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Rising Noncompensation Costs Contribute to Margin Erosion for Asset Managers: Casey Quirk and McLagan

NEW YORK and DARIEN, Conn., June 25, 2019 – Noncompensation-related expenses at asset managers have been rising steadily over the past five years and are now approaching one-third of total expense at many firms, adding to the economic stresses the industry confronts. These are among the findings of asset management strategy consultant Casey Quirk, a Deloitte business, and McLagan, a unit of Aon.

While overall industry assets under management climbed to $71.8 trillion in 2018 from $68.3 trillion in 2017, aggregate fees have declined nearly 20% in the past four to five years and overall expense growth has matched or outpaced revenue growth over the same period, according to the annual "Performance Intelligence" analysis from Casey Quirk and McLagan. As a result, operating margins fell to 32% in 2018 from 34% in the previous year.

Casey Quirk and McLagan found that noncompensation costs — including regulatory, back office processing, technology and office space — rose above 30% from 26% in 2014. As a result, for a firm with approximately $150 billion in assets under management, for example, the ongoing operational expense of conducting normal business rose $18 million to $23 million during that period, according to the analysis.

Compensation expense is also on the rise, increasing approximately 5% in 2018 from 2017 for employees below the top management level, and 3% for the most senior executive ranks. Chasing scale is becoming more difficult, with the average cost of managing each dollar of assets going up by 4% since 2014.

"It's now a necessity, not a luxury, for asset managers to reduce expenses by automating, streamlining data and technology, and shifting functions to lower cost locations," said Amanda Walters, senior manager at Casey Quirk. "Additionally, to truly impact overall costs, asset managers need to optimize their team structures and compensation plans more effectively."

Implementing these initiatives could lead to a 6.5% to 17% decrease in ongoing fixed and variable expense, according to the analysis. This could result in minimum industry-wide savings of $13 billion, allowing firms to reinvest in strategic initiatives or boost overall profitability.

Asset managers that fail to outstrip such costs with organic or acquired growth will face falling margins and lower profits for their owners or must slash costs elsewhere: shuttering business units, pruning mediocre investment strategies, and resorting to layoffs, according to the Casey Quirk and McLagan analysis.

"Today's environment serves as a warm-up to the challenges we expect during the next market downturn," said Adam Barnett, a partner at McLagan. "To succeed, firms must more effectively manage their costs and clarify their value-sharing propositions with employees and shareholders. Disruption is intensifying and no one likes surprises."

The "2019 Performance Intelligence" analysis included more than 70 investment management firms headquartered in North America, Europe and Asia Pacific, investing more than $30 trillion for institutions and individuals. In addition to Casey Quirk's and McLagan's own analysis, the study includes data from eVestment and Morningstar, Inc.

Casey Quirk, a business of Deloitte Consulting LLP, is a leading management consultancy that focuses solely on advising asset management firms. Casey Quirk was established in 2002 and acquired by Deloitte in June 2016. The firm has advised a majority of the 50 largest asset management organizations worldwide, including eight of the top 10. Casey Quirk provides senior leadership teams with broad business strategy reviews, investment positioning and strategy consulting, market opportunity evaluations, organizational design, ownership and incentive structuring, and transaction due diligence. For more information, please see the Casey Quirk website here.

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Contacts

Sarah Lazarus	Margaret Kirch Cohen	Rich Chimberg
CL-Media Relations, LLC	CL-Media Relations, LLC	CL-Media Relations, LLC
+1 617 335 7823	+1 847 507 2229	+1 617 312-4281
Sarah@cl-media.com	Margaret@cl-media.com	rich@cl-media.com