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CAPITAL MARKETS

Trends in Global Wealth Management: A Business Perspective

Key emerging business-focused technology trends in the wealth management industry

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Contents

1 Highlights

The financial markets worldwide bounced back in 2009 from the recessionary lows seen during the financial crisis years. This growth was supported by recovery in the macroeconomic environment across regions. While most of the banks that survived the crisis benefitted from this improved performance, their business priorities underwent significant changes, with most of them altering their business models to incorporate lessons learned from past mistakes. One important highlight during and after the worst of the crisis period was increased emphasis on the wealth management business by both universal banks and boutique firms.

Revenue and profit margins of the wealth management industry remained relatively stable during and following the worst of the crisis. This better performance as compared to other banking divisions led to an increased emphasis on the wealth management business by banks and other financial services institutions, with executives attracted to strong cash generation and low leverage. The wealth management business at universal banks is now emerging as a core competency that can help maximize enterprise value. This was aided by the global growth in wealth and population of high net worth individuals (HNWIs). Many of the larger banks are reorganizing their business divisions and top management teams to rightly position themselves to capitalize on this growth.

However, while wealth management is an attractive industry, it is also challenging in terms of the constantly-evolving regulatory requirements. The global financial services industry is grappling with multiple regulations. Some of these regulations, such the Retail Distribution Review (RDR) act in the U.K., will alter the way products are distributed by the wealth management industry. Other regulations, such as the upcoming Basel III norms, will affect capital adequacy requirements for the parents of many wealth management firms, leading to trickle-down impacts.

As the industry struggles to cope with the dynamic business environment while meeting client demands, wealth management firms are leveraging advancements in IT to grow their business and improve their operational efficiency. Firms are using the Software-as-a-Service (SaaS) model to create cost-effective and adaptable solutions that better meet advisor and client expectations.

2 Introduction

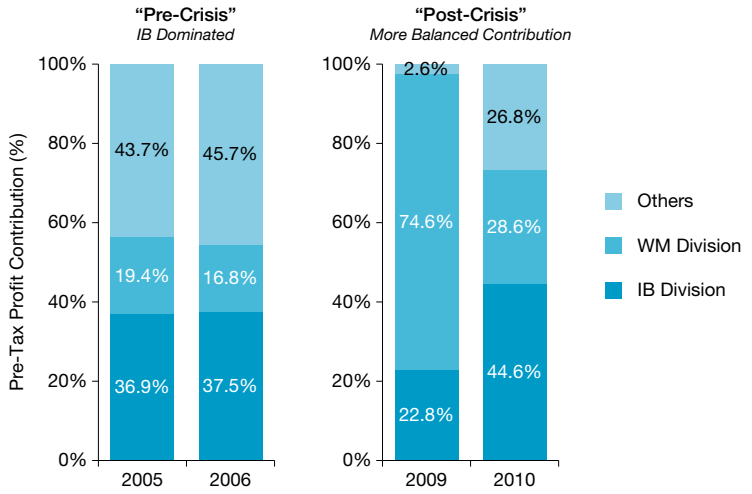
In 2010, the Asia-Pacific region overtook Europe to become the second largest wealth management market in terms of both HNWI wealth and population

2.1. Financial Performance and Background

The global high net worth individual wealth and population witnessed growth across all regions in 2010, mostly benefitting from the improved financial market performance. Global HNWI wealth stood at $42.7 tn in 2010[1]. While North America remained the largest market in terms of HNWI wealth and population, the Asia-Pacific region overtook Europe on both of these parameters to occupy the second spot. Overall, growth rates in wealth remained higher in emerging economies than in developed economies.

2010 also witnessed an increased focus by universal banks on their wealth management operations as the business environment for other operating units (such as investment banking) turned more challenging. For example, the revenue generated by investment banking divisions across most banks remained volatile, with most of them producing substantial losses in the crisis years. Recent regulations in the financial services industry are aimed towards curbing high- risk positions taken by the investment banking divisions. For instance, in the UK, the Independent Commission on Banking (ICB) report proposes ring-fencing banking operations from their riskier investment banking divisions[2]. As such, banks are now focusing more on developing their wealth management businesses, which have generated more stable revenues and margins, and have benefited from a resilient client base.

Exhibit 1: Pre-Crisis and Post-Crisis Performance of Wealth Management Division (%), 2005–2010



Source: Capgemini analysis, 2011

[1] *World Wealth Report*, Capgemini-Merrill Lynch, 2011
[2] As of October 2011, the ICB is still under discussion and is expected to come into effect in 2019, so as to provide banks with ample time to act on the recommendations

However, wealth management firms are also facing many challenges in managing and growing their business. Cost-to-income ratio for the global wealth management industry increased to 79.8% in 2010 and remains a cause of concern for the whole industry. It is of more importance in emerging markets where wealth management firms are still struggling to find the right business model.

