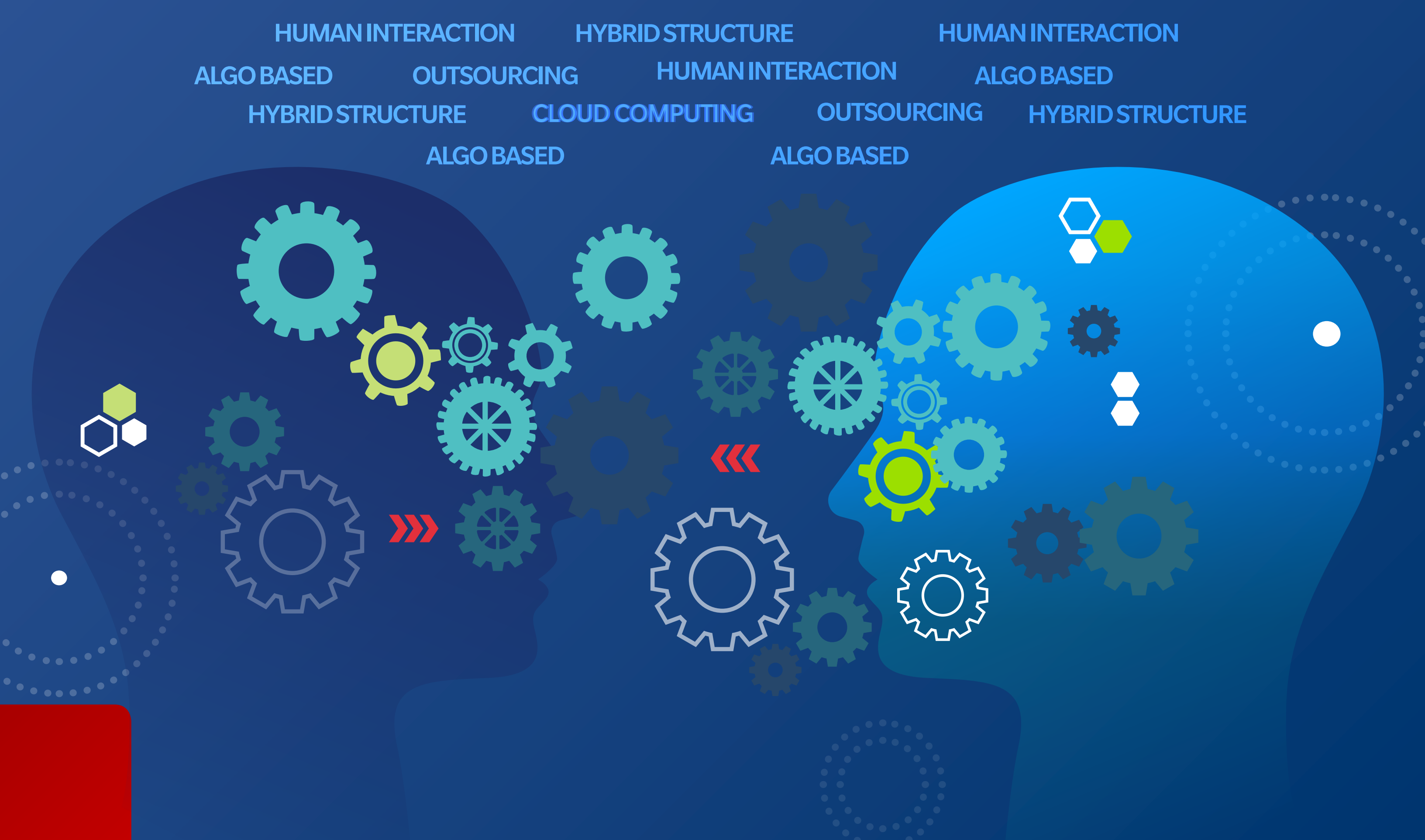

Emerging Trends in Relationship Management

eRI®

IBS intelligence

Contents

This document has been written by IBS Intelligence in collaboration with ERI, a major provider of IT solutions to the international private banking/wealth management space, as part of its contribution to the debate on the future of the industry.

