Winds of change: Wealth management reimagined

Building a better working world

Contents

Foreword

Indian wealth management sector offers tremendous opportunity given the staggering growth witnessed in recent years. There has been a significant rise in the number of High Net worth Individuals (HNWIs) as well as in their quantum of wealth. However, to realize its true potential, several issues need to be addressed as the wealth management space evolves further:

- As with other financial services sectors, it is imperative that the interests of all stakeholders - investors, wealth managers, manufacturers and regulators are balanced. Recent developments suggest that this balancing act is an evolving process that will demand both moral resolve and robust systems.
- Increasing regulatory changes are forcing wealth managers to re-engineer their business models impacting pricing, product-mix and compensation practices.
- Also the dearth of experienced well-trained wealth managers is a significant constraint given the limited talent pool.

In this context, the "Winds of change: Wealth management reimagined" paper takes a comprehensive look at the state of the Indian wealth management industry. While industry insiders will appreciate the in-depth coverage of the issues and challenges facing the industry, on the other hand industry outsiders will have access to a quick, yet in-depth view of the industry.

The report not only offers unique insights but is also forward looking covering gamut of key pointers highlighted below:

- Analysis of alignment and conflicts of interest among different stakeholders – investors, distributors, AMCs and the regulator is timely
- Comprehensive coverage and articulation of the important developments in technology which are shaping the wealth management business with an aim to providing greater clarity on emerging trends. In particular, its perspective on the key topic of the day - robo-advisors is deeply insightful
- The report draws upon the global best practices and experiences in the wealth management industry, many of which are also relevant for India
- The report covers different segments and value propositions in the wealth management sector
- Finally, this report presents a comprehensive view of the wealth management sector and is a compendium of insights and knowledge, making it essential reading for wealth managers and all those who seek a better understanding of wealth management

At Cafemutual, we are happy to be associated with this excellent work and congratulate the EY team.

Prem Khatri
Founder & CEO, Cafemutual

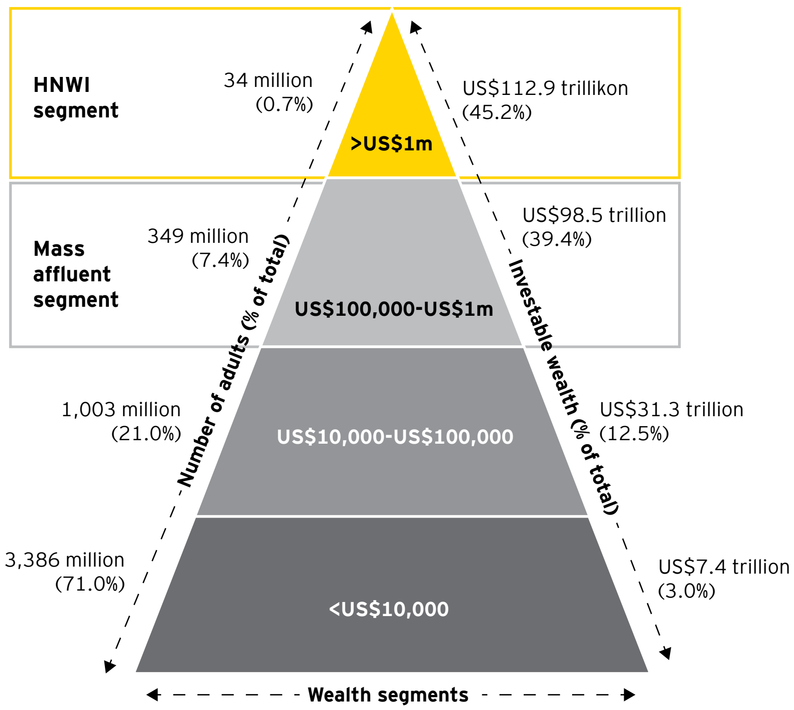
Abizer Diwanji
Partner & National Leader – Financial Services

The balance act: meeting the needs of all the stakeholders – investors, regulators and organizations

The balance act: meeting the needs of all the stakeholders - investors, regulators and organizations

1. Investors

Global wealth pyramid, 2015
Investment wealth and number of adults across various ranges

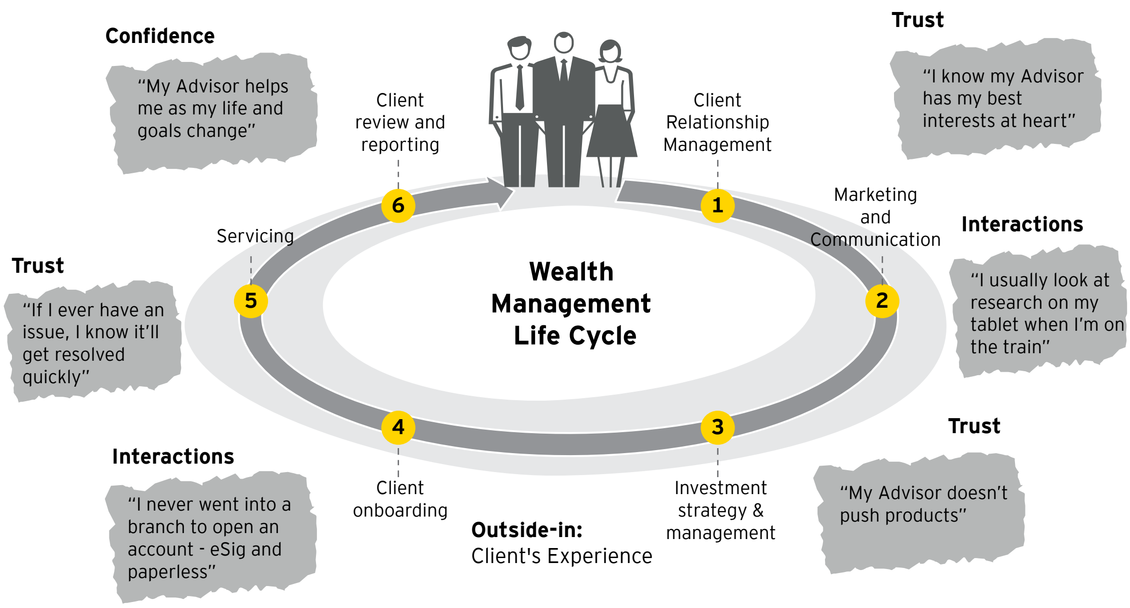


Source: Credit Suisse Global Wealth Data book, October 2015

The wealth pyramid reflects disparity in wealth levels across segments. The HNWI segment (investable assets>US$1m), makes up less than 1% of the world's population, yet own 45% of investable wealth; while the base level (investable assets <US$10,000) makes up 71% of the world's adult population but constitutes only 3% of average wealth.

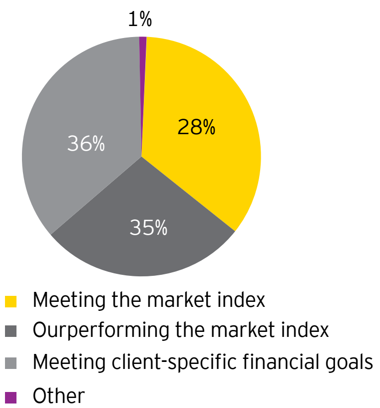
Client experience needs to be improved and optimized over the wealth management lifecycle.

Classification of market entrants



Investing expectations of clients differ by age and wealth

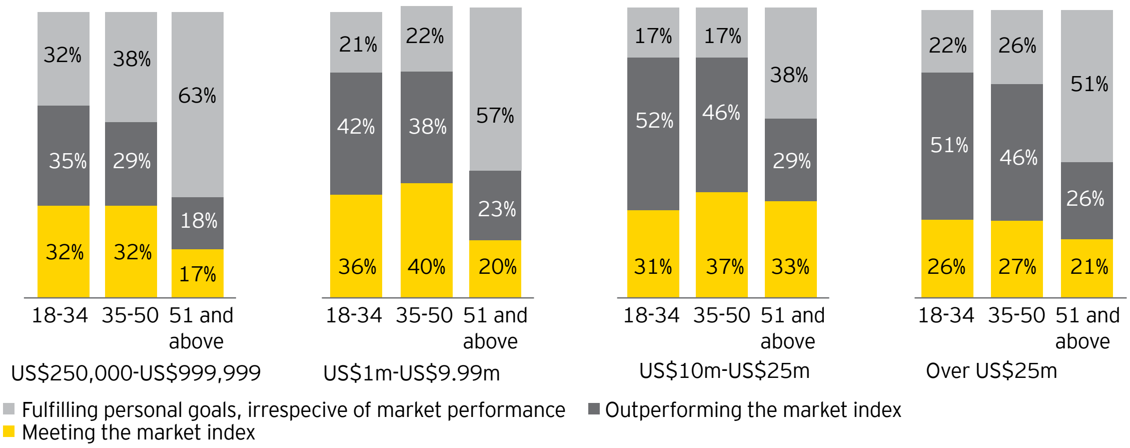
Clients' overall expectation of investing



Expectations of investors vary, from outperforming market indices to meeting financial goals, irrespective of market performance. Clients who are more focused on achieving long-term goals value the quality of interactions and tend to prefer face-to-face personalized advice, while clients with more focus on outperforming the market are interested in broader investment product offerings. These clients' value multi-channel interactions as speed and frequency of interaction are important for them.

Moreover, client investment expectations also differ by various demographics, such as age, gender and sources of income. These varying expectations lead to nuances in terms of client expectations and preferences regarding wealth advice and products.

Clients' overall expectation of investing by age and wealth segment



Source: "Could your clients' needs be your competitive advantage?" EY report, 2016

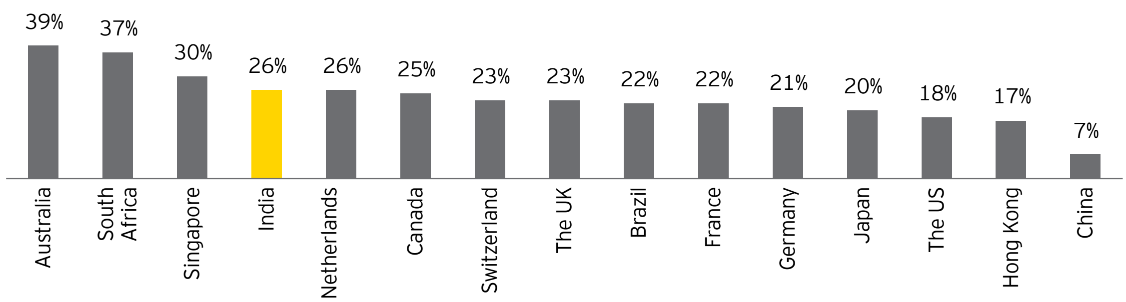
- **Sense of distrust of advisors after the global financial crisis**

  Global investor confidence was shaken by the 2008–2009 financial crisis. As the markets faltered, many clients felt the pain of significant losses in their portfolios. This caused many to scrutinize the advice their financial advisors were providing. Investors had to pay for advice, even as their portfolio value diminished. Hence, clients began to question how financial advisors were paid for their services.

Factors contributing to lack of trust (% of respondents)

Source: Global Market Sentiment Survey 2015, CFA Institute

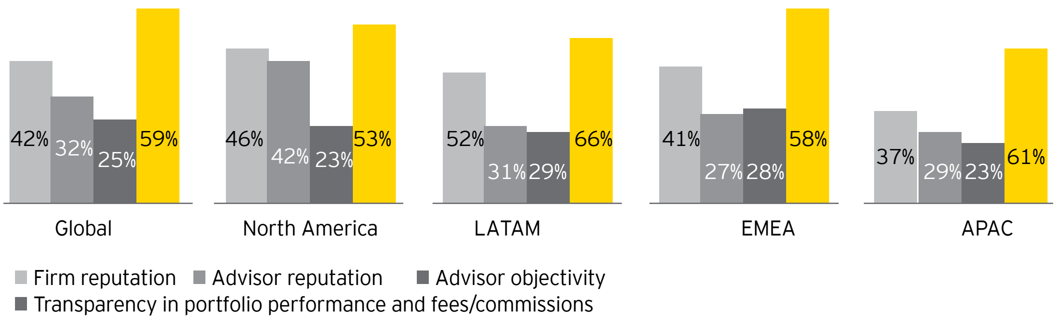
Misselling by financial advisors is a key issue (% of respondents who voted)



Source: Global Market Sentiment Survey 2015, CFA Institute

Mis-selling by financial advisors is an important ethical issue affecting market integrity across the globe. The increasing risk aversion among investors has raised the bar for the entire industry in terms of the challenges it faces in winning investor confidence and sourcing new AUM.

What are the client trust drivers?



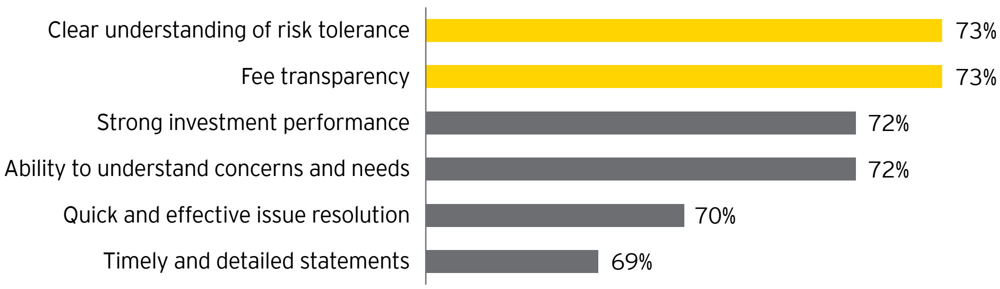
Source: "Could your clients' needs be your competitive advantage?" EY Report, 2016

Historically, wealth managers and advisors relied heavily on their reputation to gain the trust of clients. Strong reputations are not easily won; they must be earned over time through investment results and exceptional client service. While firm reputation is a crucial factor for clients, transparency in fees and portfolio performance has ranked above other factors as a key trust driver globally.

Sophisticated clients are more focused on capital preservation and value for fees

Clients have become more focused on capital preservation and value for fees, with 73% of high-net-worth individuals (HNWIs) rating clear understanding of risk tolerance and fee transparency as "high importance".[1] Notably, HNWIs rate correct assessment of risk tolerance and transparency in fees more important than even strong investment performance.

Percentage of HNWIs giving importance



Source: World Wealth Report, 2015

Baby boomers, which still form the main client segment for the wealth management industry, are in the retirement phase. Hence, capital preservation has become the new mantra for the industry. These investors are not necessarily searching for lower fees, but rather for more transparency and a strong correlation between the fees paid and value received. According to an EY survey, ~33% of clients are dissatisfied with the way they are charged and ~25% of clients are not sure how they are being charged.[2]

1 World Wealth Report, 2015

2 "Could your clients' needs be your competitive advantage?", EY report, 2016

2. Organizations

- **Types of organizations**

(a) Traditional players

Traditionally, universal banks with dedicated wealth management divisions and private banks and brokerages have dominated the global wealth management industry. Many investors typically go to a bank for investment advice because of the familiarity associated with such players.