Continued dependence upon relationship mangers and an acute shortage of qualified talent in many markets has led to higher personnel expenses. In addition to these challenges, increased regulations in the financial services industry across the globe is creating hurdles for the growth of wealth management business.

2.2. Key Market Trends and Challenges

Despite strong growth in assets, the wealth management industry still faces many challenges, and the challenging environment is forcing wealth management firms to rethink their business models. Increasing client awareness, regulatory oversight, and a shift in focus towards emerging markets are reshaping the wealth landscape. Firms now need to respond to these changes as quickly as possible to remain competitive. On a broader level, trends witnessed across the wealth management industry can be classified into two categories, namely, HNWI-specific and firm-specific trends.

HNWI-specific Trends

- Client trust in advisors and wealth management firms has been improving during the post-crisis period.
- Growth in HNWI wealth and population over last three years has been higher in emerging markets as compared to that in developed markets.
- The proportion of young HNWIs (< 45 years) has been gradually increasing across regions mainly due to the rise in number of young entrepreneurs and also due to the increase in wealth transfers towards younger generations.
- HNWI's demand for philanthropic planning and products is rising steadily.

Firm-specific Trends

- Wealth management firms are struggling to create scalable business models while facing rapid changes in the financial markets.
- The wealth management division is becoming central to universal banks' operating models.
- Regulatory oversight on the wealth management industry is increasing across the globe.
- Emerging markets (especially Singapore and Hong Kong) are emerging as new offshore centers for wealth management.
- Behavioral finance is going mainstream as wealth management firms leverage it to better serve their clients.

Other Challenges

Wealth management firms also face multiple challenges when trying to capitalize upon industry trends. At the parent level, wealth management divisions at universal banks face reputational risk arising from the trading scandals and losses arising from activities of other business units. Legal risks could also arise in cases where conflicts of interest between business units (ex. investment banking and wealth management) are not properly managed. At the business-unit level, challenges faced by firms include motivating and incentivizing wealth managers to interact with multiple business units to provide their clients with necessary information. At the distribution level, the important challenge is to offer a wide array of products to HNWIs while clearly explaining the specific details and risks of each. Some other challenges facing wealth management firms are shortage of well qualifies and experienced advisors, increased regulatory burden and constantly evolving needs of HNWI clients.

However, not all the above-mentioned challenges are global in nature. Talent shortage and succession planning problems are more pronounced in the Asia-Pacific region, while demand for sophisticated service is more relevant in the Europe. Growth in female HNWI assets requires a reconsideration of HNWI preferences primarily in the North American region.

Each of these trends and challenges has multiple business and technology implications for wealth management firms globally.

3 Emerging Technology Trends in Global Wealth Management: A Business Perspective

Wealth management business is now emerging as a key core competency across universal banks and well-balanced financial services institutions. Firms are focusing on integrating business units to improve client satisfaction by offering more targeted services. While firms have attempted to integrate multiple business units in the past, the focus was more on capturing overall firm-level synergies than on providing client benefits.

As wealth management firms try to grow their businesses, they are also facing challenges from increased regulations. Many of these regulations are expected to alter the way investment products have traditionally been distributed by wealth management firms. Some regulations have also increased the burden on data reporting. Firms will now need to process more data and create more reports, potentially increasing their costs and negatively impacting their operational efficiencies.

The industry is also witnessing dynamic changes as new firms enter the market and as clients become more demanding. Firms now feel the need to be more flexible and quicker in response to these changes to remain competitive in the industry and to better serve all stakeholders.

These changes have led to the emergence of the following key business-focused trends in the wealth management industry globally:

1. Stronger focus on leveraging enterprise value to differentiate by maximizing client benefit
2. Increased investment in IT as regulations become an operational challenge
3. Increased use of Software-as-a-Service as a cost-effective and adaptable solution to changing business needs

The technology trends covered in this document are not exhaustive in nature and only current prominent trends have been analyzed

4 Trend 1: Stronger Focus on Leveraging Enterprise Value to Differentiate by Maximizing Client Benefit

4.1. Background and Key Drivers

Enterprise value is the ability to leverage capabilities from across different business units in order to differentiate in meeting client needs. Traditionally, the primary focus of business units' integration was on capturing synergies for the firm, while the client perspective was secondary. With the rise in demand from HNWIs and advisors for value leverage across units, firms are now focusing on enhanced enterprise value for clients. Firms now see benefits of enterprise value at the parent level, business unit level, and distribution level. Some key drivers of this emerging trend are:

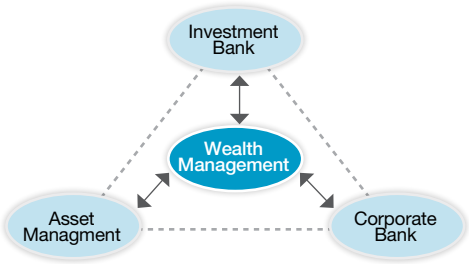
- Synergies between business units create benefits by reducing cost of funds and increasing client referrals
- Other secondary synergies such as real estate and service costs sharing help improve operational efficiencies
- Leveraging brands built by other units makes it relatively easier to enter new markets
- Improvement in client satisfaction as they are provided with additional benefits

4.2. Analysis

Wealth management is emerging as a core competency for universal banks and well-balanced financial services institutions.

