



10 Disruptive trends in wealth management



Introduction

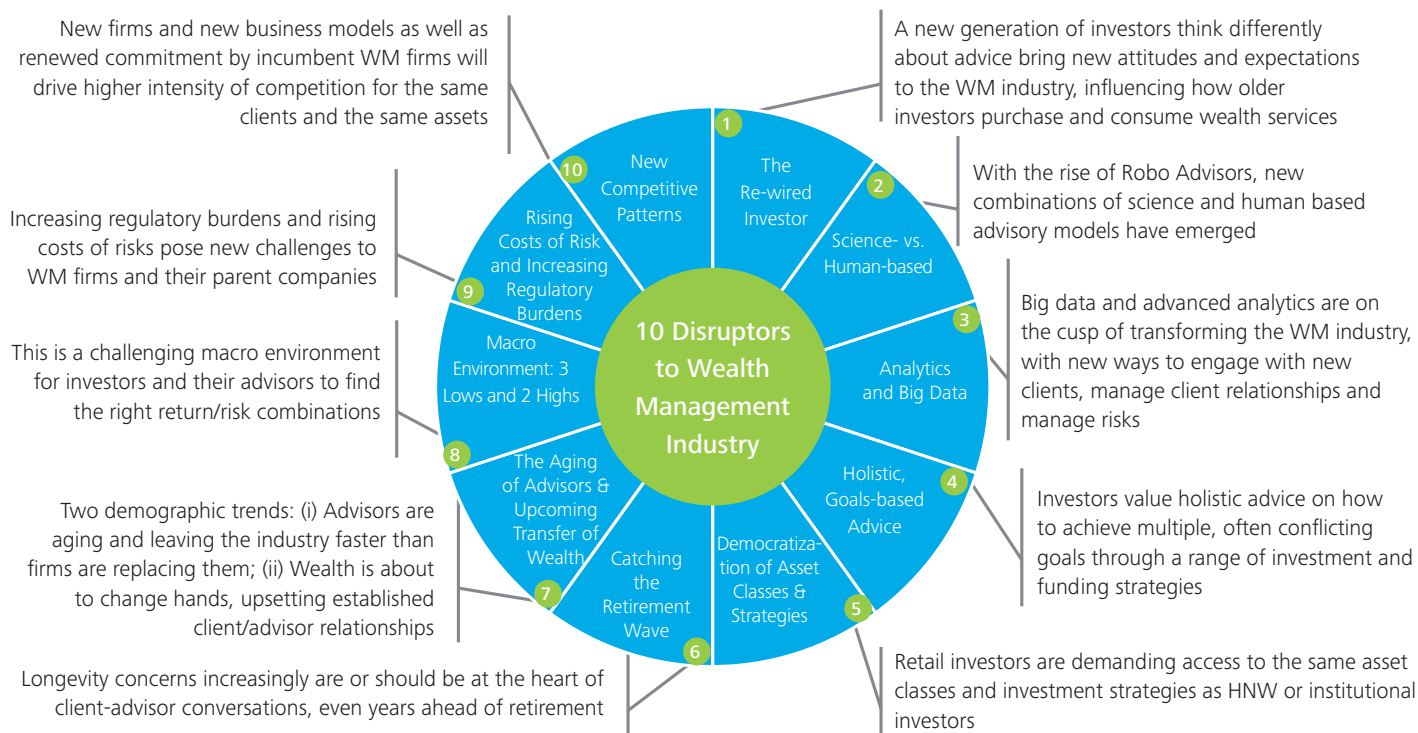
Wealth Management (WM)¹ is one of the most attractive sectors within financial services for at least two reasons: First, WM businesses tend to have greater growth prospects, lower capital requirements, and a higher return on equity (ROE) than most other retail banking businesses, hence their appeal to diversified financial services firms at a time when capital is viewed as more expensive, growth is hard to come by, and equity returns for the banking industry are close to the cost of capital. Second, WM offerings are essential to attracting and retaining profitable retail customers. For instance, based on our experience, mass affluent customers can typically represent 80% or more of the net income generated by retail banks and they often regard their relationship with a provider of WM services as their most important financial relationship. As result, many diversified financial services firms are doubling down on their WM businesses.

The WM industry is in the midst of significant change: a new generation of investors, whose expectations and preferences have been shaped by new technologies and by their living through the last financial crisis, have brought new standards to the industry in terms of how advice and investment products are being delivered. These new investors will control an increasing share of US retail assets over the next decade. Furthermore, a challenging investment environment, characterized by increased levels of uncertainty and rising costs of risk to investors and WM firms alike is making it harder for advisors to generate superior investment performance for their clients. Shifting demographics with the aging of advisors and an upcoming transfer of wealth from baby boomers to their children will upset many established advisor/client relationships and create opportunities for new firms to grow market share at the extent of incumbent firms. Finally, increasing regulatory burdens, new business models and new competitive patterns all come together to further compound the level of disruption in the WM industry.



¹ We define WM as the provision of financial advice and investment services to retail investors, ranging from low-income clients to High Net Worth (HNW) and Ultra High Net Worth (UHNW) individuals and families.

We have identified 10 principal sources of disruption in the WM industry today (**Fig. 1. the Wheel of Change is Turning on Our Industry**). They are not independent of each other but rather tend to build on each other. Together they could profoundly change our industry in the next decade. WM firms will need to adapt to these disruptors and find new ways to create value for their clients.



