Purposeful digitisation

The journey to Wealth Management 4.0

March 2024 - White Paper

Introduction

The wealth management industry has performed well over the last 20 years, weathering market shocks, financial crises plus countless regulatory and fiscal changes. But now, without an unprecedented evolution, the future looks challenging.

Whilst M&A activity has allowed some firms to grow rapidly, overall the segments of the population it serves have hardly changed. This suggests that the potential value of wealth management services is not widely recognised. New regulations are adding further pressure as pricing and propositions come under closer scrutiny. In addition, operating models reliant on ageing technology and processes are struggling to modernise and are unlikely to integrate well with the new technologies that are becoming mainstream in other industries, such as robotics and AI.

Outdated operating models

The wealth management sector is still heavily reliant on non-standard and even paper-based processes. This, combined with a lack of impactful investment in technology, has created an operating efficiency problem which ranks highly with many C-suites as one of their biggest problems to solve.

Wealth management technology has historically lagged other sectors. Regulatory complexity and demanding cyber and data security requirements pose legitimate challenges to swift evolution, as do requirements to integrate with embedded and frequently outdated legacy systems. But none of these challenges are insurmountable, in fact, other highly regulated businesses such as healthcare, pharmaceuticals, telecommunications and banking have faced similar complexities but have modernised more rapidly.

More powerful than the challenges of processes and technology is the cultural resistance to change. Internally firms tend to stick to well-established ways of working and are reluctant to adopt new technology when it is deployed. Indeed this may be, in part, due to an assumed resistance from clients to adopt technology too. However, the rapid adoption of 'digital' during COVID-19 proved clients are willing and able to change their engagement model and value the efficiency it can bring. However, rather than see this enforced change as an opportunity to improve the industry's use of technology continually, its use has slid backwards.

What is digital? – Digital is often used to refer to technology that engages with the end customer, but digital technology reaches into all areas of a firm's operating model encompassing all technology-based user experience activities. The industry's pursuit of greater efficiency will necessitate the removal of outdated ways of working such as paper forms and wet signatures and as such everything will be digital and purposeful digitisation will need to occur in all areas.

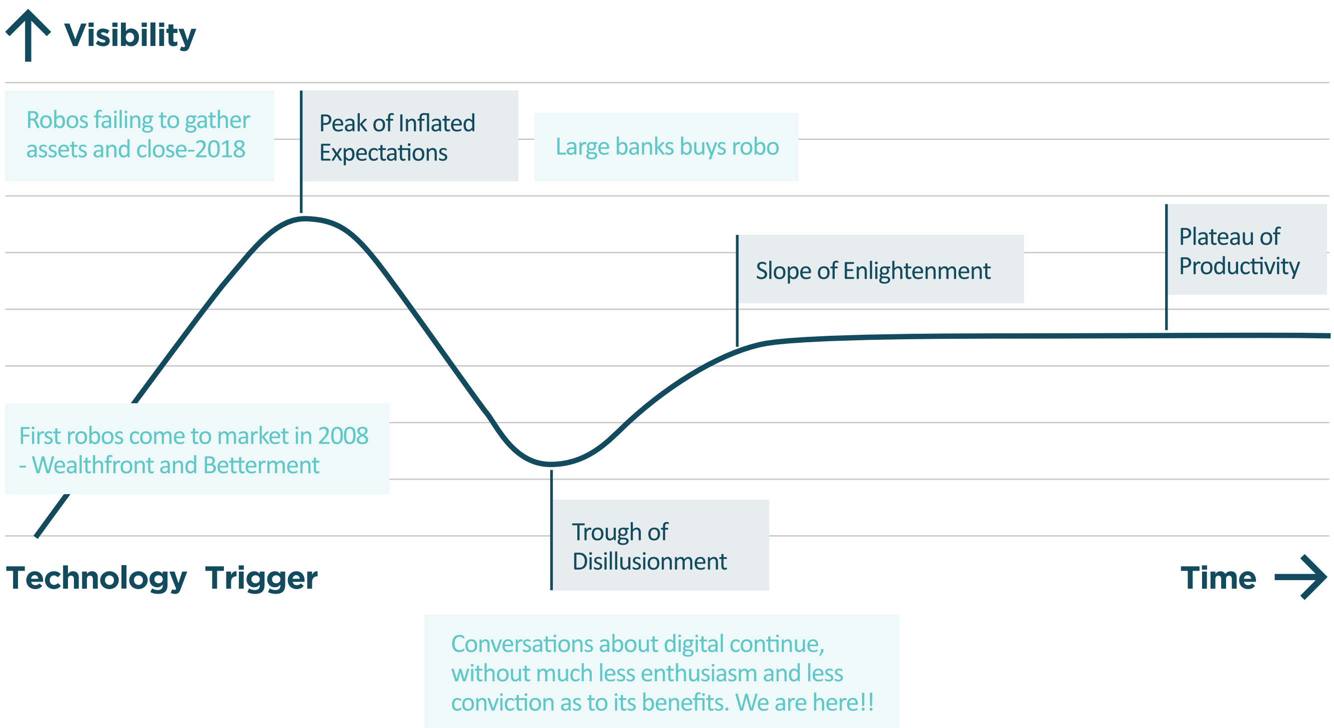
When technology arrives without a catalyst such as the pandemic, we often see technology ideas deployed with fanfare only to underperform and disappear into the background. Robo-advice - digital advice solutions where the end consumer interacts with workflows and sometimes AI in order to receive financial and investment advice - is the clearest example of this underperformance. Ambitious firms used all the digital capabilities within the industry to create a solution yet miscalculated the clients' desire for human interaction. Consequently, they struggled to displace the traditional firms with certain client cohorts. For those clients whose interest was piqued by robo-advice, the firms involved failed to distinguish their proposition and so failed to build the prerequisite levels of interest and trust required to gather meaningful assets from their customers. Finally, the collision of digital technology and old operating systems made pricing and profitability another challenge which meant many firms endured years of losses[1]. But the systems are all still available and lessons have been learned, so the ability to transform the way we engage with clients is here with us now, it is just not being widely explored.