Another category of traditional players is wire-houses. The term "wire house" was originally used to describe broker-dealers. Modern-day wire houses range from small regional brokerages to giant global institutions. Giant wire-houses are mainly full-service brokerages that provide the complete range of services, including wealth management, investment banking and trading and research. They are mega-firms with hundreds of offices worldwide that share financial information, prices and research. Wire houses are a more investment-centric option and offer a wider product offering vis-à-vis banks. Many boutique firms also offer white-globe services for wealthier clients (above US$2m of investable assets).[3]

(b) Non-traditional players[4]

During the past few years, with changing client behaviors and issues around trust, loyalty and pricing, the wealth management space has witnessed the emergence of several types of non-traditional players

	Registered investment advisors (RIAs)	Automated robo-advisors	Open investment communities	Third-party capability plug-ins
Description	Professionals who offer financial advice to their clients by delivering market knowledge and recommending financial products	Fully automated new-age players; traditional firms that have developed in-house digital capabilities	Communities that enable users to compare their portfolio performance to that of their peers	Capabilities that enable financial advisors and their clients to compare portfolios to data harvested from social media
Value proposition	Create personal relationships among financial advisors and their clients, aid in full-service financial planning and tailor specific plans for individuals based on risk and return objectives	Low fees, slick interface, quick and convenient to use and tax-loss harvesting	Social validation, low cost, reliable and actionable insights built on users' actual portfolio performance	Firm-specific
Challenges	Potentially paying for advice that does not produce substantial returns, high management fees and limited or poor interactions with the financial advisor	Have not yet been tested for investor loyalty through a bear market, fairly basic range of investments (ETFs) and possible market consolidation	No asset custody, requiring partners to make it work; need to find effective fee models; model still unproven	Firm-specific with regards to reporting but security concerns and controls need to be addressed; the need to train wealth managers (technical and mindset training) is important in general

3 "Is Your Financial Advisor Independent, An RIA Or Wirehouse Rep? You Have No Idea But You Should", Forbes, 1 August 2012

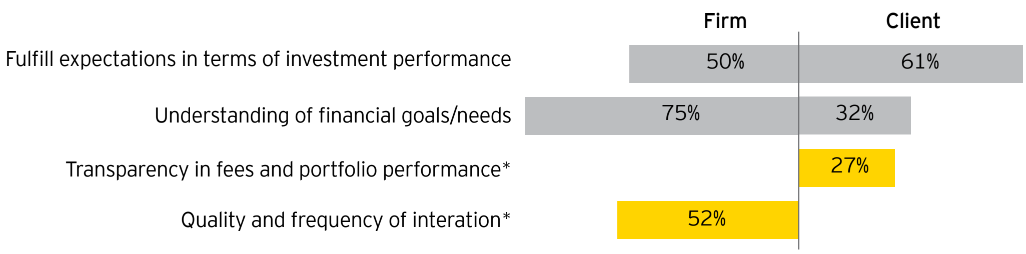
4 World Wealth Report, 2015

Wealth managers are focused on improving client experience[5]

Client experience is shaped through interactions across a client's financial journey over a long period of time. Negative experiences tend to have a lasting impact on a client's perception.

Bridging the gap between the wealth managers' strategy and the client's expectations.

Firm vs. client view: top three drivers of client experience

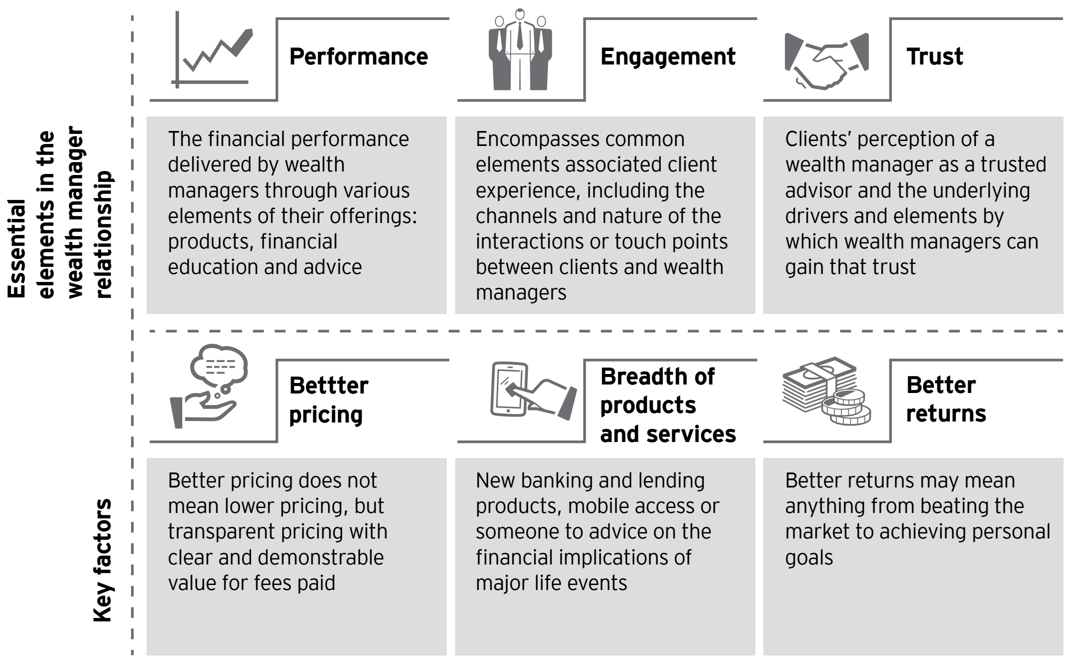


*% only included for top three choices

Fulfilling expectations in terms of investment performance and understanding financial goals are among the top three drivers of client experience for both firms and clients. However, clients and firms diverge on the importance of advisor interactions and transparency in driving client experience.

Clients place significantly higher emphasis on transparency in fees and portfolio performance while somewhat downplaying the role of advisor interaction. In contrast, wealth management firms emphasize the role of advisor interactions, while overlooking the impact of transparency.

Going forward, in order to devise a comprehensive client experience model, wealth management firms need to ensure a combination of the following:

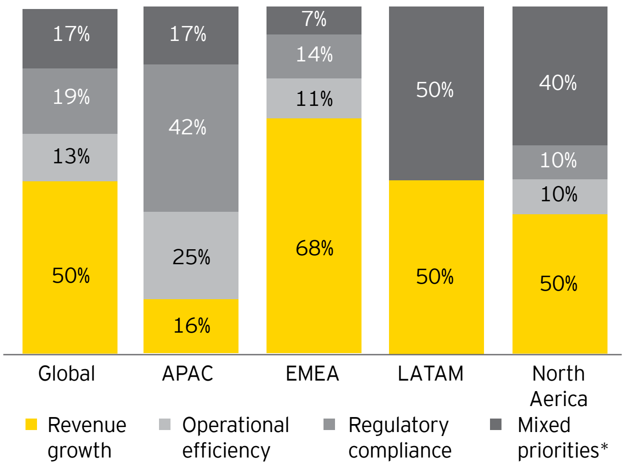


5 "Could your clients' needs be your competitive advantage?" , EY Report, 2016

- **Wealth managers are facing revenue pressure**[6]

Macro uncertainty following the global financial crisis has affected levels of transactional activity, and global banks witnessed a decline in their wealth management divisional revenue during 2015. Hence, going forward, wealth managers have outlined revenue growth as one of their strategic priorities and intend to improve revenue streams by improving client experience.

Primary focus of wealth manager strategic budgets in the next two to three years



* Firms with priorities that are balanced between revenue growth, operational efficiency and regulatory compliance

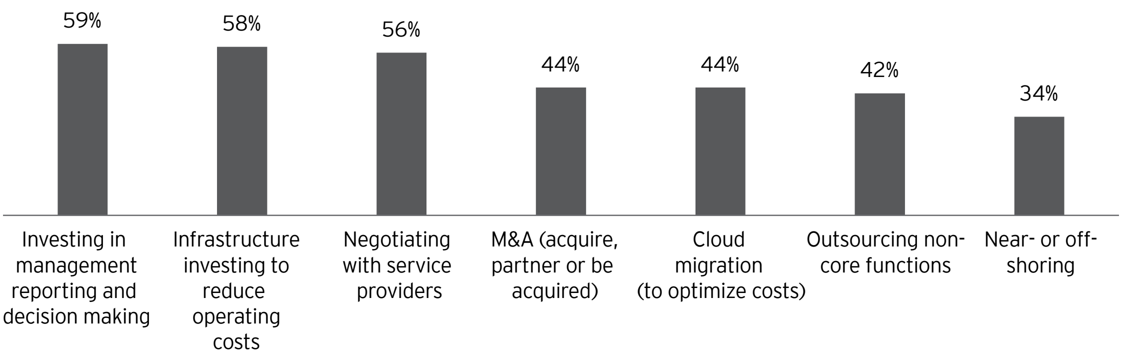
Source: "Could your clients' needs be your competitive advantage?" EY Report, 2016

In the past, wealth managers' strategic budgets were mainly tilted toward regulatory compliance, operational efficiency and addressing margin challenges. However, going forward, there is going to be a shift in focus toward revenue growth. Notably, firms in Europe and the Americas are more optimistic about directing their strategic budgets toward revenue growth compared to firms in other regions. Specific revenue growth initiatives that wealth managers are undertaking are focused on improving client experience.

- **Wealth managers are in the pursuit of greater operational efficiency**

Wealth managers across the globe are plagued by rising costs, mainly on account of increased regulatory and compliance burden. These players are in pursuit of optimizing cost and improving operating efficiency. According to a study by EY and Forbes, 52% of wealth managers are looking to significantly reduce costs and are taking a number of initiatives in this direction.[7]

Steps being taken by wealth managers to rationalize costs (% of respondents)



Source: "Seeing beyond: Unlocking the long-term opportunities in wealth and asset management", Forbes Insight-EY, 2015

6 "Wealth Management Is No Sure Bet for Wall Street Revenue", The Wall Street Journal, 19 January 2016

7 "Seeing beyond: Unlocking the long-term opportunities in wealth and asset management", Forbes Insight-EY, 2015

Digital transformation is playing a crucial role

Digital transformation is playing a crucial role in not only achieving greater operational efficiency, but also revamping the wealth management value chain. Wealth managers are making significant investments in client-facing technology that provides a total wealth view and interactive tools to improve overall client experience. Investments in technology will help to expand reach to new clients and markets and enhance products and services.

Where do you need to make additional client-focused digital investments?

Real time performance reporting for clients	42%
Total wealth solutions	42%
Client data security	38%
Advanced analytics	38%
Progress towards investor goals	32%
Portfolion accounting and analytics	26%
Product knowledge	23%
Access to client data	23%
Reglatory and compliance	19%

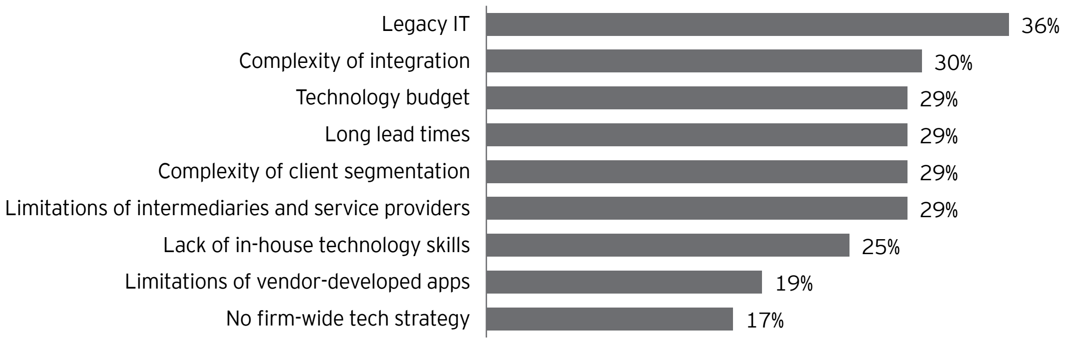
What digital capabilities for clients will you be offering or updating?

Advice and research delivery	48%
Transaction execution	39%
Payments and settlement	39%
Client service	36%
Advanced analytics-in-house	33%
Greater access to advisors	32%
Device accessibility	10%
Third-party analytics	25%
Compliance processes	20%

Source: "Seeing beyond: Unlocking the long-term opportunities in wealth and asset management", Forbes Insight-EY, 2015

Firms agree that technology is a priority and improvements are necessary. The objectives have been outlined and defined; however, in reality the firms are not able to move fast enough and face an array of challenges. Legacy platforms often struggle to scale efficiently, making the transformation slower and more expensive for traditional wealth managers.

What are the key challenges in implementing your technology strategy?

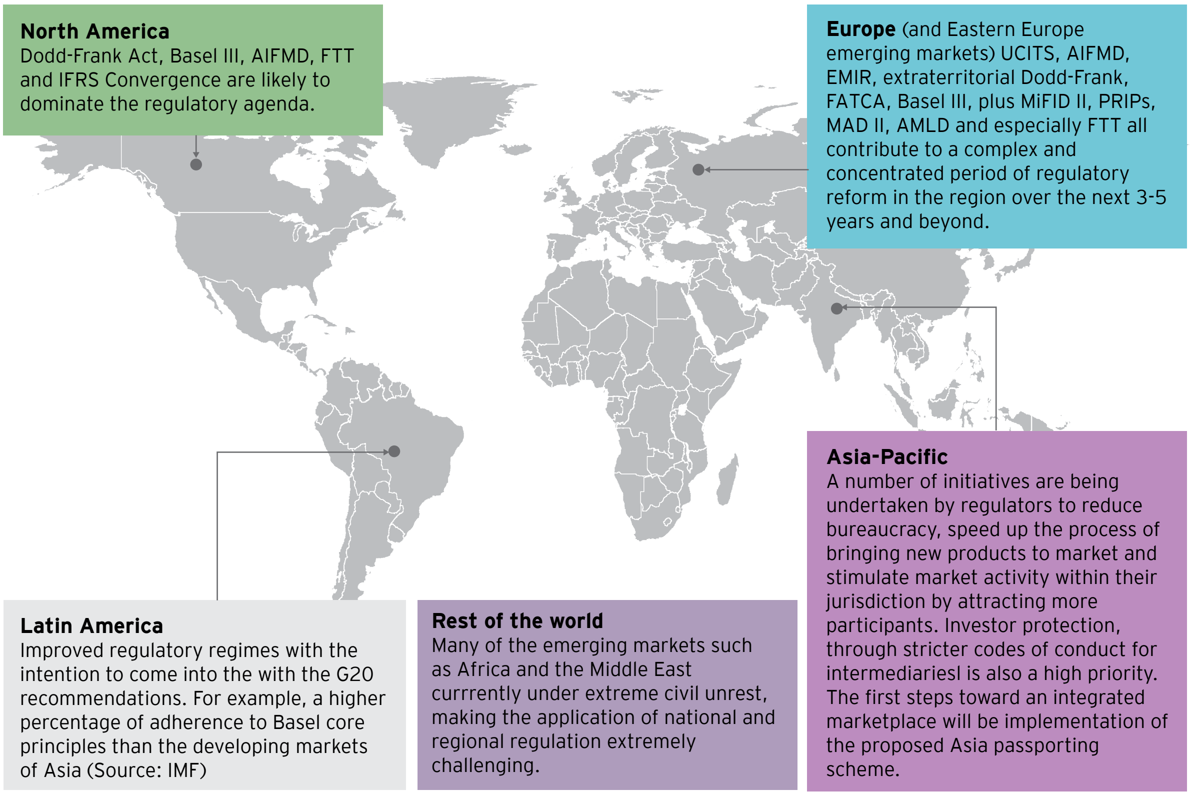


Source: "Seeing beyond: Unlocking the long-term opportunities in wealth and asset management", Forbes Insight-EY, 2015

3. Regulators

- **Evolution of regulations towards stringent compliance standards following the global financial crisis**

After the global financial crisis, regulators and governments across the world focused on tighter oversight of financial services and new regulations were created at a rapid pace. The main focus area of regulations centers on containment of risk and investor protection. Regulators are also questioning whether wealth managers and financial advisors are making recommendations that are in the best interest of the clients. Over the past couple of years — from Dodd-Frank and FACTA, to the Basel Accords and AIFMD — there has been a very evident trend toward the globalization of financial regulatory policy.



