a meeting of MINDS

WEALTH MANAGEMENT & PRIVATE BANKING

XXII

Thursday 16 November 2017 - The Lanesborough Hotel, London SW1X 7TA

THE FINDINGS

Organised by:

owenjames

In association with:

scorpiopartnership
what wealth needs next

THE FINDINGS

Thursday 16 November 2017, The Lanesborough Hotel, Hyde Park Corner, London SW1X 7TA

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SUMMARY

The twenty-first Meeting of Minds Wealth Management and Private Banking took place on Thursday 16 November at The Lanesborough Hotel, London. This document summarises the key issues raised in the topics discussed during the roundtables that took place on the day.

A Meeting of Minds Wealth Management & Private Banking is a biannual strategic forum organised by Owen James which brings together the CEOs and CIOs of the private banks and wealth managers.
The agenda encompasses investment trends and the geopolitical climate impacting them as well as the day to day issues faced by those running these businesses. Participants enjoy access to strategic insight, active involvement in shaping the industry and networking at the highest level. The day is a blend of roundtable sessions addressing a pre-researched and pre-agreed agenda with open discussion led by objective and professional moderators; keynotes provided by external speakers whose remit is to spark debate and encourage fresh and original thinking; plus substantial networking both structured and unstructured.

To find out more about taking part, please contact Simon Black at Owen James: simonblack@owenjamesgroup.com or you can contact him at 01483 862 698.

THIS REPORT

The Roundtable Sessions were moderated by Scorpio:

- Stuart Cummins
- Annie Catchpole
- Alex Johnson
- Mark Miles
- Tasha Vashisht
- Laura Cavacuiti
- Ben McNeil

We are very grateful for the time and energy they have expended on making A Meeting of Minds Wealth Management and Private Banking a success and hope you will consider this report an interesting, thought-provoking and accessible read.

As ever your feedback is much appreciated. We would also like to thank the independent experts who were part of the sessions for sharing their knowledge and giving us their time and energy both in the run up to A Meeting of Minds Wealth Management and Private Banking and on the day.

THE SPONSORS

We would like to thank all our sponsors who make these Meetings possible. The following groups took part in the Meeting and their motivation for taking part is threefold:

- To be, and to be seen as being supportive of the industry;
- To understand the stresses and strains being placed on the industry and, where possible, respond to them;
- To talk openly with these business leaders with a view to ensuring that their businesses are strategically aligned.

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HOW CAN WE COMBAT MARGIN PRESSURES? IS IT TIME TO GO FOR GROWTH?

Experts: Mark Shields and Jacquet-Lagreze Thibaut, Avaloq
Facilitator: Tasha Vashisht

Key message

Despite HNWIs wealth being projected to rise by over 20% between 2015 and 2025, profit margins are shrinking (-9bp) compared to 2007. Rising operational costs are also further increasing these margin pressures.

With increasing regulation, its associated costs and pressures on margin growth, wealth managers are being forced to re-evaluate their internal technology processes and explore new markets for growth.

In a session led by experts from Avaloq, a technology-driven financial services provider for wealth managers, universal and retail banks, delegates discussed the future market opportunities as well as solutions for growing costs and concerns around regulation.

Headlines

- A constant wave of regulation is hitting the wealth industry which is increasing costs and leading to reduced profit margins.
- In response to tough requirements of new regulation, some wealth firms are looking towards outsourcing solutions and automating their technology processes.
- The wealth industry is missing opportunities to better understand their clients through leveraging the wealth of data that firms have access to. APIs and open banking presents an opportunity for wealth firms to use client data more efficiently. It was also debated whether this data should be monetised and at what cost to the client's trust.
- Almost half of high-net-worth individuals have multiple wealth management providers. Delegates discussed the need for a strategy to become the core wealth management provider.

Key themes

Margin pressures
Delegates began by discussing slim margin growth due to stagnating revenues and equally growing costs spurred by tight criteria of regulations such as MiFID II and GDPR. One delegate pointed out that the difficulty with costs is that wealth firms are unable to pass these costs onto clients in the same way that other industries are able to. If wealth firms do consider passing costs onto clients, how can they increase the fees as well as the service value for clients? It was suggested that a new type of service needs to be developed that clients are willing to pay more for.

However, one delegate raised the issue that there are barriers to entry for new services. For example, if a firm offers an investment advice service, this may involve new regulations and a new skill set but the question is: will clients be willing to pay more for that? It was quickly agreed that wealth firms need to mutualise costs in the industry or take the cost into account and set aside the funds for it.

