

Top 10 Trends in Wealth Management 2017

What You Need to Know



People matter, results count.

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Introduction

The wealth management industry around the world is witnessing a multitude of changes due to weak economies in the developed world, strong growth in developing markets like China and India, an uncertain political future in Europe, increasing regulatory supervision, and new competition from rising FinTechs and their innovative services for High Net Worth Individuals (HNWIs).¹

Our analysis in this paper revolves around the impact of the above-mentioned dynamics on the industry players and how they are adapting through this phase of transformation (see Exhibit 1).

Regulatory supervision in the form of the DOL fiduciary rule will have a considerable impact on thousands of brokerage and wealth management firms in the U.S. and will fundamentally change the landscape of the industry, as they will be required to act as fiduciaries for their clients.

The rapidly changing client and wealth manager demands for seamless digital channels of communication and access to portfolio management are driving a lot of attention of the firms toward digital transformation. Delay in this transformation on the part of the incumbent firms has allowed innovative FinTechs to fill the needs gap and start threatening the seemingly dominant market share of the incumbents. Incumbents are now mitigating this threat and speeding up their transformation journey through collaboration with them.

Apart from digital demands of clients, technology is also changing different aspects of this industry. The advent of robotic process automation (RPA), increasing focus on cybersecurity, applications of artificial intelligence (AI) and analytics are also some major ongoing trends in this industry.

Implementation of new regulations such as Implementation of Markets in Financial Instruments Directive II (MiFID II), increasing demand from clients for self-services and personalization, and intensifying competition is also forcing wealth management firms to redesign their fee structures and operating models to put clients' interests first and add value to their relationships to make them sustainable in the long run.

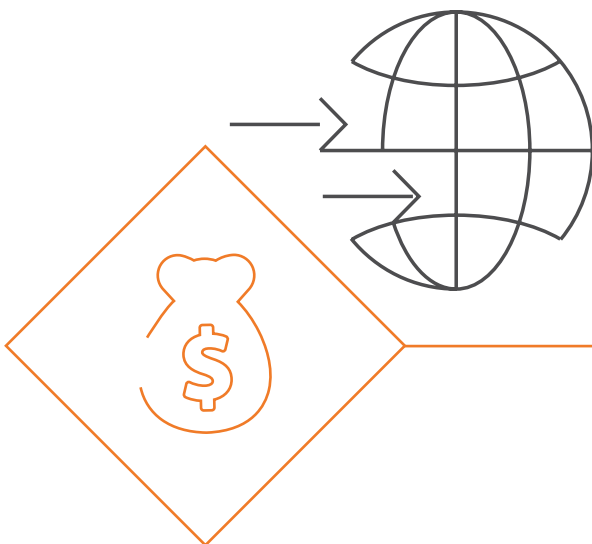
The next section provides the overview of the top 10 wealth management trends that we think will be strategically critical for firms in the near term.



¹ HNWIs are defined as those having investable assets of US\$1 million or more, excluding primary residence, collectibles, consumables, and consumer durables

Exhibit 1: Top 10 Trends in Wealth Management

Focus Area	Trend
Risk and Compliance	<ul style="list-style-type: none"> • Business-as-Usual Taking Up a Significant Share of Investment Allocation of Firms • Continued Focus on Cybersecurity in Light of Increasing Digitization • Fiduciary Duty Gaining Prominence Due to Regulatory Focus
Innovation	<ul style="list-style-type: none"> • Increasing Collaboration between Incumbents and FinTechs • Increasing Application of Artificial Intelligence-Based Analytics Solutions
Efficiency / Productivity	<ul style="list-style-type: none"> • Surge in Robotic Process Automation in Mid- and Back-Office • Growing Demand for Digital Tools by Wealth Managers
Client Centricity	<ul style="list-style-type: none"> • Emerging Advisor-Client Relationship Models to Cater to Client Demand • Evolution of New Fee Models • Intergenerational Wealth Transfer Remains a Significant Growth Opportunity



Trend 01: Business-as-Usual Taking Up a Significant Share of Investment Allocation of Firms

High cost of keeping up with day-to-day activities is precluding investment in forward looking initiatives.

Background



- The wealth management industry is facing one of its biggest disruptive challenges since the 2008 financial crisis, and over the coming decade, change in the industry will likely accelerate.
- Client needs are changing and becoming more diverse, spanning to include more emphasis on wealth transfer, retirement planning, and social impact investing, which poses a challenge to wealth management firms.
- Increase in the number of regulations and compliance-operations costs are further aggravating the challenge.
- Although firms recognize the need to respond to the changing dynamics of the industry, they are struggling to square those needs against the ongoing pressures of running the day-to-day business.

Key Drivers



- In the face of changing demands of customers and the rise of agile FinTech competitors, firms are under pressure to reinvent their business models and invest in development of new propositions.
- The ever-changing and increasing regulations continue to burden firms for keeping up with day-to-day activities.

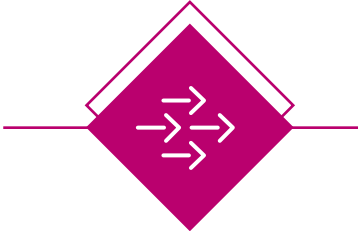
Trend Overview



- Wealth management firms are adopting different approaches to tackle the challenging requirements of the changing industry, but are struggling to transform their businesses, as they are occupied with ongoing pressures of running the day-to-day business (see Exhibit 2):²
 - 39.4% of firms' investment budgets are going into internal and external modernization initiatives, with another 15.8% into people and culture.
 - Just keeping up with business-as-usual takes a further 15.3% of investment, leaving only 14.8% and 14.7% for proposition development and business model, respectively.
- The time, money, and mindshare geared toward all these basic running-the-bank efforts appear to be making it more difficult for firms to engage in activities such as re-orienting the business model or focusing on new propositions, where real differentiation could occur.
- Many wealth management firms' executives are of the opinion that after the termination of the brokerage model, it has become difficult to predict and create the right product offerings, as noted in the 2016 *World Wealth Report*.

