset the old order and reshape fund distribution", October 2017.
2. Indefi, "Return of the living dead", November 2022.

In this constant ebb and flow between open, guided and closed architecture, there is however one clear winning channel for third-party asset managers: distributor-owned sub-advisory platforms. As of end-2022, they controlled ~20% of the European open architecture opportunity (including the UK) in AuM terms, i.e. €550bn in third-party outsourced assets, up 11% p.a. on average since 2017. **Our proprietary market projections anticipate significant growth to 2027 (€900bn and 25% of the market opportunity respectively)** as the benefits of the sub-advisory model are increasingly recognized by fund distributors.

Sub-advisory channel as a % of the European open architecture market



Sources: Proprietary market research, public sources, Indefi analyses.

An innovation-driven opportunity

While sub-advised AuM has expanded at a 10%+ rate since 2017, growth over the period exclusively derives from the launch of new mandates by both existing and new platforms. This highlights:

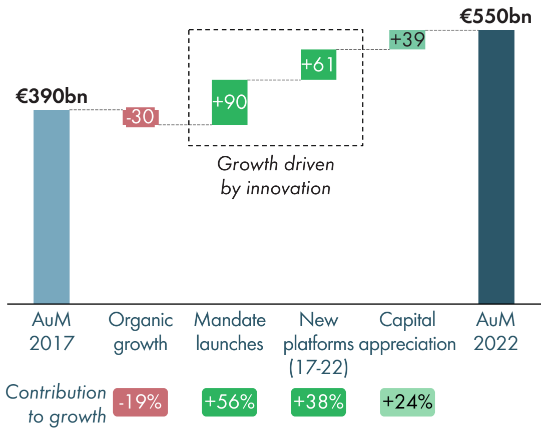
- **The appeal of the sub-advisory model for distributors**, in their drive to (re-)encapsulate margins along the value chain and exert enhanced product control;
- **The need to constantly bring to market new offers** to meet rapidly changing distributor and end-client demand, including thematic and/or sustainable strategies.

At the same time, it underlines the struggle of sub-advisory platform managers to expand their distribution reach within the realms of their group of belonging and attract flows from the variety of channels that can be tapped into. Achieving this calls for a focused business approach in terms of extracting value from third-party asset manager relationships and a renewed set of KPIs which go beyond fund/manager picking and investment performance[3].

3. Indefi, "Fund selection units: 2020 update", December 2020.

For asset managers, this result has wide-ranging implications. The most crucial one is that competitiveness in the sub-advisory channel cannot simply be derived from one-off product performance or differentiation but relies on an unfailing long-term commitment to serving the key clients that are driving growth in this channel (GFIs/ RFIs, insurance companies and leading independent distribution platforms).

Breakdown of sub-advisory market growth



Sources: Proprietary market research, public sources, Indefi analyses.

Differentiation in a not-so-diverse environment

The rise of the sub-advisory channel is increasingly playing into the hands of a select few asset managers and is ushering in a new level playing field for the industry. The top 20 asset managers captured nearly two-thirds of new inflows over the last five years, a much higher degree of concentration than what can be observed in traditional fund distribution.

In light of this increasing polarization of the market opportunity, the strategic playbook is clear:

- **Leading asset managers will need to further develop and harness the full scale of their capabilities:** This involves implementing seamless account management programs, setting-up a distribution service platform to marshal resources and capabilities toward target clients, marketing a set of differentiated services to distributors and leveraging technology advantage and digital capabilities, beyond mere investment capabilities.
- **Runners-up will have to hone their hunting skills** to take advantage of a fast-rotating market and tailor offering to individualized and fast-changing client needs. "Off-the-shelf" is over.
- Finally, **sustainability and exposure to private markets** (including hybrid liquid-illiquid strategies) should offer opportunities to conquer additional shelf space with key accounts.

About Indefi: Strategy consultants to the investment management industry.

Operating across Europe and the United States, Indefi focuses on developing and implementing growth strategies for asset managers in public and private markets, incl. distribution, product development and enhancement, sustainability strategy, acquisition support, and other drivers that enable growth. Indefi has been a UN PRI signatory since 2016. For more information, please visit www.indefi.com