Technology
The discussion about technology was broad and touched on areas such as on-boarding, outsourcing and back office processes.

Recent trends indicate that the number of high-net-worth individuals and their collective wealth is increasing thus presenting an opportunity to move towards automating on-boarding processes. One delegate stressed that the promise of technology is that businesses can be automated from the point of request through to execution. On the other hand, one delegate posed the question of whether back office costs have been reduced to the lowest cost possible before considering automation.

This led to an interesting discussion around the costs of automation and whether it is a viable solution for all wealth providers regardless of size. It was agreed that automation is an expensive digital solution which is difficult to make a business case for, especially if you offer a broad service or have a small business model. One delegate shared the example of having to move from serving affluent individuals to high-net-worth individuals because the firm lacked the resources and capacity to support the move to automation. In the scenario where the firm is unable to automate processes in-house, it was suggested that firms consider outsourcing solutions. However, one delegate added,

"Outsourcing isn't necessarily the answer. The rule of thumb is that 40% savings should be made"

In reality, an 11%-15% basis cost is what can be achieved in savings as added by the experts. Although one of the ways to combat margin pressures is through outsourcing, this doesn't necessarily result in growth. If clients see a decrease in costs for the firm through outsourcing or technology strategies then they will expect to see these reductions to be passed on in the form of decreased costs for clients. A few other caveats to outsourcing are the huge amount of resources required and the new wave of costs it creates just to keep pace with regulation. Outsourcing also impacts the client experience and reduces control over it.

Delegates pondered whether there are alternative solutions to outsourcing. It was suggested that outsourcing makes sense for businesses where growth is imminent. The smaller the player, the harder it is to justify the spend.

Data
Is it possible for banks to leverage or buy data in a regulated environment? This is the question that was posed to delegates, prompting a discussion around the potential for wealth management providers to use and/or sell the data they are privy to. Delegates agreed that,

"Data is gold because it can be used to generate revenue"

However, as one delegate pointed out, even though banks have access to client data, it cannot be used in the same way retail businesses do. Delegates in the room seemed more cognizant of the challenges of monetising data given that they operate in a highly regulated industry.

Where retail businesses may be able to sell their customer data, wealth firms are in a position of trust by clients who do not expect wealth firms to use their data in similar ways that technology firms do. It was stressed that although wealth firms may not see selling data as an option, it is important that the data should be used better internally to improve the client experience. APIs and open banking presents a looming

opportunity for wealth firms to use client data more efficiently, however, wealth managers see more challenges in implementing this.

Briefly discussing competitive threats, delegates agreed that while challenger banks are skilled at leveraging client data, the relationship is paramount in this industry – that is where the relationship manager comes in.

Improving share of wallet

"43% of high-net-worth individuals have five or more wealth management relationships"

Recent research indicates that although high-net-worth individuals have core wealth management relationships, many are choosing to give their share of wealth to more wealth managers who conduct different types of transactions for them. Experts put forward the question of whether banks should have a strategy in place to become their core wealth management provider, especially if their mission or goal is to provide a holistic service for clients. It came of no surprise to delegates that they are competing for high-net-worth individuals share of wallet but one delegate answered that it may not be necessary to have a strategy in place but rather clients should have multiple relationships with banks based on expertise and their wealth goals. Another delegate remarked that,

"A client who doesn't multi-bank is really badly advised"

It was further suggested that having a lower share of wealth presents a lower risk to wealth firms (and clients). It was concluded that although firms can't control all of a high-net-worth individual's wealth, they can take a primary share and offer advice on other investments even if they don't manage them directly.

Conclusions

To conclude, delegates agree that regulation costs are leading to margin pressures but it is difficult for banks to pass this burden onto clients. Instead banks must anticipate these costs and make funds available or find a way to mutualise these costs.

Many agreed that there is a need for automated processes to keep pace with changes in regulations. However, wealth firms (especially smaller firms) must weigh up the costs and benefits of this implementing this digital solution in-house or by outsourcing it.

In terms of the potential for data to be bought and sold, the imminent opportunities of API and open banking are interesting in theory but delegates see the drawbacks in client trust if they choose to monetise their data.

Lastly, firms see an opportunity to increase share of wallet of high-net-worth individual's wealth as it may be another avenue for growth. However, wealth managers operate in a difficult and competitive environment where high-net-worth individuals are becoming reluctant to consolidate their wealth.