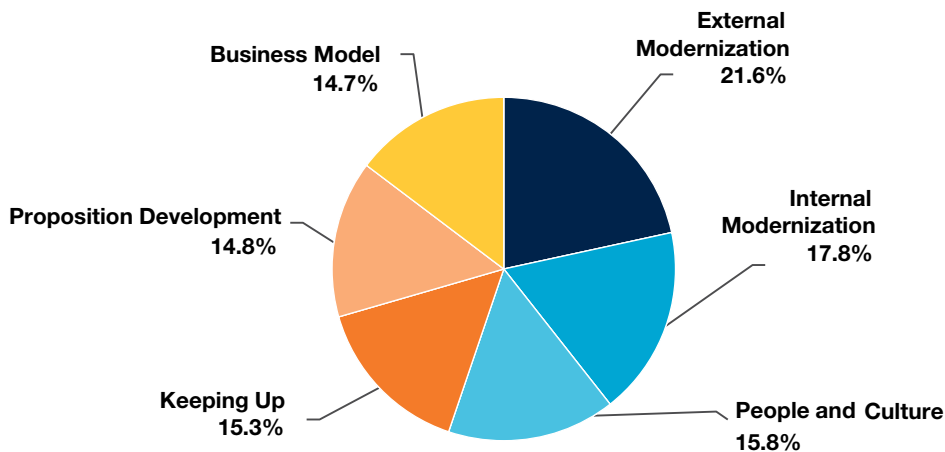
² 2016 *World Wealth Report*, Capgemini

Implications



- Firms will have to fully develop and execute clear-cut strategies for the future.
- Each firm is unique and its investment priorities should vary based on current and desired levels of digital maturity, management priorities, and the markets in which it operates.
- However, to deliver a better digital experience to increasingly demanding clients, firms can follow a specific investment approach or a combination of different approaches, depending on their unique circumstances:
 - **Balanced Approach:** Focus equally across different themes including internal and external modernization, people and culture, keeping up, proposition development, and business model.
 - **Innovator:** Major focus on business model innovation.
 - **Modernizer:** Focus mainly on internal and external modernization.

Exhibit 2: Wealth Management Firms' Future Investment Allocation, Q1 2016



Source: Question asked: "Please tell us how you would expect to allocate your investments (both effort and monetary investments). Imagine you have 20 investment chips to allocate across key future investment themes"; Total 30 responses included

Source: Capgemini Financial Services Analysis, 2016

Trend 02: Continued Focus on Cybersecurity in Light of Increasing Digitization

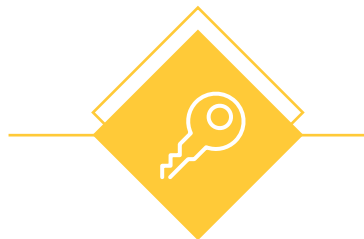
Cybersecurity is a focus area for wealth management firms as digitization and multi-channel models lead to an increase in risk exposure.

Background



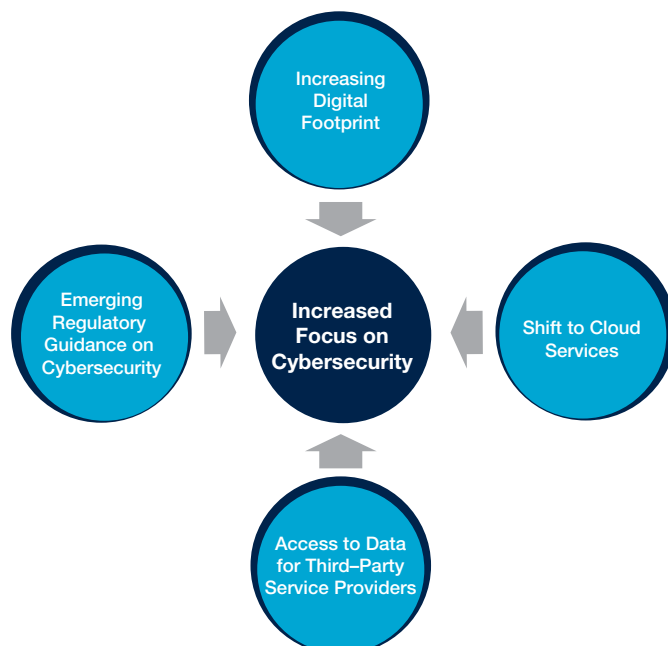
- With evolving digitization in the industry, more customers and asset managers are leveraging the power of massive amounts of financial information for real-time asset and portfolio management.
- This means that there are proprietary and third-party services that have access rights to clients' and firms' financial information in order to provide the end-user a window into their investment performance and management.
- With significant amounts of assets and sensitive financial information involved, the wealth management industry is one of the prime targets of data breaches.

Key Drivers



- With the rapid pace of innovation in digital wealth management tools, the number of touch points for the clients also increase, and therefore client data privacy and security concerns are rising (see Exhibit 3).
- This implies that regulations are likely to get stronger and firms will be held accountable and likely be penalized for lapses in data privacy and security.

Exhibit 3: Drivers for Increased Focus on Cybersecurity



Source: Capgemini Financial Services Analysis, 2016

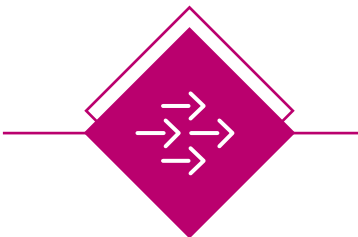
- The Securities and Exchange Commission (SEC) also listed cybersecurity as a top priority in its Examination Priorities for 2016 notice given that at least 74% of wealth managers had been a target of a cyberattack.³
- The Financial Industry Regulatory Authority (FINRA) in its annual Regulatory and Examination Priorities Letter of January 5, 2016 mentioned cybersecurity as a technology management issue under the priority area of supervision, risk management, and controls.

Trend Overview



- With evolving client expectations and competitive pressure toward becoming responsive and client-centric, wealth management firms are now increasingly moving their technology infrastructure to the cloud:
 - Cloud-based services are needed for better response times, quicker rollout of portfolio management services globally, and real-time analytics.
 - Moving to the cloud also means that risk of data privacy and security increases when compared to in-house IT infrastructure that is maintained by the firm itself.
- As third-party service providers build their services on the data held by wealth management firms, the risk exposure of the service provider is going to affect the vulnerability of the firm:
 - Proper risk assessment of third-party providers should be conducted and effective risk mitigation measures are required before access rights could be granted.
- The first line of defense at most wealth management firms is education of employees and clients on the basic principles of cybersecurity and periodic internal and external audits of information systems at the firm and its vendors.

Implications



- Investments in cybersecurity measures are expected to increase globally as wealth management firms respond to this ever-growing threat.
- Wealth management firms will increase spend on hosting their private cloud platforms in order to provide proprietary services to their wealth managers and clients, while also avoiding the risks of data leakage and cyberattacks of a public cloud.
- Investment in cyber insurance policies is also an important measure that wealth management firms should ideally take in order to protect themselves from bearing the financial burden in the event of malicious cyberattacks.