1. The re-wired investor

We speak of the Re-wired Investor to refer to new thinking patterns, standards and expectations by a new generation of investors. This new generation of investors include Gen X and Gen Y² investors, but also baby boomers who have been influenced by their younger peers.

The Re-wired investor thinks about advice differently from previous generations and expects to interact with her advisors in a different way. We have identified 9 new “mentalities” and six potential implications for WM firms (see Figure 2). For instance, investors no longer want to be treated as part of a segment but instead as unique individuals (“Just me”) with specific goals and preferences. Instead they expect to receive advice tailored to their unique circumstances.

Likewise, they want to stay in control of their financial lives and understand the advice they receive and make the important decisions themselves. They are reluctant to buy discretionary services and they are increasingly comfortable conducting their own research.

The Re-wired Investor is more skeptical of authority than previous generations of investors. She believes in the wisdom of her peers. As a result, she is likely to seek opinions and views from multiple sources of advice simultaneously, including but not restricted to experts and financial advisors and often starting with people like her friends and colleagues. With her expectations shaped by her interactions with non-financial digital firms (e.g., Google, Facebook, Amazon) as well as smartphones and other digital devices, she expects to be able to access advice anywhere and at any time, through multiple channels and devices as part of a cohesive, rich digital experience.

The Re-wired Investor has come to view risk through a different lens: she perceives risk as downside, rather than volatility. As a result, advisors have had to emphasize capital markets and hedging strategies that seek downside protection more than traditional portfolio allocations that seek to manage risk through diversification.

Lastly, she feels entitled to the same investment products and strategies available to Ultra High Net Worth (UHNW) or even institutional investors forcing WM firms to think through new ways to give their retail investors access to alternative investments and new asset classes beyond traditional fixed income and equities, as well as active strategies.

The Re-wired Investor is likely here to stay—and her influence over the rest of the investor class is likely to increase. Accordingly, WM firms and their advisors should adjust their offerings and service delivery models to “win the battle” for the Re-wired Investor—the investor of the future.



Figure 2: The Re-Wired Investor

The Re-wired investor is here to stay and his influence over the rest of the US investor class is likely to increase.

Mentalities of the Re-Wired Investor	Implications for WM firms
<div data-bbox="711 1224 760 1276"></div> Just me <div data-bbox="711 1297 760 1350"></div> Stay in control <div data-bbox="711 1371 760 1444"></div> Do it yourself <div data-bbox="711 1465 760 1518"></div> Anywhere, anytime <div data-bbox="711 1539 760 1612"></div> Digital & Personal <div data-bbox="711 1633 760 1686"></div> Wisdom of my tribe <div data-bbox="711 1707 760 1759"></div> Skeptical of authority <div data-bbox="711 1780 760 1833"></div> Risk defined as downside <div data-bbox="711 1854 760 1906"></div> Not a Second Class Investor	<div data-bbox="1143 1224 1520 1308">Bespoke Investment advice and products perceived to be tailored to individuals one at a time</div> <div data-bbox="1143 1350 1520 1434">Multi-channel Access to multiple channels and several advisory models at the same time</div> <div data-bbox="1143 1476 1520 1560">Multiple sources of advice Not just from one advisor, but from other advisors, peers, experts, social media</div> <div data-bbox="1143 1602 1520 1686">Rich digital front end Expectations formed interacting with non-FIs; must be simple, intuitive, self-directed</div> <div data-bbox="1143 1728 1520 1812">Risk Management as Hedging Downside protection and hedging more than diversification</div> <div data-bbox="1143 1854 1520 1938">Democratization of investments Access to same high yield assets & strategies once available only to wealthier investors</div>

² Gen X, the approximately 45 million Americans born in the late 1960s and 1970s, and Gen Y, the approximately 60 million Americans born in the 1980s and first half of 1990s

2. Science vs. Human-based advice

Technology is poised to change the nature and delivery of financial advice in some significant ways, much as it has transformed other industries such as tax preparation, taxi booking, and accommodations, to mention just a few. In the last five years, a number of “robo advisors” have emerged. These firms leverage client survey data into complex algorithms that produce customized financial plans and asset allocations. They also help investors find relevant research within an ever-growing universe of studies, interviews, and market commentaries. Some firms have also pioneered tools and methodologies that generate real-time trade and investment recommendations tailored to individual investors’ history and preferences. Once the models and algorithms have been built and tested, investing and trading tools can be made available to customers with limited human intervention, emphasizing the shift from human-based, person-to-person advice to science-based, model-driven advice.

Robo advisors are growing in popularity and have gained traction in the marketplace but still have quite a bit of room for growth. A survey by consulting firm Corporate Insight finds that total assets managed by the 11 leading robo advisors in the US rose 65% over the past year, hitting \$19 billion in December 2014.³ While significant, this figure represents less than 0.1% of the \$33 trillion retail investable assets in the US.⁴ Furthermore, with aggressive pricing (~0.3% of AUM)⁵ the potential for the current generation of robo advisors to generate meaningful bottom line and create a return for the Venture Capital firms behind many of them is still unproven.

Nevertheless, robo advisors present the potential for significant market disruption. For one, their businesses are built on a solid premise: some forms of advice (especially investment advice such as asset allocation or fund/stock picking) can effectively be produced and delivered through technology. This approach is especially attractive

for investors who are technology-savvy and want to have greater control over their financial lives—the Re-wired Investor of the future that we profiled above. While robo advisors have not had the distribution and access to investors to grow fast so far, this may be about to change: incumbent WM firms with deep pockets and wide distribution capabilities are now either developing in-house capabilities or by partnering with some leading robo advisors. With access to large pools of investors, established and well-funded companies could drive rapid adoption of new forms of science-based advice and create new expectations for the rest of the market.