AN OVERVIEW OF THE CHANGING SHAPE OF THE 'IFA' WORLD AND THE COMMERCIAL OPPORTUNITY IT OFFERS WEALTH MANAGEMENT

Expert: Phil Middleton, Schroders
Facilitator: Laura Cavacuiti

Key message

As the implications of RDR continue to reverberate, adviser business models have needed to adapt and change rather dramatically. As such, there has been a substantial shift towards outsourcing their investment offering.

Headlines and key questions

- The session considered the numbers behind this trend and the opportunities it holds for wealth managers

- Roundtable participants discussed the shift in product trends following the introduction of structured fees for financial advisers and the products that advisers now want from wealth managers

Key themes

Following the Retail Distribution Review, the tectonic plates of advice and investments shifted radically. The interest in upgrading the client base to a higher minimum asset level is intense. Adviser business models more specifically have been transforming at a rapid pace, and the industry has witnessed a substantial shift towards outsourcing investment offerings.

The intermediary market size is growing and has hit the £1.5 trillion figure, continuing on a 6% growth rate. Data shows that vertically integrated firms are one of the fastest growing segments within this sector, and other IFAs are underperforming. What does this mean? In a nutshell, the industry is facing a huge period of change.

Slowly but surely, the reality of RDR is sinking in amongst the independent wealth community. Even the most stoic of IFAs is facing up to the fact that increasing amounts of regulation is set to hit the industry and independent firms. However, the market is expected to continue growing at a c.6% CAGR until 2020 due to a mixture of macroeconomic and regulatory factors.

In 2017, data shows that minimum asset sizes for new clients have been reduced – but advisers implementing minimum asset levels have increased. Increased client segmentation and robo-advice channels have played a role in this. Participants in the roundtable expressed concern that this may widen the already considerable advice gap as clients seek a cheaper alternative solution for their investment requirements.

In turn, fees are creeping up and a growing proportion of advisers are now charging clients a percentage of assets under management. Portfolio outsourcing continues to grow, with more advisers outsourcing more of their assets.
Participants of the roundtable opined that they have been seeing less people using traditional multi-managers and multi-asset funds. There is much more of a focus on outcome-oriented products. The number of financial advisers shrank rapidly following the announcement and implementation of RDR, although this has now since stabilised.

But like most things, the changing trends of the IFA world are not occurring in a vacuum. The impact of political and social change has had a dramatic effect on the peaks and troughs for this advisory community.
Brexit led several wealthy individuals take money out of the UK, and redistribute into European markets. Whilst UK property had been booming in recent years, the industry is seeing a lot more diversification since the referendum as investors seek to minimise their risk exposure.

And alongside this wavering uncertainty in the success of British markets, comes an increasing interest in passive investing. As more and more firms are under pressure to reduce costs, roundtable participants stated they are seeing many modern portfolio services begin to use passive investments whereas previously they had used active vehicles.

Because clients are much more aware of the total expense ratios than they used to be, UK investors are beginning to replicate American passive investment trends. And as a result of this, charging needs to be very transparent and appropriate for each and every client:

"They will pay, as long as they know exactly what you are doing and they are happy with it."

For those clients who do want to continue using passive investing however, the explanation for this is most likely to be echoing the digital opportunities offered through robo-advice and their cheaper associated costs.

Conclusions

Brexit has set the scene for the changing IFA community this year, causing some concerns and rifts in the shifting marketplace. As discussed in the roundtable, participants are seeing increasing numbers of advisers charging clients a percentage of assets under management. Portfolio outsourcing also continues to grow, with more advisers outsourcing more of their assets – all types of DAM continue to benefit as a result.

There has been continued client segmentation and greater minimum asset requirements which may widen the advice gap, and robo-advice has undoubtedly played a part in this. However, the majority of advisers see new technology as an opportunity.
The impact of RDR is interpreted relatively positively and demand for passives is continuing at a steady pace, but allocation weightings remain relatively low.
All in all, participants agreed that to survive, the IFA community needs to remain on top of these dominant changes and fluctuating trends, demonstrating flexibility and adaptability.

THE FUTURE OF INVESTMENT ADVICE

Experts: David Aston and Jann Ewehart, EY
Facilitator: Alex Johnson

Key message

The future of investment advice remains a subject of continued debate following the ever increasing utilisation of digital automation by financial institutions. The conversation has matured over the past decade. Incumbents are no longer grappling with the question of whether to launch robo-advisory solutions, but are now contending with the extent of automation for prospective clients.