Source: EY Global wealth and asset management industry outlook 2014

Key regulations impacting the wealth management industry[8]

Markets in Financial Instruments Directive (MIFID II)	The MiFID framework aims to create more efficient and robust market structures by improving investor protection and increasing transparency. The framework is expected to significantly impact the wealth management and private banking space; banks will have to review their business models and pricing structures. One of the changes with a major impact on the retail and private banking business is related to the advisory service. In the future, private clients will have to decide whether they want to be advised dependently or independently.
Alternative Investment Fund Managers Directive (AIFMD)	AIFMD is an EU-specific legislation focused on the financial regulations of alternative investment fund managers, hedge funds, private equity funds etc. The purpose of AIFMD is to increase investor protection and effectively monitor and prevent systemic risk and disorderly markets. The reporting obligation applies to registered and authorized AIFMs. Wealth managers strive to offer a broad range of investment products across the full gamut of asset classes. With AIFMD, there are concerns that the choice of investment products may become more limited. However, some industry experts feel that the worries surrounding AIFMD are not true. AIFMD is intended to facilitate the marketing of alternative products via cross-border registration in Europe. This will enable HNWI investors to include a much wider range of alternative assets in their portfolio allocation.
Foreign Account Tax Compliance Act (FATCA)	FATCA came into effect in 2014 and has far-reaching consequences for the global wealth management industry and US taxpayers. The primary aim of FATCA is to increase tax compliance by US taxpayers who have financial assets held outside the country. The FATCA legislation imposes on all foreign financial institutions a legal mandate to determine who among their clients are "US persons" and report specific information on those accounts, either indirectly (via intergovernmental agreement) or directly, to the IRS . Severe penalties are imposed for non-compliance.

Case study: impact of regulations on the UK wealth management industry[9]

The UK's wealth management space was subject to the retail distribution review (RDR), designed to improve standards of advice and fee transparency. In 2006, the FCA established the RDR to evaluate how advice was provided and at the beginning of 2013, the recommendations of the review were implemented. The biggest change was banning the commissions paid to advisors, requiring that clients be charged fees. Advisors were also required to make it clear whether they were offering independent advice or restricted advice, i.e., advising on products from a single provider. The changing regulatory environment has led to a change in the business models of wealth management players. A number of retail banks conducted a strategic overhaul of their wealth management divisions and simplified and narrowed operations, while several international players pulled out of the European wealth management space to focus on domestic operations. The upheaval paved the way for a fertile market for hiring and winning clients and against this backdrop, independent firms flourished.

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8 "Which regulations will impact private banking?", PUM Professional Wealth Management, 12 January 2015, www.pwmnet.com/Regulation/Which-regulations-will-impact-private-banking

9 "Regulation transforms UK wealth management business", Financial Times, 11 August 2014; "The DOL's Fiduciary Rule: What We Can Learn from the U.K.", 28 September 2015, www.advisorperspectives.com/articles/ 2015/09/28/the-dol-s-fiduciary-rule-what-we-can-learn-from-the-u-k

Global trends in wealth management

Global trends in wealth management

The wealth management space is evolving rapidly amid tightening regulations, fast-paced customer demands, market shifts, competition from unconventional sources and disruptive technologies. These factors have resulted in a paradigm shift for wealth managers. Some of the key trends shaping the wealth management industry are as follows:

1. Regulation and compliance[10]

- **Increasing regulatory complexity**

  The global financial crisis paved the way for increased regulatory scrutiny and tighter oversight of the wealth management industry. It is not just the sheer volume of new regulations, but also uncertainties regarding the interpretation of regulations, delayed timelines and inconsistencies between regulators that are materially increasing the risk of non-compliance as well as challenging existing business models. One of the biggest challenges that wealth managers will continue to face is keeping up with the dynamic regulatory environment in their home jurisdictions and in international markets.

The second version of the Markets in Financial Instruments Directive/Regulation (MiFID II/MiFIR) is one such example of legislation coming from the European Union that will have a significant impact on the global wealth management industry. For instance, the UK wealth management industry's main concern is the time scale to implement MiFID II (implementation deadline of January 2017), which will be extremely difficult to meet as firms need to implement a number of changes to meet the requirements.[11]

- **Focus on international tax transparency**

  The overall stance on tax transparency is becoming more intense, with supranational organizations driving regulatory initiatives. Going forward, international efforts to reduce tax arbitrage and improve transparency will accelerate and it will become harder to avoid taxation.

For instance, the Foreign Account Tax Compliance Act (FATCA), which requires foreign financial institutions (FFIs) to report information about financial accounts held by US taxpayers, is in effect. Moreover, the OECD (following in the US's footsteps) has created the Common Reporting Standard (CRS), which was implemented from January 2016 and will require firms to identify and report tax residency-related information of individuals and entities in over 100 jurisdictions.[12]

Going forward, there will be more regulatory requirements that wealth managers will need to meet. The stream of new and revised regulations will continue, triggered by efforts to harmonize national regulations globally to ensure a level playing field.

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10 "Digital disruption and the game-changing role of technology in global wealth management", EY report, 2015

11 "The wealth management industry: changes and opportunities," World Finance, 7 July 2015

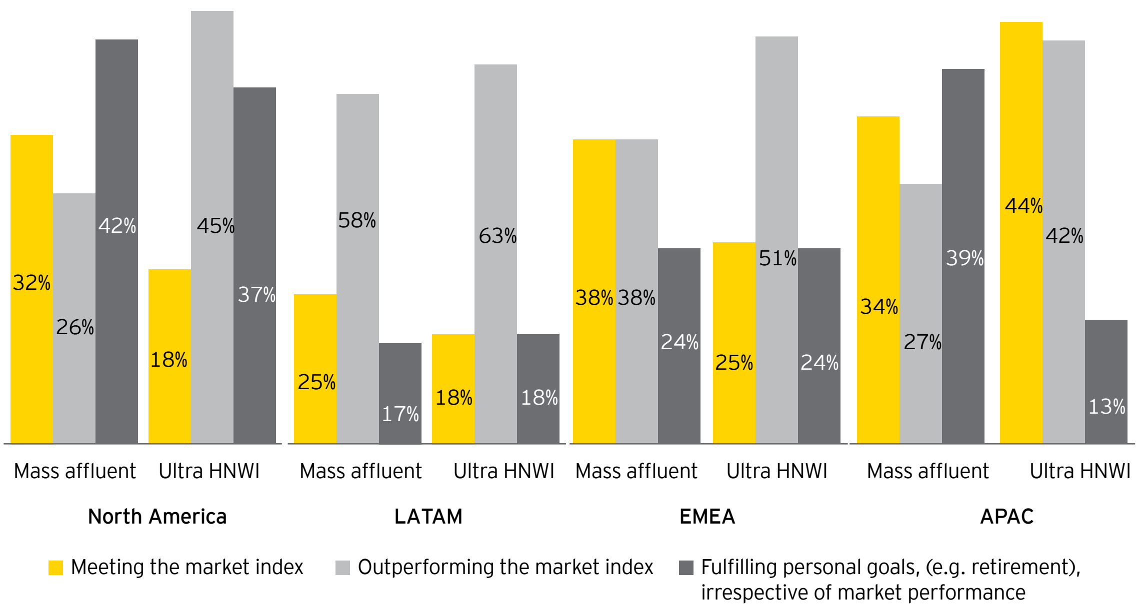
12 "The wealth management industry: changes and opportunities," World Finance, 7 July 2015

2. Changing client needs[13]

- **New generation of clients**

The wealth management industry is witnessing a phase of change as its largest investor segment, the baby boomers (born between1946 and 1965), is in the retirement phase and assets are being transferred to the next generation of investors: Gen-X (born between1966 and 1980) and Gen-Y/millennials (born after 1980). Currently, millennials are the largest and fastest-growing adult segment across the globe and represent the greatest opportunity for the wealth management industry. Millennials are not only growing in number, but also accumulating assets at an impressive rate. In fact, millennials are entering their prime earnings years and also have the prospect of large inheritances. They have the potential to become the wealthiest generation in history. Notably, this group of investors is different from their predecessors in terms of attitudes toward managing their finances and expectations in relation to client experience. While baby boomers were more keen on investing in stocks and particularly interested in diversifying their assets, millennials tend to hold more cash (40% of assets are in cash) and are distrustful of the stock market (90% of millennials are intimated by the stock market) mainly on account of their experience with the global financial crisis.[14] Moreover, millennials' investment objectives are diverse and vary across asset classes as well as regions.

Investment objectives of the next generation of investors by region



Source: "Could your clients' needs be your competitive advantage?" EY Report, 2016

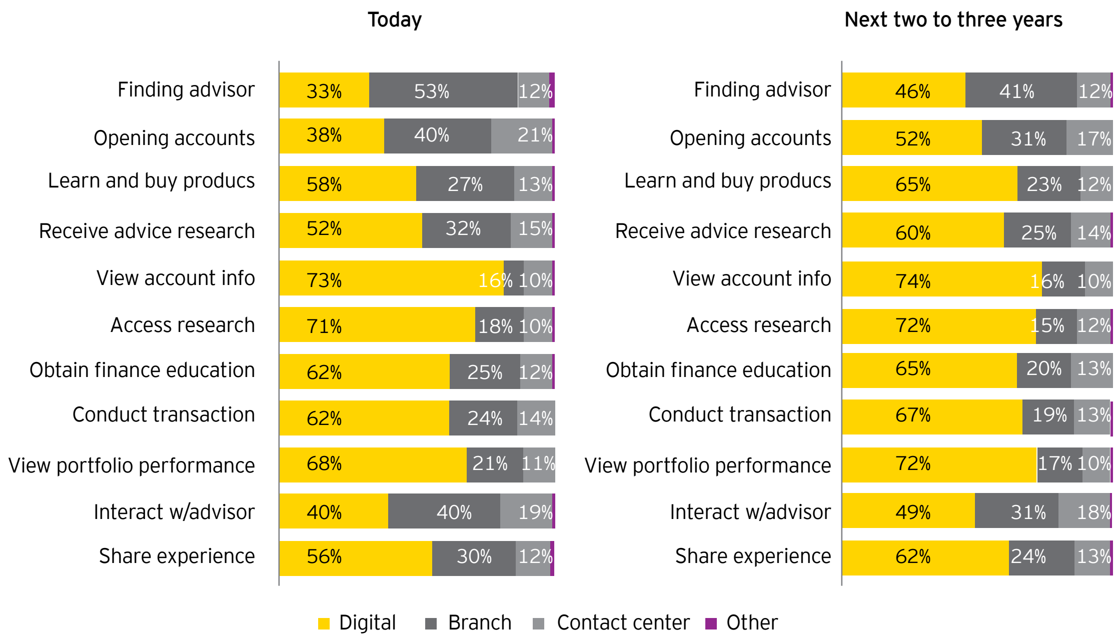
13 "Could your clients' needs be your competitive advantage?" , EY report, 2016

14 "From Baby Boomers to Millennials - Investing Through the Ages", iGrad, 25 November 2015

- **Empowered clients**

  Client needs and expectations are changing dramatically with regards to client experience, quality of service and delivery channels. The industry is witnessing a change in demand for products and services as well as preferred channels for customer engagement. Digital capabilities are at the top of the list of wealth management clients' must-haves. Clients are increasingly demanding that wealth management firms offer more interactions — from account opening to the provision of advice — through digital channels. The new wave of empowered clients is challenging the status quo in wealth management.

Clients primary channel preference



- **Customer loyalty is declining**

  Customer loyalty is declining as clients have become wary of their financial service providers following the financial crisis and barriers in switching between financial firms have reduced. According to a survey by EY, 73% of wealth management clients have relationships with multiple wealth managers and 4 out of 10 clients are open to switching wealth managers. This represents incremental revenue opportunity of US$175b-US$200b (based on the fact that global wealth managers manage client assets worth ~US$120t) for firms willing to make strategic investments to improve their client experience.[15] Moreover, trust and price sensitivity issues have led some new generation investors to explore do-it-yourself investing. This trend is supported by the rise of automated invested platforms (robo-advisors).

15 "Could your clients' needs be your competitive advantage?" , EY report, 2016

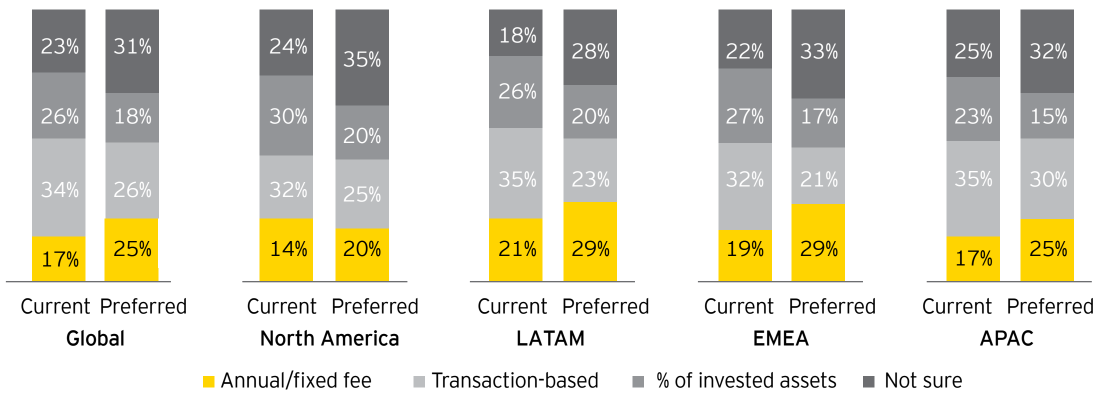
- **Clients are eager for a new level of public transparency**

  Investors have overwhelmingly identified transparency of portfolio performance and fees as one of the key requisites in the rapidly transforming wealth management space. However, the traditional views of transparency are no longer enough and investors are demanding a new level of public transparency. Clients are eager to rate their advisors and connect with like-minded clients in public forums to exchange ideas and share positive and negative experiences. For instance, social media can be used as a platform to review or rate advisors.

- **Changing fee-structure preferences**

  Currently, the global wealth management industry follows a transaction-based (i.e., commissions) or an asset-based compensation model. However, client preference for fixed fees is rising, while preference toward both asset-based fees and commissions is on the decline. Furthermore, clients are becoming less sure about how they want to be charged in every single region.

