Emerging Differentiators of a Successful Wealth Management Platform

Changes in the wealth management industry point to the need for scale and flexibility – goals that can be achieved through a platform that enables wealth managers to differentiate their services from those of their competitors.

Executive Summary

The wealth management industry has traditionally focused on high-net-worth (HNW) and ultra-high-net-worth (UHNW) market segments. However, lower-end segments – mass affluent and mass market – are becoming more attractive. In North America, for example, these segments constitute the biggest share of the country’s total wealth – accounting for 41% and 18%, respectively.¹ The mass consumer market is growing at a rapid clip, with around 10,000 baby boomers retiring every day.² These two segments are easier to serve, since they tend not to seek sophisticated products or customized service. They are also more willing to perform routine transactions on their own – allowing financial advisors (FAs) to focus on core activities such as needs analysis, investment research and portfolio management. Highly automated advisor platforms seamlessly integrated with investor channels can adequately service these segments – permitting FAs to scale up.

However, today’s wealth management industry is not yet equipped to fully leverage the mass affluent and mass markets; industry players have focused on a low-tech, “high-touch” delivery model designed for HNW individuals – one that cannot scale to serve the mass affluent and mass market profitably. The financial crisis of 2008 exposed the lack of scalability of the high-touch model, the inefficiencies in FA customer relationships, and the inadequacy of current front-end FA platforms in catering to emerging market demands.

Advisor platforms designed for scalability, coupled with a swift response to rapidly changing market conditions, can be very effective in capturing these two segments. The same platforms can also be used in the high-touch delivery model designed for UHNW and HNW individuals.

In this paper, we will analyze the key lessons learned and trends in the wealth management industry following the 2008 financial crisis. We will also discuss how these factors translate into a wealth management platform that enables wealth managers to scale their capabilities and be proactive – all while focusing on their core...
competency of managing client relationships and investment research. Wealth managers considering building in-house capabilities or outsourcing should evaluate these features in the context of their client segments.

Lessons from the Global Financial Crisis
Data from various studies indicates that during the financial crisis, financial advisors and wealth managers were poorly prepared to respond to sudden changes in market conditions. Many wealth managers were also saddled with their domestic securities platforms, and therefore unable to take advantage of better-performing foreign markets. These factors had a direct impact on portfolio returns and, eventually, customer satisfaction.

Scalability and Proactiveness
A survey of retirement plan customers (see Figure 1) showed that only 37% reacted to the crisis by modifying their investment portfolios. People actually curbed their spending by adjusting their lifestyle. The survey also revealed that financial advisors were hesitant to reach out to their customers for fear of being questioned about the poor performance.

Dependency on a high-touch model and the lack of technologically advanced advisor platforms also played a role. Contacting every customer in a short span of time to discuss and change their portfolio is not humanly possible.

The survey data suggests that FAs who were proactive and contacted their customers during the downturn were twice as likely to be recommended to family and friends as those who did not (see Figure 2).

Proactive advisors have always been winners in the wealth management industry; however, the tools and techniques required to maintain a competitive edge change with time and the target segments. The tools used for UHNW and HNW cannot be applied to the mass affluent and mass markets. When the number of customers substantially increases for the same amount of investible assets, the scalability of the operating model becomes a key deciding factor in the FA’s ability to be proactive. Wealth management firms must therefore create an environment that enables and empowers FAs.

While industry experts have made various suggestions for how wealth management firms can achieve better operational efficiency, the two strategies below can have a direct impact on the scalability and performance of financial advisors when implemented with the right technology platforms.

- **Shift to sticky products** - These offerings tend to be long-term investments, and are discretionary mandates that empower financial advisors to adjust portfolios without customer approval.
- **Improve frontline performance** - There has been increasing emphasis on investing in the front office to improve relationship management. This will require not only training advisors, but also providing them with...
the tools and platforms they need to scale up and serve more customers.

Higher Cost Structures: Here to Stay
Traditional asset classes have not generated pre-crisis alpha levels (stocks whose price is too low because investors believe it carries a high risk). However, investors continue to demand the same level of returns at a lower cost - forcing wealth managers to venture into new asset classes and geographies. The new regulatory environment and the demand for greater transparency have placed even more stress on wealth management firms’ existing resources.

Meeting these challenges requires significant improvements to front, middle and back-office processes in order to accommodate new asset classes and geographies, and provide transparent reporting to regulators and customers.

Developing A Successful Wealth Management Platform
Lessons from the 2008 crisis have outlined the strategic direction for wealth management firms. However, implementing these strategies will require these businesses to increase their adoption of technology in virtually every area to support new operating models (this is in addition to the efficiency and cost savings already expected from technology). The goal should be to implement an advisor platform that enables FAs to be discrete and proactive, affords scalability and product customization, and lowers costs. Providing access through multiple delivery channels to offer a seamless client experience can add to the overall value proposition.

The Rep As Portfolio Manager Model: Discretionary Mandates for Proactiveness and Scalability
Increasingly, financial advisors prefer discretionary mandates, given the “stickiness” and the various operational benefits they provide. This trend has been boosted by clients’ preferences for such mandates and their perception that they thereby receive better service. Such a model - where the FA acts as the client’s portfolio manager by creating or customizing external models to suit the client’s needs without seeking the client’s approval first - is called “Rep-as-PM.” This is in contrast to “Rep-As-Advisor;” where the FA acts as a portfolio manager but cannot act solely at his discretion.

