COVID-19 and the mutual fund industry
An acceleration of trends
COVID-19 and its economic and social disruptions have given new urgency to the challenges facing mutual funds. Last year, in our publication *Mutual fund outlook: the time to act is now*, we highlighted trends we expect to see from 2019 to 2025, such as slower growth and shrinking fees. These trends have all accelerated,¹ and mutual fund managers need to move even faster to maintain and improve their positions.

With the pandemic in mind, you may now be rethinking your forecasts and expectations for the near- and mid-term future. But this isn’t just about playing defense: There are steps you can take now to help you prosper over the next five years.

¹ PwC, *Mutual fund outlook: The time to act is now*, July 2019.
An industry under pressure:
Tighter margins, more consolidation and a changing workplace

Organic growth in the US mutual fund industry has continued to slow, despite upside surprises in the overall market. The long-term outlook is under stress, too, from downward pressure on fees, reduced profit margins and changing investor preferences. Adding a pandemic to the list deepens the challenge for asset managers trying to remain competitive.
A difficult road ahead: pressures on the margins

Clearly, asset managers can’t depend on AUM (assets under management) growth and the fees it generates to sustain their business as they once did. Last year, we estimated US AUM growth would average 5.6% annually between 2018 and 2025;\(^2\) we now forecast such growth to hit only 3.1% between 2019 and 2025. There’s a much more difficult road ahead.\(^3\) Meanwhile, the market keeps shifting into passive funds. In 2019, passives accounted for 39% of total US mutual fund/ETF industry assets. By 2025, we estimate they’ll account for 55% of the industry’s total assets (see Figure 1).\(^4\)

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Figure 1: The growth in passive funds moves forward, unabated

<table>
<thead>
<tr>
<th>Year</th>
<th>Active AUM ($T)</th>
<th>Passive AUM ($T)</th>
<th>Total AUM ($T)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>$10.3 T</td>
<td>80%</td>
<td>$20.0 T</td>
</tr>
<tr>
<td>2019</td>
<td>$22.4 T</td>
<td>61%</td>
<td>$38.5 T</td>
</tr>
<tr>
<td>2025</td>
<td>$26.8 T</td>
<td>55%</td>
<td>$52.3 T</td>
</tr>
</tbody>
</table>

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\(^{2}\) Ibid.

\(^{3}\) PwC analysis based on data from ICI.

\(^{4}\) Lenova, Olga. “Corporate Governance In The Age Of Passive Investing,” Mondaq Business Briefing, February 14, 2019, accessed on Factiva June 20, 2020 and PwC analysis based on data from ICI.
While this shift to passive inherently results in lower revenues for managers, downward fee pressure isn’t new. By 2025, we calculate that expense ratios across active and passive funds will be about a third lower than their already low levels in 2019 (see Figure 2). The ongoing decline in total expense ratios (TERs) for both active and passive funds means fund managers could find it hard, or impossible, to find any profit margin improvement.

Lastly, there is one trend that is consistent across fund products and the workplace: the rise of environmental, social and governance (ESG) funds. Consumers are demanding it, and workers are expecting it. In fact, we anticipate that total assets of ESG-based funds will grow an average of 10% annually between 2019 and 2025.

Figure 2: Active and passive total expense ratios in active and passive funds continue to fall

![Figure 2: Active and passive total expense ratios in active and passive funds continue to fall](image)

<table>
<thead>
<tr>
<th>Year</th>
<th>Active TER</th>
<th>Passive TER</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>84 bps</td>
<td>23 bps</td>
</tr>
<tr>
<td>2015</td>
<td>74 bps</td>
<td>16 bps</td>
</tr>
<tr>
<td>2019</td>
<td>66 bps</td>
<td>12 bps</td>
</tr>
<tr>
<td>2025</td>
<td>57 bps</td>
<td>8 bps</td>
</tr>
</tbody>
</table>