Clients' current and preferred fee structure



Source: "Could your clients' needs be your competitive advantage?" EY Report, 2016

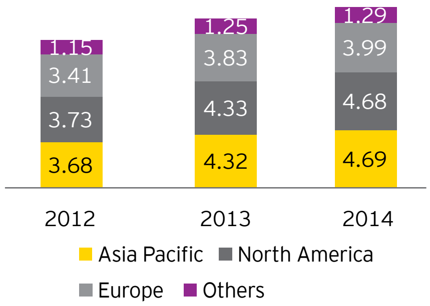
3. Shift in global wealth epicenters

- **Wealth creation shifting toward Asia-Pacific**

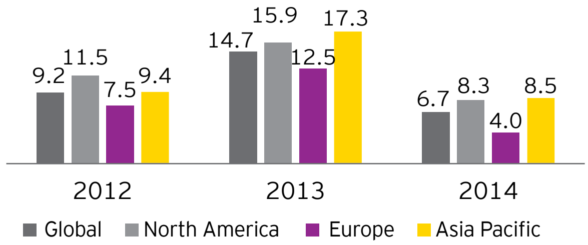
  Asia-Pacific ranks #1 in terms of the number of high-net-worth individuals (HNWIs) — customers with more than US$1m in investable assets — and #2 in terms of HNWI wealth. During 2014, Asia-Pacific recorded the highest growth in HNWI population (up 8.5% y-o-y) and edged past North America to become the region with the largest number of HNWIs (4.69m). The region also witnessed the highest growth in HNWI financial wealth (up 11.4% y-o-y to US$15.82t), second only to North America (US$16.2t).[16]

16 "World Wealth Report 2015", CapGemini, RBC Wealth Management

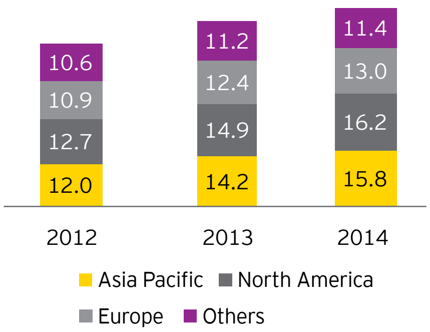
HNWI population (millions)



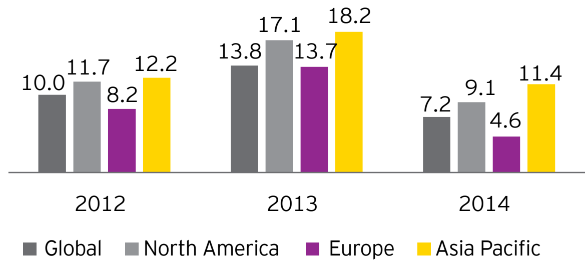
YoY growth rate of HNWI population (%)



HNWI wealth (US$t)



Y-o-Y growth rate of HNWI wealth (%)



Source: CapGemini, RBC-WM, World Wealth Report 2015; Note: Other regions include Latin America, Middle East and Africa

The tremendous growth in HNWI population and wealth in Asia-Pacific is expected to continue, with key emerging markets such as China and India leading the way. China and India represent ~10% of global HNWI wealth and account for 17% of the global increase in new wealth since 2006. These regions added ~US$3.2t during 2006–2014. In 2014, China's HNWI population grew by 17.5% to 890,000 and India's HNWI population increased by 26.3% to 198,000. During the same period, HNWI wealth in China increased by 19.3% to US$4.5t and in India by 28.2% to US$785b. India also recorded the highest annual gain in both HNWI population and wealth in the region as well as globally.[17]

Going forward, Asia-Pacific is expected to lead global HNWI wealth, with HNWI wealth in the region growing by 10.3% annually through 2017. By 2018, Asia-Pacific is expected to make up more than one-third of global wealth.[18] Hence, in the near future, this region is expected to significantly contribute to the global wealth management profit pool.

17 "Asia-Pacific Solidifies Position As World's Top Wealth Market", CapGemini, 15 September 2015; "Asia Pacific Wealth Report 2015", CapGemini, RBC Wealth Management

18 "Re-thinking private banking in Asia Pacific", EY report, 2014

4. Competitive environment

The competitive landscape for wealth managers is multidimensional, involving traditional and non-traditional players. In a study by Forbes and EY, more than half of the respondent wealth managers (52%) agreed that the industry is facing significant competitive pressures.[19]

Key sources of competitive pressure for Wealth Managers

Lower-cost traiditonal competitors	63%
New digital competitors	65%
Firms with stronger band recognition	62%
Firms with more-diverse service offering	55%
Traditional managers shifting to alternatives	44%
Firms with more-specialized product offerings	58%
Ability to provide transparency	38%
Lack of scale in key products	40%

A number of specific forces are driving competitive pressure in the industry. The most frequently cited factor is lower-cost traditional competitors, followed by new digital competitors, including existing players, resorting to digital channels.

Source: "Seeing beyond: Unlocking the long-term opportunities in wealth and asset management", Forbes Insights, 2015; Note: Figures are the percentages of executives indicating a four or five on a five-point scale (where one equals no change and five equals significant change).

- **Traditional players rebalancing structures**

  Several players are rebalancing their international wealth management operations. While some wealth management players are focusing on high-growth markets, such as Asia-Pacific, others are exiting the international wealth management industry entirely.

Case study: Credit Suisse sets up wealth management business in China[20]

Swiss Bank Credit Suisse has citied wealth management as a key focus area for its future growth. The bank plans to focus on the Asia-Pacific region and aims to more than double its pre-tax income from the region to US$2.19b by 2018. The bank is looking to expand wealth management capabilities in China and plans to secure an onshore license to operate wealth management business in China.

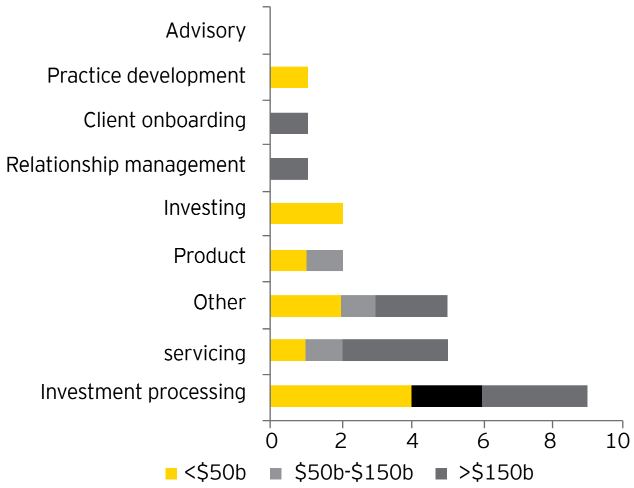
The industry is also witnessing market consolidation along its value chain. According to Forbes Insights, 42% of wealth managers are outsourcing non-core functions to optimize costs.[21] Mainly mid- and back-office operations and, in some cases, entire IT infrastructures are being outsourced to external service providers. Some such large external service providers manage substantial volumes of client assets for the wealth managers they serve.

19 "Unlocking the long-term opportunities in asset and wealth management", Forbes Insights, 2015

20 "Credit Suisse to step up wealth management business in China", www.dealstreetasia.com , 5 April 2016; "Credit Suisse has high hopes for China", Financial Times, 5 April 2016

21 "Unlocking the long-term opportunities in asset and wealth management", Forbes Insights, 2015

Whether you outsource today or not, which areas of your business do you think are best suited to business process outsourcing?



Source: "Could your clients' needs be your competitive advantage?" EY Report, 2016

According to EY Wealth Management Platform Market Survey:

- Technology outsourcing is the most prevalent.
- Cost is still the key driver of the decision to outsource.
- Firms were clear about not outsourcing any client-facing business functions.
- Firms prefer to buy (invest in) rather than build new technology platforms.
- Rising costs, growth in business and growing obsolescence of their current platforms were identified as key drivers to invest in newer platforms. Ability to access newer technology was also cited as a reason to invest in new platforms.

Case study: Deutsche Asset & Wealth Management in Asia has outsourced back office operations[22]

Deutsche Asset & Wealth Management (DeAWM) outsourced its wealth management back-office operations in Singapore to a specialized service provider Avaloq. This move will help the global bank focus on its core business – client advisory and investment management – and enable it to handle larger client volumes. Technology outsourcing will help the bank focus on HNWIs with assets of US$2m-US$25m as a part of its global strategy to expand its AWM business in Singapore. In Singapore, ~70 employees of Deutsche Bank moved to Avaloq. According to Mark Smallwood, DeAWM's head of franchise development and strategic initiatives in the Asia-Pacific region, in order to manage a large number of accounts, a very robust technology platform is necessary to ensure an efficient cost-income ratio.

Going forward, wealth mangers, all of whom are currently facing similar challenges – compliance, competition and a changing environment – can consider shared infrastructure platforms, i.e.bundling parts of back-office infrastructure into a common platform, to rationalize costs.

- **Entry of non-traditional players**

  As wealth management services become more sophisticated, some lines of business, such as a holistic wealth planning and management of complex family wealth issues or the use of big data to create risk profiles and targeted investments, have become important for the sector. In many cases these lines of

22 "Deutsche Bank Asia Wealth Unit Targets 20% Revenue Gain", Bloomberg, 28 October 2014; "Deutsche Asset & Wealth Management to outsource back-office operations in Singapore to Avaloq", The Asian Banker, 3 September 2014; "Deutsche AWM is the first bank in Asia to outsource back office operations", Asian Private Banker, 30 November 2015

business have been integrated into the capabilities of wealth managers, while in other cases players from other industries are onboarding these areas and emerging as new players. The following are two examples of emerging non-traditional players:

a) Fintech firms

The gap between customer expectations and incumbent performance provides a classic opportunity for technology-based market entrants to fundamentally alter the existing models. The growing use of mobile devices for doing business is making it easier for these new entrants to challenge the status quo and exploit areas of dissatisfaction and underinvestment. New business models are emerging that rely on technology to meet the evolving client needs. Fintech players are commoditizing the traditional asset allocation advice model, which is eroding pricing power and simultaneously raising the bar for better and faster service. These digitally enabled entrants leverage technology to ensure lower costs and deliver customer-centric wealth management services on more efficient and flexible platforms that can be scaled up rapidly.

Moreover, these non-traditional entrants are targeting specific areas of the wealth management value chain. They are replicating value offerings of digital bellwethers, such as immediate fulfillment through digital channels (no physical delivery and no paper trail), convenient online and mobile channels as well as highly customized and personalized client offerings. Successful market entrants combine a compelling value proposition with state-of-the art technology. Such firms are not only capturing market share, but also applying downward pressure on margins.

Classification of market entrants

Aggregator	Innovator	Disintermediator
► Redefines the interface between wealth managers and clients ► Provides increased transparency on pricing and services to customers ► Applies pressure on the profit margins of incumbents	► Introduces innovative products and services to customers ► Makes use of powerful technology platforms to meet the evolving client needs ► Captures market share and applies pressure on the profit margins of incumbents	► Redefines the rules of wealth management (such as face-to-face advice) ► Offers enhanced customer experience aimed at a certain group ► Captures market share and applies pressure on the profit margins of incumbents

Source: EY IT in Wealth Management 2015

Digital providers are targeting the wealth management market mainly through investment advisors that provide automated customized advice, including goal setting, allocation, monitoring and rebalancing (robo-advisors); portfolio review providers that offer financial management portals to track portfolio and advisor performance; and investment communities that offer a platform to share and discuss investment ideas.

Going forward, a more serious threat to traditional wealth management firms will emanate from established online brokers which complement their transactional expertise with wealth management services.

The digitization of the financial sector will continue at a rapid pace, and the elements evolving will not only be sector-specific, but also include other elements such as the intersection of biometrics in a digitally enhanced identity capability.

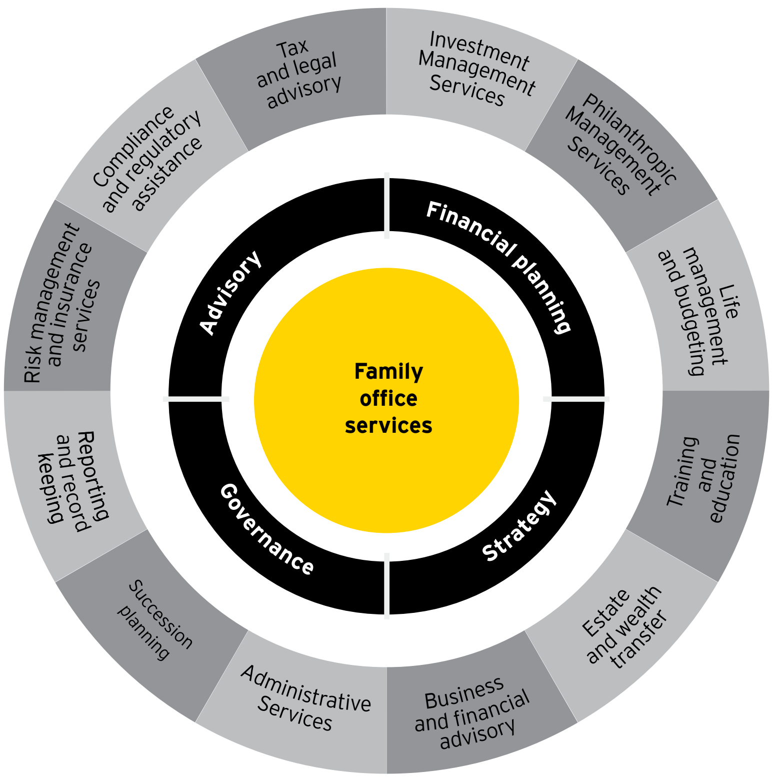
b) Family offices

Family offices (FOs) are private wealth management advisory firms that serve wealthy families. FOs provide standard wealth management services, day-to-day administration and management of a family's affairs, and other services such as tax compliance work, private trust services, document management, recordkeeping services, expense management, bookkeeping services, family support services and family governance. FOs also handle non-financial issues such as the education of family members and travel arrangements.[23]

There are mainly two type of FOs:

- **Single FOs (SFOs)**: SFOs offer the same services as top-tier wealth managers but are devoted to a single ultra-affluent family. These firms typically cater to families with more than US$100m in assets.
- **Multi-FOs (MFOs)**: Most entrepreneurial wealth managers are mainly focused on starting MFOs, which handle a number of families as clients. On average, clients in such firms have assets worth US$40m to US$50m. MFOs also facilitate pooling of assets and sharing of costs.[24]

Family office services



Source: EY Pathway to Successful Family and Wealth Management

In developed markets, such as the US and Europe, FOs have been around for decades. There are an estimated 4,500 FOs across these continents and they manage assets worth ~US$2t. FOs have gained prominence because of wealth holding families' desire for greater control and privacy over their investments and fiduciary affairs, as well as lifestyle management. Indeed, this desire for control has gained even more resonance since the 2008–2009 financial crisis.

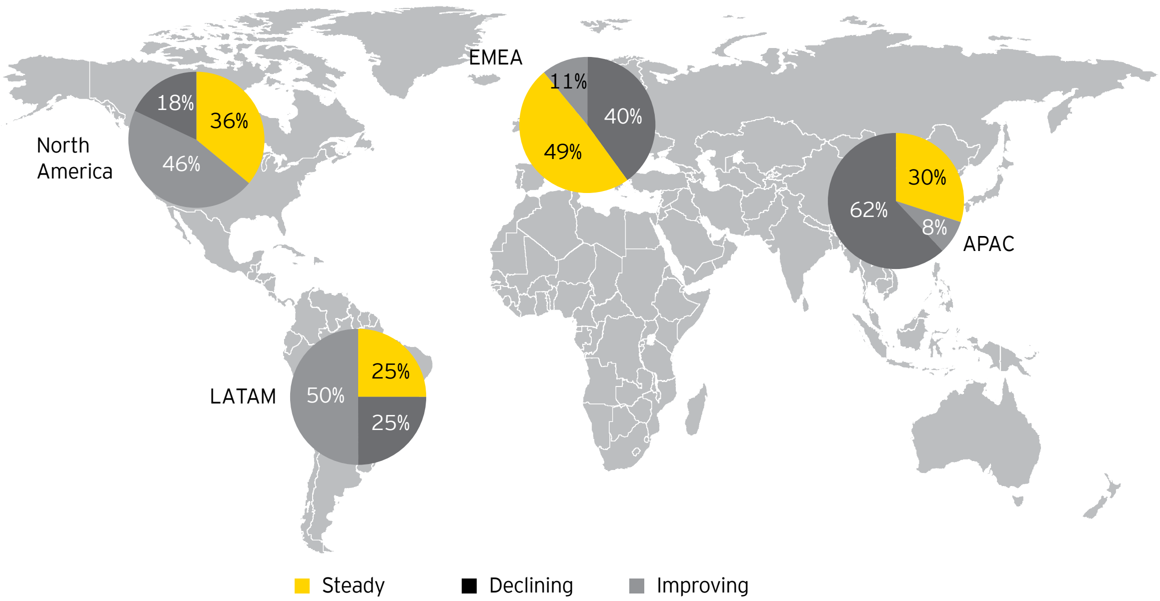
Going forward, FOs will play an even bigger role in wealth management as wealth grows, particularly in the emerging markets, and also for "old money" among entrepreneurial families in developed markets.