The inability of FAs to react in a crisis, as revealed in the McKinsey study cited earlier, is addressed by this model, which can directly improve front-line performance. In fact, research by MMI² shows that the Rep-As-PM business model has recorded spectacular growth in recent years, despite the regulatory hurdles (See Figure 3, next page).

Rep-As-PM comes in several forms:

- **Full authority:** FAs have full authority over the portfolio and can create models of their own.

- **Partial authority with boundaries:** The FA uses models that are pre-defined strategies provided by the sponsors and external investment managers, with a limited set of funds/vehicles/securities that can be used in a particular model. Many sponsors and family offices limit the leeway the FA has to change the allocation for any security in a model. Some FAs might be allowed to replace the security with another from a limited set of securities with similar attributes.

- **No Authority:** The FA cannot change the asset allocation of the models designed by investment managers. These models could be proprietary to the organization to which the FA belongs, or may be sourced from a third party for a fee. Among all the Rep-As-PM models, “partial authority with boundaries” has the highest demand.

The advisor platform will need to accommodate all of the variations of the Rep-As-PM business model, and therefore must be highly configurable and business rules-driven. Platforms designed with an open architecture will see high demand from wealth management firms for the following reasons:

- **Enhanced scalability for client servicing:** FAs can change models and strategies as they deem fit, based on changing market conditions. The discretionary model allows FAs to implement the change to the model across all clients without any client approval process. Trade orders can be generated at the click of a button for all clients and portfolios that are rebalanced.
Significant reduction in operational cost:
The non-discretionary model is manually intensive. Reacting to a volatile market becomes a time-consuming task; by the time the FA gets approval from the client, the market could have turned unfavorable. The discretionary model, on the other hand, provides control and tactical flexibility, especially in the case of investment portfolios consisting of third-party models. An FA can quickly move funds in and out of these models from all clients’ accounts.

The implementation of a true Rep-as-PM model in an advisor platform requires sophisticated technology. The two components listed below are essential.

- **An open architecture platform:** The model distribution process is complicated – requiring seamless integration among all participants. For FAs to fully function as portfolio managers, access to models from multiple investment managers is essential.

- **Integrated research capability for FAs:** Categorizing models based on style, risk/reward and other statistical data needs to map to clients’ risk profiles. FAs also require data on asset classification and their qualification for replacement in an allocation strategy. They need strong investment research capabilities to compare assets and models from multiple managers.

The decoupling of product manufacturing and distribution has been the standard in the market for quite some time. The Rep-as-PM model has taken this a step further by using multiple models in a portfolio and customizing investment models to meet individual needs. Highly configurable advisory platforms with open architectures that integrate with multiple model providers and investment research data providers will be a key differentiator, since they provide for scalability, proactiveness and product customization.

**Integrating Online Channels**
Non-discretionary mandates comprise the bulk of a financial advisor’s business. Investors’ expectations of service levels and FAs’ proactiveness is no less important here than it is in the case of discretionary mandates – a fact confirmed by the McKinsey research. Integrating wealth management platforms with online channels, Web portals and mobile devices allows instant and more effective communication with investors, who can go online and quickly approve any changes in the portfolio advised by the FA. While this is not as efficient as the Rep-as-PM model, it shortens the approval turnaround time and can increase scalability significantly.

Online channel integration with the FA platform has several other benefits. Investors today are tech-savvy, and want to use IT tools to analyze their own risk profile and do their own research. They seek more transparency, and 24x7 access to their financial data and portfolio performance. Mass affluent and mass market segments are willing to perform tasks that do not necessarily add value if done by advisors. For example, updating personal information about investors and responding to risk-related questionnaires can be taken off the FA’s hands – allowing them to focus on investment strategies instead.

Increasing online communication between FAs and their clients and enabling self-service for those customers can afford a seamless customer experience and help reduce client attrition.

**Automated Overlay and Tax Management**
Overlay management was introduced in the wealth management industry as investors’ portfolios matured from single, Separately Managed Accounts to multiple Separately Managed Accounts – each managed by the respective
money manager. With the industry moving from multiple sleeves of Separately Managed Accounts to Unified Managed Accounts and Unified Managed Households, overlay management has become increasingly important. The overlay manager is responsible for overseeing the client’s account activities for tax optimization, client-specific compliance and restrictions, as well as portfolio rebalancing with tracking error considerations. Given the intent behind the Rep-As-PM model - responding quickly to volatile markets and taking tactical steps for more returns - model and portfolio rebalancing and overlay management need to be fast and efficient.

Advancements in technologies and tools have enabled the automation of overlay management. Although many wealth managers have automated some or most of the activities associated with overlay management, very few have been able to completely eliminate all manual activities. Automated overlay management not only brings in operational efficiency and speed, it also enables savings of overlay and tax optimization fees. The current overlay and tax management fees are both between 10-20 bps. The total savings of 20-40 bps can increase profitability or be used for competitive pricing.

With so much focus on the financial advisor/client relationship, wealth management firms can use the savings from automated overlay and tax management to better reward their financial advisors and pass some of the savings on to the end customer.

The Next Frontier
Players in the wealth management industry are currently focusing on automation to improve scalability, reduce cost and enable better product customization. Sooner or later, best practices will be well established with industry-wide adoption. This will lead to more innovation and new ways to increase market share. The process of advisors generating leads and acquiring and retaining customers could become the focus of the industry. With technology already enabling new business models in wealth management, plus the affinity of the millennial generation for Internet and social media, customer acquisition through electronic channels could play a major role in the industry. Wealth management platform providers thinking ahead in this direction will be better positioned for winning in the future.

Footnotes
References

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