[1]E.g. Investec's robo solution 'Click & Invest' closed in May 2019 after 2 years of loses, see Private Banker International, 16 May 2019; Nutmeg was acquired by JP Morgan in June 2021, it made losses each year of its existence even though it amassed £3.5bn in assets under management, see Portfolio Adviser 17 June 2021

Gartner's Hype Cycle

Digital technologies' rollercoaster journey in wealth management follows an observable pattern described by Gartner as the hype cycle. The Hype Cycle methodology provides a framework for understanding the maturity, adoption, and potential impact of emerging technologies over time.

Fig 1



Innovation Trigger: A potential technology breakthrough kicks things off. Early proof-of-concept stories and media interest trigger significant publicity. Often no usable products exist and commercial viability is unproven.

Peak of Inflated Expectations: Early publicity produces a number of success stories — often accompanied by scores of failures. Some companies take action; many do not.

Trough of Disillusionment: Interest wanes as experiments and implementations fail to deliver. Producers of the technology shake out or fail. Investments continue only if the surviving providers improve their products to the satisfaction of early adopters.

Slope of Enlightenment: More instances of how the technology can benefit the enterprise start to crystallize and become more widely understood. Second- and third-generation products appear from technology providers. More enterprises fund pilot schemes; conservative companies remain cautious.

Plateau of Productivity: Mainstream adoption starts to take off. Criteria for assessing provider viability clearly defined. The technology's broad market applicability and relevance are clearly paying off.

The need for purposeful digitisation

Digitally, wealth management technology is currently in the "Trough of Disillusionment" wondering how it will make it up the "Slope of Enlightenment". But with digital capability so integral to the future of the sector perhaps what we are concluding is that overall, the wealth management industry and the operating models it sits upon are in the same position.

Expecting the future for wealth management to be secured by an influx of money via an intergenerational wealth transfer is misguided, as are expectations that eventually newer technology such as AI, blockchain or machine learning will simply replace analogue processes and create new efficiencies.

To secure its future, wealth management needs to embark on a process of purposeful digitisation now. Starting in the back office and working forward through every element of the business, this process would finally arrive back with the client as a fully tech-enabled 'Adviser 4.0', a crucial element of the new operating model Wealth Management 4.0 - the world beyond digital. Those resistant to change will not survive, while adaptable companies will take their languishing competitors' clients and open new, exciting channels of growth.

The catalyst for transformational change

Prices have been on a long-term downward trend in the industry, nudged along steadily by the increasing levels of transparency demanded by regulation. Today the total cost of ownership when including platform/custody, investment management, asset management and financial advice is consistently over 2% often reaching beyond 2.5%. Previously when compression occurred the rule applied was whoever 'owns' the client holds the power and as such, planners and investment managers have heaped pressure on asset managers and custodians to reduce fees. But this time is different.