01 INTRODUCTION: HERE COMES THE MONEY

Warren Buffett famously stated, "Forecasts may tell you a great deal about the forecaster; they tell you nothing about the future."

The world, post the financial crisis of 2008-09, has witnessed rapid growth in wealth of high net-worth investors (HNWI), increasing from USD 53Tn in 2013 to USD 68Tn in 2017 at a CAGR of 6%. This upsurge in wealth is further characterized by the increase in global net investable assets (NIA), as pertains to HNWI, estimated to reach USD 70Tn in 2021. On a global basis, this increase in NIA can be attributed to the top economies – USA, China and Russia – accounting for 50% of the same. This flood of money has created a sharper focus within the Wealth Management industry on protecting existing client relations through superior advice and bespoke relationship management services.

The Wealth Management industry is in the throes of a significant change, with a new wave of investors entering the market. Over the next few years, a transfer of wealth amounting to USD 10Tn is expected from the USA, Germany and Japan. This provides wealth managers with a unique opportunity to attain a stronger foothold within the industry. New client expectations are centered around their exposure to the digital era and know-how of alternative investments. Hence, the need for wealth managers to specifically focus on the relationship aspect of wealth management is paramount. This involves investing in new hybrid relationship models, robo-advisory services and other exclusive customer-oriented infrastructure. Revolutionizing key service offerings such as inheritance tax planning, estate management and investment advisory/management services will enable wealth management firms to gain a competitive advantage, resulting in a greater retention of HNWI assets and attracting new clients. Furthermore, client centricity, transparency and ease of doing business are the key focal points for these new age relationship management tools.

The other focus area for the wealth management industry is the evolving regulatory landscape. A greater emphasis has been laid, by leading government agencies, on the need for transparency in providing investment advisory services. These agencies are attempting to mitigate the lack of trust and clarity that clients have traditionally experienced by requiring firms to adhere to more stringent disclosure norms and protocols. A consequence of these new regulations is the entry of low cost fintech companies providing outsourced solutions. These outsourced capabilities are being actively adopted by wealth management firms of all sizes in a bid for them to retain focus on their core strengths and segments.

02 NEXT-GEN MANAGEMENT ADVISORY MODELS

Three distinct advisory models are currently emerging that are redefining the relationship management landscape. These structures will re-engineer the client-wealth manager relationship and provide solutions directly linked to the needs expressed by the clients themselves

D2C advisory – Direct-to-customer robo-advisors:
This model utilizes a comprehensive AI interface to deliver end-to-end relationship management services - portfolio allocation, management and rebalancing capabilities;

Business-to-business (B2B):
Advisory involves equipping traditional advisors with their own white label digital platform solutions. These platforms permit advisors to effectively customize these capabilities and provide them to market participants in a specifically packaged manner;

Hybrid advisory:
This relationship management model effectively unifies the core aspects of the traditional advisory and robo-advisory solutions, providing an effective mix of algorithm and human-based portfolio management.

Tools like robo-advice & interactive brokerage platforms will find a market with extremely well-informed investors who are looking to minimize costs. Technology has its place in relationship management, but can't supplant human interaction. At the end of the day, Robos can't build relations.

– Vice President, Leading Wealth Management Firm, South Asia

"Banca Consulia stands for a new concept in banking, based on enhanced advisory services wherein people, namely clients and employees, take center stage. ERI has developed a platform for us that entirely meets our requirements: to implement a top-to-bottom digital transformation and to streamline and simplify all advisory processes. ERI's platform delivers a premium and comprehensive digital experience to Banca Consulia's advisers and clients. This enables us to devote more precious time to building relationships, which is essential for managing complex market environments, by analysing each client's personal circumstances and requirements" – *Antonio Marangi, Managing Director – Banca Consulia.*

03 ROBO-ADVISORY - THE FUTURE IS NOW

The D2C model provides direct-to-customer robotic advice with limited human assistance. The term "robo-advisory" is a misnomer and does not relate to actual robots providing clients with investment advice. It is however based on an automated algorithm that understands the user's risk-return preferences and provides investment solutions based on the same.