Wealth management is emerging as a core competency for universal banks and well-balanced financial services institutions. Firms are reorganizing internally to leverage different business units to better serve their wealth management clients. Some financial services firms have created dedicated investment banking teams that focus only on designing/making available offerings for wealth management clients. One such instance of deriving maximum benefit from enterprise value is where a firm leveraged its leadership position in investment banking to gain access to the wealthiest individuals and then offered them institutional products that other wealth managers cannot offer.

Exhibit 2: Wealth Management Emerging as a Core Competency for Universal Banks



Source: Capgemini analysis, 2011

This is a challenging and on-going process, and firms still have a long way to go as only 57% of advisors[3] currently believe that firms are properly leveraging enterprise value. This presents a significant business challenge and opportunity for wealth management firms. In order to leverage enterprise value, IT and enabling functions are as important as investments on the business side. IT is a significant area, with the need to provide a global (regional and capability-level) vision for IT systems, as well as to ensure mitigation of compliance and conflict of interest risks within the enterprise value strategy. Firms need to create IT functions that are agile and scalable in nature as investments in IT require tailoring to cope with continuous changes in the business environment.

4.3. Implications

Enterprise value can be rewarding to the firm, but first needs to be understood from the client's point of view. Enterprise value should therefore begin from the client perspective and focus on achieving key client benefits.

Firms can benefit from an inclusive, targeted, long-term enterprise-value strategy that is communicated top-down, but need to be patient and understand that the process of enterprise value transformation is a long-term evolution given the complex challenges involved. Reputational and legal risks, capability gaps, and risk appetite can limit enterprise value at the parent firm level. Motivating and ensuring service quality across business units are the trickiest challenges at the business-unit level.

[3] *World Wealth Report*, Capgemini-Merrill Lynch, 2011

5 Trend 2: Increased Investment in IT As Regulations Become an Operational Challenge

Regulations aimed at protecting investors from misguided selling of financial products will alter the way wealth management firms distribute products to their clients.

5.1. Background and Key Drivers

Regulations in the financial services industry are increasing across all regions. Many of these regulations will have consequences that could require a change in the business models of wealth management firms. Regulatory authorities are focusing on protecting investors from misguided selling of investment products, which will impact how these products are bought and sold. For example, the Dodd–Frank Wall Street Reform and Consumer Protection Act in the U.S. and the Retail Distribution Review in the U.K. are scrutinizing how insurance and other products are sold by financial institutions. They also propose ways to clamp down on any practice that is not deemed as investor friendly.

As such, wealth management firms are spending increasing time and efforts to adhere to these regulations, while keeping operational costs low. Some key drivers to increased investment in IT to meet regulatory challenges are:

- Increase in regulations across different segments of the financial services industry
- Need for better systems to ensure compliance with variation in regulation across regions
- The high priority placed by HNWIs and advisors on the risk management practices of wealth management firms

5.2. Analysis

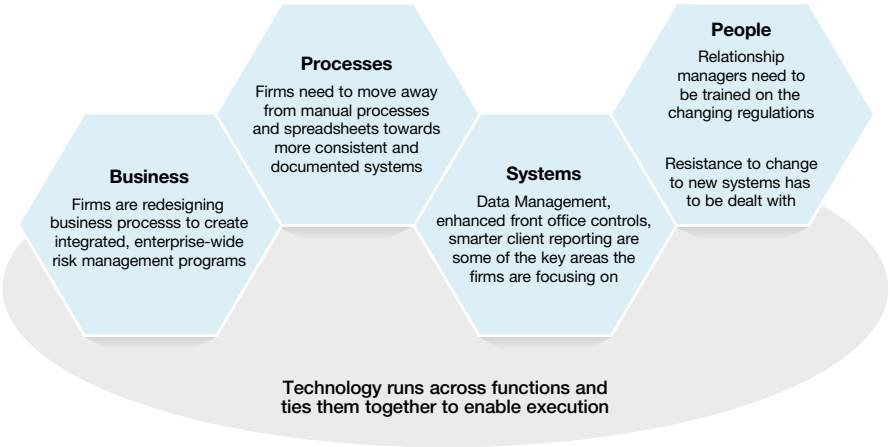
Wealth management firms are prioritizing their scarce resources in order to meet regulatory challenges both at global and regional levels. Firms are under pressure to gather, maintain, and report large amounts of data, putting increased pressure on their current IT systems. Firms have been directing a significant portion of their technology budgets towards meeting compliance requirements, especially since brand reputation is a critical factor for success in the wealth management industry.