However, we do not believe science-based advice will fully displace human-based advice, nor are robo advisors likely to dis-intermediate financial advisors in a major way. Rather, we may see a not-too-distant future where science-based advice may draw customers who could not previously afford a personal advisor or were not comfortable with human-based advice—potentially expanding the advice market. We could also see winning advisory models combine elements of the science and human-based advice models into a hybrid model. The balance between the two will likely vary across investor segments (see **Figure 3: Human vs. Science-based Advice**) based on investors’ ability to pay for advice, the complexity of financial needs, their self-confidence, and financial background, etc. Furthermore, investors are likely to continue to seek personal advice for needs that reach beyond investment (e.g., tax and estate planning) or involve emotional issues (e.g., securing health care for elderly parents). Financial advisors should try to harness the power of science-based advice to effectively outsource some aspects of their work while focusing their time on the elements of advice where they can add most value to their clients and differentiate themselves. Incumbent WM firms will need to invest in building the technology platforms and tools that will enable this hybrid advisory model.

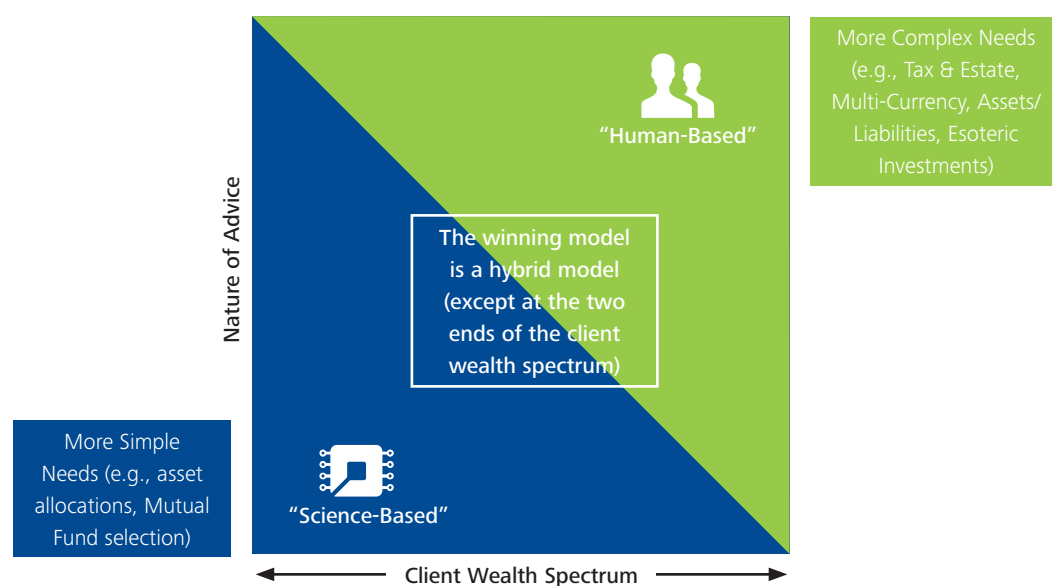
³ “Notes on Retirement: Total AUM Increases for 11 Leading Robo-Advisors,” Mark Miller, Wealth Management.com. December 22, 2014 (link: Corporate Insights Survey)

⁴ “US Households Control \$33.5 Trillion in Investible Assets,” InsuranceNewsNet. November 12, 2014 (link: Insurancenewsnet.com)

⁵ Fee analysis of leading robo advisors Wealthfront and Betterment

Figure 3: Science vs. Human Based Advice

The “winning” advisory model will likely be a hybrid model that combines the best elements of science and human based advice, taking into account differences in needs and willingness to pay across the client wealth spectrum