As stated previously, the NIA are expected to reach USD 70Tn by the year 2021 – 5% of this projected amount is estimated to be derived from robo-advisory services. Presently, within the US alone, there are more than 200 functional robo-advisors. This solution is increasingly advanced as a tool to onboard and attract key millennial clients. These clients are characterized as tech-savvy, do-it-yourself and constantly on the lookout for the most attractive deal. Currently, this group of investors accounts for USD 2Tn of overall global assets under management (AuM). Furthermore, with the impending transfer of wealth from the baby boomer generation to the current generation, these millennials are imperative to the future financial sustainability/success of wealth management firms worldwide.

A secondary demographic that is being targeted by financial companies are the "mass affluent." This segment is a part of the new wave of investors who are aiming to receive investment advice on an economic basis and, thus, build their respective mini-fortunes.

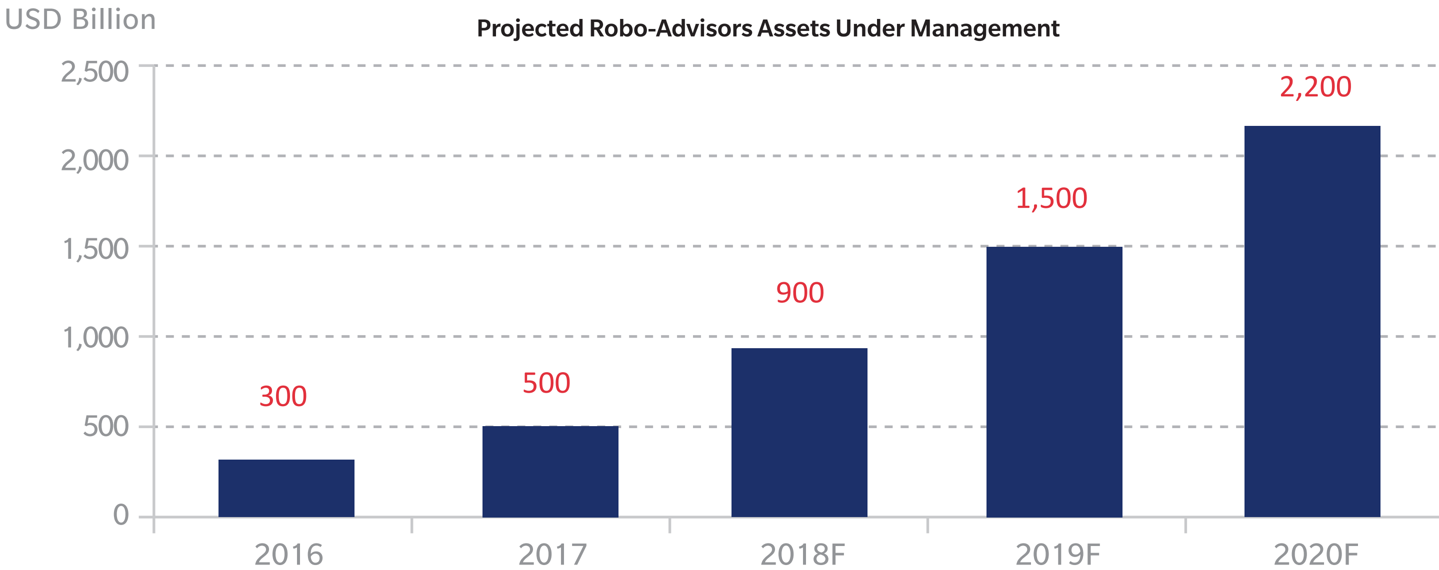

Figure 1

Source: IBS Research

From a financial perspective, robo-advisory provides a unique opportunity to wealth management firms. The cost of developing an algorithm and updating the underlying parameters on an ongoing basis costs a fraction in comparison to traditional wealth management services offered. The fee ranges from 0.25 – 0.5% of AuM (as opposed 0.75 – 1.50% of AuM for traditional services). Further, via this advisory model and the associated customer base, the average account size will range from USD 20,000 to USD 50,000, a far cry from historical HNWI ticket segments.