-39%

5 PwC analysis based on data from ICI. Estimates for 2020 based on PwC Analysis.
6 PwC analysis based on data from Simfund data and internal estimates.
7 PwC analysis based on data from ICI.
8 Lenova, Olga. “Corporate Governance In The Age Of Passive Investing,” February 14, 2019, Mondaq Business Briefing, accessed on Factiva June 20, 2020 and PwC analysis based on data from ICI.
9 PwC analysis based on data from ICI. Estimates for 2020 based on PwC Analysis.
The big get bigger

Across all asset management, consolidation continues, and the pandemic doesn’t seem to be slowing M&A appetites. We now expect that up to 20% of today’s mutual fund firms could be bought or eliminated by 2025.10 Mega managers, the top five US mutual fund managers, will take most of the growth, accounting for 68% of mutual fund AUM by 2025, up from 53% at the end of 2019.

This will affect products, too. Along with firm consolidations, we see changing investor preferences and demand for lower fees leading to closure of roughly one in seven mutual funds between now and 2025.11 New products, such as a 30% growth in ETF funds, will likely offset some of these closures, so we now expect a 6% net reduction in the overall number of registered fund products.12 Most mutual fund managers will face some difficult decisions in the days ahead, as they try to maintain consumer interest while competing with mega managers’ scale.

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11 PwC analysis based on data from ICI and Strategic Insight Simfund.
12 Ibid
14 Ibid
15 PwC analysis based on data from ICI and Strategic Insight Simfund.
16 Ibid
Rethinking the workplace

Many US mutual fund managers had already been making sizable digital investments when the COVID-19 pandemic hit. This helped them switch their teams to working from home (WFH). Our June 2020 Remote Work Survey found that 69% of financial services (FS) executives surveyed felt their firms’ employees were at least as productive after the abrupt shift to WFH.17

The pandemic won’t last forever, but the pre-pandemic workplace is unlikely to return any time soon; the need to reduce costs won’t allow it. Some 70% of FS companies will have the majority of their employees work from home at least once a week.18 We now predict a 10% reduction in mutual fund employment over the period from 2019 to 2025, tied to cost trimming, fund consolidation, and increased automation and outsourcing.19

Firms will likely lean heavily on digital labor and third-party service providers. For example, we expect that mutual fund accounting outsourcing could nearly double to around 80% by 2025.20 Tax outsourcing could rise from 70% in 2019 to 90% by 2025.21

Lastly, to continue to attract a workforce with the kinds of skills their firms need to continue to grow in the digital economy, mutual fund managers will have to consider how they are recruiting and training employees, aligning corporate and employees’ values, addressing sustainability and corporate responsibility, and their overall investment thesis in the market.

Prediction 7: Approximately 70% of FS companies will have the majority of their employees work from home at least once a week.22

Prediction 8: We expect that there will be a 10% workforce reduction in mutual funds over the period from 2019 to 2025.23

Prediction 9: Mutual fund accounting outsourcing will nearly double to roughly 80% by 2025,24 and mutual fund tax outsourcing will rise from 70% in 2019 to about 90% in 2025.25

17 PwC, “Financial services firms look to a future that balances remote and in-office work,” July 1, 2020.
18 PwC analysis based on data from PwC, “Financial services firms look to a future that balances remote and in-office work,” July 1, 2020.
19 PwC analysis based on data from ICI and internal estimates.
20 PwC analysis, based on Simfund data, Form ADV and internal estimates.
21 Ibid
22 PwC analysis based on data from PwC, “Financial services firms look to a future that balances remote and in-office work,” July 1, 2020.
23 PwC analysis based on data from ICI and internal estimates.
24 PwC analysis, based on Simfund data, Form ADV, and internal estimates.
25 Ibid
Building the future-fit mutual fund: Strategic positioning, tech transformation, rethinking the workforce and value for money

Tighter margins, more consolidation and a changing workplace: There could be some tough years ahead, especially if your funds aren’t particularly differentiated. But client needs aren’t going away, and there will be winners. Your success could depend on how you position your firm, use technology, define your workforce and create value.
1. Strategic positioning

With this pressure, you have to give clear and consistent direction to your employees, investors and regulators. For many, this means questioning what products you offer, where you compete, which distribution channels you use and how you tell your story.