- **Pressure on margins**

  Perceptions of margin pressure vary by region. According to an EY survey, ~50% of firms in North America and the LATAM region believe that margins are still improving, while views are less favorable in APAC (8%) and EMEA (11%). Although the margin picture varies by region, the threat of emerging non-traditional players, compliance costs and fee pressures threatening margins is recognized globally.

23 "What are 'Family Offices'?", www.investopedia.com; "What Is A Family Office?", Forbes, 13 August 2013

24 "Financial Advice, Served Rare", The Wall Street Journal, 17 May 2013; "Why you need a family office", Mint, 22 December 2015



Source: "Could your clients' needs be your competitive advantage?" EY Report, 2016

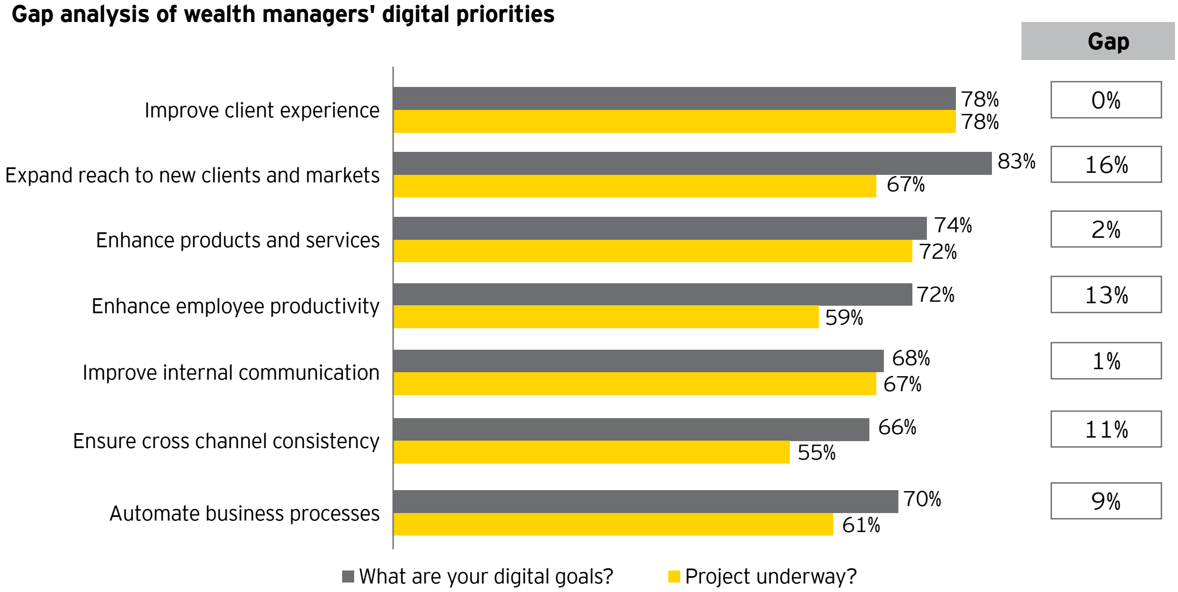
Going forward, margin pressure is expected to remain a major challenge across the global wealth management industry in the face of increased competition and ongoing regulatory costs. In an EY survey, more than 75% of respondents cited the cost of regulatory compliance as the main cause of declining margins, followed by competitive fee pressure (64%) and macroeconomic conditions (52%).[25]

25 "Could your clients' needs be your competitive advantage?" , EY Report, 2016

5. Disruptive technologies: impact of digital on the wealth management space[26]

Digital technologies are emerging as disruptive forces and fundamentally transforming how wealth managers serve clients and conduct their business operations. In the past, wealth managers targeted their IT-related investments at the back-office to drive efficiencies. The emergence of digital technologies for delivering services is forcing wealth managers to invest in their front-office digital capabilities or run the risk of falling behind.

Gap analysis of wealth managers' digital priorities



Source: "Unlocking the long-term opportunities in asset and wealth management", Forbes Insights, 2015;

- **Four technologies leading the charge: mobile, social media, advanced analytics and cloud-based computing**

  Emerging digital technologies are disrupting traditional value propositions and operating models in wealth management. The combination of these digital technologies will fundamentally shape client value propositions and operating models of wealth managers in the coming years:

  - Mobile is developing into the preferred channel for clients across all wealth bands because of the "anytime, anywhere" and context-aware capabilities of mobile devices. No consumer technology has reached widespread adoption so quickly, and no consumer device has allowed consumers to connect with each other so easily as the mobile phone. Moreover, the mobile channel represents an unparalleled distribution network.
  - Social media and collaboration platforms provide wealth clients the ability to interact with peers on portfolio strategies and client advisor performance.
  - Through big data and advanced analytics, wealth managers can improve insight generation and decision-making by infusing data into all aspects of revenue generation, cost control and risk mitigation.

26 "IT in Wealth Management 2015", EY Report

- Cloud computing provides wealth managers the opportunity to reduce infrastructure costs and increase agility and time-to-market. Cloud computing is mainly used for non-core activities not involving confidential client data.

Digital technologies transforming the wealth management space

	Applications for wealth managers	Emerging trends
Mobile computing	- Increase productivity of client advisors and front-office staff through mobile access to enterprise applications - Integrate mobile as key channel for clients to provide feature-rich services that enable wealth managers to deliver advice and engage on a personal level	- Mobile-firt development. User experience is designed for mobile first, then permeated to other channels - Relationship orientation. Talet form factor shifting client experience from transactional focus towwars stronger relationship orientation
Social media	- Use internal and external social networks to improve collaboration and knowledge sharing - Monitor client sentiment towards products and services by screening social media sites, respond rapidly to feedback - Apply social media to drive customer advocacy and establish trust with customers	- The social CEO. Senior executives use social media to interact effectively with clients and engage within community - Social media as service channel. Divert customer service requests from costly call centers towards social media interactions
Advanced analytics	- Generate new insights through client profiles enriched with external data from social media to inter occurrence of major life events and promote financial products linked to these events - Enhance risk models by applying advanced analytics to multiple data sources	- 360° client profile. Customer analytics thatcombines internal with external data sources to create real-time and holistic view on clients. - People analytics. Determine new approaches to attracting and retaining talent base through advanced analytics
Cloud computing	- Use cloud offerings for non-core and non-critical services to turn large and up-front capital expenditures into smaller and ongoing operational expenditure - Drive standardization and faster development times through cloud development platforms	- Pay-as-you-go cloud models. Ability to apply browser-based technologies for non-core business applications, such as enterprise content management, performance management cycle and recruitment

Source: EY IT in Wealth Management 2015

- **Effects of technology**

Digital can add significant value for wealth managers across the following areas:

Digitally enhanced client relationships	Most digital players are trailing the spectrum in enhancing customer engagement through digital capabilities and channels. Digital technologies offer the means to enrich and extend face-to-face interactions. Adaption of mobile channels is crucial for tech-savvy entrepreneurially minded HNWIs. Moreover, consumers are constantly switching between devices. Hence, wealth managers need to put truly integrated multi-channel access into place. Digital channels also allow wealth managers to leverage social media connectivity.
Increased front-office productivity	Client advisors may spend more than one-third of their time on non-client-facing tasks. Moreover, the number of clients per advisor is also steadily increasing. Hence, there is a need to increase the productivity of client advisors. Technology provides several opportunities to increase the productivity of client advisors and reduce the amount of time spent on low-value and administrative tasks. Web-portals provide clients a platform for 24/7 account management, while web conferencing facilities can be used as replacement for face-to-face meetings along with offering clients the flexibility of "anytime, anywhere" support.
Mid- and back-office operational excellence	Wealth managers can reduce overheads within the value chain and create a flexible infrastructure by employing digital technology in the back- and middle-offices. Advanced systems for digital document management can ensure data is managed securely and efficiently. Automated client relationship management tools allow real-time tracking of client interactions across all touch-points. Portfolio management systems offer core features such as auto-rebalancing that can reduce time-intensive manual processes. Real-time portfolio data can provide automatic alerts to ensure ongoing suitability of investments.
Generating new insights	Wealth managers need to deal with large volumes of data, including massive amounts of market and financial data as well as client data. Advanced analytics can be used by wealth managers to create value-adding insights from volumes of proprietary data. Traditionally, most players have focused on their client data to identify revenue opportunities. Some players are applying similar techniques to their employee data, with the goal of utilizing their people assets in more productive ways.
Improved decision-making	Major decisions to drive revenue, control costs or mitigate risks can be infused with data and analytics. Big data has the ability to improve management decision-making: by enriching data from management information systems with intuitive graphic elements and by integrating data from external systems such as financial markets, regulators and other stakeholders. The result is a uniform, real-time view of operations that allows different departments to base their decisions on the same facts.

Harnessing digital enablers to enhance customer engagement and achieve operational efficiencies will result in major benefits for wealth managers, such as revenue uplift through more interactive relationships providing cross- and up-selling opportunities; substantial reduction of cost-to-serve through digitization of the value chain and process excellence; the ability to personalize products specific to channels; and opening up new business opportunities.

- **Cybersecurity**

During the past few years, wealth managers have noted the increased relevance of cybersecurity and cyber threats. Digital, cloud computing and big data are making online services more open and accessible to customers as well as attackers. Critical information assets of organizations are more exposed to targeted attacks than ever. The security defenses of organizations are under increasing pressure, further eroding the traditional perimeter and, in turn, creating more motivation for threat actors.

Wealth managers need to keep up with the changing regulatory environment and avoid future fines, reputational loss and high implementation costs. Cyber threats will continue to multiply. The advent of the digital world, and the inherent interconnectivity of people, devices and organizations have opened up a whole new playing field of vulnerabilities.

India wealth management

India wealth management

Overview

The Indian economy has crossed the US$2t landmark and is poised to become a US$3t economy over the next five years, considering an 8% GDP growth rate.[27] Unlike in mature markets such as the US and Europe, wealth management in India is still evolving. India has the potential to become a high-growth wealth management market supported by its young affluent investor base, improving wealth levels among global Indians, strengthening regulatory environment and an increasing share of organized players, including independent wealth advisors and brokers/agents who act as financial advisors.[28]

Wealth management potential grows with a rise in HNWI population

India has the world's fastest growing high-net-worth Individual (HNWI) population (individuals with over US$1m in investable assets) both in terms of the number of individuals and the wealth levels. The country recorded the highest growth rate across the globe in the number of HNWIs (at 26.3%) and in their wealth (at 28.2%) in 2014. As of December 2014, India was home to 1, 98,000 HNWIs, and HNWI wealth amounted to US$785b.[29] The rise in HNWI population has been partly driven by e-commerce start-ups and rising income levels. First-generation e-commerce entrepreneurs have also made a significant impact on the ultra-HNI (UHNI) landscape (individuals with over INR250m in investable assets), which is a fast growing segment as well.

Statistics related to the UHNI market in India[30]

Key parameters	Value
UHNI base India	1,20,000
UHNI wealth India	INR100t
Investible surplus	INR20t
Total AUM	INR2.8t
Total relationship managers (RMs)	512
Total client base	20,000
Average relationships per RM	40

Only 3% of the total net worth of UHNIs across India is currently managed by advisors, implying a huge untapped opportunity.

Over the next five to seven years, India is expected to stand-out as a growth story in terms of increasing wealth and will continue to drive increase in new wealth across the globe. According to industry estimates, the combined net worth of wealthy Indians is expected to rise to US$6t over the next five years.[31]

27 "GDP to grow 8% in FY16; hit $3 trillion mark in five years: Arvind Panagariya", Economic Times, 30 June 2015

28 "Top of the Pyramid 2015", Kotak Wealth; "Emerging Opportunities in Indian Wealth Management Industry: Market Size, Strategies, Products, and Competitive Landscape", Bric Data Industry Forecast Report, May 2012

29 "India has the fastest growing HNI population in the world", Café Mutual, 16 September 2015, http://cafemutual.com/news/trends/513-india-has-the-fastest-growing-hni-population-in-the-world

30 EY Research and Analysis

31 "India's local wealth managers push to grow as foreign rivals struggle", Reuters, 2 September 2015

The balancing act: meeting the needs of all stakeholders (investors, regulators and organizations)

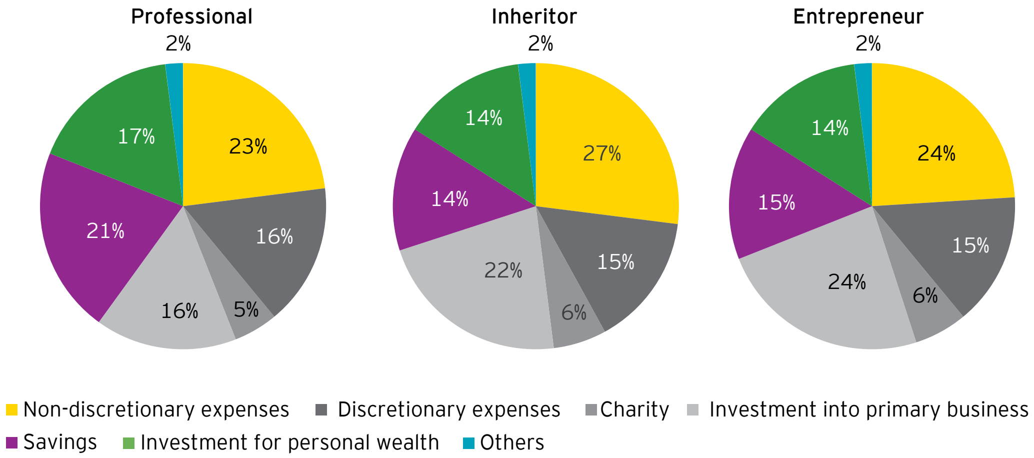
Investors

- **Profiling of investors**[32]

Key attributes of UHNIs in the Indian context:

	Professionals	Inheritors	Entrepreneurs
Sources of wealth	Work benefits	Inheritance/ entrepreneurship	Entrepreneurship
Motives for wealth creation	Self-actualization	Wealth preservation and growth	Self-recognition and achievement
Drivers of spending	Attaining value for money	Maintaining luxurious living	Attaining a luxurious lifestyle
Approach to investing	Professional, disciplined and planned with systematic goals	Organized and planned	More opportunistic and informal
Attitude to charity	Responsible and conscious, and give time and money	Compassionate, give money but have less time to indulge personally	Empowered, rarely give personal time and mainly provide monetary support
Attitude to perpetuation of wealth	Wealth is for the family, but they must strive to merit wealth	Wealth needs to remain within the extended family	Wealth is unconditionally for immediate family

Allocation of income by UHNI category



Source: Top of the Pyramid 2015, Kotak Wealth Management

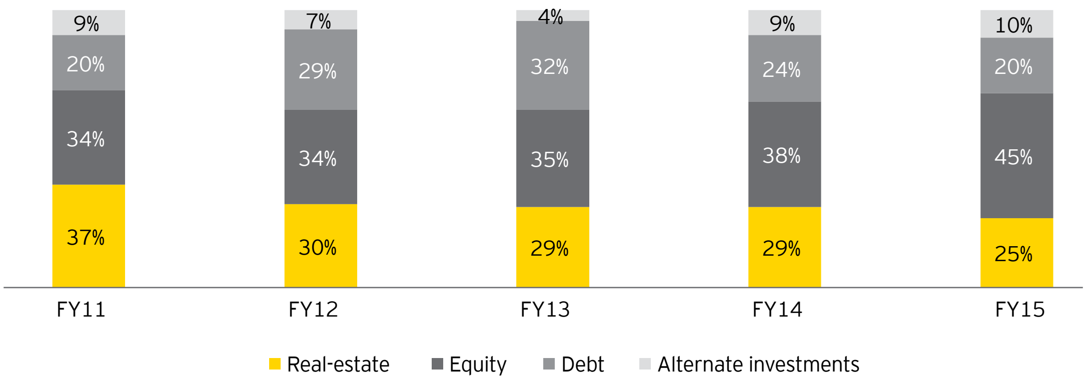
32 Top of the Pyramid 2015, Kotak Wealth Management

Within UHNIs, the difference in demographic profiles reflects in their lifestyle patterns and priorities. All UHNI groups allocated the highest portion of their income toward non-discretionary expenses. The next major investment category for entrepreneurs and inheritors was their primary business while for professionals it was savings. Professionals tend to have higher discretionary expenses as unplanned and impulse spending seems to be higher due to their corporate lifestyle. They also have a higher tendency to save.