Firms are creating newer IT tools to meet these challenges while also emphasizing the critical need for data management systems to be regulation compliant. Firms in the industry are also spending to create stronger risk-management infrastructures, especially around actions involving client interactions, to cope with current and expected future regulatory initiatives.

5.3. Implications

Wealth management firms need to revisit their IT systems to ensure that they have complete systemic support to meet the changing regulatory requirements. Firms are discovering that regulations are no longer a matter of technical compliance, but a complex, enterprise-wide change. They should ensure a co-ordinated focus on business, systems, people, and processes to meet regulatory challenges.

Exhibit 3: Different Functions of a Wealth Management Firm Must Work Together to Make the Firm Regulation Compliant



Source: Capgemini analysis, 2011

6 Trend 3: Increased Use of SaaS Model As a Cost-Effective and Adaptable Solution to Changing Business Needs

6.1. Background and Key Drivers

To cope with the dynamic business environment, wealth management firms need agile IT solutions that are also scalable in nature. Traditional desktop-based IT products fall short in serving these needs due to their inherent features, such as requiring the end user to ensure installation of product updates, to take care of server maintenance and storage and backup facilities. Lead time required in creating these products is also much longer, and suppresses a firm's ability to quickly cope with changing business requirements.

Wealth management firms have slowly started adopting SaaS-based solutions to help advisors leverage web-based tools in a more cost-effective and time-effective manner. They are leveraging SaaS to provide fast, cost-effective solutions to advisors and end users. Some key drivers to increased adoption of SaaS by wealth management firms are:

- Need to quickly create agile solutions that address evolving business conditions
- Reduced burden on internal IT infrastructure possible with the implementation of SaaS
- Reduced need to communicate version upgrades with end users
- Cost-efficient method to create quick models/prototypes which can be enhanced per business requirements

Wealth management firms using SaaS cite reduced costs, enhanced speed of delivery, and better user experience as the key reasons for choosing a SaaS model.

6.2. Analysis

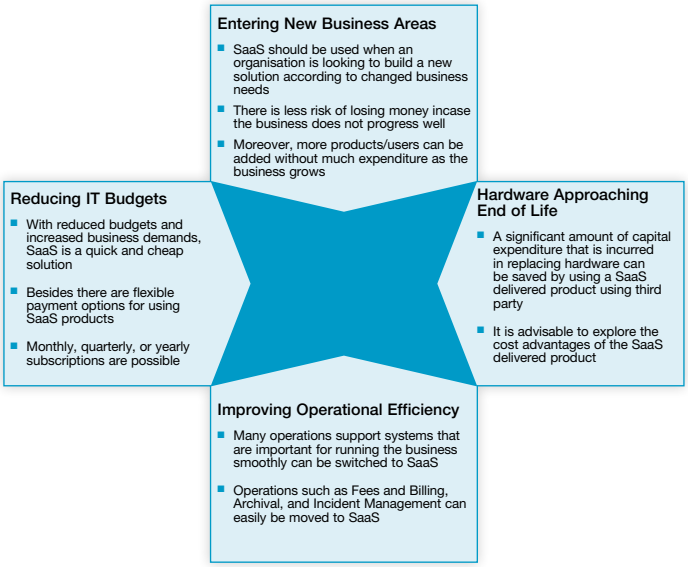
Increased competition in the wealth management market requires advisors to plan and execute strategies that require accelerated deployment of products and services. SaaS empowers advisors and agents by giving them cheap, easy, and fast access to multiple financial modules. SaaS-based solutions have gone beyond the initial customer relationship management module and are now offering access to over 60 financial modules such as risk, compliance, databases, and reports.

SaaS adoption rates are also on a rise due to lower costs and ease of implementation. In large wealth management firms, the deployment of software on wealth management advisory workstations can be tedious and error-prone. These firms have a difficult time developing these massive programs and are increasingly turning towards SaaS providers for help. Wealth management firms using SaaS cite reduced costs, enhanced speed of delivery, and better user experience as the key reasons for choosing this model.

6.3. Implications

Wealth management firms already understand the importance and utility of SaaS models; however they need to realize how to leverage SaaS for financial modules such as performance measurement and risk evaluation. Firms with lower IT budgets can also look towards implementing SaaS-based solutions due to their low cost nature.

Exhibit 4: Situations Where SaaS Can Be Optimally Leveraged by Wealth Management Firms



Source: Capgemini analysis, 2011

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