Headlines

- Market participants were adamant that when it comes to the pertinence of robo-advisory services, the generational divide between consumers is a key influencer in how investment advice is likely to change in the future.
- Delegates were in agreement that the narrative surrounding the digitalisation of investment advice has shifted from one focussed initially on the efficacy of robo-advice, to one hinged on whether such tools should be fully automated or encompass a more hybrid solution for customers.
- Moreover, a key stumbling block which emerged from both sessions centred on how to maintain a consistent level of trust with clients bearing in mind the growing utilisation of automation.

Key themes

The roundtable discussion began with an outline describing how clients' growing preference for digital channels is continuing to influence wealth and asset managers' service delivery models. More specifically, the discussion coalesced around the emergence of two alternatives to the traditional advisor-based wealth management proposition; a fully automated digital wealth manager, or a hybrid solution encompassing digital automation in conjunction with an advisor-assisted element of interaction.

The general consensus amongst delegates was that the combination of an advisory service offering both human and digital interaction – the hybrid model – is the most attractive solution in terms of meeting the demands of consumers and tapping prospective growth moving forward. The reasons behind this level of agreement were multifaceted in nature.

Firstly, participants agreed that the hybrid model's appeal relates closely to the customer's continued interaction with a financial advisor. The general consensus in the room was that despite the growth of automated investment advice, the importance of the human element remains pivotal, especially in harbouring or maintaining trust with customers. Furthermore, another important reason behind the growing demand for automated investment advice is the changing expectations of tomorrow's clients.

According to some participants, the ever increasing digitalisation of society will only induce increased pressure on wealth managers to meet the normalised needs of future clients through better digital channels. More explicitly, participants anticipate that future clients in need of investment advice will almost certainly expect

some degree of digital interaction with respect to their investments, rather than a purely face-to-face exchange with a financial advisor.

However, a noticeable portion of delegates broached the topic of millennial customers' expectations from a different angle. Some noted that the only reason millennials are more likely to use fully or partially automated wealth management platforms is due to an inability to afford face-to-face investment advice, and not merely due to millennials' infatuation with technological innovation. The argument posed by these participants hinged less on the importance of technology as a disruptive force, and more as a secondary tool enabling the industry to better service a wider market of prospective 'advice orphans'.

Throughout the session a number of delegates generously provided tangible examples of the difficulties their firms have experienced when attempting to adopt new digital tools more generally. One delegate noted the incessant hurdles involved in implementing a standardised market platform across multiple jurisdictions from a financial and operational perspective. This issue of legacy IT systems remains a key stumbling block for established market players; an obstacle that clearly appears to be less of an issue for challenger firms.

In addition to this, the conversation expanded further, touching on the human impact of increased automation. Some delegates were keen to express the opinion that new technology entrants in the market will not result in the total eradication of financial advisors or the human element more broadly. If anything, it could very well enhance the demands on financial advisors to justify the incremental service they provide, which consequently, is likely to increase the talent requirements for financial advisors in the future.

In conclusion, it was clear during the roundtable that the narrative surrounding the future of automation and digital advice platforms has matured from those conducted in the past. Incumbents no longer see Fintech as a threat but as an opportunity to further improve their service offering for clients. Moreover, many incumbents in the market are now actively engaging with robo-advisory services themselves, either through acquisitions, joint partnerships, or even through building platforms from scratch. Ultimately, the consensus amongst participants was that while automation will change the service offering for certain segments of the market; it will not lead to the termination of human advisors altogether.

Conclusions

- The increasing proliferation of digital wealth management advice represents a growing trend in the industry to service the needs of mass affluent clients unable to afford face-to-face investment advice.
- Trust remains an important pillar in the relationship between clients and their investment management firms; maintaining this in the face of growing automation remains a key challenge for firms.
- Ultimately, firms must adopt a balanced service model, determining exactly which elements of the proposition to automate in conjunction with the human element of personal advice, grappling with existing hurdles in terms of legacy IT systems.

ARE YOU PROVIDING YOUR INVESTORS WITH VALUE FOR MONEY?

