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# The Power to Change

## How Business Insights Fuel Success
## Part 1: Challenges in a Changing Wealth Management Landscape

WHITEPAPER

In this three-part white paper series, we look at why today's wealth managers need better insights into their businesses to cope with the changing wealth management landscape, how the flexibility and freedom to experiment can drive profitability, and how leveraging the right technology infrastructure translates into client acquisition and retention.

## Moving with the times

Domestic and international regulatory frameworks are being reshaped. Industry participants are merging or exiting the business. New competitors are entering the fray. Fees, margins and costs are under pressure. Demographics are shifting. And client service and communication expectations are being radically revised in a digital age.

In this fast-paced, increasingly globalized and competitive landscape, wealth managers must move with the times. The changes and challenges are numerous, all-pervading, and in many cases gathering speed.

### Regulation

The Boston Consulting Group's 2016 Global Wealth report[1] found legal and compliance costs at its survey participants have reached 4% of total operating expenses, up from 2% in 2012, with regulatory spending representing up to 13% of IT costs, especially for smaller regional players.

Meanwhile, more than 75% of respondents to Ernst & Young's 2016 Global Wealth Management survey[2] cited the cost of regulatory compliance as the main cause of declining margins. In Europe, that figure jumped to 93%. What impact Brexit will have—potentially adding another level of compliance and complexity for firms operating from or into the UK—remains to be seen.

For European participants, the nature of the regulatory challenge is shifting as we look ahead, with the European Commission's focus turning to making existing legislation work better, rather than on introducing new rules, notes management consultancy Baringa Partners[3]. "But less regulation doesn't mean less scrutiny, whether in relation to remuneration, conduct and culture, or systemic risk."

In the UK, for example, the FCA's thematic review on suitability uncovered a number of poor practices, says Baringa. In response, it "called on firms to make 'substantial improvements' in gathering, recording and regularly updating customer information."

In Asia-Pacific by contrast, regulatory change—and the compliance pressures wealth managers face—continue to gear up. This is reflected in the EY survey, which found that APAC has the highest percentage of firms (39%) citing regulatory compliance as the primary focus of their strategic budgets over the next two to three years, compared to 11% for European firms and 9% in North America.

The global focus on increasing transparency, suitability and investor protection will give wealth managers a major headache for years to come, significantly impacting firms' revenue potential, costs and operational complexity. The question is, do you have the information to meet your investor and regulatory disclosure responsibilities? Just as important, can you access, collate and manage that information efficiently to cope with ever-tighter investor and regulator timeframes, and to stop your costs from ballooning?

### Heightened competition

Competition in the sector is increasingly intense and globalized. The emergence of robo-advisors is just one high profile example.

"We estimate that the number of asset and wealth management-focused financial technology companies has more than doubled, from roughly 315 (with funding of $1.7 billion) in 2012 to about 700 (with funding of $4.9 billion) in 2015," says the BCG report. "These companies are known primarily for low-cost, algorithm-based asset-allocating platforms (or robo-advisors), but they also offer digital advice, portfolio composition and execution, as well as customized portfolio optimization and recommendations for HNW clients."

The EY survey similarly suggests fintech entrants with a clear digital channel focus present a significant threat to firms in EMEA. "The research indicated that approximately half of the clients in the region are familiar with automated advice services and are likely to consider opening an account with a provider."

[1] *Navigating the New Client Landscape,* The Boston Consulting Group, June 2016

[2] *The experience factor: the new growth engine in wealth management,* EY, May 2016

[3] *Wealth and Asset Management Regulatory Guide,* Baringa Partners, May 2016

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Scale is another factor. Many large universal banks have merged their wealth and asset management divisions in a bid to generate better synergies. The goal is to help wealth managers differentiate themselves through personalized advice and "whole bank" investment advisory capabilities, while enabling asset managers to develop more customized products that meet high net worth clients' requirements.

At the same time, Mercer[4] points to the incidence of private bankers leaving financial institutions "to become independent asset or wealth managers—essentially, setting up multi-family offices and continuing to serve their high net worth clients. We see this growing trend continuing around the world, creating additional business challenges for larger financial institutions."

Meanwhile, many European wealth managers are trying to tap the emerging opportunities in other markets, particularly in Asia, to attract new assets. However, they are often up against local providers with ever more sophisticated offerings that appear to be enjoying growing success.

[4] *Challenges for Wealth Management Firms in 2016: Are You Prepared?,* Mercer LLC, February 2016

**Fees and margins**

Fees have become a major issue both for regulators and investors. The EY survey reports that approximately a third of wealth management clients are unhappy with the way they are charged, with AUM-based fees the greatest source of client dissatisfaction. "While the industry has moved from transaction-based compensation (i.e. commissions) to asset-based fees, client preferences are moving clearly toward fixed fees," it notes.