³ "Is your wealth manager a target for a cyberattack?", Deborah Nason, *CNBC*, February 3, 2016, accessed October 2016 at <http://www.cnbc.com/2016/02/02/is-your-wealth-manager-a-target-for-a-cyberattack.html>

Trend 03: Fiduciary Duty Gaining Prominence Due to Regulatory Focus

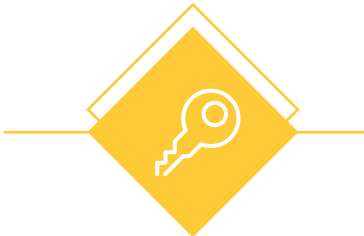
Fiduciary duty, in conjunction with a best-interest advice model, is gaining significance due to further focus on client interests by regulators.

Background



- In April 2016, the Department of Labor expanded fiduciary responsibility to wealth managers to recommend what is in the best interest of their clients.
- This rule is expected to have widespread impact on the U.S. wealth management industry when it goes into effect in April 2017, such as requiring adherence to new protocols, and emergence of new business and fee models.
- The main thrust of the regulation is for wealth managers who were not previously subject to fiduciary obligations.
- The U.S. often leads by example in consumer rights-related regulations, as has been seen before with know your customer (KYC) and anti-money laundering (AML) laws, and this move opens the door for other countries to follow suit (in case they are not already doing so).

Key Drivers



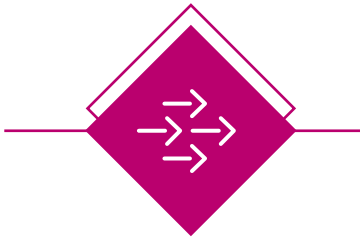
- The regulation aims to curb a US\$17 billion per year cost to clients due to firms incentivizing wealth managers to recommend products that have higher fees.⁴
- The regulation aims to help raise investment advice standards for retirement accounts by increasing transparency in fees and holding wealth managers accountable.
- There has been huge public support to standardize the quality of investment advice and regulate wealth managers.

Trend Overview



- The DOL rule will force wealth managers to satisfy the best interest contract exemption (BICE) conditions, which mandates the wealth manager must disclose fees and conflict of interest.
- Independent broker-dealers, who currently operate under less-stringent standards that only require investment advice be suitable, face the greatest disruption.
- Brokers and wealth managers now need to operate in a new stricter regulatory environment, and they will have to determine additional disclosures required and execute communications to investors in a periodic manner.
- The rule will enforce a new level of disclosure and transparency to clients, giving them legal recourse in case of dispute.

⁴ "Obama Vetoes Resolution to Kill DOL Rule; New Lawsuit Filed", Diana Britton, WealthManagement.com, June 9, 2016, accessed October 2016 at <http://www.wealthmanagement.com/legal/obama-vetoes-resolution-kill-dol-rule-new-lawsuit-filed>



Implications

- There is likely to be a shift to a fee-based advisory model due to increased scrutiny and regulatory requirements, and firms doing so will have to address existing Financial Industry Regulatory Authority (FINRA) and SEC rules while ensuring that the recommendations are in the best interest of the client (see Exhibit 4).
- Retirement accounts, which wealth managers deem too small to profitably provide conflict-free advice to will be welcomed by automated-advisors.
- Individuals will be directed toward services that are more scaled and less expensive, and should lead to clients asking more questions about conflicts and compensation.
- There will be increased competition, as businesses move toward a Registered Investment Adviser (RIA)-based model that will lower costs and enhance delivery models and products for clients.
- Existing businesses will require additional investment to ensure compliance with new rules, which may force the smaller companies, particularly Independent Broker Dealers (IBDs) to consolidate their resources.
- Sales of high-commission annuity products are expected to slow because of compliance with BICE conditions.

Exhibit 4: Impact of Fiduciary Rule



Source: Capgemini Financial Services Analysis, 2016

Trend 04: Increasing Collaboration between Incumbents and FinTechs

Wealth management firms are increasingly collaborating with FinTechs to develop offerings to fulfill evolving client preferences.

Background



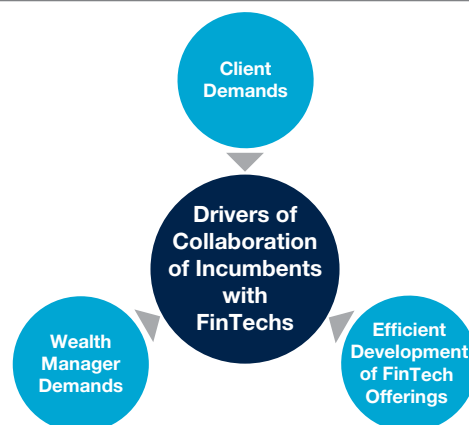
- The wealth management business has traditionally been based on the personal trust and goodwill between the client and the wealth manager.
- Many firms and wealth managers were slow to react to the threat from new entrants, based on a belief that well-established brands and relationships would offset any competitive advantage a new player may bring.
- As a result, investment in innovation did not keep up with changing client (and wealth manager) expectations for a seamless and digitally enabled experience.
- FinTech firms saw this gap, and entered with service offerings focused on investment management, although there are now offerings also in the advisory space as well as third-party capabilities to ease firm-level processes such as onboarding, compliance, and prospecting.

Drivers



- HNWIs and wealth managers have been looking for services that allow them to leverage the convenience of digital technologies.
- Most incumbents did not have services in place that could allow access to client portfolios in real time or manage them online.
- Fees have also been higher for wealth manager-driven relationships; portfolio rebalancing would also mean more fees, as there is more advisor involvement for consultation:
 - Many investors have been looking for services that have transparent pricing and charge lower fees for standardized services, and can replace the need for a human advisor.
- Incumbents see an opportunity to jump-start their FinTech offerings by collaborating with startups who have built market-ready solutions, thus cutting down time-to-market of newer services for clients (see Exhibit 5).

