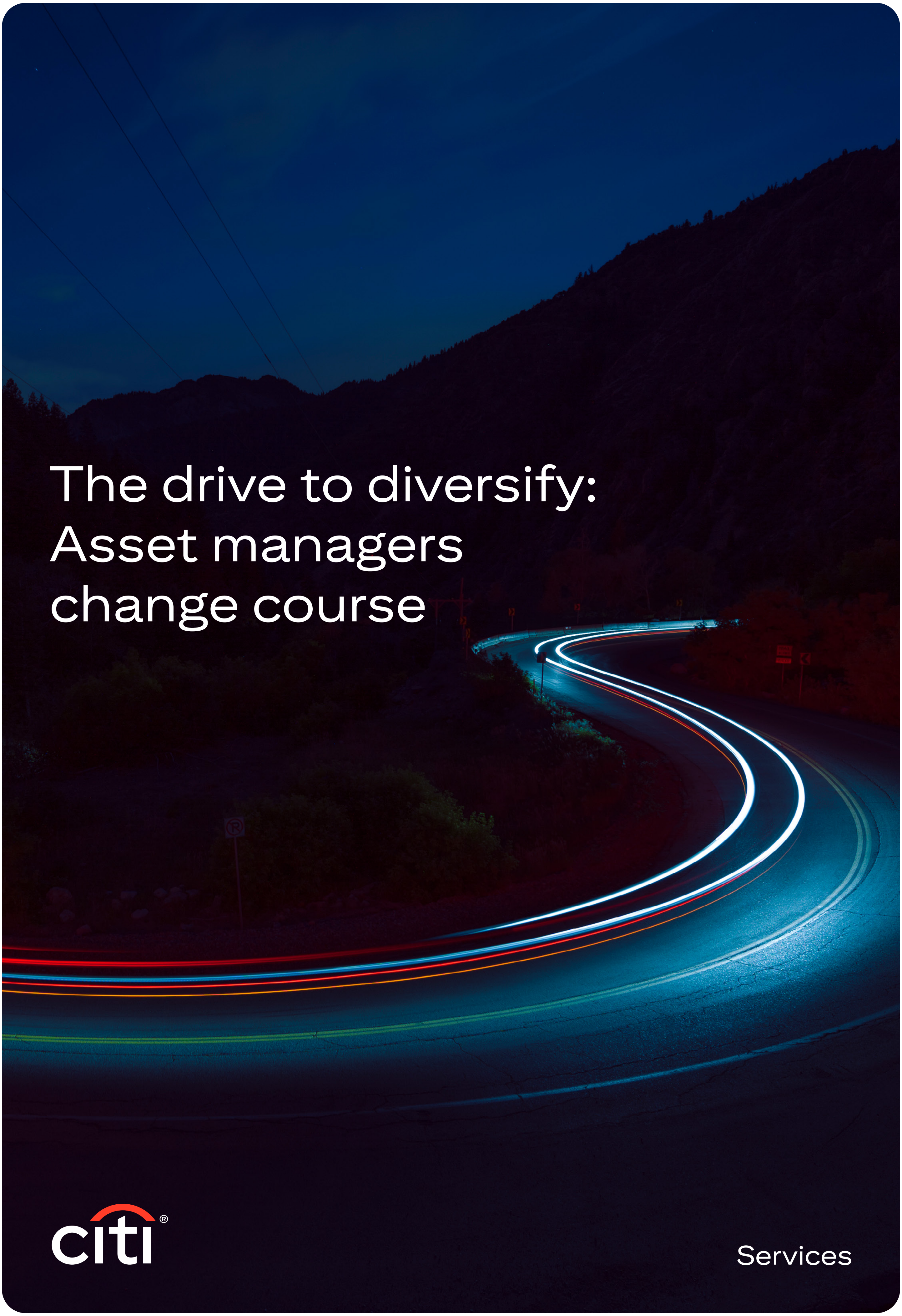
The drive to diversify: Asset managers change course



Services

What began as a trickle is now rapidly turning into a flood.

Active asset managers in Europe, hungry for higher yields and better client diversification, are testing the waters with new investment products. Whereas previously, equities and fixed income were the strategies of choice for most asset managers, an increasing number are now repositioning themselves towards passives and private markets.

As asset managers embark on this ambitious diversification drive, choosing the right fund domicile and service provider has never been more important.

If you can't beat them, join them

Active asset managers are feeling the pressure as client withdrawals show no sign of tapering off following disappointing returns and concerns about fees.

Data from Boston Consulting Group (BCG) found that out of the $128 trillion controlled by global asset managers, active's Assets under Management (AuM) share declined from 65% in 2023 to 61% in 2024.[1] Amongst institutions, active's AuM share has shrunk to 38% - down from 44% five years ago.

"These outflows from active funds are primarily happening because investors, both retail and institutional, are redeploying their cash into lower cost passive products," said Sarah Sutton, Europe Head of Sales and Client Service, Investor Services, Citi.