**Innovative products.** As funds with less complex investment strategies get squeezed, look for ways to stand out with more differentiated products. Some of the most promising areas will likely include more exchange-traded funds (ETFs), smart-beta funds, periodically disclosed active ETFs, and ESG and outcome-oriented funds.

**Scale or niche? Maybe more ...** Large firms have the advantage of scale, but bulkling up indiscriminately isn’t the only way to boost your long-term business prospects. You may turn to M&A more selectively: to expand relationships with investors, deepen niche product offerings, access technology and streamline operations. Depending on your position, smarter deals may lead to more growth than bigger deals.

**Right-source operations.** What does your firm really need to own? Savvy executives will use combinations of outsourcing, insourcing and co-sourcing. Don’t just cut costs; consider sourcing impacts, such as oversight risks and decision-making control. As you explore options for non-core services like data management, accounting, compliance and tax, look for partners that can help standardize processes, use data and technology, and bring expertise to the table.

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**Outsourcing**
- Legal compliance
- Data management
- Pre-trade compliance
- Investment research
- Custody and asset servicing
- IT services

**Insourcing**
- Portfolio management
- Investment management
- Trading and execution
- Product development

**Co-sourcing**
- Tax compliance
- Marketing intelligence
- Fund distribution
- Risk management

“Where the economy goes from here, no one can say for certain. Part of being a future-fit fund manager includes being prepared for the continued disruptions in the market.”

—Rachael Bradley, US Asset & Wealth Assurance Leader
2. Technology transformation

If you aren’t modernizing your technology infrastructure, it will be increasingly obvious to your clients. That’s because asset managers now depend on technology and high-quality data to reduce costs, analyze risks, make better investment decisions, deliver higher returns to investors and increase profits. You’ll want to stay on top of these key development areas:

**Business continuity plans** should keep your technology infrastructure scalable and agile in times of crisis.

**Vendor assessments**, including evaluation of controls, take on more weight as a vendor’s technology investments are now critical success factors.

**Total user engagement**, including with their total online experience, is gaining in importance as a way of keeping customers, along with improved transparency.

**Risk management** technology solutions will help to address evolving compliance, regulatory and risk areas.

**Indexing controls** may help you provide insight into how your passive funds track indices as planned.

**Cloud technology** keeps getting more attractive as a way to reduce your physical infrastructure and ongoing maintenance costs.

However you approach tech transformation, your program’s success will likely depend on access to high-quality data. You’ll need to source and develop reliable, consistent, quality data — to support sound analysis and decision-making, produce new revenue streams, drive M&A activity and align with third-party vendors to make sound right-sourcing decisions.
Lastly, as more FS work is done remotely, if you’re not keeping up with technology, it can be hard to know how you’ll succeed. This isn’t just about day-to-day execution of the job. You should think about digital upskilling, cybersecurity, feedback and other digital programs that have become a high priority for remote work.
3. Workforce of the future

Now that remote work could be with us for a long time, you’ll need to address technology—but it’s also time to identify and update processes, job roles and cultural changes that need to occur to make this shift work.

You’ll want to consider broader trends. As automation techniques improve, you may need fewer back-office employees to cover key roles, even as you expand your bench with more employees skilled in data analytics, cybersecurity, vendor oversight, and productivity and wellness.

Lastly, the nature of the workforce in the mutual fund industry is still changing, regardless of the pandemic. Firms that are succeeding have a diverse workforce that is capable of using the latest technology in a host of areas, such as data and analytics. In order to retain these valued workers, winning firms have had to alter their culture to stay competitive in the talent race, such as by improving work-life balance and becoming more socially conscious in their approach to investment.