Exhibit 5: Drivers of Collaboration



Source: 2016 World Wealth Report, Capgemini

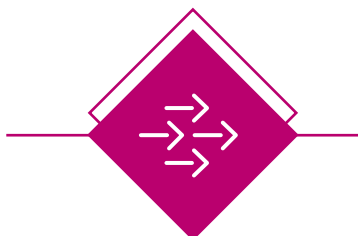
Trend Overview

- FinTechs are making inroads along the entire expanse of the wealth management lifecycle, innovating standard wealth management functions, ranging from client acquisition, to advice, to compliance.
- New FinTech offerings, including automated advice platforms, open-investment communities, and third-party capability plug-ins are increasingly being embraced by HNWI as alternatives to traditional face-to-face advice in some cases:⁵
 - Globally, HNWI propensity to use automated advisory services increased substantially to 66.9% in Q1 2016, compared to 48.6% in Q1 2015.
 - HNWIs are increasingly turning to digital networks, swapping insight and information with peers through open investment communities—nearly half of HNWIs (47.5%) tap into online peer-to-peer networks at least weekly to find out about investment ideas, while 25.6% use them monthly or quarterly.
- FinTechs have made the greatest inroads in investment management, where 17.4% of customers say they rely solely on them and an additional 27.4% use them in addition to their traditional providers.⁶
- The unmet client need for automated-advisory services was a critical area targeted by a number of FinTech startups that built their businesses around this service.
- Startups such as Betterment and Wealthfront allow investors to use their proprietary automated advisors and let the programs manage and rebalance their portfolios for better returns.
- As these FinTech services gain traction among customers, the incumbents have taken notice and started looking at possible forays into the technology and are making efforts to make them market-ready:
 - Collaboration seems to be the most favorable way to ramp up these services quickly, leveraging the customer base and brand of the incumbent, and the technological head-start of FinTechs.
 - UBS Wealth Management Americas and SigFig announced a strategic alliance in 2016 to develop financial technologies for the UBS unit, which would assist its nearly 7,000 advisors and their clients.⁷
- A majority of executives (76.7%) see opportunities for partnerships with FinTechs, allowing traditional firms to leverage FinTech expertise without engaging in expensive in-house development, as noted in the 2017 *World FinTech Report*.



Implications

- Investing in developing FinTech capabilities to attract younger HNWIs has become an area of focus for most incumbent wealth management firms.
- Offering its clients the option to move to an automated-advisory platform with lower fees would impact their source of income and would mean that they have to grow the number of clients on the platform in order to make up for the lost fee income.
- The cost incurred by developing or acquiring automated-advisory services may have to be compensated through wealth manager job cuts at these firms.
- Hybrid advice models could take center stage as HNWIs may prefer to allocate a certain portion of their portfolio to an automated-advisory service and still retain the human advisor relationship for a majority of their investments.



⁵ 2016 *World Wealth Report*, Capgemini

⁶ 2017 *World FinTech Report*, Capgemini and LinkedIn in collaboration with Efma

⁷ "The UBS-SigFig Partnership", Janet Levaux, ThinkAdvisor, September 26, 2016, accessed October 2016 at <http://www.thinkadvisor.com/2016/09/26/the-ubs-sigfig-partnership>

Trend 05: Increasing Application of Artificial Intelligence-Based Analytics Solutions

Firms are increasingly using artificial intelligence and analytics to assist wealth managers in providing personalized and contextual services to their clients.

Background



- Regulations increasingly require wealth management firms to capture more data along each step of the value chain, as a result firms are looking for technologies such as artificial intelligence and machine learning to help assimilate, process, and discern this data.
- The legacy technology, still prevalent in the wealth management industry, is unable to reconcile the vast amount of structured and unstructured information.
- Wealth managers are spending an increasing amount of time trying to aggregate data, provide real-time analytics, send customized financial reports etc., losing precious time that would be better spent advising clients on investment strategy.
- AI-based cognitive computing solutions that help to structure, aggregate, and analyze data to provide evidence-based insights have the capability to provide more personalized insights and enable greater engagement.

Key Drivers



- The need to manage complex asset classes and sophisticated portfolios requires delving deeper into detailed transactions.
- There is a growing client demand for more personalized advice, which entails researching challenges peculiar to an individual client and then collaborating extensively in order to develop relevant solutions.
- Clients are also demanding more access to real-time analytics and this is one of the prime opportunities for wealth management firms to offer differentiated propositions.
- Digital disruption from emerging FinTechs has resulted in increased competition.

Trend Overview



- Wealth management firms of all sizes are harnessing the power of artificial intelligence and analytics to enable faster action and decision making by wealth managers.
- Using automated platforms provides cost benefits for the companies in the long run as they are able to replace existing legacy infrastructure to a more efficient data management platform.
- AI has numerous applications in wealth management to help augment wealth manager efficiency and capabilities (see Exhibit 6):
 - **Real-Time Financial Planning:** AI solutions are helping wealth managers by running applications that enable real-time planning and control:
 - Hedgeable has launched an AI-powered bot, Katana, which will help perform tax-loss harvesting.⁸

⁸ "AI-powered robo adviser takes aim at the richest clients", Suleman Din, *Financial Planning*, October 19, 2016, accessed October 2016
<http://www.financial-planning.com/news/ai-powered-robo-adviser-takes-aim-at-rich-clients>

- **Data Aggregation & Reconciliation:** There has been an increased demand for data aggregation and analytics solutions that seamlessly sync data from disparate sources such as brokerages, custodians, financial institutions, etc.
- **Behavioral Segmentation:** AI-based solutions can help wealth managers segment and micro-segment clients based on behavioral data:
 - Solutions such as SEI Wealth platforms help capture behavioral insights and enable wealth managers to anticipate future demand.⁹
- **Personalized Reporting:** AI solutions are helping save wealth managers' precious time by sieving through large numbers of financial reports and personalizing them on the basis of clients' needs:
 - Morgan Stanley is using 3D Insights Engine, which analyzes the vast number of research, information, and products available to a wealth manager and sorts them to ensure wealth managers receive information relevant to their client portfolios.¹⁰
- **Provide Actionable Investments Insights:** Stock forecasting algorithms based on machine learning will support wealth managers by providing insights into the best strategies for optimizing and maximizing their portfolios:
 - DBS has implemented an AI-based solution to help wealth managers evaluate various financial options available for their clients.
- **Risk Management:** Predictive analytics and cognitive computing-based AI solutions process large amounts of data to suggest the greatest downside risk for each position and quantify risk premiums based on probability:
 - EidoSearch utilizes advanced pattern recognition by processing large data sets to produce probabilistic predictive analytics that help forecast volatility and the downside risk to the portfolio.¹¹

Exhibit 6: AI Applications in Wealth Management

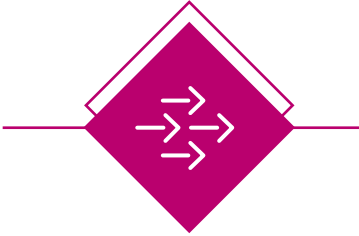


Source: Capgemini Financial Services Analysis, 2016

⁹ "Behavioral segmentation drives long term profitability for wealth management industry", Mark Kitchen, *Wealth Adviser*, November 4, 2014, accessed October 2016 at <http://www.wealthadviser.co/2014/04/11/200577/behavioural-segmentation-drives-long-term-profitability-wealth-management-industry>