As well as pressure on fees, the BCG survey found average revenue and profit margins declined for wealth managers from 2012 to 2015. According to EY, margin declines remain a particular feature for firms in APAC and Europe: "In APAC, 62% of wealth management firms say their margins are declining (compared with just 18% in North America). When asked for the top factors, 88% pointed to competitive fee pressure and 63% cited the cost of regulatory compliance."

**Client expectations**

Clients' service expectations—and the ensuing demands they put on wealth managers' operations—are another area of rapid change.

"Providing clients with quality advice and products at the right time through the best channel—increasingly a digital channel—will dramatically improve the client experience, which will ultimately lead to increased client trust and loyalty, and a higher level of activity and interaction," states the BCG report.

More customized service models, based not just on wealth and cost-to-serve, but gender, age and behavioral characteristics, are an essential element in improving that client experience.

As BCG observes: "In order to succeed, wealth managers will need to adopt a more comprehensive client-centric approach, decide how to sensibly segment their current and prospective clients, clearly identify their clients' needs, and define value propositions accordingly."

Better client service takes a multitude of forms, but the central elements are:

**1—Delivering risk-adjusted investment performance**

Investment performance has always been crucial to the client experience. However, there is no single definition of performance.

"While some clients' expectations are to meet or outperform the market, other clients measure their performance expectations against their financial goals, regardless of overall market performance," says the EY report. "These varying expectations also lead to nuances in terms of client expectations and preferences regarding wealth advice and products and services."

For example, clients more focused on achieving their long-term goals tend to

## Do you know which clients want what? Do you have the infrastructure and operational flexibility to provide it?

prefer face-to-face personalized advice and bundled services, says EY, while those seeking to outperform the market want broader investment product offerings (e.g. hedge funds and private equity) and value multichannel interactions.

Preserving wealth and/or achieving market-beating investment performance in the current low interest rate and complex macro environment is challenging. Given the decline in yields on low-risk investments, investors have had to move into higher-risk assets, such as corporate and high-yield bonds and various alternative asset classes, to meet their mandates.

Fierce client scrutiny over portfolio performance is adding to the pressure. To demonstrate to ever more discerning clients they offer value for money, wealth managers must justify the performance achieved by explaining how and why it has evolved over time, that the risk has stayed within agreed boundaries, and reference it against relevant peer benchmarks.

### 2—Excellent client communication

Wealth managers need to provide clients with fast, easily accessible, and more relevant and transparent information about their portfolios—and do it for less cost and with fewer resources.

*Digitalization is key.* Its relevance cuts across age and wealth segments, notes the EY report, with most clients now expecting digital access to their accounts and investment activity.

A clear digital strategy requires a multi-channel delivery mechanism—spanning the web, mobile phones, tablets, etc.—that can provide clients with the flexibility to access information and communicate with their wealth manager or advisor in the way they desire.

Communications also need to be flexible. Some clients may only require a regular overview of their account holdings and movements. Others want a more detailed drill down, for example into the performance of specific assets. Transparency into the exact fees paid, and performance attribution to demonstrate the performance value achieved for those fees, is another powerful trend.

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*Mobility is an important related requirement.* Advisors need the freedom to meet prospects and clients where they want, and have the tools on-hand to onboard clients, provide advice or discuss their investments using real-time portfolio and performance data. Fingertip access to clients' investment and risk profiling information would enable advisors to offer relevant additional services and products too. The result will likely be more satisfied clients with a clearer sense of the value they receive.

*Consolidated financial information is crucial.* Do you have access to external data—including where assets are held by multiple custodians—that will enable you to provide clients with a holistic view of their holdings? Wealth managers that can will not only look good in front of their clients, but gain insights into where opportunities exist to expand the relationship.

### 3—Multi-channel client service experiences

Digitalization is not just about enhancing communications. According to the EY survey, a firm's digital channel and self-service capabilities are primary factors in the client service experience. "In fact, the digital bar for wealth managers is rising, as clients demand that wealth firms offer more interactions—from account opening to the provision of advice—through digital channels. The bottom line is that digital efforts must continue to evolve and expand."

The priority for firms then must be to close the current gap between expectation and delivery. "While the direction toward digital channels is clear," says EY, "the industry continues to be slow at delivering true multichannel offerings, as firms face challenges with legacy core IT systems, bureaucracy and regulatory priorities—challenges that traditional wealth managers can confront by utilizing a range of tools and functionality available through specialist third-party technology vendors."

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## A helping hand

Wealth management has always been a relationship-driven business. What distinguishes the best wealth managers is the level of service they deliver, and the degree of value and sense of trust clients feel they obtain. But, increasingly, it is technology that gives the essential support to those relationships. Without a technology infrastructure that provides the flexibility needed to grow and adapt, while delivering much-needed compliance capabilities and operational efficiencies to overcome their manifold challenges, firms' future survival will be in serious jeopardy.

We discuss the key technology components wealth managers will need to thrive in this changing landscape in the third paper in this series. To receive your copy, please contact your SS&C Advent representative.