Platforms historically held on to their lofty fees through their direct link to end investors, but they are now facing heavy pressure from advisers and challenger models to reduce costs. But they can only move their prices as fast as their internal operational transformations allow, so while compression will come it will come slowly.

The story is similar for asset managers who have compressed active fees in the face of competition from passive investment and in response to demands from asset allocators. But having done this for a few years their fees are now heavily squeezed. Adding to this perilous position are lower Assets Under Management (AUM) inflows and increasing costs for running the businesses. There is not much to extract from asset managers in the short term.

Discretionary managers benefitting from third-party introducers are seeing a rotation from bespoke solutions to model portfolios. Model portfolios can be managed incredibly efficiently but if this rotation continues, and it looks like it will, it will present a commercial challenge to any investment firm previously established to manage bespoke portfolios. Similar AUM and staff costs but lower annual fees will be hard to bear, and this will limit investment firms' ability to reduce fees on bespoke solutions and may even inhibit their capacity to enter into a price war on models.

> So, with nowhere else to go, demands for fee compression will fall closest to the client and that means the adviser (financial or investment). As a result, the impact of price compression on wealth managers will be significant.

Service or outcomes

The wealth management industry's commercial model has focused heavily on ongoing client service since the Retail Distribution Review (RDR) in 2012. With this approach, some wealth managers have established themselves as the 'go-to' adviser for their clients' ongoing financial needs, but the ongoing service model has unintended consequences.

The erosive force of inflation on purchasing power and the impact high fees can have on investment return are well documented. Combine the two and the net return from a balanced wealth management solution could be quite underwhelming, which may lead to challenges when the value of the solution is assessed.

Impact of High Fees

An investor looking at long-term capital market returns data could assume a 60:40 portfolio return of circa 8%, leaving the investor with a net 3% after inflation and fees. Currently, the same investor could leave their money in the bank for a not significantly different ex-inflation return of circa 2.5%. Long-term investors can expect the compounding of returns to widen the gap between cash and 60:40. But there will be some who question who receives the most value from the money invested - the industry or the investor. Some will argue that Wealth Managers and, in particular the financial adviser side of that service, offer more than investment returns, but a recent study by Royal London and Lang Cat -The 'Meaning of value report' - suggests 50% of clients believe it's the most important requirement.

New Consumer Duty regulation places a high value on good outcomes and value for money and through these lenses, costly wealth management services are a target. But as we have seen via the 'Dear CEO' letter (issued at the start of 2024 to the largest 20 wealth managers) the regulator is equally interested in ensuring ongoing services are carried out when the client is paying for it.

Within this interesting juxtaposition is an incredible opportunity for firms to:

- Invest in the business to reduce the cost to serve and evolve the service model, allowing today's clients to become more profitable and receive better net investment outcomes.
- Reducing the cost to serve makes previously unprofitable clients profitable and a more dynamic lower-cost service model makes the industry more enticing to new customers which delivers exciting organic growth opportunities.

Learning from other sectors

The oil and gas industry provides an interesting example of how the value of a resource is impacted by efficiency. A reserve of oil remains in the earth if the price of oil is too low and the cost of extraction too high. However, an improvement in the efficiency of the extraction process transforms the value of the reserve even if the price of oil remains unchanged. Currently, the 'extraction' of wealth management services is inefficient and the costs are high are a result – this determines which clients a wealth manager can service profitably and ensures the persistence of the advice gap

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Wealth Management 4.0

There is talk in the industry of reaching 3.0, so referring to 4.0 could simply be considered an attempt at one-upmanship.

But the fact that we are currently looking at digital as the future rather than the present and simply a stepping stone to the future is a clear signal of how far we need to travel. We need to look 10-15 years into our future and build a plan to get there in five years if we are to grasp the opportunities that technology presents instead of being made obsolete by it.

Industry 4.0 is the next phase of technology beyond digitization, driven by disruptive technology including the rise of data and connectivity, analytics, human-machine interaction, and improvements in robotics. This era of connectivity and advanced analytics began in manufacturing in the mid-2010s and holds significant potential for the future of operations and production.

The wealth management supply chain – from back office to client

Studying other industries can provide clear guidelines for wealth managers looking for operating efficiency. The first step is optimising the 'supply chain'.

Most industries, including ones as heavily regulated as financial services such as pharmaceuticals and food and beverage, focus heavily on supply chain optimisation in order to control the cost and quality (value for money) of the goods and services they provide. The areas of focus are varied, this paper focuses on a small number to allow for comparison to wealth management.