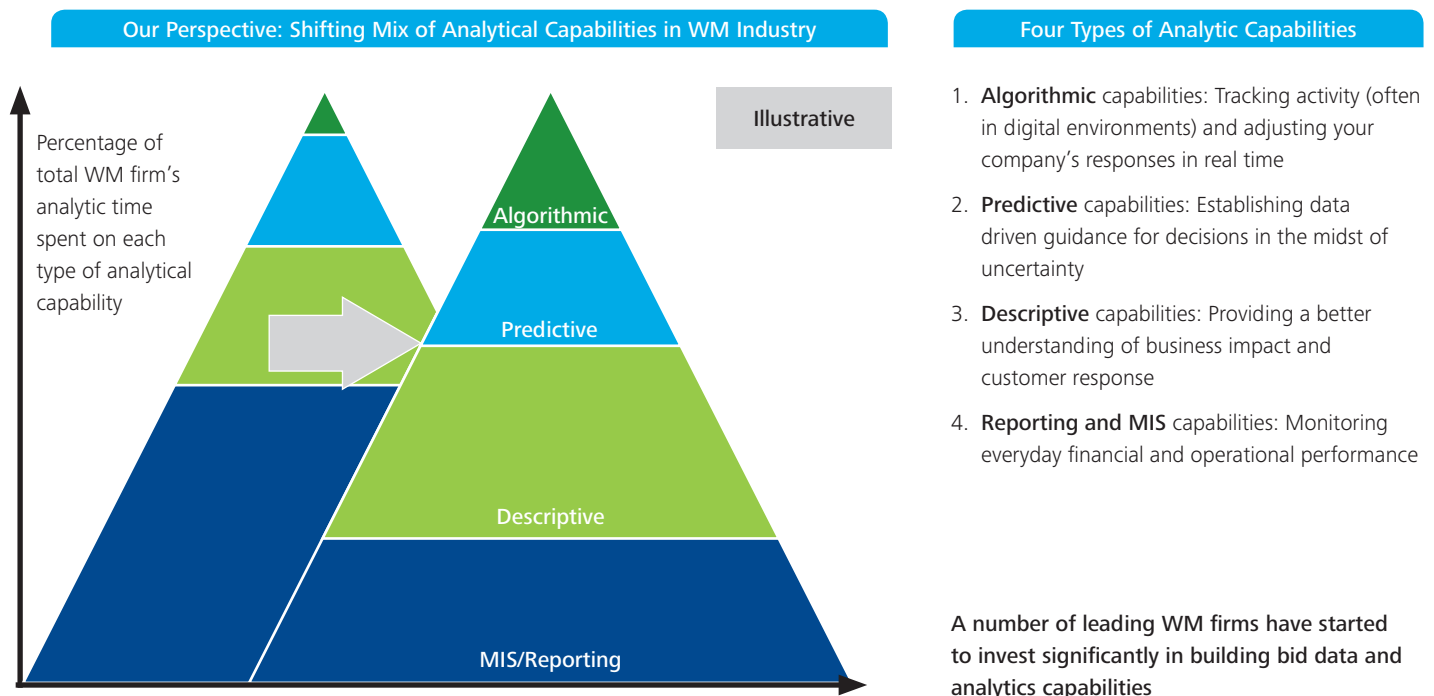
3. Analytics and big data

As volumes of consumer data continue to grow exponentially—in 2012, 2.8 zettabytes of data were created, and this figure is expected to grow to 40 zettabytes by 2020⁶—new technologies have emerged to help process make sense of it. As a result, Big Data is in the process of revolutionizing entire industries (e.g., retail, consumer goods, healthcare). With leading WM firms now investing in building more advanced analytics and data management capabilities⁷, the industry could be poised to go through the same kind of transformation.

While most WM firms currently use fairly simple analytics based on MIS and reporting systems, to deliver key business insights around client segments, advisor books, product penetration, and training program effectiveness, we expect to see firms develop more descriptive and predictive analytics that combine internal and external, structured and unstructured data to create more complete and insightful client profiles. This enhanced insight will allow firms to assess existing or potential new clients' propensity to purchase various products and services, their lifetime value, investment style, and risk tolerance. Over time, the WM industry will likely also develop its own brand of algorithmic analytics that supports investment decisions in real time (see Figure 4)

Figure 4: Four Types of Analytical Capabilities

The Wealth Management industry is behind the curve in terms of leveraging big data and analytics, but it may be poised to make rapid progress in the next several years



⁶ Big Data—The Next Big Thing in Consumer Engagement, Deloitte 2014

⁷ For instance, UBS recently held an innovation competition in which over 80 vendors demonstrated their methods for extracting meaningful insights from client data. Source: "UBS Turns to Artificial Intelligence to Advise Clients," by Jeffrey Voegeli, Bloomberg Business. December 7, 2014 (link: Bloomberg)

To date the industry has identified only some of the benefits that these new analytical capabilities could unleash. This is only a formidable list (see Figure 5). Nearly all core management processes, from prospecting and sales to advice and portfolio construction, from risk management to supervision, could be deeply affected and made significantly more efficient and effective. All stakeholders, including advisors and their management teams, clients and regulators, could benefit. Not all WM firms will invest sufficiently to develop these new capabilities, but those that do could create potential competitive advantage for themselves. We are on the cusp of a major disruption.

Figure 5: Analytics Example Use Cases in WM

Most WM core processes will be impacted by advanced analytics



1. Business Performance Management:

- a) Track business results and key drivers (client segments, advisor books, product penetration, etc.)
- b) Reveal and track advisors' propensity to adopt various tools and methodologies



2. Client Acquisition:

- a) Leverage internal & external data (social, TP data bases) to create comprehensive *prospect profiles*
- b) Map relationships and generate *client leads*



3. Client Retention:

- a) Leverage channel and social data to assess *client sentiment* and *client risk* real time (instead of surveys)
- b) Leverage external/internal data to understand client interests, connections and personality create best *client/advisor match* to increase connectivity and stickiness



4. Client Sales:

- a) Leverage external data sources to create *Net Worth* and *Share of Wallet* profiles for existing clients
- b) Measure client's *propensity to purchase* various funds or types of advice
- c) Assess *client lifetime value*
- d) Correlate transaction and channel data with market events to reveal *client true risk tolerance*



5. Client Advice:

- a) Leverage client survey and other information to create tailored *portfolio allocations*
- b) Rebalance portfolios real time and generate real time, *trade/investment ideas* based on client preferences and market events
- c) Leverage cognitive computing technology to create Q&A capability and provide *person-to-machine advice*



6. Supervision:

- a) Compare personality and investment profiles with investment/trading activities and client actions to flag *suitability* issues

4. Holistic, goals-based advice

The basis for competition among advisors has changed: In the past, financial advisors focused on investment advice (e.g., portfolio allocation, stock picking, mutual fund selection) and tried to convince clients of their ability to deliver superior investment returns for them. However, investment advice has now become largely commoditized, at least for mass market or emerging affluent clients, with most WM firms, even the smaller RIAs, having access to basically the same products, tools, and models. Furthermore, studies have demonstrated that stock pickers tend to underperform market indexes over time and that advisors on average fail to generate above-market average returns for their clients.⁸ Consequently, it is difficult for most financial advisors to prove their services are differentiated based on their investing prowess.