Customers of the robo-advisory model benefit as they gain a means of receiving investment advice on a cost-effective basis. A crucial component of this model of investment management is positioning the solution in an ideal manner. Existing wealth management firms can leverage their own specific brand name and client reach to effectively capture this particular market opportunity. This process is further supplemented by banks adopting/ developing the appropriate infrastructure. Key financial institutions such as BlackRock, UBS and Schroders' have taken an active approach by investing in proficient platforms to provide a holistic D2C robo-advisory solution.

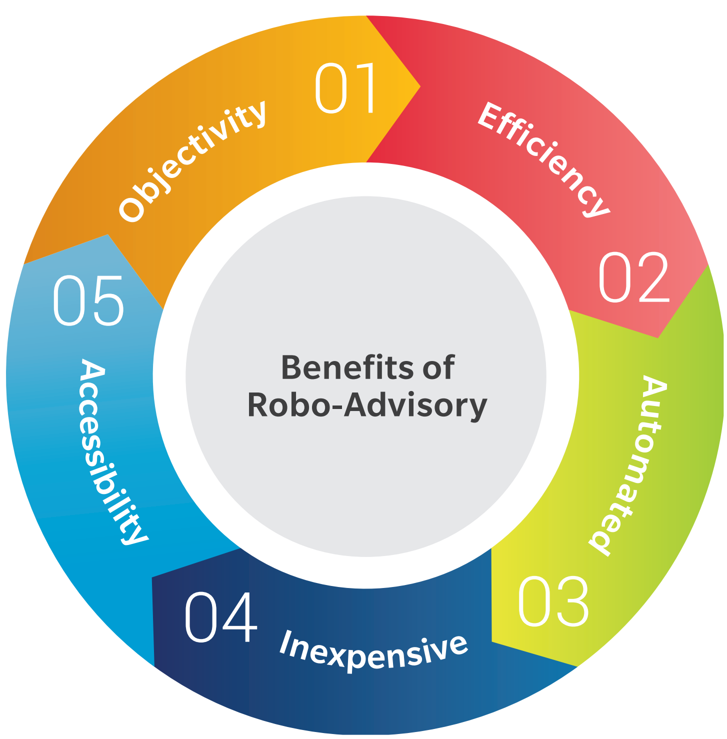

Figure 2

Source: IBS Research

Wells Fargo is one of the large-sized banks to take the plunge with regards to robo-advisory management models. The Bank has developed its "Wells Institutional Investor" to meet the growing demands for affordable investment management services. The underlying methodology entails the client completing a survey detailing their risk-reward preferences and the platform providing investment recommendations based on the same. This platform rebalances the portfolio on a timely basis dependent on revisions in the client's financial preferences. This initiative has enabled Wells Fargo to provide its wealth management solution in a clear, transparent and client-involved manner. It also aligns specifically with the Bank's vision of improving the ease of conducting business.

> *Brokerage firms and algorithmic traders are trending towards robo-advisory services to better align customers' customized portfolios with their respective risk appetites and financial objectives. However, human intervention will remain important specially when the sums invested are in the 6-7 digit range*
>
> *- Director, JP Morgan, Wealth Management*

04 HYBRID MODEL - THE IDEAL MIX

With regards to relationship management advisory models, the success of traditional models is underpinned by the trust between the investor and relationship manager. These models provide clients with a face to discuss their optimal investment portfolio. However, with the advent of fintech over the past decade, the computation of certain processes, such as asset allocation, portfolio management and optimal recommendations, has become more robust. As discussed in the previous section, a wave of fully automated advisors has emerged in providing end-to-end wealth management services. The Hybrid Advisory Model is an amalgamation of the two extremes and provides an ideal mix of wealth management services encompassing the key facets of both new and old age models.