This is corroborated by BCG's findings, which noted that passives have seen their institutional AuM share jump from 17% to 20% over the last five years.[2] "In order to stem client withdrawals, we have noticed that more European active managers are beginning to strengthen their passive capabilities," continued Sutton.

Some are doing this either by establishing passive funds from scratch or through tactical M&A, while others are launching Exchange Traded Fund (ETF), again either from scratch or exploring launching share classes of existing mutual funds. Many are looking to the US, where the conversion of Mutual Funds into ETFs has become an established route to market, although this is still more an aspiration than reality in Europe.

"For many European active managers, launching a passive product, such as an ETF, offers compelling distribution opportunities, particularly in the under-tapped retail segment," commented Sutton.

Active managers take on private markets

European active managers are also eyeing up private markets, as they look to shore up performance and broaden their distribution footprints.

Notwithstanding recent macro events, i.e. high interest rates, inflation, US trade tariffs, etc, private markets have consistently outperformed public markets over a 5-, 10-, 15- and 20-year time horizon[3].

"Private market strategies have delivered strong returns over the long-term. Amidst volatility in public equities and fixed income, some active managers are now seeking out an illiquidity premium by doubling down on private markets," said Sutton.

Buoyed by the enticing returns on offer, retail investors are also turning to the private markets. Whereas historically, large asset owners, e.g. pension funds, insurers, sovereign wealth funds, etc, were the main, traditional buyers of private market funds,

this is starting to change, as more wealth advisers and high net worth individuals up their allocations as well.

This retailisation trend is expected to be a major growth driver for the asset class.

According to data provider Pitchbook, private market assets are on course to accumulate $24 trillion by 2029, a $5 trillion jump over the next four years.[4]

"European active managers want to capitalise on this retail shift into private markets. We have seen an uptick in active managers supplementing their existing fund ranges with semi-liquid private market products, such as evergreen funds and European Long-Term Investment Funds (ELTIFs)," said Sutton.

Elsewhere, some managers are pinning their hopes on tokenisation as a retail distribution tool for their private market funds.

"Certain tech-savvy managers are toying with the idea of digitally distributing fractionalised private market fund units to retail investors. In addition to generating greater liquidity for private markets, it could also help democratise the asset class," noted Sutton.

A transition is not without obstacles

While passive funds, i.e. ETFs, and private markets can unlock plenty of distribution opportunities for active managers, diversification can create potential problems in other areas.

Take ETFs, for example.

"Operationally, running an ETF is very different from overseeing a traditional active fund. Managers need to understand how the ETF ecosystem works, together with the roles and responsibilities of ETF-specific service providers, such as Authorised Participants (APs), the entity responsible for creating and redeeming ETFs, market makers, who provide contractual pricing 'on-exchange' and ETF Brokers, who match ETF buyers with sellers with many firms playing a combination of roles concurrently. This whole learning process will take time. Getting it right, however, is key as issuers are all chasing the same, finite pool of assets," said Sutton.

> Private market funds, especially those being sold to retail investors, pose unique challenges too.

"If an institutional-focused manager chooses to launch a private market fund aimed at retail, then they will need to overhaul their operations, so they can support the needs, e.g. reporting requirements, of hundreds of investors, versus just 10-20 institutions," said Sutton.

To meet the frequent subscription and redemption demands of retail investors, firms will also need to refine their liquidity risk management profiles.

"A private market manager will not win mandates if they are unable to cover the subscriptions and redemption requests of retail clients in good time. Retail or quasi-retail investors will likely not buy a private market fund if it takes them three months to redeem their money. The reality is that managers will need to sit on more idle cash if they are to meet the heightened liquidity demands of retail/quasi retail investors," said Sutton.

Luxembourg and Ireland step up

As more managers go down the path of diversification, they are gravitating towards tried and tested, onshore EU fund domiciles, namely Luxembourg and Ireland.

Together with their stability and strong creditworthiness, Ireland and Luxembourg are home to a number of reputable and flexible fund wrappers.

"In Luxembourg, private market managers can avail themselves to either the recently updated ELTIF 2.0, SICAR, Specialised Investment Fund (SIF) or Reserved Alternative Investment Fund (RAIF)," said Eduado Gramuglia Pallavicino, Citi Country Officer & Banking Head for Luxembourg.

Similar sorts of fund structures are also available in Ireland. "Private market managers domiciled in Ireland can leverage the enhanced ELTIF 2.0 regime as well, but also the Qualifying Investor AIF and Retail Investor AIF," said Cilian Ó'Gógáin, Head of Investor Services, Ireland, Citi.

However, Ireland is rapidly cementing itself as a leading European hub for ETFs.

"Ireland is home to over 74% of the European ETF market,[5] partly because ETFs domiciled there are subject to a much lower withholding tax on US dividends, at least relative to other onshore European jurisdictions," continued Ó'Gógáin.