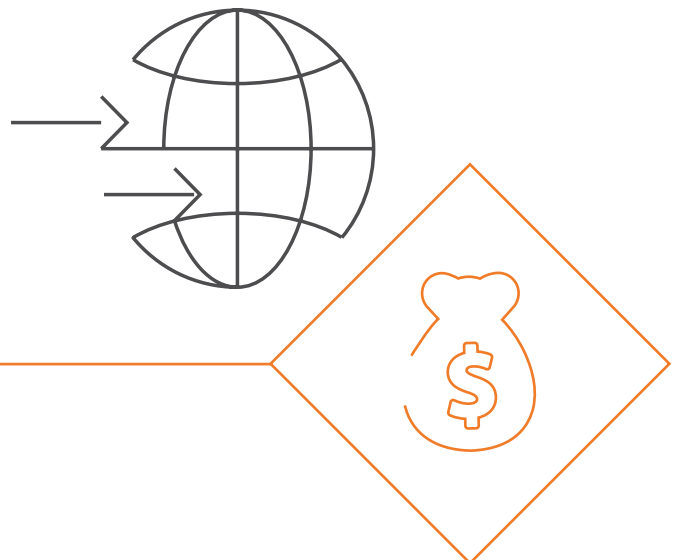
¹⁰ "Wealth management: big data, better relationships", Helen Avery, *Euromoney*, November 2015, accessed October 2016 at <http://www.euromoney.com/Article/3503551/Wealth-management-big-data-better-relationships.html>

¹¹ "AI in Digital Wealth mgt: Sniffing out investment opportunities", Efi Pylarinou, *Daily Fintech Advisers*, March 22, 2016, accessed October 2016 at <https://dailyfintech.com/2016/03/22/ai-in-digital-wealth-mgt-sniffing-out-investment-opportunities/>



Implications

- As reporting requirements, customized insights, and other factors make data management a strategic function for wealth managers, the investment in scalable, open architecture-based integrated data management solutions is expected to increase.
- AI-based analytics platforms are expected to become an integral part of regulatory risk management offerings, helping firms comply with regulatory norms and scrutiny in a more transparent and efficient manner.
- Wealth management firms will increasingly need to leverage their analytics solution to increase client stickiness and gain market share as the client demand for self service and personalization will fuel the growth of artificial intelligence and analytics.



Trend 06: Surge in Robotic Process Automation in Mid- and Back-Office

Firms are focusing on implementing cost-efficient operating models through robotic process automation, in order to keep up with disruptive technology being used by competitors and increasing cost due to regulatory pressures.



Background

- Traditional operating models are not nimble to adapt to the ever-changing regulations and shifting client behavior.
- The practical applications of robotics to replace routine, repetitive, rules-based tasks by automation are being recognized in the wealth management industry.
- RPA has the potential to enhance the operational efficiency in the wealth management industry.



Key Drivers

- As regulations increase in their scope and regulators become more stringent, the fines for non-compliance, whether intended or not, are increasing in magnitude.
- Downward pressure on fees continues to impair the wealth management industry as emergence of digital alternatives enable lower pricing and change in business models.
- As the scope and complexity of asset classes and assets under management increase exponentially, firms are looking for methods to drive operational efficiency and reduce cost.
- Firms looking to provide a differentiated customer experience are expecting to benefit from the faster and less error-prone delivery of routine services as a result of automation.



Trend Overview

- The benefits of robotic technology include cost savings, increased efficiency, accuracy, and enhanced security compared to human-driven processes (see Exhibit 7).
- Firms can leverage RPA to improve profitability in the short term and improve their positioning in the long term by enhancing the client experience.
- Streamlining of processes will help improve compliance and also lead to more scalable and flexible infrastructure capable of adapting to changes in regulations in a short time.
- Typical use cases that will accrue benefits due to robotic process automation include:
 - **Account Rebalancing:** Portfolio rebalancing activities that require professionals to manually compile Excel spreadsheets are being automated:
 - Spectrum Management Group utilizes an automated application to rebalance client portfolios according to client preferences.¹²

¹² "How automation and integration can turn advisory firms into well-oiled machines", Leslie D. Thompson, *Investment News*, November 9, 2015, accessed October 2016 at <http://www.investmentnews.com/article/20151109/BLOG02/151109935/how-automation-and-integration-can-turn-advisory-firms-into-well>

- **Compliance and Regulatory Reporting:** Compliance with new regulations involves activities such as monitoring behavior and conducting background checks:
 - Credit Suisse AG and Palantir Technologies recently launched Signac to monitor employee behavior and ensure compliance.¹³
 - **Customized Portfolio Reports:** The ability of legacy architecture-based systems to create customized reports is very limited; automation of reporting systems helps improve accuracy and is highly contextual:
 - Silicon Valley Bank wealth advisory business utilizes a custom platform to automate and customize their investment portfolio and balance sheet reporting on a client-by-client basis.¹⁴
 - **Customer Support:** Virtual assistants are replacing customer support functions, which can move up to more value-added tasks:
 - Bank of America launched 'Erica', a virtual assistant inside their banking app to respond to customer queries via text messages.¹⁵
 - **Client Onboarding and Diligence:** KYC, AML, and due diligence processes during client onboarding are being automated.

Implications

- Automation will help remove individual silos between separate functions in the mid- and back-offices.
- Wealth managers will be freed up from administrative, time-consuming activities, to apply themselves to perform core business activities such as driving HNWI engagement and portfolio management.
- Shorter cycle times will help improve client experience, which in turn, will help generate more sales and create differentiation in the competitive market.
- Emerging technologies such as natural language processing will help generate customized metrics and prepare reports on individual client portfolio data.
- There will be a significant impact on the workforce, which will be freed up from their responsibilities due to automation and will have to be reskilled to handle higher value tasks.

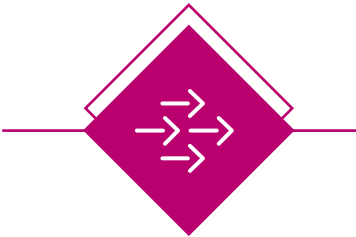


Exhibit 7: Applications of RPA in Mid- and Back-Office



Source: Capgemini Financial Services Analysis, 2016

¹³ "Credit Suisse, CIA-Funded Palantir Build Joint Compliance Firm", Jeffrey Vögeli, wealthmanagement.com, March 22, 2016, accessed October 2016 at <http://www.wealthmanagement.com/regulation-compliance/credit-suisse-cia-funded-palantir-build-joint-compliance-firm>

¹⁴ "Wealth Advisor: Silicon Valley Bank", Addepar, accessed October 2016 at <https://addepar.com/clients/silicon-valley-bank/>

¹⁵ "Bank of America launches AI chatbot Erica — here's what it does", Harriet Taylor, CNBC, October 24, 2016, accessed October 2016 at <http://www.cnbc.com/2016/10/24/bank-of-america-launches-ai-chatbot-erica--heres-what-it-does.html>

Trend 07: Growing Demand for Digital Tools by Wealth Managers

Wealth managers are demanding more digital tools and capabilities to manage their day-to-day work effectively.