Figure 3 provides a spectral representation of the activities most suited to be undertaken by human and robotic advisors. Robo-advisors can provide the complete gamut of activities mentioned above, however, with varying levels of success. Similarly, traditional advisors are currently benefitting from technological advances in portfolio allocation, people management and investment automation. The portion in the middle of the spectral chart depicts the optimal mix for hybrid advisory services that can be provided by a combination of human interaction and computational engineering.

A Hybrid Advisory Model is a blended approach to relationship management melding the core services of traditional relationship management with robo-advisory. It enables clients to attain the best of both worlds with automated portfolio management services and with a high-degree of human interaction (e.g. financial planning strategies, etc.). The value addition of this approach is that clients gain from the experience, judgement and emotional support of a human wealth manager. The relationship manager's inputs are also critical at the time of repositioning the portfolio mix and timing the retention/liquidation of key assets. Additionally, robo (algorithm) based asset allocation and portfolio optimization specifically addresses the client's risk-return needs.

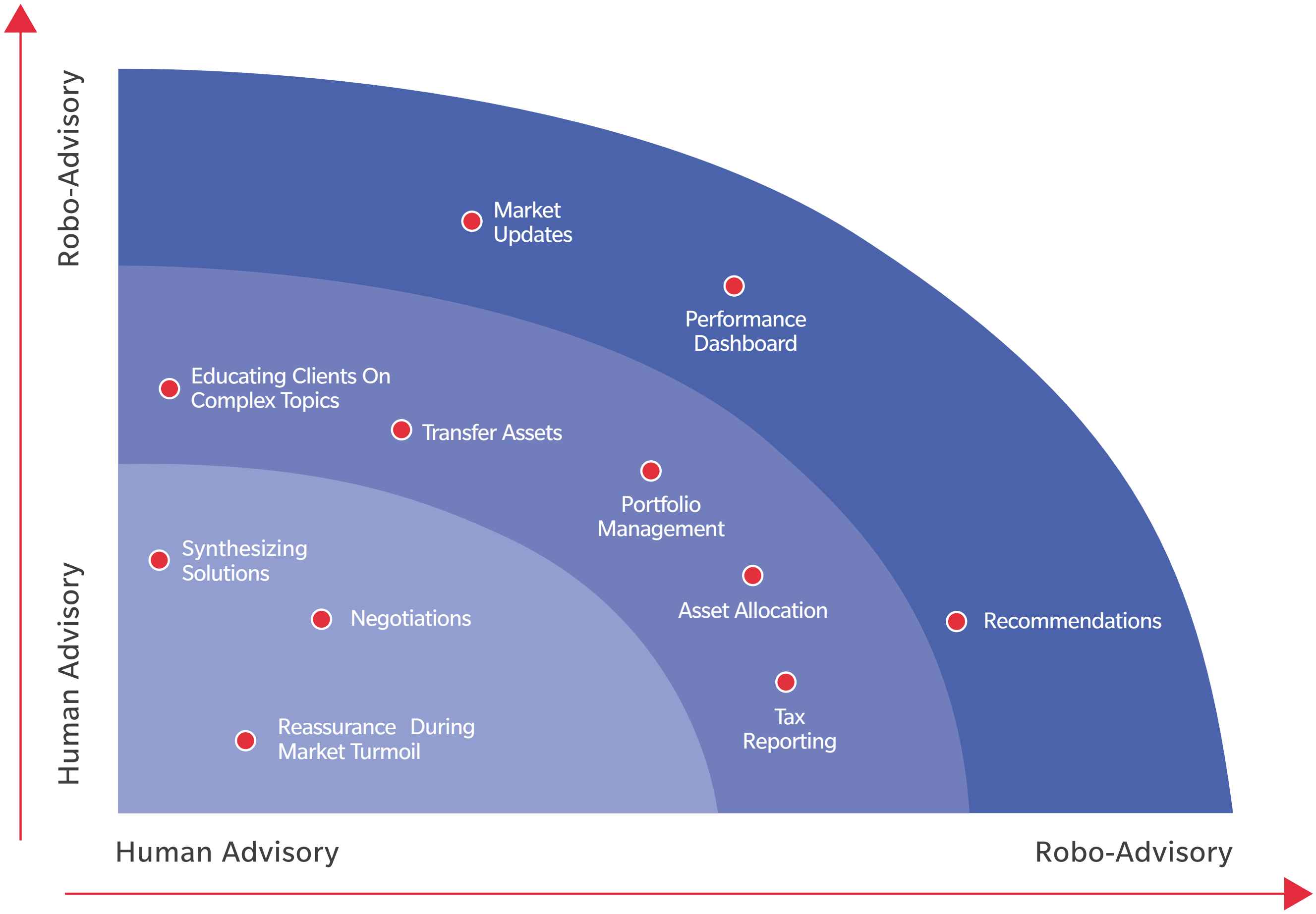

Figure 3 *Source: IBS Research*

The hybrid advisory model is centered around two key operating strategies that distinguishes them from the traditional wealth management services:

Algorithm-based asset allocation:

The client's preference with regards to their risk – reward matrix and desired timeframe for payoff are analyzed. Based on these inputs an optimal portfolio mix is designed for the client, encompassing pre-defined investment vehicles and asset classes. A detailed analysis of the client's requirements is undertaken to ensure compliance

> *The nature of relations with our customers is far more cohesive as customers appreciate the personal touch that a human can bring in. Having said that, we leverage algorithms to digitally offer customers a recommended course of action based on their risk profile. For example – when a customer logs on to their investor dashboard, they will be presented with a suggested action based on a recent market-shaping event that will fit their risk profile*
>
> *– Relationship Manager, Credit Suisse*

with a broader set of investment criteria;

Macro - micro-based portfolio strategies:
Micro investment strategies can be determined for clients based on their risk profile. These strategies are peppered with macro-economic elements to determine the client's optimal portfolio mix in the prevalent economic climate. These portfolios can be further fine-tuned on demand, based on customer interaction.