Expert: Haney Saadah, EY
Facilitator: Mark Miles

Key Message:
The impending arrival of MiFID II is ushering in fresh questions with regards to value for money. A large number of unknowns make disaggregating costs and charges – one of MiFID's key requirements – difficult, especially when estimating these up front. A range of response options are therefore being discussed by the industry – namely to demonstrate best efforts and reasonable assessment criteria. These however place the onus firmly on the banks, which few are comfortable with.

Headlines:

- The regulator wants greater engagement between advisors and investors. This should facilitate more accurate pricing and the ability to manage expectations with regards to what investors can reasonably expect from their holdings.

- To deliver true value for money, conversations should pivot from cost and charges towards investor protection and customer outcomes. Having said this, the question of how to validate achievement of clients' outcomes remains up for debate as goals and investment ambitions usually span over several decades.
- Predicting the impacts of MiFID II and other regulations will be a challenge that many firms are responding to by investing heavily in front office training, developing marketing materials to manage portfolio declines, for example, and ramping up communications training.
- Ultimately, many agree that value for money is linked to good governance, and culturally organisations need to live and breathe values that are in the client's best interests.

Key themes:

To date, money and effort has already been spent interpreting regulation so delegates expressed frustration at the remaining ambiguity. Several argue that by now, regulators should have devised templates to help standardise how costs and charges – a key concern – are reported.

The KIID document was cited as a good example of a 'standardised document' that helped end clients better understand and compare financial products. The worry otherwise is that firms disaggregating costs and fees in their own ways will not directly facilitate comparability for the end investor – and could risk some banks coming across as non-compliant.

This is especially pertinent as traditionally private banks could (and would) give away additional services for free so identifying ways to disaggregate, quantify and charge for these now poses challenges.

Interestingly, 'value' is a concept that means different things in different markets: "If you are an international private bank or wealth manager – you are likely to charge different prices in different markets, for example Switzerland vs. Asia vs. the UK – but marrying these up in the eyes of the regulator can be a challenge."

The regulator argues that pre- and post-sale fees should theoretically marry up but the vast majority in the room agreed that this is not really the case in practice. One delegate said that to stave off this issue, they will not be providing their customers with a cost at point of sale – instead, they are developing a fee schedule with the help of which clients can look at particular products.

This led to questions around whether regulation is more focused on cost or service: "Bells and whistles are not seen as valuable but how else do you differentiate your service?" Moreover, some pointed to the fact that if fees are going to be the primary point of differentiation, then "that's a race to the bottom in which nobody wins….[Meanwhile] service provision is difficult to scale; we have to think about cost to provision, which is why no one is making money in advice."

Indeed, some argued that the products on offer are similar, but it's the service that is the differentiator and that is often the most challenging thing to quantify. Moreover, one delegate pointed out that: "Quality advice is independent of market performance so how do you explain fees in tough markets?" Unbundling costs for products is easier than for advice, and as a result a few wondered if MiFID II was another attempt at RDR, especially in Europe.

The regulator maintains that issuing templates is unhelpful and potentially misleading precisely because business models vary so greatly. Moreover, because the nature of wealth management relationships is so personal, and every client is different, it must be up to the firm to demonstrate, on a best effort basis, the (reasonable) assessment criteria applied when servicing and charging clients.

Some delegates found it helpful to think of the relationship between the fund manager and the wealth manager as that of a manufacturer and a distributor model. The focus is therefore on manufacturers to explain why they're charging what they're charging rather than bias anyone towards or against active or passive: "The issue is not in how much you charge but with that approach – what do you provide? What does the client get?"

Besides, numerical target returns are not necessarily best measures of value. This is important to remember, especially when it comes to distributors. "Large numbers of unknowns make estimating and reporting difficult, especially when calculating up front…But then, when conversations become more qualitative (rather than data driven) – what then? How do you disaggregate and price then?" This is why the regulator does not want rigid

templates – instead, the flexibility ought to lie with the banks, enabling them to provide justification for the service they're providing.

"It's an undisputed fact that clients will pay more for value, so if we're charging premium rates, clients perception needs to be aligned and they should feel like they're receiving premium … It becomes about positioning and does your advisor understand your needs? It's not about what value for money is per se, it's about what the clients thinks it is, and whether they're getting it."

Conclusion:

While it is challenging to predict what the impact of regulation will be – many delegates did say their firms are preparing by investing in training – front office training, preparing marketing e.g. to manage portfolio declines, and rolling out general communications training.

Client sophistication will also need to be better understood and reflected in future conversations.