At the same time, consumers' lives have become more complicated and the investment environment has grown more uncertain, creating a need for more advice, not less. For instance, as consumers try to achieve multiple goals (e.g., sustaining a certain lifestyle, buying a second house, paying for children's education, retiring with confidence and ease, funding rising healthcare cost of aging parents, etc.) they need advice on how to fund these multiple goals over time, how to make trade-offs between them, and how to use the full strength of their personal balance sheet and manage to the right mix of assets and liabilities over time.

To meet investor needs, WM firms and their advisors should shift to holistic, goals-based advice and measure performance based on achieving clients' goals within agreed timeframes rather than beating market benchmarks. This is also a way to broaden the range of advice advisors provide, from investment to wealth management, and escape the commoditization of investment advice.

Leading WM firms have invested millions⁹ to develop and train staff on goals-based advisory frameworks and tools. For instance, some tools help clients identify and prioritize personal goals, develop funding and investing strategies to achieve those goals. Other programs advise clients using a combination of factors, from client's current assets and liabilities to life stages, life events and multiple personal needs.

Further, a number of software providers now offer white label solutions to support wealth management firms' offerings of goals-based solutions to clients. We expect firms that serve a mass affluent client base will increasingly leverage industry standard, third-party solutions, while High Net Worth (HNW) firms are likely to rely on in-house solutions. Goals-based wealth management is likely to become the industry norm across more wealth tiers.

Despite these developments, a recent industry survey by Deloitte suggested that many advisors in the industry still face significant barriers to providing holistic advice to their clients, including access to the right tools and software, training, access a wide range of products and services, and compensation.¹⁰ We believe WM firms must address these barriers in order to meet their clients' changing needs.

⁸ For example, a recent study published by the National Bureau of Economic Research found that investors with an advisor gain around 1.8% per year; however, these investors are paying on average an additional 1.7% for that advisor thus negating nearly all of the additional return. Source: "Are financial advisors worth the money?" by Kim Peterson, CBS Moneywatch. December 3, 2014 (Link: [CBS News](#))

⁹ "Goals-Based Investing Is On The Rise," by Cyril Tuohy, InsuranceNewsNet, October 1, 2014 (Link: [InsuranceNewsNet](#))

¹⁰ Making retirement security a reality: What can financial institutions and advisors do?, April 30, 2015

5. Democratization of investment solutions

Increasingly retail investors expect the same access to potentially high yield asset classes and strategies as wealthier, accredited investors. As indicated above, the Re-wired Investor does not want to be treated as a second class customer. Instead, retail investors are increasingly expecting the same access to high yield asset classes and strategies as wealthier, accredited investors, especially in the wake of a low yield environment following the financial crisis.

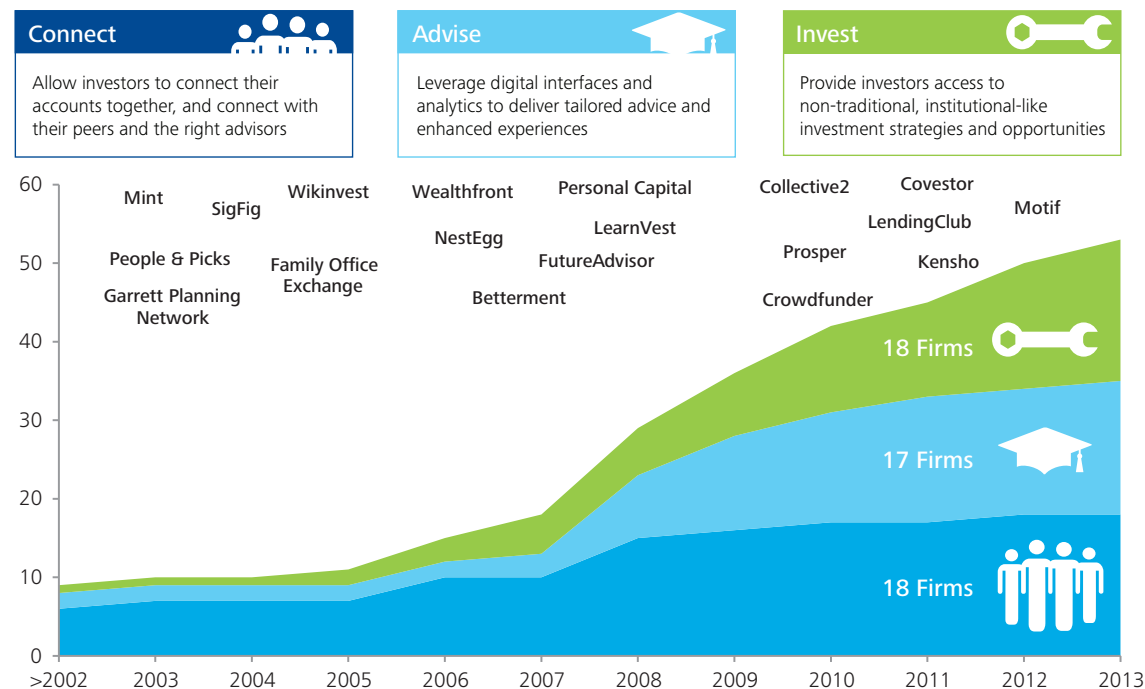
A number of start-up firms have entered the market in the last five years to respond to this drive for yield and access to best-in class investment solutions that were historically the sole purview of commercial or high net-worth investors (see Deloitte: [Digital Disruption in Wealth Management, 2014](#))

- Some firms provide mass market investors access to sophisticated, institutional-like trading strategies, either by copying the trading strategies of professional portfolio managers or by using automated trading strategies developed by hedge fund managers.