Inventory

Physical manufacturers use a variety of optimisation techniques to reduce the cost of inventory. Studies into supply chain including those carries out by McKinsey, Cap Gemini and IBM - United States, point to substantial efficiency and cost reduction gains of 10-30% from investment into supply chain[2].

The comparison for wealth managers would be the safekeeping of assets either on multiple platforms, platform-as-a-service, outsourced custody solutions or in-house solutions. The cost of these solutions can vary by as much as 25bps plus any additional human costs for dual keying due to poor integrations.

Optimisation of the wealth management industry's equivalent of inventory could reduce the total cost of ownership for the client by 10-15% as well as save many operational hours.

Transportation and logistics

The movement of goods and materials is closely related to inventory and so, unsurprisingly, other industries dedicate time to route analysis software and other optimisation techniques such as consolidating shipments.

The movement of money and assets either as part of trade processing or making and receiving cash payments is the wealth management supply chain equivalent. Simple actions such as coordinating investment managers to bulk their orders can lead to small reductions in costs per transaction which lead to a much-reduced cost over time.

Supplier Management

Collaboration with vendors and providers is another important part of supply chain optimisation. Understanding a supplier's business allows each partner to streamline and synchronise their process for reduced lead time and better pricing.

Providers of outsourced services such as fully disclosed custodians and outsourced trading desks have preferred ways of working which, if followed, reduce their costs to serve. Aligning a firm's business processes to these ways of working can help when negotiating reduced fees from the provider.

The wealth management supply chain – from back office to client

Process Management

Every industry has administrative processes, but what is apparent when speaking to firms who continually optimise their supply chain is just because they work a certain way today doesn't mean they will do the same tomorrow. The focus on processes is not limited to 'in house', suppliers whose processes create friction are also expected to improve.

Paper fact finds, LOAs and documents requiring wet signatures are unfortunately still commonplace in wealth management, as is dual keying to different systems and platforms, all of which adds cost and reduces efficiency in the wealth management supply chain and, as a result, adds costs to the client. Addressing these issues will improve client outcomes.

Customer Service

Wealth management would not traditionally consider customer service as part of the supply chain, but other industries see clear benefit in including the delivery of the final products and services to clients in their approach to supply chain optimisation. One phenomenon they are looking to avoid is The Bullwhip effect. This occurs in manufacturing when small fluctuations in demand at the consumer level lead to amplified fluctuations in demand which cause friction and cost throughout the supply chain.

In wealth management inefficiencies at the customer service end of the supply chain are often the cause of the high cost of servicing assets. Similarly, inefficiencies in working through the supply chain from the inventory end of the supply chain contribute to the high cost to clients for wealth management services. Undoubtedly both examples of the bullwhip effect are instrumental in the size of the advice gap.

By adopting a proactive approach focused on continual improvement, wealth managers can optimise their supply chain, mitigating the bullwhip effect, enhancing operational efficiency, and delivering greater value to clients all while simultaneously reducing their own ongoing costs. The first step is human-led optimisation and digitisation, this allows for the future deployment of robotics, AI, machine learning and blockchain which will reduce costs and increase capacity even further.

[2]See for example: Capgemini – 'Integrated supply chain management drives superior business outcomes, 7 February 2024

Reviewing the Proposition

Service and cost

Time-cost analysis of a proposition can help identify scalable and non-scalable services and adjust fees proportionally to the cost of delivering the service. Deeper analysis will help ensure propositions and pricing accurately reflect each client's needs and will allow businesses to continually assess, adapt and optimise their costs to serve and the fees they charge clients. A high-level example is in Fig. 2