Background



- HNWI wealth is at an all-time record and is up over 58% since 2006, but this wealth growth has coincided with decreasing profitability for wealth management firms.
- One of the biggest challenges for firms is to effectively leverage digital technology to transform their businesses and increase profitability.
- Wealth managers are increasingly recognizing the valuable role digital technology can play in delivering the best possible service to HNWIs but they are not satisfied with the tools provided to them by their firms, which poses a big challenge to the firms.
- The challenge is further exacerbated by the fact that HNWIs are also expressing high demand for digital tools.

Key Drivers



- Digital tools enable wealth managers to automate or eliminate low-value back-office, operational and administrative tasks, and focus more on client-facing activities.
- There is a high correlation between a firm's digital maturity and asset acquisition/retention and its consequential profitability, which is creating an imperative for wealth manager demand for digital:
 - Globally, 72.9% of HNWIs say digital maturity is very or somewhat significant in their decision to increase assets with their wealth management firm over the next 24 months, as noted in the 2016 *World Wealth Report*.
- Increasing competition from technology-enabled advisory services.

Trend Overview



- For decades, the wealth management industry has been resistant to transformative digital technology, but now, driven by changes in client behavior, wealth managers are demanding digital capabilities.
- Wealth managers, even the ones who may have been reluctant earlier are embracing digital tools to fend off competition from technology-enabled advisory services and reap the multiple associated benefits:
 - More than 80% of wealth managers recognize the positive impact digital tools can have on client interactions, and their overall ability to do their job, according to 2016 *World Wealth Report*.

- Wealth managers cite digital tools as important in multiple areas, such as better collaboration with clients, less paperwork, and ability to better leverage client data (see Exhibit 8).
- Moreover, HNWI are also expressing high demand for digital tools, with 65.0% of HNWI citing sophisticated digital channels as highly important.¹⁶
- Wealth managers also have begun to understand that they need to overcome their resistance to change as is evident by the fact that 78.9% of wealth managers would like to pilot new digital tools, and 53.0% have already lobbied their firm to improve digital capabilities:¹⁷
 - However, wealth management firms are not able to fulfill the digital demands of wealth managers, which could be explained by the fact that 54.6% of them are not fully satisfied with their firms' digital capabilities.

Exhibit 8: Factors Influencing Wealth Manager Digital Adoption, Q1 2016

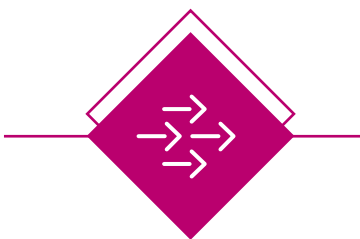


Source: Question asked: "To what extent do you agree to the following statement with respect to drivers for your interest in and adoption of digital tools in your wealth management practice? My adoption of digital is being influenced by..."; Scale is 1–7 with 1 being the lowest and 7 being the highest"; Data representative of respondents who assigned a rating of 5–7

Source: Capgemini Financial Services Analysis, 2016; Capgemini Wealth Manager Survey, 2016

Implications

- Wealth management firms need to revisit their strategy and take bold steps to overcome resistance to change toward digital technology.
- Firms will have to efficiently leverage digital technology to transform their businesses and reap both top-line revenue benefits and bottom-line gains.
- In order to retain their wealth managers, firms need to fulfill their demands related to digital tools and capabilities, as 38.7% of wealth managers might leave their firms due to lack of digital capabilities, as highlighted in 2016 *World Wealth Report*.
- Firms will need to make progress on all aspects of digital maturity to ensure they remain relevant to clients who may be wooed by technology-driven competitors.



¹⁶ Global HNW Insights Survey 2016, Capgemini

¹⁷ Capgemini Wealth Manager Survey, 2016

Trend 08: Emerging Advisor-Client Relationship Models to Cater to Client Demand

New models of advisor-client relationships are emerging to serve clients and build long-lasting relationships with them.

Background



- Changes in regulatory mandates and new entrants into the industry have been shifting the operational landscape for wealth management firms.
- The typical HNWI is evolving into a highly demanding client, looking for high-end financial planning and professional advice.
- Clients are also becoming more aware of the types of alternative services available to them and demanding better fee structures from their asset managers:
 - Alternative asset management providers now offer lower fees for standardized services and transparent pricing for clients, which means that competition is bound to drive pricing trends across the industry, thus impacting margins for most firms.

Key Drivers



- Investor demands have changed with the advent of digital communication and as a result firms and wealth managers need to offer services such as real-time and online portfolio management that fulfill these expectations:
 - Such services might reduce the involvement of wealth managers to a certain extent and should lower costs in the long run for the firm.
- HNWI attitudes are changing and they reveal the growing importance of the firms on their wealth management relationships:
 - Globally, 36.0% of HNWIs believed that the firm is the reason to hold assets with them, compared to 24.0% who said the wealth manager was the reason.¹⁸
 - As firms become important entities in wealth management relationships, they need to set in place business models that leverage the brand value and technological capabilities they bring to the table.
- New regulations such as the SEC's Uniform Fiduciary Standard and the DOL's Conflict of Interest rule are ensuring better investor protection by proposing increased transparency and disclosure guidelines.

Trend Overview

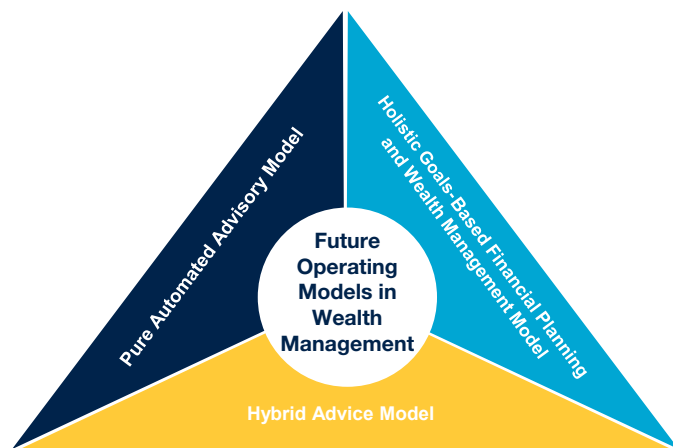


- Investor demands and regulations are encouraging new business models in the wealth management industry that focus on providing better customer experience and value add.
- Firms now have a number of business models in place among which the following are the most impactful and likely to be offered by most of the players in the industry (see Exhibit 9):

¹⁸ 2015 World Wealth Report, Capgemini and RBC Wealth Management

- **Pure Automated Advisory Model:** Suitable for HNWIs with basic investment needs with no need for a personal touch, and primarily relies on technology for investment guidance as well as act as a touch point.
 - **Holistic Goals-Based Financial Planning and Wealth Management Model:** Characterized by a personal relationship between the client and wealth manager and frequent human interaction, this model provides holistic and customized advice.
 - **Hybrid Advice Model:** This model lies in between the above two models and takes advantage of both technology-driven and traditional advice, where the wealth manager takes the calls on whether to steer clients to the digital or personal relationship services.
- The diversity of strategies indicate that no single course of action is the perfect one and only time will tell which way the industry will move in this era of interdependence between technology and the human advisor.