- **UHNIs' preference for investing in physical assets is on the decline**

  Indian investors are typically keen to invest in tangible assets, such as gold and real estate: ~86% of Indians' household assets are in real estate and gold.[33] UHNIs also have a preference for real estate. The tangible nature of real estate makes it an attractive investment and over 90% of UHNIs have exposure to real estate investments in addition to their primary residences. However, during the past few years, UNHIs have shifted toward equity markets as the real estate market has stagnated a bit.[34]

Asset allocation of Indian UHNIs



Source: Top of the Pyramid 2015, Kotak Wealth Management

- **Investors are price-sensitive**

  India is a price-sensitive market and since the wealth management industry is at a nascent stage, investors are extremely value conscious and particular about the alignment of the price charged by financial advisors with the value being delivered. Moreover, millionaires in India are not accustomed to paying a fee for wealth management advice. Hence, the fee-based advisory model has not picked up in India. Domestic wealth managers, particularly large private banks, mainly refrain from offering fee-based advisory services and instead focus on commissions from transactions.[35]

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33 "Wealth Managers Exit India as Millionaires Hard to Entice", Bloomberg, 23 June 2014

34 Top of the Pyramid 2015, Kotak Wealth Management

35 "Wealth managers exit as India as millionaires hard to entice", Bloomberg, 23 June 2014

Organizations

- **Players in the Indian wealth management space**[36]

  Products offered: Wealth managers in India mainly sell mutual funds, private equity funds, real estate funds, non-convertible debentures, portfolio management services, structured products and tax-free bonds to investors.

Business model	Market positioning	Key characteristics
Universal banks	Strong	▶ Includes large players, mainly private banks; recently some PSU banks have also announced plans to launch wealth-management services ▶ Developed lending portfolios ▶ Extensive reach ▶ Relatively low entry levels ▶ Cross-sell potential with both retail and corporate customers
Wealth management specialists	Medium	▶ Mainly foreign players with strong understanding of advisory services ▶ Offerings are mainly managed/structured products ▶ Typically high entry barriers
Global investment banks	Weak	▶ Focus on the UHNI segment ▶ Institutional approach to serve clients with investment banking products
Brokers/dealer discount/ online brokers	Strong	▶ Large number of players ▶ Focus on the mass affluent segment ▶ Mainly offer mutual fund products
National distributors	Strong	▶ Some firms are affiliated to a brokerage firm with a large network of sub-brokers ▶ Large firms with extensive distribution network ▶ Multiple products
Family office	Weak	▶ Holistic advisory services for specific client segments such as entrepreneurs
Robo-advisors	Upcoming	▶ Fully automated or hybrid investment managers ▶ Algorithm-based advice without human intervention ▶ Suitable for small-ticket retail investors ▶ Available at a lower cost ▶ Consistent and transparent advice
Others (independent funds/insurance advisors, etc.)	Medium	▶ Very low entry barriers ▶ Commission-driven model ▶ No dedicated wealth management offering

36 "Wealth management in India: Challenges and Strategies", Cognizant Report; "Indian wealth managers rush in as foreign players exit", Business Standard, 24 February 2016; "Robo advisors best for small investors", Mint, 18 October 2015

- **National distributors provide significant support to Independent Financial Advisors (IFAs)**

  The Indian wealth management sector is characterized by a unique category of players called national distributors (NDs), which are large multi-location, multi-product companies. Some NDs are affiliated to brokerage firms and have a strong network of sub-brokers. NDs offer significant support to independent financial advisors (IFAs). IFAs can leverage the strong infrastructure platforms and distribution reach to focus on client acquisition and business development while focusing less on administrative requirements.

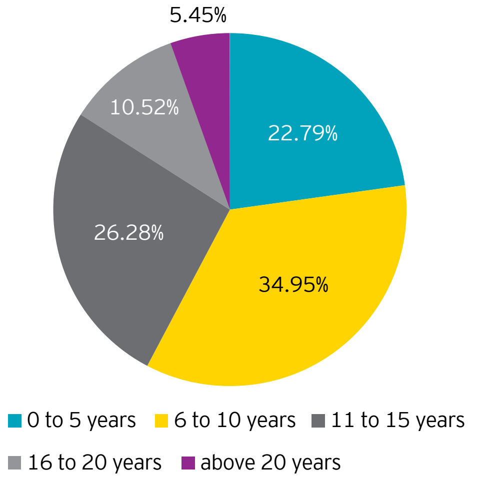
- **Indian wealth managers gain as global players exit**

  Recently, many foreign players have exited or scaled down their wealth management operations in India mainly on account of increased competition, high costs and increased regulatory restrictions. Global banks operating in the Indian wealth management space are struggling because of a narrow client base. Moreover, it is difficult for them to set up a cost-effective presence in smaller cities and they are also subject to increased regulatory burden vis-à-vis local players due to compliance with their home country regulations. In order to benefit from the rising levels of wealth and capitalize on the gap left by struggling global players, many well-established home-grown players have announced plans to expand beyond metro and tier-1 cities and add more financial advisors. Some domestic players are also looking at acquiring certain businesses and poaching talent from their global counterparts. Domestic wealth managers already hold a market share of ~75% and their expansion plans will further pressurize foreign players.[37]

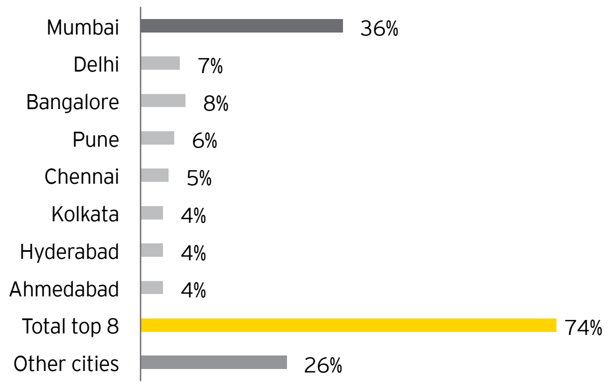
- **Caliber of financial advisors in India**

  There are very few qualified financial advisors in India. According to a survey by the National Council of Applied Economic Research (NCAER), 67% of investors in the country rely on informal advice for their investment decisions.[38] Certified financial planning (CFP) is the most well-recognized and internationally accepted financial planning qualification provided by the Financial Planning Standards Board (FPSB) of India. In India, there are 1,834 CFP certified professionals (as of March 2016) catering to a population of more than 1.3b. Around 58% of CFPs have less than 10 years of experience. Moreover, 74% of CFPs are from the top 8 cities, with the maximum concentration (36%) in Mumbai.[39]

Years of experience



Share of total CFPs



Source: FPSB India, Annual Report 2015-16

37 "India's local wealth managers push to grow as foreign rivals struggle", Reuters, 2 September 2015; "Indian wealth managers rush in as foreign players exit", Business Standard, 24 February 2016

38 "Investment advisory registration sluggish as Sebi focuses on safeguarding investors", The Economic Times, 9 June 2015

39 FPSB India, Annual Report 2015-16; India live population at /www.worldometers.info/world-population/india-population/

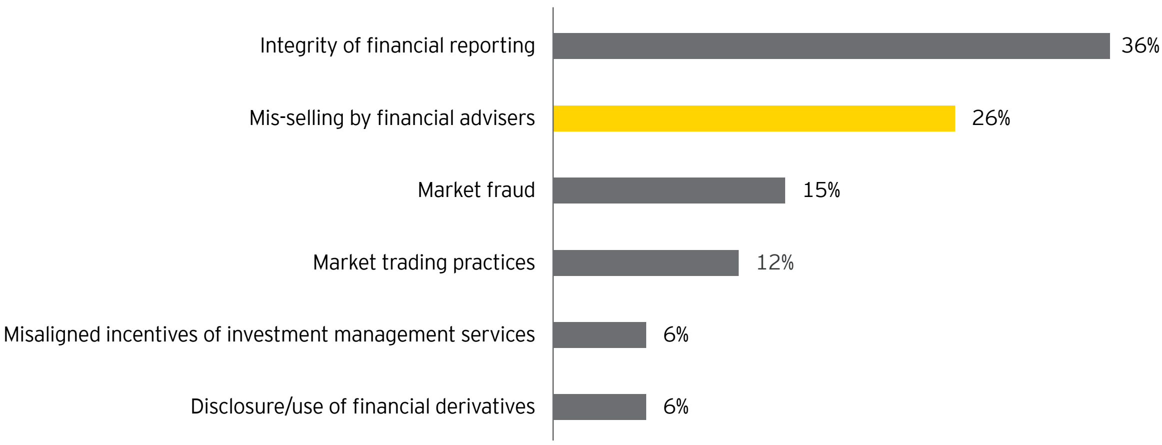
The Indian wealth management industry lags heavily behind global counterparts on educational standards for financial advisors. For instance, with the advent of MiFID-II across several jurisdictions in the European Union, the skill-set requirements for financial advisors are expected to increase:

- **France**: A financial investment advisor needs to have any one of the following: a national first level degree of economics or legal studies, relevant professional training of at least 150 hours or two years of professional experience.
- **Germany**: A financial investment advisor needs to be a certified financial investment specialist or an approved financial investment expert (IHK); have a degree in mathematics, economics or legal studies from a German university; or have a professional qualification such as certified banking specialist, business administrator, financial advisor and investment specialist with at least one year of professional experience in investment advice.

Recently, there have been some initiatives in India to strengthen the skill sets of financial advisors. For instance, independent financial advisors (IFAs) formed a national body, Foundation of Independent Financial Advisors (FIFA), in 2012. It functions as a knowledge sharing platform for IFAs as well as professionals such as CAs, MBAs, CFAs and CFPs.[40] Moreover, a number of certification requirements have been introduced such as license from IRDA for selling insurance product, MF certification from AMFI and NSE certification for capital markets. However, there is a need for a strong campaign by regulators to enforce the need for certified distributors.[41] In 2013, SEBI introduced rules on investment advice and set April 2015 as the deadline for all wealth managers who were advising on products to obtain two mandatory qualifications from the National Institution of Securities Markets (NISM): Series X-A and Series X-B. The qualifications are aimed at giving financial advisors proper understanding of the structure of the securities market as well as understanding of asset allocation, product selection, portfolio construction and portfolio rebalancing based on clients' needs.[42]

Moreover, mis-selling is one of the key issues plaguing the Indian wealth management sector, making investors wary of financial advisors.

Most serious ethical issues facing India (% share of respondents)



Source: "Global market sentiment survey 2015", CFA institute

40 "Independent Financial Advisors form national body", Business Standard, 9 April 2012

41 "Role of regulators in wealth management", Business Line, 10 September 2011

42 "Embracing the structural shifts in Indian wealth management", Hubbis, 20 April 2015, //www.hubbis.com/articles-content/4058

Mis-selling occurs partly because of a lack of financial literacy amongst customers and partly because of a tendency among certain relationship managers to push products that fetch higher fees. Earlier, distributors were paid upfront fees at the time of investment and trail fees as long as the investor stayed invested in a staggered manner. As certain wealth managers had resorted to churning investments in order to gain from upfront commissions, AMFI issued a circular in 2015 to cap upfront commissions at 1%.[43]

Case study: SBI aims to counter mis-selling by revamping incentive criteria for wealth managers[44]

In January 2016, the State Bank of India (SBI) launched its wealth management services, called SBI Exclusif. SBI has differentiated itself from other banks by linking the performance incentives for relationship managers with customer satisfaction and wealth maximization. As a result, financial advisors are not incentivized by pushing higher commission products to boost top line.

- **Issues involving fraud in wealth management in India**

  Scams in the wealth management sector have shaken the faith of investors in the sector. However to avoid such incidents from happening in the future, wealth management players need to strengthen their internal control frameworks and keep a stringent watch on their employees.

Regulators

The regulatory environment in the Indian wealth management industry is still evolving, with a number of regulations aimed at protecting the interests of investors.

Some key proposals/guidelines by regulators affecting the Indian wealth management space

- **SRO for wealth management:**

  In 2011, capital markets regulator, Securities and Exchange Board of India (SEBI), proposed a self-regulatory organization (SRO) for the Indian wealth management sector that would help regulate business and serve as a medium for SEBI to implement various wealth management initiatives.[45]
- **Investment advisor guidelines by SEBI:[46]**
- SEBI's Investors Advisor Regulations, which came into force in January 2013, focuses on the fact that an investment advisor has to be unbiased and should not have any conflict of interest.
  - Investment advisory services have to be separated from all other activities such as distribution. A distributor can sell product but cannot offer advice.

43 "Will cap on upfront commissions work?", Mint, 30 Mar 2015

44 "SBI taps into wealth management segment", Mint, 15 January 2016

45 "Sebi favours self regulation model for wealth managers", Hindustan Times, 24 April 2011

46 Investment Advisers Regulations-2013, SEBI, 21 January 2013; "Mandate For a Safe Advice", Money Today, March 2013, //www.businesstoday.in/moneytoday/perspective/sebi-mandatory-for-investment-advisors-to-maintain-record/story/192738.html; "Investment advisory registration sluggish as Sebi focuses on safeguarding investors", The Economic Times, 9 June 2015

- Any entity/individual willing to engage in the business of providing investment advice to clients is required to be registered with SEBI. Moreover, an investment advisor should be professionally qualified, with a post-graduate degree in finance, accountancy, business management, banking, etc. or a graduate degree with relevant experience of at least five years. The individual also needs to be certified by NISM or FPSB.
- To be an investment advisor, corporate bodies need to have a minimum net worth of INR2.5m and individuals INR100,000.
- Investors should ensure proper risk-profiling of clients, and the investment advice provided should be appropriate to the client's risk profile.
- Investors also need to maintain a record of KYC, risk profiling and assessment, suitability assessment of advice provided, agreements with clients, investment advice provided (written as well as oral), rationale for arriving at investment advice and a list of clients with date of advice, nature of advice and fees charged.