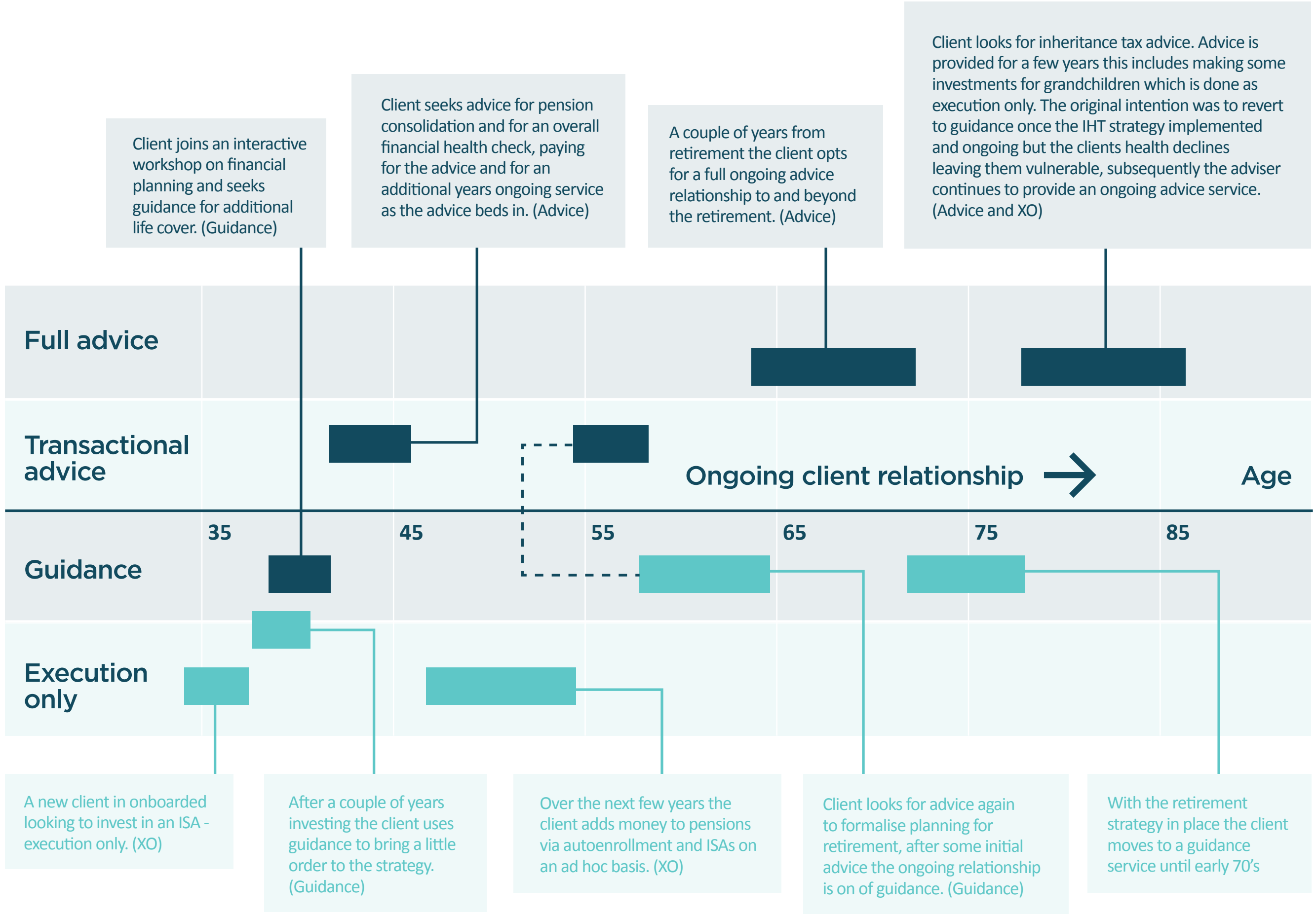
Fig 2

Not scalable	Face to face engagement	Fluid changing between these depending on service need analysis and value for money	Highest cost
Semi-scalable	Virtual meetings		High cost
Scalable	Personalised digital content		Medium cost
Scalable	Personalised AI led advice		Highest cost
Scalable without limit	Centralised investment Proposition	Core to WM 4.0	Low cost
Scalable without limit	Safekeeping of assets (PaaS/custody)	Core to WM 4.0	Low cost

Clients Life stages - thinking a different way

Table showing the advice lifecycle for the average client

Fig 3



Through a 50y+r relationship the client rotates between execution only, guidance and advice, each delivering value for money at the appropriate time

The ease of moving between advice, guidance, and execution-only behaviours may depend on factors such as the complexity of the client's financial needs, their level of financial literacy, and the availability of suitable services from financial institutions. Firms will need to be clear and transparent to clients about the nature of the services offered, including any limitations or restrictions associated with each service model. They must also ensure that clients are aware of their rights and protections under the regulatory framework, empowering them to make informed choices about how they wish to receive financial assistance.

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The future of the industry Adviser 4.0

Looking at operating costs alone isn't enough to power wealth management out of the trough of disillusionment, and to guarantee it is seen as good value for money by a far more diverse client cohort than it serves today. To complete the transformation, we need to radically evolve the customer service element of the wealth management supply chain.