- Other firms allow investors to diversify their portfolios into exotic asset classes. For instance, lending platforms allow investors to become creditors to individual borrowers for a fixed rate of return. Crowdfunding firms make it possible for investors to pool equity investments together. Both types of firms essentially serve as a central point for bringing investors together with people that need funding.
- Lastly, some firms put analytics directly at the retail investors' fingertips, allowing them to create their own empirical research and test their own hypotheses, much like institutional investors have always done.

Large, incumbent WM firms have generally paid little attention so far to these start-ups and the capabilities that they are actively building. However, innovation is shifting in the direction of democratizing access to investment solutions as exemplified by the number of start-ups dedicated to that cause (see Figure 6: Digital Innovation Shifting from Connecting and Advising to Investing). Incumbents should follow—because their clients will likely demand that they do.

Figure 6: Digital Innovation shifting from Connecting to Advising and now Investing



Source: Deloitte Analysis, 2013

6. Catching the retirement wave

Wealth managers serve clients across the wealth spectrum. All but the wealthiest of these clients have one primary concern is whether they will outlive their assets. Many investors simply want assurance that they can generate enough income in retirement to continue their current standard of living. But providing that assurance is no longer as simple as it once was; longer life expectancies, the rising cost of medical care, and concerns about the potential insolvency of government entitlement programs have generally shaken these investors' confidence in their retirement security.

For advisors, providing advice and planning around retirement income is an incredibly complex task. Advisors need to help their clients make numerous assumptions around portfolio returns, spending patterns, inflation, future tax rates, longevity, housing costs, healthcare expenses, the future of social security and many more issues. An error in any one of these assumptions could significantly affect a client's retirement plan.

Despite significant efforts over the last decade to improve retirement income planning services, many wealth management firms are still optimized around offering accumulation advice rather than income planning. Meeting the needs of clients focused on retirement will require new capabilities, including new products, tools and services. Clients need access to a suite of saving and investment solutions, not just traditional retirement products such as annuities and defined contribution plans.

To address their clients' "longevity challenge" wealth managers must find new ways to engage with clients early in their working careers, well before a traditional wealth management engagement would begin, and help them balance their short and long-term financial goals through wise trade-offs. By encouraging them to save early and providing advice, planning, products and services, wealth managers can help clients prepare confidently for retirement.

As already noted, retirement planning is about a stage of life and not simply about tax-deferred accounts. While corporate plans are an important component of a plan for retirement, they are only one component of retirement planning. So plan providers should actively engage plan participants and remind them to take a holistic view of their portfolio, recognizing that a 401(k) is only a single component of a comprehensive retirement plan. Retirement plan providers must look for ways to broaden participant engagement and expand their relationship into a personal advisory and educational relationship well before any type of distribution event. Here, new robo adviser capabilities may prove helpful in scaling up advice economically. Technology assisted 'Centers of Excellence' where clients can access qualified subject matter experts could help as well.

Providers of retirement products should think more broadly about wealth management, and traditional wealth management firms should put retirement and longevity concerns at the heart of the advice they give to investors of all age groups and wealth tiers.



7. The aging of advisors & upcoming transfer of wealth

Two major demographic shifts will impact the WM sector in the coming decade: the aging of advisors, with many approaching retirement age, and the transfer of wealth from baby boomers to their children. Both trends could result in a massive dislocation of existing advisor/client relationships. In other words, assets will likely change both owners and advisors.

The advisor population is aging rapidly and preparing for a significant transition with 43% of US Financial Advisors over the age of 55 years old, the industry is contending with the expectation that approximately 1/3 of this current workforce will retire in the next 10 years.^{11,12,13} The WM industry will need to recruit and train nearly 240,000 advisors just to maintain current service levels—a concern by any measure, but especially challenging given the persistently low graduation rates at wirehouse training programs.¹⁴ Furthermore, wirehouses also find it increasingly challenging to retain their graduating classes beyond a few years, and it is costly to train a new generation of advisors only to see them leave and join smaller, competing broker dealers and RIAs.

The aging of the US Advisor population is creating other challenges as well.¹⁵ First, the growing generational gap between advisors and the Re-wired Investor makes it challenging for some advisors to understand and adjust to the needs and preferences of a younger generation of wealth, resulting in weakened client-advisor relationships. Second, many advisors have been slow to adopt new tools, use mobile channels, and to evolve toward new advisory models that balance human and science-based advice. This is no simple resolution and many incumbent WM firms struggle with this issue, often investing in training without realizing significant return on their investments.

The aging advisor is likely to be a significant issue for the industry as whole. This challenge will put a premium on creative recruiting practices (e.g., tapping new talent pools for future advisors), more effective training, and more sophisticated change management programs (to allow for managing advisors' propensity to adopt new tools and methodologies). Firms should continue to shift toward a team-based approach to promote continuity of relationships even as lead advisors retire. New technologies and robo advice capabilities have the potential to somewhat ease the shortage of advisors by allowing existing advisors to spread themselves over a greater number of client relationships. However, this increase in efficiency is likely to be offset by increased regulatory requirements (for instance, a move to fiduciary standards).