- **The RBI's guidelines on regulating wealth management services (WMS):**
- In June 2013, the Reserve Bank of India (RBI) issued draft guidelines on wealth management and distribution services offered by banks:
  - In April 2016, the RBI asked banks that currently offer investment advisory services through an internal department to reorganize their operations within three years and set up a subsidiary for investment advisory services. This is to ensure an arm's length distance between banking activities and investment advisory services. Banks will need specific approval from the RBI to set up the subsidiary. The subsidiary would have to be registered with SEBI and would be subsequently regulated by SEBI.[47]
  - Banks must ensure segregation of the marketing function from operational processes, such as approval/transaction processes at branches. Banks must ensure that the sales process is transparent and products are sold through trained employees in bank branches. Banks should strictly follow KYC and AML rules, have a robust internal grievance redressal machinery, and prevent their staff from receiving any incentive (cash as well as non-cash) directly from a third-party issuer.
- **SEBI may impose cap on upfront commissions:**
  - The Association of Mutual Funds (AMFI) in April 2015 urged asset management companies to cap upfront commissions at 1% and total payout to distributors, including trail commissions, at 1.75% during the life of a mutual fund product. While upfront commissions are paid by AMCs to agents on the sale of a product, trail commission is paid through the life of an investment. However, as some AMCs have dissented against AMFI's recommendation, SEBI is likely to intervene going forward. The capital market regulator has asked AMCs to confirm if they had capped upfront commissions as a possible prelude to regulatory action.[48]

47 "RBI asks banks to set up subsidiary for investment advisory services", Mint, 21 April 2016; "RBI plans to ban incentives for third party product sales", The Economic Times, 28 June 2013; "RBI norms on wealth mgmt services to be tightened", Business Standard, 29 June 2013

48 "Mutual funds: Sebi may impose cap on upfront commissions", Mint, 11 December 2015

- **Regulatory pressure is forcing wealth management players to rework operating models**

  After the announcement of the Investor Advisors Guidelines, there has been increased focus on client centricity, fiduciary responsibility and compliance. Regulatory requirements regarding advisor qualifications, infrastructure, risk profiling and suitability criteria have become more stringent. For the past few years, there has been a push from regulators and industry bodies to move toward a trail commission–based model and reduce up-front commissions to reduce mis-selling and the chances of churn.

  One of the biggest impediments to the current wealth management model is the stipulation that investment advisors must maintain an arm's length from distribution activities. The income of investment advisors must be in the form of fees from clients and not through commissions earned on the distribution of mutual fund products. Players are skeptical about separating advisory and distribution businesses as this may prove to be an inconvenience. Moreover, the cost of running two separate firms is high.

  Only 285 registered investment advisors (RIAs) have registered with SEBI (as of August 15) in about two years, a miniscule fraction of the number of practicing financial advisors. Most advisors prefer not to join as ambiguous regulations and high compliance costs make operations difficult; advisors who choose to not register continue to operate without any reprimand. Moreover, most of these RIAs are banks or corporates for whom setting up a separate division is not a costly affair.[49]

- **Additional regulatory layer proposed by SEBI may keep foreign players away from Indian wealth management business**

  - With the aim to root out undeclared wealth and ensure tax compliance, SEBI wants to gain oversight of foreign banks managing Indian wealth. The capital market regulator has reached out to large international banks and wealth managers to register their offshore units with SEBI if they are soliciting business in India. By registering with SEBI, private banks would have to admit to managing funds of wealthy Indian clients and may also prompt further requests from SEBI to share information. Many foreign banks and wealth managers have already exited the Indian wealth management business because of the high cost of operations and regulatory burden. This might deter foreign players from having any presence in the Indian wealth management segment and offering services to wealthy Indians.[50]

  - Going forward, the regulatory environment may further evolve and there may be tighter norms around the skill-set requirements for advisors, disclosure requirements to ensure more transparency, stricter rules regarding investment advice and data privacy, etc.

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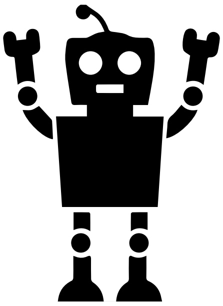
49 "Will Sebi Investment Advisers Regulations be a damp squib?", Mint, 11 February 2015; "Advisers hesitating to register with Sebi may be wrong," Mint, 10 August 2015

50 "SEBI Wants To Gain Oversight Of Foreign Banks Managing Indian Wealth", The Huffington Post, 7 August 2015; "India seeks to step up scrutiny of offshore wealth managers", Reuters, 6 August 2015

Robo-advisers: myth and reality

The global wealth management industry is being revolutionized by the rapid pace of digital innovation. After the global financial crisis, while traditional asset managers focused on meeting the enhanced regulatory requirements and resolving other crisis-driven complexities, several new age digital players focused on developing simpler and cheaper methods of delivering financial advice in an innovative way. This paved the way for virtual advice, and amidst the increasing evolution of virtual advice, one of the most recent disruptions is the robo-advisor movement, i.e., the emergence of a new group of digital wealth management firms offering automated investment advice services. Notably, these firms are challenging one of the main paradigms of the wealth management industry: the need for face-to-face interaction and a personalized human touch to financial advice.



What are robo-advisors?

Robo advisors are an automated, low-cost money management providers that mirror the role of a traditional financial advisor. They offer user-friendly digital platforms and conduct individualized risk profiling via algorithms to determine an optimal asset allocation for investor's portfolio vis-à-vis the archetypal time-intensive face-to-face consultations carried out by traditional wealth managers.[51] The basis for this technology is that algorithms can provide sound and logical financial advice at a fraction of a cost compared to human advisors.[52]

Trends driving the emergence of robo-advisors

The emergence of this new breed of digitally powered wealth managers has been driven by the following trends[53]:

Focus on mass market

- Wealth managers have traditionally focused on the high-net-worth (HNWI) and ultra-HNI segments, which align better with the economics of their advisor-based business model, providing sophisticated products and face-to-face service. This left less affluent investors devoid of high-quality wealth management advice.
- Robo-advisers have the ability to make wealth advice economically feasible to the mass market. Their operating model differs from that of traditional players in that it is less sophisticated in terms of products but clear and efficient in scalability. This, in turn, has enabled these players to reach client segments that have traditionally been out of reach of wealth managers.
- The mass market offers tremendous potential for wealth managers worldwide. Although these clients may be relatively small on an individual level, when aggregated they represent a significant asset base (for instance, in the US, the mass affluent segment offers a market potential of ~US$10t). These digital firms have made it possible to bring investment advice to the masses and unlock the large potential of underserved segments through their low-cost and potentially highly scalable solutions in order to meet core wealth management needs.

51 "Finance briefing: The rise of the robo-adviser", Financial Times, 22 March 2015

52 "The Rise of Robo Advisors", India Today Money, 17 December 2015

53 "Advice goes virtual", EY Report, June 2015; "Robo-Advisors: Real Change Or Overhyped Trend?", Forbes, 23 Jun 2015; "Wealth managers face 'sweeping changes'", Financial Times, 16 November 2014; "Robo Advisers to Run $2 Trillion by 2020 if This Model Is Right", Bloomberg, 18 Jun 2015; "Generations: Demographic Trends In Population And Workforce", http://www.catalyst.org/knowledge/generations-demographic-trends-population-and-workforce#footnote5_hwfb9cm

Demographic shift

- The wealth management industry is witnessing a phase of significant demographic change as its largest investor segment – the baby boomers (born between 1946 and 1965) – retires and assets are transferred to the next generation – Gen-X (born between 1966 and 1980) and Gen-Y/millennial (born after 1980).
- Younger set of investors have largely been underserved by traditional players, with only 18% of financial advisors in the US targeting Gen-Y clients.
- Traditional wealth managers are facing challenges in establishing the right connect with millennials, who are tech-savvy and believe in a do-it-yourself approach. On average, a financial advisor is over 50 years of age, which results in a generational gap and a slight disconnect with the younger generation.
- The simple technology platforms offered by new-age digital wealth managers resonate well with the needs of millennials. Digital entrants have also benefited from the fact that many millennials do not have a trusted advisor relationship and feel comfortable using technology to manage their finances. Hence, digital firms are well positioned to capitalize on the generational shift.

Advanced digital capabilities

- Digital has changed the way people interact, creating opportunities for new engagement models with end investors.
- These technology-backed automated investment services (robo-advisors) have been developed on the premise that many of the activities performed by traditional investment advisors can be replicated by adopting advanced digital capabilities.
- Robo-advisors have successfully leveraged the demand for user friendly and interconnected digital services and deployed a simple streamlined digital experience for clients.
- These firms have created direct-to-consumer models to provide the basic elements of wealth management advice, minimizing the traditional reliance on human advisors. Digital platforms automatically invest and rebalance according to clients' goals and risk tolerances sans human interference.

How robo-advisors work[54]

Robo-advisors use a combination of simplified client experience, lower fees and increased transparency to offer automated advice direct to consumers. These digital entrants have changed the fundamental economics and scalability of servicing the underserved segments by combining the basic components of a wealth management offering with seamlessly integrated technology, lower pricing, greater transparency and client-relevant digital content. The process followed by most robo-advisors is as follows:

Step 1: Investors are required to complete a comprehensive online questionnaire designed by behavioral finance experts. This comprises questions related to the investors' specific needs, financial goals and risk appetite.

Step 2: The robo-advisor platform uses proprietary algorithms to process the inputs, and select a portfolio (mainly focusing on exchange-traded funds [ETFs]) to provide a tailored investment plan to investors. The portfolio is periodically rebalanced to optimize profits and taxes.

Step 3: The portfolios are monitored consistently by computers. Investors can re-adjust their goals and risk tolerance, which will trigger re-balancing of the portfolio.

Robo-advisors mainly provide automated portfolio management, with limited focus on tax, retirement and estate planning, and can charge lower fees because of automation. They offer passive investment and charge lower fees. Technology has revolutionized the wealth management space, leading to the emergence of two alternatives to the traditional wealth management model: fully automated digital wealth managers and hybrids, which pair computerized services with a human touch (advisor-assisted digital wealth managers).[55]

Fully automated digital wealth managers

Investors use fully automated investment services to create a diversified portfolio. This model follows a direct-to-customer approach without assistance from a financial advisor. Firms offer easy-to-use tools that simplify customer experience. Clients complete a profile and risk tolerance questionnaire online and receive a recommended portfolio, composed mostly of low-cost ETFs, optimized to meet their needs. These firms are mostly popular with millennials and low-ticket investors.

Case study: Betterment, a leading new age fully automated robo-advisor

Betterment, a digital investment start-up, uses algorithms to help clients invest money and charges much lower fees compared to traditional advisors (15–20 bps on average for small plans). It has emerged as a leader among robo-advisors with nearly US$4b in assets and 150,000 clients. It is also the most well-funded robo-advisor start up in the US (valued at US$700m as of March 2016).

4 "Advice goes virtual", EY Report, June 2015 ; "Robo-advisers try to calm investor nerves", Huffington Post, 1 February 2016; "Why investors should approach robo-advisors with caution", MarketWatch, 27 November 2015

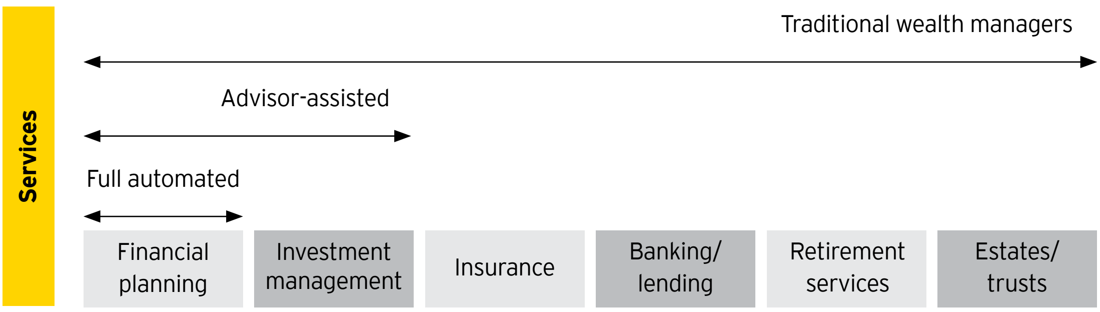
5 "Can Robo Advisers replace Human Financial Advisers", The Wall Street Journal, 28 February 2016; "Advice goes virtual", EY Report, June 2015; "Robo-advisor Betterment raises $100 million", Fortune, 29 March 2016; "Personal Capital slashes account minimum to $25,000 from $100,000", Investment News, 18 November 2015; "When Personal Capital Talks, People Should Listen", Forbes, 1 October 2015

Advisor-assisted digital wealth managers	This model combines digital client portals and investment automation with financial advisors typically conducting simple financial planning and periodic reviews over the phone. These firms also offer value-added services such as asset aggregation capabilities that allow for more holistic advice than fully automated wealth managers, based on a comprehensive view of clients' assets and liabilities, as well as expense-tracking and advice on budgeting and financial-goal planning.

Case study: Personal Capital, a hybrid automated investment platform

Personal Capital employs a combination of technology and human touch and employs all the features of a top-notch robo-advisor, such as automated tools for portfolio management, budgeting, risk analysis and retirement planning. It has over 850,000 registered users and US$1.5b in assets under management. Recently, it cut minimum account requirement to US$25,000 from US$100,000 to attract young/small ticket investors.

Traditional vs. digital wealth managers[56]



	Robo-advisors		
	Fully automated digital wealth managers	**Advisor-assisted digital wealth managers**	**Traditional wealth management firms**
Business model	Software-based delivery of customized and automated investment advice	Phone-based financial advisor accessible through digital channels for personal advice	Face-to-face advice mainly through the branch network for comprehensive wealth management
Client type	Millennial, tech-savvy and price-sensitive customers who want to match market returns and pay low fees	Mass market and mass affluent clients who value human guidance and technology	Affluent, HNWI and ultra-NHI clients who value guidance from a trusted financial advisor
Value proposition	A convenient, easy-to-use and low-cost online platform offered directly to consumers	A digital platform combined with advisor relationship; affordable pricing for a fully diversified portfolio	A dedicated FA with full range of investment choices and comprehensive wealth planning

56 "Advice goes virtual", EY Report, June 2015

	Robo-advisors		
	Fully automated digital wealth managers	Advisor-assisted digital wealth managers	Traditional wealth management firms
Fee structure	A 0.25%–0.50% fee on assets managed; minimums may apply	A 0.30%–0.90% fee on assets managed; monthly fees per planning program; minimums may apply	A 0.75%–1.5%+ fee on assets managed; varies by investment type; minimums may apply
Investment process	Risk profile, target asset allocation, managed investment account, automated rebalancing and easy access	Virtual FA meetings, financial planning, risk profile, target asset allocation, managed investment account, automated rebalancing, easy access and periodic reviews	In-person meetings with a dedicated advisor, financial planning, investment proposal, target asset allocation, brokerage and managed accounts, automated rebalancing, in person access and reviews
Investment vehicles	ETFs and direct indexing	ETFs and stocks	Stocks, bonds, ETFs, mutual funds, options, alternative investments, commodities and structured products

Benefits of robo-advisors[57]

- **Shortage of financial advisors**

  The wealth management industry is facing a shortage of financial advisors. Most veteran advisors are getting ready to retire, and there are few young replacements. According to a research by Cerulli Associates, the average age of advisors in the US is close to 60 (as of 2015), with 43% more than 55 years old and a mere 11% younger than 35. Moreover, going forward, the demand for financial advice is probably going to outstrip the number of qualified people who can deliver it. According to estimates of consulting firm Moss Adams, the wealth management industry in the US may face a shortage of at least 200,000 advisors by 2022.[58] Meanwhile, emerging economies are also facing an acute shortage of qualified financial advisors. For instance, In India, there are only 2,500 certified financial planners (CFPs). Thus, it is not possible to spread their reach to serve more than 62m households that have annual incomes above INR500,000.[59] Today, most wealth managers focus only on HNWIs/ultra-HNIs, leaving enough scope for robo-advisors to fill in the demand–supply gap.