Fully tech-enabled

Portals and mobile apps only scratch the surface of capability of digital. Those firms which have embedded client-led journeys or robo-advice in their portals have clearly progressed further, but 4.0 will be transformational.

The current combination of human advisers in person combined with virtual meetings will expand to include online chatbots, and data-rich digital dashboards giving clients 24/7 access to service, data and analysis.

Personalised insights and recommendations will come from wealth managers leveraging AI and machine learning algorithms. As is the case today,, this will provide advice tailored to clients' individual financial goals, risk tolerance and investment preferences but at higher speed and lower cost. Adviser 4.0 will be instantly reactive to a client's inbound needs while also proactively using sophisticated analysis of investments and economic conditions to suggest the best next steps. AI and robotics will dramatically decrease the time from fact-finding through to advice through to implementation, markedly reducing administrative costs.

Interactive workshops and webinars will deliver tailored events to educate clients about financial planning, investment strategies, and market trends. These virtual events will provide an opportunity for clients to learn from industry experts, ask questions, and engage in peer-to-peer discussions in a collaborative learning environment.

Over time these will evolve into Augmented Reality (AR) and Virtual Reality (VR) experiences which create immersive experiences for clients. Clients will be able to explore virtual investment portfolios, visualise different asset classes, and simulate investment scenarios in a virtual environment. AR and VR experiences will aim to enhance client engagement, facilitate learning, and foster a deeper understanding of complex financial concepts.

Overall, Adviser 4.0 will offer clients a seamless and interactive experience, leveraging advanced technologies to deliver personalised advice, foster engagement, and empower clients to make informed financial decisions with confidence. Clients will have access to a variety of interactive channels and digital tools to engage with their wealth manager in ways that are convenient, personalised, and immersive.

> Adviser 4.0 will be able to work with a significantly higher number of clients without fear of degradation of service or quality of advice.

Capacity analysis

For Wealth Management 4.0 to succeed it must adapt to work with a higher volume of clients paying lower fees. This won't be successful if firms rely solely on technology at the point of client engagement. Optimising the capacity of the adviser is essential and for this, we can look at supply chain techniques again and focus on finite capacity plans. Finite capacity plans allow firms to carefully balance between client needs, adviser capabilities, and business objectives.

1. Basic client segmentation

Dividing clients into segments based on factors such as investable assets, complexity of financial needs, and level of service required allows wealth management firms to tailor their propositions to ensure they have solutions for each segment. This segmentation takes into account the service proposition analysis on scalable and non-scalable functions as well as the fluid regulatory propositions now available.

Once the Wealth Management 4.0 model is in place machine learning will be able to identify patterns of behaviour, evolving segmentation further

2. Client Service Level Agreements (SLAs):

Establishing clear service level agreements outlining the scope of services, communication frequency, and expected response times for each client segment follows. As with client segmentation, client service optimisation uses data from the service and regulatory proposition analysis. As firms evolve and adopt robotics and AI, clients' options will evolve from face-to-face, hybrid or self-serve into a number of human/machine combinations blending optimal efficiency with preferred levels of service

Simplicity is the ultimate sophistication - The commercial benefit of the average client. Within the UK population, the majority of people are UK residents, paid through PAYE, have access to the core UK tax wrappers of ISA, Pension, Bond and capital gains accounts and have a risk profile of between 4-6 out of 10. Whilst levels of earnings, outgoings and long-term objectives will differ there will be significant uniformity, particularly through the wealth accumulation phase. Currently, neither client nor wealth manager benefit from the efficiency of normal, instead much effort is dedicated to ensuring each client is considered unique. Given the negative impact high costs can have on return, there is a clear case for suggesting those who accept that they fit in the boundaries of the average client will benefit from processing efficiencies. Similarly, firms should openly embrace the opportunity to provide light touch services efficiently to Mr and Mrs Average.

3. Advisor Skill Assessment – Knowledge and technology:

The knowledge, experience and qualifications of each wealth manager will influence which clients and client scenarios they are able to work with. Whilst complex cases may be linked to the highest revenue, under today's model they also require the most resource.

As a firm evolves from today's capability to Wealth Management 4.0, the time taken to manage complex scenarios will reduce. Effectively arbitraging between efficiency gains and the value of complex advice will ensure value for money for the client and high-quality fee revenue for the wealth manager.