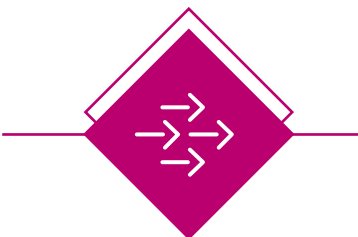
Exhibit 9: Wealth Management Operating Models of the Future



Source: Capgemini Financial Services Analysis, 2016

Implications

- Automated advisory platforms may be implemented to help personal wealth managers better manage their time and also foster better interaction and active participation for clients in portfolio rebalancing, thus providing better experience for them.
- Pricing models need to be revised often according to market dynamics so that clients do not move on to a new wealth manager just because it could undercut the incumbent on pricing.
- Innovation is needed in designing value propositions from time to time so that the younger generation clientele find reasons to stay invested with their primary wealth manager.
- Compensation and benefits structures at wealth management firms will need to be revised as it constitutes a large chunk of total non-interest expense.



Trend 09: Evolution of New Fee Models

Demand for transparency by customers and push by regulators is resulting in different and innovative fee models.

Background



- The wealth management industry often follows a transaction-based or an asset-based fee model, however, client preferences for fee structure are changing.
- Clients are becoming more focused on areas such as paying for value delivered, and 73% of HNWI's assign high importance to fee transparency (even higher than the importance given to strong investment performance).¹⁹
- These shifting HNWI preferences, along with regulatory pressure, such as those from the implementation of regulations such as MiFID II in Europe and the U.S. Department of Labor (DOL) extension of fiduciary responsibility rules to wealth managers are likely to set off a wave of experimentation in fee structures.²⁰

Key Drivers



- The advancement of technology and newer regulatory changes are pushing the industry to alter the way they charge for their services.
- Changing clients' expectations in terms of accountability and fee transparency is also posing a challenge to wealth management firms.
- The rise of new entrants such as low-cost automated advisory services is further aggravating the challenge.

Trend Overview



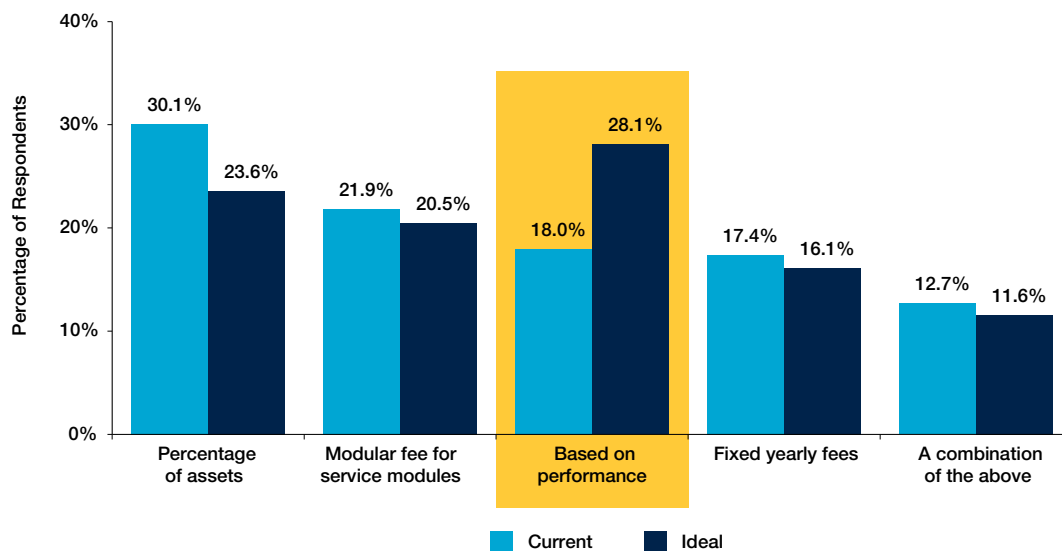
- Traditionally, HNWI's have been paying for the wealth services they avail on the basis of their assets under management (AuM) but now their preference for fee structure is changing, such as paying according to investment performance (see Exhibit 10):
 - 30.1% of HNWI's currently pay a fee based on the percentage of AuM but only 23.6% of HNWI's would prefer to do so in an ideal world.
 - Pay for performance is ideal for 28.1% of HNWI's, about 10 percentage points more than the 18.0% of HNWI's who currently do pay by performance.
- Also, the investment management model has evolved from a pure transaction-based model to a more holistic goals-based financial planning:
 - Transaction-based fee models often drive wealth managers toward short-term investment horizons, which may be contrary to clients' long-term financial planning goals (if they are the primary remuneration model).
- Increased regulatory requirements have also made the situation challenging for wealth management firms:
 - Regulations such as MiFID II and Retail Distribution Review (RDR) have mounted pressure on wealth management firms with regard to fee transparency.

¹⁹ 2015 World Wealth Report, Capgemini and RBC Wealth Management

²⁰ MiFID II directive in Europe and the U.S. Department of Labor's extension of fiduciary responsibility rules require wealth managers to recommend what is in the best interest of their clients

- As a result, new pricing strategies, such as fixed yearly fees, modular fee-based service modules, and fee based on investment performance or combinations of these fee types are emerging.
- Firms are introducing a variety of innovative fee structures:
 - XY Planning Network, which caters to Gen X and Gen Y clients, eschews commissions, sales fees, and asset minimums in favor of a monthly retainer.²¹
 - IAM Advisors offers flexibility to its clients to choose from either the standard fee that is based on the account size or a discounted fee with a performance based bonus.²²
 - While the examples remain fairly niche, many of the larger wealth management firms and private banks are also looking at how they will need to evolve their fee structures, balancing profitability with remaining competitive.

Exhibit 10: Payment for Wealth-Related Services

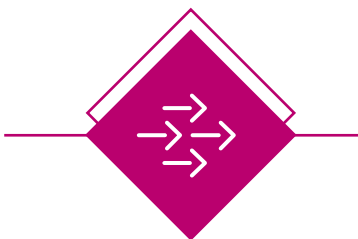


Source: Questions asked: "How do you currently pay your wealth manager for wealth-related services?"; "In an ideal world, how would you like to pay your wealth manager for wealth-related services?"