As advisors retire, so too will their fellow Baby Boomers, initiating the largest transfer of wealth in history. Over the 55-year period from 2007-2061, \$58.1 trillion is expected to move from one adult population to another.¹⁶ Historically wealth transfers from one generation to the next have resulted in 90% of heirs changing advisors,¹⁷ presenting both an opportunity and a major threat for WM firms. Firms must meet this by building multi-generational relationships with their clients and their families—and by adapting to meet the expectations of their new clients, many of whom look more like the Re-wired Investor (outlined above) than their parents' generation.

¹¹ "The incredible shrinking advisor: How onerous new rules are driving away financial planners in droves," by David Pett, Financial Post, January 30, 2015. (Link: [Financial Post](#))

¹² "A Hunt to Find the Next Generation of Financial Advisors," by Rachel Abrams, New York Times. June 24, 2014 (Link: [New York Times](#))

¹³ "Advisors slow to train successors," by Andrew Osterland, CNBC. May 1, 2014 (Link: [CNBC](#))

¹⁴ "A Hunt to Find the Next Generation of Financial Advisors," by Rachel Abrams, New York Times. June 24, 2014 (Link: [New York Times](#))

¹⁵ "One of the Fastest-Growing Careers Is In Desperate Need of Young Talent," by Halah Touryalai, Forbes. August 8, 2012 (Link: [Forbes](#))

¹⁶ Deloitte Research

¹⁷ Deloitte Research

8. A new investment environment: 3 lows and 2 highs

The financial crisis and its aftermath have changed the environment for both wealth managers and investors in several profound ways. Investors are now forced to navigate an environment plagued by three lows and two highs:

1. **Low Interest Rates** by historical standards that make it challenging for investors to generate returns on their deposits and other short-duration investments;
2. **Low inflation rates** for the foreseeable future (with deflationary risk) that have forced investors to rethink long-held assumptions about financial and real assets appreciation;
3. **Low/Slowing Rates of Economic Growth** around the world that make it more challenging to find satisfactory returns without taking on extraordinary risk;
4. **High volatility** across financial markets has challenged long-held assumptions about the wisdom of diversification, of long only strategies, and market timing;
5. **High levels of Financial Leverage** by individual investors and pressure to de-lever personal balance sheets will force many to scale down their bets.

As a result, investors have much less of sense of direction than they used to. The confusion is only compounded by widely divergent scenarios and forecasts by research analysts, market economists, and others, including winners of the Nobel Prize in Economics. Often their only conviction

is that long-only strategies will no longer work. This climate of uncertainty has several key implications for WM firms and advisors. For instance:

- a) Advisors will have to factor multiple, divergent market scenarios into “What If” Analyses. This requires hard thinking as well as new levels of modesty, but is key to building and maintaining trust from investors
- b) Firms will develop increasingly sophisticated research and modeling capabilities to support scenario analyses;
- c) Advisors will need to be proactive in reaching out to clients in times of volatility and proactively rebalance portfolios;
- d) Firms will have to develop new product offerings for managing their clients’ cash and other short duration assets and support their value in real terms. This may require bringing some traditionally institutional offerings to retail investors;
- e) Advisors will have to design investment strategies that would perform well in a deflationary environment or, at a minimum, would allow investors to quickly unlock long positions and move into more defensive positions;
- f) Firms will need to continue to manufacture structured notes that allow investors to place bets on macro trends and market indices while protecting investors against downside;
- g) Hedging and risk management will be at a premium with capital markets capabilities including F/X and interest rate swaps



9. Rising costs of risk and heavier regulatory burden

In just the past few years, the WM businesses of several global banks have attracted significant regulatory action from the US government. These actions highlight how the risks WM firms must manage as part of business as usual has risen over the past 10 years. They also highlight the reputational risks that WM businesses pose to their parent companies (and how the cost of this risk relative to the profit growth contribution of these businesses has increased).

WM firms have always had to manage activities that are inherently fraught with risk, from running adequate KYC/AML processes for on-boarding clients to applying suitability standards to investment decisions and performing due diligence on fund managers, from processing trades and other transactions to extending credit to clients, to cite just a few (see Figure 7).

The cost of these risks is especially high for HNW businesses such as Private Banks and their parent companies because of the breadth of their product offerings (from investments to capital markets and lending) and the sensitive nature and high profile of their client base. The regulatory environment has changed rapidly since the 2008 crisis—and the full regulatory impact is still not clear. What is clear is that the regulatory burden on WM firms, their advisors and their clients is getting ever more complex.

This is where we could see regulatory burden shifting in 2015-2016:

- **Consumer Protection:** Much of the regulatory focus will likely be centered on consumer protection issues. The concept of putting the customer first and acting in their best interest is a common theme in the guidance issues by regulators. There is a particular focus on transactions

that include “wealth events” such as with a rollover IRA or an inheritance as well as with “at-risk” clients such as the elderly. Regulators want to ensure that firms have a culture of compliance and the supervisory structure in place to enforce it. Regulators may also try to accelerate a transition to fiduciary standards for plan providers and brokers.