The regulatory frameworks in both countries are robust too, which has helped underpin their popularity amongst traditional and alternative asset managers, together with asset owners.

According to Sutton, firms domiciling either ETFs or private market funds in Ireland and Luxembourg will be subject to UCITS and the Alternative Investment Fund Managers Directive (AIFMD) respectively, both of which put a strong emphasis on client protection and asset safekeeping.

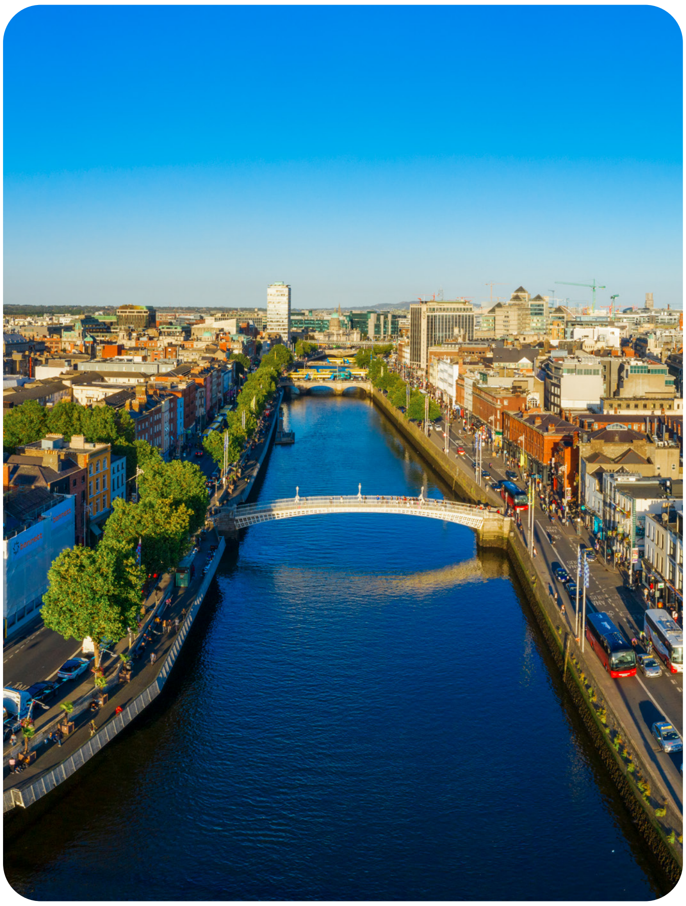
In the case of AIFMD and UCITS V, fund managers are required to appoint a depositary to oversee their service providers, asset safekeeping practices, and cash-flows. To ensure depositaries perform the job to the highest standard, the regulations subject them to strict liability should any assets go missing on their watch.

Along with selecting a suitable fund domicile, managers must also choose the right service provider when launching new products.

The good news is that both countries have a deep pool of service provider talent and experienced subject matter experts covering both private markets and ETFs.

"Citi has been in Ireland and Luxembourg for many years now. Along with its Investor Services business, i.e. custody, depositary, fund administration, ETF Servicing etc, it also provides prime brokerage, and core banking services. As a universal bank, we provide global markets capabilities to our ETF clients," said Gramuglia Pallavicino.

In 2025, Citi will go live in Ireland with its Velocity ETFs Platform, which enables issuers to outsource a lot of the heavily lifting involved with launching and running an ETF. The platform will



take care of all aspects of setting up an ETF, from the initial legal, regulatory and compliance requirements, to appointing and onboarding service providers (custodian / market-makers / APs), to product registration, exchange listings and ongoing capital markets functionality. Not only does this reduce costs for issuers, but it supports scalability and accelerates speed to market by avoiding duplication, enabling firms to focus on their core strengths, namely portfolio management and distribution.

"Citi's platform allows funds to be launched in a matter of months, versus building from scratch, which could take at least 1-2 years per issuer. Consequently, costs will be significantly lower, on a 'launch' as you go basis, versus an entire platform build for individual managers, not to mention meaningful headcount and technology savings," said Ó'Gógáin.

In the case of private markets, Citi can cross-sell managers products from its Trade and Treasury Solutions, Commercial Bank and Investment Bank businesses, allowing firms to consolidate their counterparty relationships. "A lot of private market clients look to us for access to financing and balance sheet, something which is not always available at other providers, particularly standalone asset servicers, i.e. non-bank administrators," said Gramuglia Pallavicino.

Sutton concludes: "The bank has a deep pool of subject matter experts across multiple asset classes, including passive funds and private markets, and a level of global connectivity few others can match."

1. Boston Consulting Group – April 2025 – From Recovery to Reinvention
2. Boston Consulting Group – April 2025 – From Recovery to Reinvention
3. FS Investments – June 14, 2024 – Private equity has historically outperformed public markets
4. Pitchbook – Charting AUM growth in the private markets
5. Irish Funds – July 25, 205 – New Irish Funds Guide: Why Ireland for Exchange Traded Funds

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