HOW TO GO ABOUT PUTTING BRAND VALUES INTO PRACTICE?

Expert: Michael Patrick, Farrer & Co.
Facilitator: Laura Cavauiti

Key Message:
True differentiation can be a challenge for organisations so 'values' can be established to more clearly demonstrate brand philosophy, personality and ways of working. In doing so, "you need to treat everyone like it's your party, make them feel included." How firms choose to play this out will be interesting.

Headlines:

- Reputation and brand are often intertwined so many think in terms of internal and external factors affecting it.
- Identifying values that you share with colleagues, clients or even prospective client can extend loyalty and engagement.
- Trust and confidence are slow to build and quick to erode. With multiple external and internal factors feeding into your brand – marketing, communication and brand crisis management are likely to rise in importance on the C-suite agenda.

Key themes:

Often, one of the greatest challenges for a business is to identify how to genuinely differentiate itself from competitors. Many do this by identifying brand 'values' that underpin its philosophy, way of thinking and practice of the organisation. This is important because if people (e.g. clients, employees, prospective clients and so on) identify particular values they believe they share with a brand – then they are more likely to remain loyal and engaged in the long-term.

According to some experts, 'values' need to be applied 'top-down'. In other words:

"Leadership teams need to put forward and demonstrate their brand values; this should then trickle down into other areas of the business such as recruitment, culture and training."

Senior leaders need to be seen living and breathing their brand values, and (when possible) create brand advocates for the firm. In the words of one delegate:

"You need to treat everyone like it's your party, make them feel included."

Perhaps unsurprisingly, reputation and brand are often intertwined. Donald Trump and Richard Branson were put forward as just some examples of leaders representing their brand.

Other ways to live out your brand is through the language you use; the graphics, colours and visuals you use; your website and marketing materials; the work that you do; and ultimately – the way your clients (and employees) speak about you.

When thinking about threats (and opportunities) to a brand – many think in terms of internal and external factors affecting it. In discussing the idea of brand and reputation, many were, perhaps unsurprisingly, drawn to last year's Panama Papers leak, as well as this year's more recent Paradise Papers.

Trust is slow to build and all too quick to erode. For example, many found it surprising that Appleby (the offshore legal advice firm) knew about that hack as far back as last year, yet did little to forewarn its clients. One delegate specifically commented on this situation saying:

"This is a textbook lesson in how not to crisis manage…once clients lose confidence and trust – [brand reputation] is not easily recoverable."

Moreover, the latest leak led to some interesting discussions, such as the idea of broadcasters and news outlets using stolen data to benefit the public good. However, if nothing criminal is uncovered – to what extent is the discussion really in the public interest?
Confidentiality agreements can of course be considered but some delegates and experts felt that the sheer act of taking action, can often give the issue more oxygen. Great care needs to be taken in enforcing such agreements because in the long-term it could make things worse e.g. could be interpreted as 'media gagging'.
Naturally, this also led participants to touch on recent legislations such as the GDPR:

"Given that we're holding lots of sensitive and confidential information, does data protection legislation make us all data companies?"

Candidly speaking, several said that the last thing they want to do is report themselves to regulators e.g. disclosing the fact that they may have taken a 'hit' from hackers. According to one delegate, their bank registered over 2.5 billion attempts on their banking systems in the last year alone. They are conscious that countless more remain unidentified, highlighting the colossal scale and indeterminable landscape for future issues.

Conclusion

How firms choose to play out the brand communications and brand management piece will be important, because as with most things – it will be a case of *when*, not *if*.

WHAT DOES YOUR PERFECT OUTSOURCING PARTNER LOOK LIKE?

Experts: Farzana Khalil, Multrees with Andrew Waldren, Sandaire
Facilitator: Mark Miles

Key message

When a firm devises its overall business strategy and target operating model, all options including outsourcing should be considered. A strong cultural fit must be part of the due diligence that a client conducts on a potential outsourcing partner in order to ensure a successful long-term relationship.

Headlines

- Consolidation and increased regulation continues to elevate the attractiveness of outsourcing as a way to meet operational challenges.

- Outsourcing can lead to increased control, rather than a perceived lack of it, if it allows a firm to focus on its own value proposition.
- Due diligence on any external partner should be thorough and identify a cultural fit between the firms in order to ensure a potential successful partnership.
- A successful outsourcing environment depends on clear communication channels and the value of personal relationships built up between staff.
- There is no 'one size fits all' when it comes to outsourcing and it should be considered only if the price is right.