- **Financial Products:** There is also growing concern around a variety of products that may be subject to market, credit, liquidity, interest rate or operational risk. Products that raise regulatory concern include variable annuities, retail alternative investments, non-traded real estate investment products and other structured products.
- **Conflicts of Interest:** Conflicts of interest are also at the core of regulatory concerns and tie back to the concept of acting in the best interest of the customer. Regulators around the world are focused on having wealth managers identify and mitigate such conflicts. Key examples include fees and compensation incentives, and trading-fee rebate.
- **Outsourcing:** Regulators want assurance that outsourced activities are in full compliance with all applicable securities laws and regulations (including FINRA and MSRB rules). Areas of focus include ensuring that proper due diligence and risk assessment is performed on potential providers, and that sufficient supervision is implemented for outsourced activities.
- **Cybersecurity:** Recent attacks, both within the financial services industry and others such as retail and healthcare, have kept attention focused on this issue. Regulators want to ensure that controls, governance, and processes at wealth managers are well thought out and are in compliance.

While regulatory risk is not a new issue for wealth managers, the stakes are higher than in the past. The wealth management industry is centered on trust; one “risk event” such as a cyber-attack or a major regulatory fine, can destroy that trust, and in turn, the reputation of the institution. As such, regulatory risk management is not simply a cost of doing business but rather an investment in the reputation and long-term health of the institution.

Figure 7: Key risks facing wm businesses

WM businesses and their parents face multiple risks which costs have only risen since the financial crisis



10. Convergence and new competitive patterns

Since the financial crisis we have seen an increase of competition in the WM industry, driven by a renewed commitment by incumbent WM firms, new investments by retail banks and the emergence new firms and new business models. All in all, more firms and more advisors are competing for the same clients and the same assets. Key competitive trends include:

- Continued convergence of brokerage and private banking models to serve affluent clients with a broad range of advisory, investment, banking and lending capabilities. Brokerage firms are busy building banking/lending capabilities while private and trust banks try to emulate their sales culture and their investment capabilities.
- Large, diversified banks emphasize cross-selling of wealth and banking services to their client base and continue to coordinate their various WM business models and brands, treating them as distinct channels rather than distinct businesses, further blurring distinctions between WM businesses.
- Continued fragmentation of financial advisory with Independent Registered Investment Advisors (RIAs) continuing to gain market share at the expense of wirehouses.
- Established asset managers have entered the retail arena, competing directly with entrenched discount brokerage providers.
- Competition for mass affluent clients has increased with banks and discount brokerage firms targeting this segment. Robo advice capabilities will likely enable the distribution arms of insurance companies and asset managers to provide advice to the same clients and increasingly compete with other WM firms.
- Digitally enabled start-ups are capitalizing on a high rate of innovation in the industry.¹⁸

We expect these trends to drive a further increase in the intensity of competition across most WM markets and client segments, impacting the margins of WM firms. Investors across all wealth tiers have never had as many options for advice as they do today, and they will use this leverage to insist on greater value.



Conclusion

This is a time of significant change and disruption for the WM industry. New forms of advice and new ways to deliver that advice will continue to emerge, and competitive positions will erode while others will strengthen, creating winners and losers across the industry. While retail investors will likely benefit from all the changes WM firms must strategically evolve to adapt to these critical shifting dynamics.

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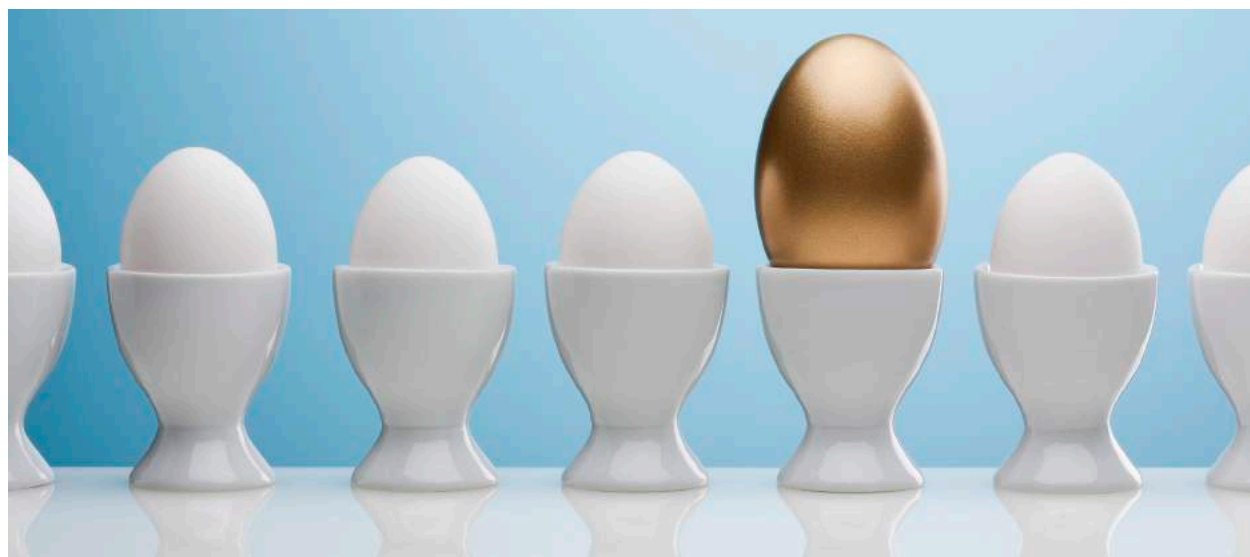
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