Whilst the current adviser skills and qualifications will remain relevant, new skills will emerge: the skill of working with new technology and with regulatory fluidity.

Unlike today where a knowledgeable and experienced adviser can get by with few technology skills, the most prized Adviser 4.0 will combine knowledge and experience with technology proficiency and will be equally comfortable assisting a client using guidance, or transactional advice as they are at delivering ongoing advice.

Firms and advisers that fail to upskill will rapidly seem outdated and by Wealth Management 4.0 their proposition will be too expensive to compete.

4. Continual capacity reviews:

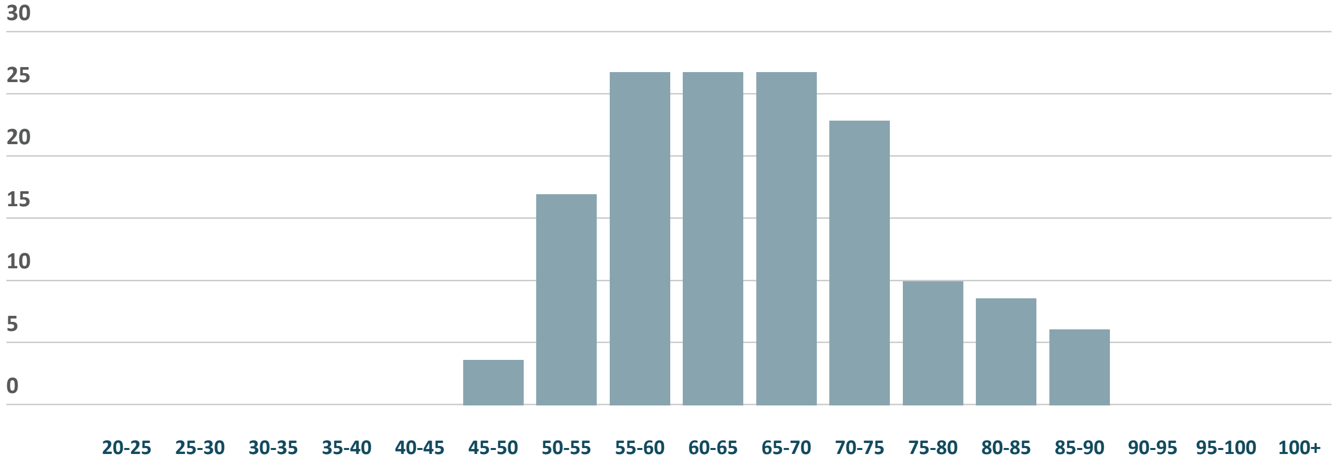
Continual monitoring across multiple key metrics will ensure each wealth manager is working to their optimised capacity and let firms ensure a balanced workload is distributed across the firm.

Note - *Implementing a finite capacity plan is not about maximising the number of clients per wealth manager at all costs. Instead, they are tailored to the unique needs of their clients and wealth managers and the overall proposition that each firm seeks to deliver. From here it can optimise resource allocation, improve client satisfaction, and drive business growth.*

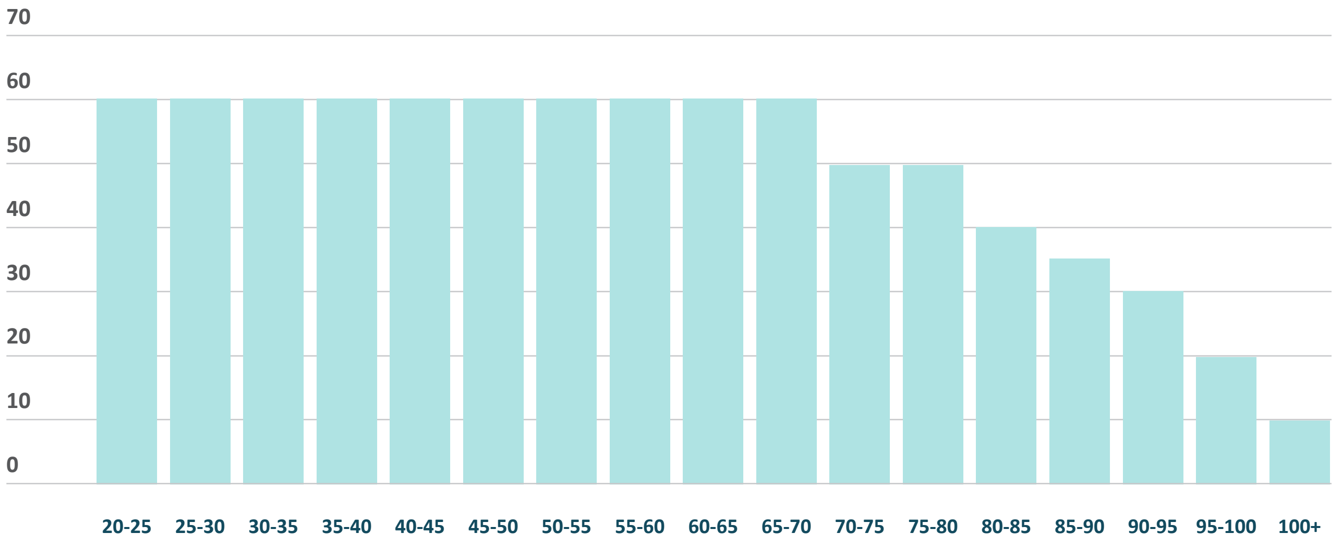
Adviser optimisation
in extremis.........