Source: Capgemini Financial Services Analysis, 2016; Global HNW Insights Survey 2016, Capgemini

Implications

- Fee structures will shift as firms adapt to narrowing commissions and greater price transparency.
- Firms need to re-examine their value proposition and evolve their fee models accordingly.
- Confident wealth managers will focus on investment and service performance fees as a differentiator, and move away from the current percentage fee on assets.
- For firms moving toward a hybrid advice model, their fee structures will evolve accordingly. For example, they can have a standard asset-based fee for simplified online investment management, complemented by modular add-on fees for different services such as tax support, robust financial planning, etc.



²¹ "Fees at a Crossroads", seic.com, January 2016, accessed October 2016 at <http://www.seic.com/docs/Advisors/SEI-Fees-at-a-Crossroads-Full-Report.pdf>

²² "Fee Structure", iamadvisors.com, accessed October 2016 at <http://www.iamadvisors.com/fee-structure/>

Trend 10: Intergenerational Wealth Transfer Remains a Significant Growth Opportunity

Intergenerational wealth transfer along with catering to unique needs of younger HNWIs continues to be a growth opportunity for wealth management firms.

Background



- The older generation of HNWIs will be transferring their wealth to their heirs over the next few years.
- This transfer would entail the need for financial and legal expertise, implying that there is a huge opportunity for wealth managers to be a part of these transactions.
 - Within the U.S. alone, an estimated US\$59 trillion of wealth is expected to be transferred to heirs, charities, estate taxes, and estate closing costs from 2007 to 2061, with an estimated US\$36 trillion going to the heirs.²³
- Improper or delays in succession planning has been a major reason for HNWIs to suffer losses in wealth.
- Demands of younger HNWIs align with their experiences of other services consumed on digital channels:
 - Wealth management firms have to innovate in digital services for their digitally progressive clients in order to outpace their competition.

Key Drivers



- Younger heirs to HNWIs' wealth are members of a generation whose demands have been molded by the digital era and different investment philosophies in the face of changing global economic dynamics.
- Consequently, there is a propensity for the next generation of HNWIs to shift their newly inherited wealth to wealth management firms that provide services in sync with their expectations.

Trend Overview



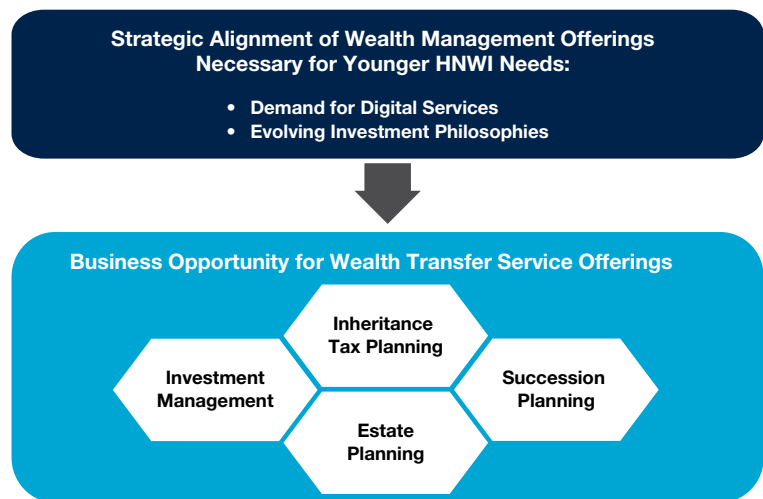
- Most of the wealth transfer amounting to US\$10 trillion will take place in the U.S., Germany, and Japan; China is also expected to witness a significant intergenerational wealth transfer after tremendous HNWI wealth growth over the past decades of robust economic growth.²⁴
- Many of the next-generation owners are expected to sell their businesses (in case their families own any) and set up family offices, which would lead to a demand for professional managers to run private investment groups.
- Selling off businesses will also release a large amount of cash to allow the HNWIs to look at alternative forms of investment and spending.

²³ "New Report Predicts U.S. Wealth Transfer of \$59 Trillion, With \$6.3 Trillion in Charitable Bequests, from 2007-2061", Boston College Center on Wealth and Philanthropy, May 28, 2014, accessed October 2016 at http://www.bc.edu/content/dam/files/research_sites/cwp/pdf/Wealth%20Press%20Release%202014-05-28-9.pdf

²⁴ "Six predictions about the great wealth transfer", Family Capital, July 5, 2016, accessed October 2016 at <http://www.famcap.com/articles/2016/7/5/five-predictions-about-the-great-wealth-transfer>

- Business leaders who decide to retire, would need services such as succession planning over the years leading up to their retirement:
 - Herein lies a significant opportunity for wealth management firms to initiate and deepen the array of services and scope of engagement with the succeeding generation.
- Wealth management firms have to be prepared to handle the huge wealth transfer as their expert services in inheritance tax planning, estate planning, and management of the investable wealth that will now be owned by the next generation would be in demand.
- Digital transformation at wealth management firms needs to be a priority as maturity in these capabilities would be a competitive differentiator or even a necessity when the younger-generation HNWI plan the shift of their wealth away from the current wealth managers (see Exhibit 11).

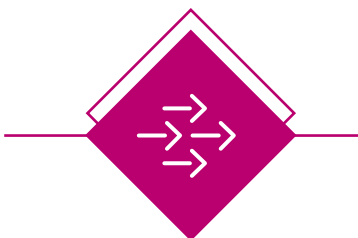
Exhibit 11: Offerings Alignment for Wealth Transfer Services



Source: Capgemini Financial Services Analysis, 2016

Implications

- Wealth management firms should focus on developing services and solutions keeping in mind the major investment themes and behavior being pursued by the new owners of HNWI wealth.
- Investment in digital transformation is critical, as most HNWIs and in fact their own wealth managers, are not satisfied with the level of digital enablement available through the firms' services.



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About the Authors

Anirban Acharya is a Senior Consultant with the Market Intelligence team in Capgemini Financial Services with over four years of experience specializing in capital markets and wealth management.

Ashish Pokhriyal is a Senior Consultant with the Market Intelligence team in Capgemini Financial Services with over four years of experience specializing in capital markets and wealth management.

Heena Mehta is a Senior Consultant with the Market Intelligence team in Capgemini Financial Services with over five years of experience specializing in capital markets and wealth management.

Varun Rawat is a Lead Consultant with the Market Intelligence team in Capgemini Financial Services, with more than six years of consulting experience in banking and capital markets industry.

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- **David Wilson** – Head of Strategic Analysis Group
- **Chirag Thakral** - Manager, Market Intelligence



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