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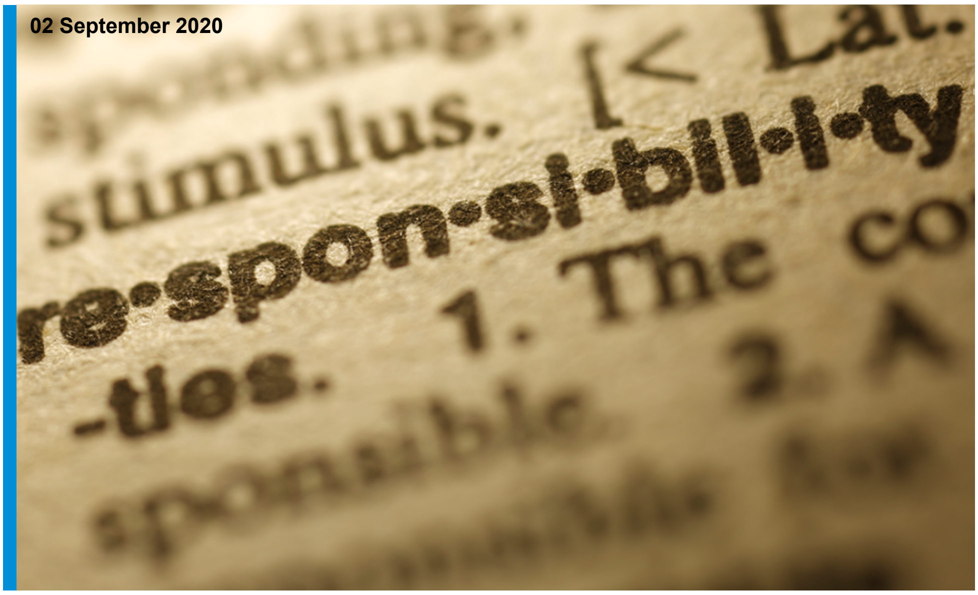

Three Ways Asset Managers Can Embrace Responsible Product Innovation

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Asset managers have to define what they mean by responsibility and align their products with that definition. And they need to invest in data, technology, and people in order to always focus on improving their outcomes rather than reducing costs and headcount.

Those were the key takeaways from the third installment in a European series of Asset Management Innovation (AMI) Initiative Responsible Innovation roundtables.

Twenty-two senior industry practitioners gathered virtually in late June to consider how the asset management industry can incorporate responsible innovation into product design.

In our previous workshop in March 2020 (https://blogs.cfainstitute.org/investor/2020/06/01/three-ways-asset-managers-can-evolve-their-business-model-and-embrace-responsible-innovation/), we discussed the challenges incumbent asset managers face integrating responsible innovation into all aspects of their business, from culture to products, when it isn't already part of the organization's DNA.

At best, changing a firm's mission and culture is difficult and time consuming. So we surfaced three strategies to help integrate responsible innovation into the business model. This meant going outside an incumbent player's structure through the start-up, spin-off, and asset managers alliance.

Since products and their outcomes are the ultimate expression of the asset manager's activities and brand, in the June workshop, we homed in on three steps for asset managers to cultivate responsible innovation in their products:

1. Define Responsibility and Stick to It

Asset managers can no longer avoid explicitly stating what they mean by responsibility. The pressure from social and generational change demands that they spell it out.

Responsibility is subjective, with as many potential definitions as there are asset managers. Though such alternatives as the Sustainable Development Goals (SDGs) could provide a common denominator, asset managers must each choose their own definition and embed it in their mission and values to ensure that it is integrated into their products throughout their life cycles.

While this value adjustment might be challenging, especially for the incumbent asset managers, it is an important step in reviving and strengthening trust in the industry. A product's success or failure should be clearly explained to clients. This won't be easy in an industry that stigmatizes failure. But clarity about the intent and outcome of our actions is critical to trust. Investors need to have the data to judge a product's performance/impact and asset managers must cultivate that transparency.

Lastly, however they define responsibility, asset managers must engage with retail clients. The biases and goals of non-professional investors are distinct from those of their professional counterparts. Professional investors, asset managers among them, need to know why a product is sensible and relevant for a retail investor.

Asset Management Innovation (AMI) Discussion Participants

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Thibaut Gunsey, CFA	Olivier Leblue, CFA

2. Invest in Data and Technology

Once responsibility is defined, asset managers should apply as much data and technology as possible to create better outcomes for clients and other stakeholders in line with its own definition of responsibility.

Some areas have more data available than others, but asset managers must be proactive. For example, one of the objectives of the EU's environmental action plan is to bring clarity to what is and isn't "green" and to provide full transparency on the underlying investments and quantify which are green and which are brown. An asset manager's responsibility might be to work to make that aspiration a reality for their clients. Also, while some believe regulators can hamper innovation, responsibility might mean engaging with them to keep them aligned.

In other areas, both data and technology are available and could be more widely applied to "augment" the investment process. Application of artificial intelligence (AI) and machine learning in investment management is still somewhat marginal. But it will become indispensable. So there is still time for asset managers to get ahead of the curve.

An important caveat: AI and machine learning must be explainable. They can't be a black box. We need to have confidence that what we do is repeatable before we move it to production. And we must be able to make it understandable to our clients. No one trusts a benchmark that is uninvestable or a code or product that is irreproducible.

Finally, despite the stigma, failure needs to be permissible. Responsible innovation requires a "fail better" environment where failure is an opportunity for insight, analysis, and growth rather than blame and recrimination.

3. Focus on Creating Better Outcomes Not Cutting Headcount or Costs

Reducing costs and headcount are short-sighted responses to the challenges asset management firms face. They're classic short-termism: Such measures will improve the P/L for the next reporting season, but only at the expense of the firm's long-term viability.

Asset managers need to think beyond the next quarter and, for example, apply AI and machine learning techniques to improve outcomes for all stakeholders as well as their competitive position in the marketplace. The augmented analyst who effectively fuses their innate human intelligence with AI (https://blogs.cfainstitute.org/investor/2018/03/29/artificial-intelligence-and-the-future-of-investment-management/) will make firms more competitive and more likely to survive. And that means embracing a free-to-fail environment where staff retraining and constant fine tuning are the order of the day.

Finally, for innovation to grow in prominence in the asset management industry, we need more "translators," people with hybrid backgrounds and expertise in multiple disciplines — asset management and AI, for example. Professionals with these so-called T-shaped skills will be essential in helping C-suite and senior management teams understand and validate responsibly innovative products.

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