Another key differentiator of the hybrid model from the traditional model is the ability to integrate data points from a wide array of sources, including social media and internal systems such as CRM, among others, to create a conclusive, precise and risk-adjusted investment portfolio.

Barclays Bank is reportedly in the process of setting up a hybrid advisory wealth management model combining the sophistication of automated advisory services with a human element. This approach is part of the Bank's move towards embracing the fintech ecosystem within the industry while maintaining a human element to the process. This model will enable the Bank to optimize its fee structure by allocating a standardized investment vehicle fee based on the online system, and a customized fee for distinct human-oriented personalized services.

05 CLOUD COMPUTING

Cloud-based computing provides the wealth management industry with an important value driver that has had a significant impact on the functioning of both financial and non-financial companies. This digital technology will enable wealth managers to seamlessly collate information and provide key insights to clients as to how their portfolios should be structured. Cloud-based facilities have already established a key role within the banking industry as they have effortlessly synchronised with various functions of the bank.

Effective implementation of cloud computing will enable the firm to reduce infrastructure cost and the time required to test new initiatives in the market. Deeper insights with regards to business, regulations and compliance decisions will be attainable in an efficient manner, enabling faster and more nuanced advice to clients.

Sensitivity of uploading client data on the cloud has inhibited wider adoption of cloud services. Knowledge transfer sessions are required to be undertaken to inform the relevant parties of its use and functionality.

UBS is one of the pioneers that aims to dispel this notion and has reportedly adopted a fully-functional cloud based system. The Bank, one of the world's largest wealth managers, has adopted this computing system to power its digital transformation, reaping the benefits of reduced dependence on legacy systems, leveraging new digital channels and reimagining the way its business and people operate. It has migrated its risk transformation platform on to the cloud and has effectively reduced its daily calculation turnaround time by over a 100% and experienced infrastructure savings of 40%.

06 ECONOMIES OF SCALE VIA OUTSOURCING

Outsourcing has been a significant disruptor in the functioning of various industries, including manufacturing, technology and banking, among others. The Banking industry has observed a significant increase in this trend over the past few years. Banks, and more specifically the investment management industry, have been outsourcing critical non-core functions to third-party players. These services include regulatory compliance, stress testing solutions and business process outsourcing (BPO) units.