### Financial services jobs are changing

<table>
<thead>
<tr>
<th>Fewer jobs</th>
<th>More jobs</th>
<th>New jobs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operations</td>
<td>Analytics</td>
<td>Productivity</td>
</tr>
<tr>
<td>Procurement</td>
<td>Cybersecurity</td>
<td>Stakeholder relations</td>
</tr>
<tr>
<td>Technology</td>
<td>Innovation</td>
<td>Vendor management</td>
</tr>
<tr>
<td>Finance</td>
<td>Vendor management</td>
<td>Wellness</td>
</tr>
</tbody>
</table>

Financial services jobs are changing: Operations, Procurement, Technology, and Finance, resulting in more jobs in Analytics, Cybersecurity, Innovation, Vendor management, Marketing, and Risk, and new jobs in Productivity, Stakeholder relations, and Wellness.
4. Value for money

These days, investors want it all: superior returns, excellent client service and programs that are socially conscious. You’ll want your offerings to give the value that your specific clients care about the most.

**Socially conscious products:** While ESG investing has existed for some time, it keeps gaining traction with both existing and potential clients. It’s getting regulatory attention, too. For now, there are no standard definitions for ESG investing in the US, but investors will expect enough visibility to understand your approach for themselves.

**Humane asset manager:** The industry still suffers from a loss of trust stemming from the 2007 financial crisis. Now, with societal shifts tied to the pandemic, we’re all confronting society’s broader issues more directly. This is shaping up to be a bigger issue than lower AUM growth and fee suppression. It’s also a chance to differentiate your offerings by redefining your firm’s relationship with its employees, boards and society at large, by:

- Focusing on financial wellness and outcomes
- Improving diversity, inclusion and the well-being of employees
- Shifting priorities beyond financial performance
- Caring for and helping to protect the environment
- Fostering involvement in the communities in which your firm operates
- Becoming agents of societal change and elevating the moral purpose of the industry.

Competing based on purpose rather than price has its own challenges, but it may help your clients and society. Some fund complexes’ long-term survival may even depend on it.

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**Prediction 10:** We expect total assets of ESG-based funds to grow an average of 10% annually through 2025.\(^{26}\)

\(^{26}\) PwC analysis based on data from Simfund data and internal estimates.
Premium services: Investors understand the need to pay for services, but as many valuable services are now available at low or no cost, the fund value proposition just isn’t as reasonable to them. You may want to consider how performance-linked and/or fulcrum fee structures could better align your managerial ability with investor value. You may also explore new ancillary services, such as automated tax-benefit advisors, financial wellness tools and more complex analytical guidance. In addition to generating revenue, these services are sticky — embedding firms in the daily lives of their clients and increasing customer loyalty.

Data, again: You may already have access to your “secret weapon,” if you can put it to work. Good data is essential to identifying and understanding investor value, as well as a firm’s ability to deliver it. Data can give you valuable insights into what investors want and need. You may also be able to monetize it, creating new revenue sources, such as subscription services, and using data to identify ways to reduce costs.

Changes are coming—just faster now

Last year, we saw that the mutual fund industry was hitting a wall. Now, COVID-19 is magnifying and accelerating the challenges facing the sector. We are still seeing a fee crunch and slower AUM growth, but the compression is happening over a shorter timeline and with more severe results.

Mutual funds that make it to the other side of this market need to be future-fit:

- Positioned to succeed in a market dominated by mega managers
- Using an adaptable tech infrastructure that is suited for what comes next
- Supported by a remote workforce with the right mix of talent to meet their goals
- Providing real value to investors while also maintaining sustainability promises.

It’s obviously a tall order. But your clients are counting on you to give it everything you’ve got.

“More than ever, the future is uncertain. But, the mutual fund industry should look at this uncertainty as an opportunity to remake itself, providing new value to the investor and sustainability for society.”

—Bernadette Geis, US Asset & Wealth Management Leader
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