Fig 4

Traditional Adviser Client base - 150



Adviser 4.0 Client base



Capturing the opportunity

Wealth managers also need to finesse their new client acquisition strategy to ensure it targets the right clients for the optimised adviser. As is the case today,, too many clients will lead to issues with capacity and too few to commercial challenges, and sales and marketing functions will need to react more quickly to demand under the Wealth Management 4.0 model.

With less than 10% of the population engaged with wealth management, the potential opportunity within the population is vast. Approximately 25% of the population have ISAs, Life Insurance, Pensions, and Mortgages and so are in the near orbit of wealth management and are proof that its solutions do appeal to a wider section of the population.

In traditional supply chains, the term 'Demand sharing' refers to the collaborative sharing of demand information and forecasts between different entities within the supply chain, such as manufacturers, distributors, retailers, and suppliers. The goal of demand sharing is to improve inventory management, reduce stockouts, minimise excess inventory, and enhance overall supply chain efficiency.

In the context of Wealth Management 4.0, we are considering demand-sharing techniques to judge capacity in all areas of the business and optimise marketing, client servicing and operational capacity with the goal of achieving the best commercial results.

The capacity analysis mentioned above will identify when a firm is lacking the capacity to service certain client segments e.g. 'at-retirement' clients. The analysis will enable sales and marketing functions to focus efforts on different client segments where capacity allows ensuring that the organic growth matches the optimised firm's capacity.

Suppier Management

As referenced earlier in the paper supplier management is an important aspect of optimising a supply chain. Demand demand-sharing methodology also supports how firms work with suppliers. As such, a wealth firm looking to target a different client segment may wish to engage with their partners to ensure new clients can be serviced efficiently.

Data analysis and forecasting can have influence at all points of the supply chain to achieve excellent commercial results and to mitigate risks such as the previously described bullwhip effect. Wealth Management 4.0 firms will use technology to establish an iterative feedback loop to continuously monitor and evaluate the impact of marketing efforts on demand generation and client engagement as well as monitoring the effects downstream to ensure all parties involved in the supply chain are contributing to the most efficient ways of working.

Conclusion

The Wealth Management industry needs to keep delivering strong commercial results in the face of fee compression and needs to modernise in order to attract clients outside the narrow section of the population it currently serves. A total transformation is required if it is to achieve this; efficiency and cost control from the back office through to the front, dramatically increased client-to-wealth manager numbers, distinctly lower fees and a much greater penetration of the population, along with a continued focus on long term relationships and client loyalty are all required.

Embracing the intent of regulation to deliver good client outcomes at a reasonable price as well as acknowledging the freedom to change the service offered to clients as part of the advice guidance boundary review is part of the approach.

Learning lessons from other industries will have an impact on the cost of wealth management. Many aspects including the capacity within each organisation, its efficiency and the way it controls its own costs will influence the cost of services. This will be increasingly important as part of growth and retention because price will form a key part of the continual assessment of value for money.

Establishing a continual process of optimisation across all aspects will allow this to happen now and to keep happening in the future. Reducing the cost of wealth management services is not about a race to the bottom on price, or about reducing the quality of advice given. Instead, it is about ensuring the value of services provided is clear and not distorted by inefficiencies and that the wealth management industry's undeniable expertise is available to all who need it.

Wealth Management 4.0 is the future of the industry, and under that model the future is outstanding.

Speak to Davies about optimising your existing business and creating an actionable roadmap to the future.

Notes

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