- **Rational advice**

  Robo-advisors work on algorithms and therefore, unlike traditional wealth managers, they are immune from biases and other forms of conflicts of interest. For instance, many traditional advisers receive additional compensation for choosing high-cost funds for the client's portfolio. With robo-advisors, the investor need not worry about the financial advisor pushing products to boost commissions as automated advisors mostly focus on low-cost ETFs.

57 "The Pros and Cons of Robo advising", The Wall Street Journal, 27 July 2015; "When Personal Capital Talks, People Should Listen", Forbes, 1 October 2015; "Small Firms Try to Fill Adviser Shortage", The Wall Street Journal, 20 November 2013

58 "Are wealth management firms really facing a shortage of financial advisers?", efinancialcareers, 4 January 2016, //news.efinancialcareers.com/us-en/230242/wealth-management-financial-advisers

59 "Mutual Funds in India: Being Future Ready," EY Report, September 2015

- **Low fees**

  Traditional advisers charge between 1%–2% of actively managed client assets per year for their services while robo-advisers charge as low as 0.25% or even less for starter portfolios. Robo-advisors are able to charge much lower fees compared to traditional firms mainly on account of the scale effects of the technology. Robo-advisors have to only incur a one-time fixed cost in developing the algorithm. Hence, they incur much lower costs vis-à-vis traditional firms, which have to employ expensive wealth managers. Lower costs get translated in the form of lower fees for the clients. Hence, robo-advisors are able to profit from having a wider customer base and lower operating expenses.

- **Lower account minimums**

  Robo-advisers usually charge extremely low or no account minimums and hence, they appeal to investors, especially small ticket and young investors, whose portfolios are not large enough to meet the minimums set by traditional financial advisers. Robo-advisors ensure that small ticket investors and young professionals get access to quality wealth management advice, which so far was only available to the ultra-wealthy.

- **Portfolio re-balancing**

  Robo-advisors have made portfolio re-balancing easily available to their client base. Traditionally, portfolio rebalancing was a feature made available by financial advisors to only their wealthiest clients. Rebalancing ensures that the allocation of investments in different asset classes is in line with the client's financial requirements and risk tolerance. Also, traditional advisers monitor portfolios periodically while automated advisers can continuously monitor the portfolio and are as such able to harvest profits or losses more effectively.

- **Transparency**

  Robo-advisors have democratized access to quality financial advice without discriminating customers on the basis of assets. This model has a transparent fee structure and is attractive to tech-savvy and less wealthy investors who require only simple investment management.

Challenges associated with the robo-advisor model[60]

- **Limited customization**

  Robo-advisors mainly fill the needs of beginners and investors with uncomplicated financial portfolios. These firms mostly focus on the "one-size fits all" approach, and different individuals with varied personal situations may end up getting allocated a similar portfolio based on their risk profile. For instance, automated services may not take into account the number of dependents or earnings of other family members, which may alter an investor's savings pattern.

- **Customer base**

  Robo-advisors mainly cater to small ticket investors and millennials. According to a TABB research, millennials may not be as "sticky" as their needs become more complex over the years, but the low-fee model followed by robo-advisors forces them to focus solely on small and less profitable accounts. Moreover, as robo-advisors strive to expand their investor base and look to grow beyond the millennial and low-ticket customer base, these players are likely to face high client-acquisition costs.

60 "The Rise of Robo Advisors", IndiaToday, 17 December 2015; "Another Report Questions The Sustainability, Industry Impact Of Robo Advisors", 1 October 2015, accessed via FamilyWealthReport; "Robo-Advisors and Traditional Investment Advisors Battle for Hearts and Minds of Retail Investors: TABB Research", BusinessWire, 30 September 2015

- **Stiff competition from traditional firms**

  Robo advisors have taken the wealth management industry by storm by capitalizing on the first-mover advantage over traditional firms due to better customer-facing technology. However, traditional wealth managers are fighting back by making significant investments in digital tools.

Case studies: how traditional firms are fighting back

- **Charles Shwab's virtually no fees robo-advisor service**[61]

  Charles Schwab introduced automated online investment advisory services known as Schwab Intelligent Portfolios in 2015 to offer ETFs to customers for comparatively low fees. Unlike for its traditional business, there are no advisory fee, trading commission or account-service fee for its robo-advisor platform; there is only a fund management fee of ~0.15%–0.35% of Assets Under Management (AUM). The main aim of introducing this service with virtually no fees was to retain customers who were looking for automated advisory and were moving to other firms to save on advisory fees. The company has grown its asset base to US$5.3b in its debut year. Going forward, it plans to expand its robo-platform beyond just ETFs to a more complete investment menu.

- **Vanguard's hybrid service with near robo-pricing**[62]

  Vanguard rolled out its hybrid robo-human money management service in early 2015. The new Personal Advisor Services require a minimum balance of US$50,000 and attract an annual charge of 0.30% of assets vis-à-vis its traditional financial planning service, which requires a minimum balance of US$500,000 and costs 0.70% per year. The new platform has attracted more than US$7b in advisory assets (as of March 2015), in addition to the US$10b assets that Vanguard has moved from its old platform. The hybrid service combines automatic asset allocation and portfolio rebalancing with access to human advisors via teleconferencing and videoconferencing. At the front end, customers can interact with a human planner on goals and risk appetite and also seek advice regarding key decisions. Unlike other robo-advisors, which are aimed primarily at millennial investors, Vangard is targeting baby-boomers as it expects these older do-it-yourself investors to need help in managing finances as they approach retirement.

- **Performance in volatile markets**

  The rise of robo-advisors and their automated investment strategies has largely coincided with a multi-year up trend in the stock markets (bull run). Their underlying business models are still untested in down markets. The nascent industry is yet to demonstrate its performance in a highly volatile market, which would be the ultimate test.

61 "Charles Schwab Introduces Its Robo-Advisor: Is This The Next Big Thing In Investing?", Forbes, 21 November 2014; "Schwab 'robo adviser' grows to $5.3 billion in its debut year", Reuters, 6 January 2016; "Schwab plans to expand its robo-adviser beyond just ETFs", Investment News, 11 November 2015

62 "Vanguard Rolls Out New Robo-Hybrid Advisor Service With $17 Billion In Assets", Forbes, 5 May 2015

Going forward: potential impact of robo-advisors on the wealth management space

Some traditional players have been downplaying the impact of robo-advisors. However these new digital entrants have been able to develop a streamlined digital experience for clients, which had been largely lacking in traditional wealth managers' digital offerings. This, combined with increased transparency and lower fees has the ability to make wealth advice economically feasible for the mass market.

Robo-advisors are swarming into the wealth management industry. The current market share of robo-advisor firms is marginal as they have only gained a miniscule share of (AUM) globally but several companies already have over US$1b of assets under management.[63] Several research studies forecast that robo-advisors are going to witness significant growth going forward as these firms have managed to do in a couple of years what the incumbent wealth management industry has failed to accomplish since its inception, i.e., make quality financial advice available across demographics at an affordable cost. Robo-advisors will be key to unlocking access to the mass market services, which, in turn, would help in growing the overall wealth management market. Moreover, these firms have received strong funding support from venture capital funds. According to a study by MyPrivateBanking Research, hybrid robo-advisors are expected to grow by size to US$3.7 trillion of assets globally by 2020. The study predicts that the total market size for hybrid robo-advisors will further increase to US$16.3t by 2025, which will be 10% of total investable wealth around the world by that date. In contrast pure robo-advisors (fully automated) are likely to hold only 1.6% of the total global wealth by the middle of the next decade.[64]

Robo-advisors' steps to streamline the client online experience, provide greater transparency and improve the economics for the mass segments are irreversible and they are making traditional financial advisers rethink their business models. According to a research by Accenture, robo-advisors could result in possible fee reduction of as much as 70% for some services.[65] Traditional advisors will need to ensure that their service offering is commensurate with the fees tagged to it. Moreover, robo-advisors will also force traditional advisers to increase focus on their digital channels.

63 "Investment Advisory : The rise of the Robots ?" Chappius Halder & Co, June 2015; "Advisor: You can't 'robo' retirement planning", CNBC, 23 January 2015

64 "Industry Researchers Discover New Sub-Species - The "Hybrid" Robo Advisor", 17 February 2016, accessed via FamilyWealthReport

65 "Banks must exploit the situation", Business Line, 11 April 2016 accessed via Factiva; "Advisor: You can't 'robo' retirement planning", CNBC, 23 January 2015

Traditional wealth managers can effectively prepare themselves to counter the threat of robo-advisors by boosting their digital capabilities or by integrating with robo-advisors:[66]

Acquisitions

Greenfield development → Building robo-advisory capabilities ← Partnership

Greenfield development

- Traditional firms can develop their own robo-advisor platforms in-house to effectively capitalize on this opportunity and target both existing as well as new clients. However, in-house deployment comes with its own set of risks, such as high costs of development.
- **Case study: Charles Schwab and Vanguard have deployed in-house robo-advisors**[67]

  Wealth management behemoths Charles Schwab (with its automated platform Schwab Intelligent Portfolios) and Vanguard (with its hybrid platform Vanguard Personal Advisor Services) joined the robo-advisory race in early 2015, reacting to the explosive growth of automated investment start-ups.

Acquisions

- Acquiring an existing robo-advisor is another option for traditional firms to develop their firm's automated advice capabilities. However, traditional firms should factor in the target's growth potential, client base, technological capabilities and potential synergies. Another reason spurring the slew of acquisitions of start-up robo-advisors by incumbent firms is to replicate the innovative spirit of these start-ups in other areas.
- **Case study: BlackRock acquires FutureAdvisor**[68]

  Blackrock, the world's largest fund manager, acquired a digital adviser, FutureAdvisor, that generates automated portfolios in order to woo millennials. FutureAdvisor continues to function as an open-architecture platform, i.e., it can recommend more than just BlackRock funds.

Partnership

- Another way to develop these capabilities is to partner with existing robo-advisors. This will enable the incumbent firm to adapt quickly and result in lowering of costs, minimization of risk and limited organizational changes. However, there could be several challenges, such as cultural issues and conflicts in terms of ultimate goals.

66 "Investment Advisory : The rise of the Robots ?" Chappius Halder & Co, June 2015

67 "Investing's Old Guard Gets Its Algorithm On", Bloomberg Businessweek, 20 March 2015

68 "BlackRock buys 'robo-advisor' to woo millennials", Financial Times, 26 August 2015

Case study: BlackRock acquires FutureAdvisor[69]

In October 2014, Fidelity partnered with robo-advisor firm Betterment to create Betterment Institutional, a platform that was made available to Fidelity's adviser clients. However, after a year-long collaboration, Fidelity announced plans to end its relationship and set up its own robo-platform, which will be launched in phases during 2016–2017. According to Fidelity, its clients want a more integrated platform that is customizable and allows the advisor more flexibility in investment decisions and product selection.

Developments in the robo-advisor space in India

As the prevalence of rob-advisors has increased globally, these platforms have also made their way to India. Typically, robo-advisors across the globe channelize client's funds into low-cost index funds and ETFs. Robo-advisors in India offer a variety of mutual funds products. The Indian wealth management landscape has not witnessed a proliferation of robo-advisors as there is a lack of a wide range of index funds and ETFs.

Robo-advisers in India are mainly of three kinds:[70]

Basic	Ready portfolio of pre-selected funds Limited risk profiling and customization
Advanced	Customized mutual fund portfolio construction; goal-based financial advice Comprehensive financial counselling (telephonic) Extensive risk profiling and customization
Evolved	Customized mutual fund portfolio construction Goal-based financial advice; basic life and health insurance related advice Tax optimization; expense restructuring Extensive risk profiling and customization

69 "Fidelity and Betterment, Once Partners, Become Robo Rivals", 23 November 2015, ThinkAdvisor; "Betterment Partners With Fidelity To Bring Financial Advisers Into The 21st Century", Business Insider, 15 October 2014

70 "Would you let a robo-adviser handle your hard-earned money?", The Economic Times, 13 July 2015; "Will US-style robo-advisory models work in India?", 22 February 2016, http://www.capital-anchor.com/2016/02/22/will-us-style-robo-advisory-models-work-in-india/; "Should you put your trust in robo advisers?", mydigitalfc.com, 9 October 2015

Robo-advisors operate on a very low-cost model compared to traditional wealth management firms. In India, most professional financial planners charge INR15,000 to INR40,000 a year to manage a client's portfolio, while wealth management firms, which mainly cater to wealthy clients, charge 0.75% to 1.5% of AUM per year. Robo-advisors are mostly free of cost and earn either from trail commissions from fund houses or charge a very low advisory fee. The typical fee structure of robo-advisors is either of the following[71]:

- **Charge levied on investors**: They generally charge between INR1,000 and INR7,500 per annum, or ~0.15% of AUM
- **Compensated by fund**: They only work on commissions they get from fund houses, with no charge from investors

Case studies: robo-advisor platforms in India[72]

- Aditya Birla's MyUniverse offers all three verticals of personal finance – insurance, investment and money management – on one platform. It uses technology to create a portfolio and suggest asset allocation based on investor inputs, such as the investing time frame, amount of investable money and risk profile. For these services, the company does not charge the customer but relies on commissions.
- ICICI Securities offers end-to-end financial planning services online. Advisers from the company interview investors to get an understanding of their goals, cash flows, assets, etc. and profile them. A central team of financial planners design a comprehensive plan and the data is fed into an algorithm, which stimulates 2.6m paths for asset allocation. The robo-advisory platform, called Track and Act, manages the clients' finances, giving suggestions on a real-time basis. Investors can track their entire portfolio online. The first year's fee is INR17,500 with a portfolio review every six months and from second year onwards, it is either INR7,500 or 0.15% of AUM, whichever is higher.
- ArthaYantra also offers online end-to-end financial planning, from evaluation to management. Risk profiling is done online with the help of behavioral finance. Investors' inputs are stimulated on 60 model portfolios and an optimum one is designed.[23] Once the report is generated, a financial planner explains it to the investor. The company provides mutual fund related investment advice, as well as recommendations on health and life insurance, and also gives tax planning guidance. The algorithm also analyses expenses and gives expense rationalization tips. Investors are charged an annual fee of INR1,000.

71 "Robo advisors best for small investors", Business Standard, 18 October 2015

72 "Robo advisors best for small investors", Business Standard, 18 October 2015; "Online mutual fund platforms are fast and convenient", Business Standard, 6 September 2015

platforms are gaining popularity mainly on account of changing demographics, acceptance of mutual funds as a wealth creation tool, low penetration, etc. Currently, only 5% of the Indian population invests in mutual funds. Given the surge in the number of internet users (which has crossed 400m) and mobile phone users (which has crossed 1b), many investors are investing in mutual funds through online channels.[73] As more people start investing, the demand for quality financial advice is on the rise and low-ticket investors, who cannot afford the services of a wealth manager, are turning towards robo-advisors.

In a country as diverse as India, with around 125m middle income professionals, robo-advisory holds tremendous potential. Traditional advisors have faced difficulties in growing scale as reaching clients beyond top tier cities has been a challenge. The large underserved population would benefit from the presence of robo-advisors. With the advent of these large-scale low-cost algorithm-based automated services, high quality asset allocation and investment guidance can be made available to all segments of investors.

However, there may be certain cultural issues in proliferation of robo-advisors in India as in the US as many Indian investors are not open to online investing and there may be a lack of trust in terms of recommendations made by digital wealth managers. Moreover, there is also a lack of widespread financial literacy in India and many investors themselves are not completely aware of the basics of investing and risk. Another challenge in the effectiveness of robo-advisors is the lack of reliable data available to develop robust algorithms and execute a credible financial plan for an individual based on particular financial goals and risk characteristics.

73 "Online MF distributors, robo advisors catch fancy of private equity players," The Economic Times, 1 April 2016

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