The outsourcing of these processes enables wealth management firms to focus on their primary role of client management whilst directing tertiary (back office) activities to external agencies. A deep understanding of the competencies must be ascertained and a comprehensive governance framework defined for the success of the outsourcing program. The outsourcing activities also constitute data management, stock pricing, IT functions and other non-core processes.

The outsourcing methodology is beneficial to clients as it enables firms to invest a greater proportion of their capital in customer-oriented innovations and solutions. A greater focus on regulatory compliance is another key parameter for financial institutions to approach external firms that specialize in these practices. Finally, this model enables managers to keep an eye on their cost-to-income ratios associated with their specific investor portfolios. This is achieved as non-core expenditures are optimised by outsourcing these activities to third-party specialists within the industry. Thus, through focused control over core capabilities, outsourcing will enable wealth management firms to drastically reduce their costs and optimize their earnings' potential.

Deutsche Asset and Wealth Management (DeAWM), a division of the Deutsche Bank Group, has recently employed the services of an external provider to undertake its business process outsourcing functions. These outsourced capabilities primarily involve the firm's back office operations and IT framework. This strategy has enabled DeAWM to further strengthen its position in the wealth management space and focus on its core-client-facing strengths.

Another example pertains to ERI and Swisscom joining forces in Switzerland to provide private-banking and wealth management outsourcing services to banks and other organisations operating in the Swiss financial centres. This new offering brings together the OLYMPIC Banking System software package from ERI, a leader in the private banking sector, and Swisscom's banking operation, which will provide the following services: information technology outsourcing (ITO), application management (AM) of OLYMPIC Banking System and third-party applications, as well as business process outsourcing (BPO).

07 WAY FORWARD: ONE SIZE DOESN'T FIT ALL

The wealth management industry is going through a wave of transformation due to the changing needs of new age customers as well as digitalization. A challenging investment environment, characterized by increased levels of uncertainty and rising costs of risk to investors and wealth management firms alike, is making it harder for advisors to generate superior investment performance for their clients. Shifting demographics with the ageing of advisors and an upcoming transfer of wealth from baby boomers to Gen X & Y will upset many established advisor-client relationships and create opportunities for new firms to grow market share and create a scramble for new clients. Further, the imposition of a stringent regulatory environment has created an atmosphere for innovation and digital evolution.

The ideal spectrum of advisory services offered, dependent on client wealth and preferences, envelopes a combined approach of traditional and robo-advisory models – Hybrid Advisory Model. Intuitively both clients and investment managers benefit from the approach as the former receives bespoke investment advice and the latter receives an optimal fee mix – standard and customized fee. The other developments pertain to the digitalization of key aspects of the relationship management process – outsourcing of tertiary services and the impact of cloud computing on the investor portfolio decision making process. These technologies are enabling managers to focus on core activities and to provide deeper insights to the benefit of the client. The dual process of client retention and new client onboarding will be of immense importance in redefining the wealth/relationship management landscape.

With advancements in AI and technology, the relationship management industry is on a path to complete automation with minimal manager inputs. Key activities that specifically involved human interaction and support will eventually come within the robo-advisory domain. These activities include client/investor education, negotiations and providing analytical support to the client in times of market turmoil or bubbles.

A word of caution, the adoption of the aforementioned processes should be undertaken with care as a “one size fits all” policy may yield inconsistent results. Viability checks and business requirement needs must be fulfilled/undertaken to determine the overall suitability of these processes. The wealth management landscape is well and truly on its way to its next evolutionary phase.

How to contact ERI

www.olympicbankingsystem.com

GENEVA	Tel.	+41	22 342 12 29	**LONDON**	Tel.	+44	203 457 9880
LUGANO	Tel.	+41	91 913 95 00	**LUXEMBOURG**	Tel.	+352	46 10 50 1
ZURICH	Tel.	+41	44 204 93 00	**SINGAPORE**	Tel.	+65	6622 5959
PARIS	Tel.	+33	1 55 37 85 85				

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