Key themes

The session began with a brief scene-setting on the current status of outsourcing within the industry and reasons to consider it as an option.

There have been several external factors pushing wealth managers to contemplate outsourcing as a business strategy. Ever increasing amounts of regulation have put pressure on cost margins while advances in technology threaten traditional operating models. Consolidation among wealth managers continues to be prevalent with outsourcing becoming an increasingly attractive option in response to challenges which arise with increased scale.

Furthermore, client experience is now a main area of focus for wealth managers as firms want to concentrate on building valuable client relationships rather than on executing purely on back office processes in-house.

Discussion then turned to the practicalities of outsourcing as one delegate shared first-hand experience as an investment manager with a current outsourcing relationship. The investment manager in question found that his firm's existing operating model was 'running out of steam' following a recent acquisition. As a comparatively small business, the back office team faced considerable challenges in dealing with dozens of custodian banks on behalf of family office clients and time spent dealing with different infrastructure systems.

As a result, a new target operating model was identified with outsourcing considered alongside other solutions including global custodian banks and software companies. An outsourcing partner appeared to be the optimal solution to allow the firm to focus on its own value proposition rather than managing operational infrastructure.

Delegates agreed that in seeking an outsourcing partner, a strong cultural fit is of salient importance. In particular, the relative size of an outsourcing firm combined with its client base is seen as two of the main factors to consider in a potential partner. Several delegates spoke of negative experiences when dealing with large outsourcing firms who did not align to their own cultural values. Moreover, one delegate emphasised the need to be transparent with end clients about an outsourcing partner and explain why such a relationship should result in better client outcomes.

Once outsourcing has been established, it is also important to foster a healthy working relationship and continue to maintain it on a daily basis. One delegate highlighted regular office visits from their current outsourcing partner as a means to build relationships on a personal level. Such an approach means that the investment manager knows everyone by name on the outsourcing side and can initiate daily calls to sort out any problems.

However, whilst delegates were keen to express their views on the benefits of working with an outsourcing partner, several participants of the roundtable were also very mindful of the many potential barriers to working with such a partner. One delegate noted that there were not many reliable outsourcing firms and unless there is a truly compelling offering available, it can sometimes be easier to '*stick with the devil you know*'.

Indeed, all delegates perceived that there is huge risk in the potential upheaval of changing custody relationships, both for staff and clients. Anecdotal examples of cases where the process of transferring client assets from one investment manager to another took as long as a year were shared amongst the group. Another delegate highlighted an individual business need to ensure consistency in their custodians although this could be overcome if the firm no longer had to cover custody costs.

A perceived loss of control was also seen by delegates as a significant hurdle to overcome in an outsourcing environment. Nevertheless, one delegate with experience in this realm stated that rather than losing control, it increased it and ultimately allowed the investment manager to focus purely on execution.

Delegates also highlighted the specific challenges they have faced within their firms which have not been fully resolved by outsourcing various functions within their operating models. One delegate shared an example of having to use an off-the-shelf online valuation software solution from an external provider although it was limited in its functionality. This is currently complemented with the business's own in-house systems to make the software more engaging for clients as it has been unable to identify a better external solution at an attractive price point. As a result, the business was not willing to risk changing provider unless the price was compelling and the functionality was an upgrade on its current solution.

Another operational challenge for delegates was the ability to efficiently execute transactions across different platforms encompassing different portfolios. Several participants in the roundtable noted the fact that some share classes are unavailable on certain platforms plus the associated timing risk when trying to execute portfolio changes across platforms at the same time. Delegates agreed that the balance of power is increasingly in the hands of large platform providers while regulation is pushing investment managers toward more commoditised products at the expense of client outcomes.

Final discussions were centred on the key ingredients of a successful outsourcing relationship. Cultural fit was re-emphasised as an important factor when looking for an outsourcing partner and it was agreed that one solution does not fit everyone. As with any business relationship, building personal connections and trust is vital to securing a long-term future for both parties. A good mind set is also fundamental to success in being able to perceive an outsourcing firm as a 'partner' and not just a 'supplier'.

Conclusions

- Consolidation within the industry coupled with regulation continues to push outsourcing to the front of the agenda as wealth managers consider their options for potential business growth.
- Outsourcing is not a panacea to all operational challenges but can be an attractive option if the price is right and allows the client to focus on its own value proposition.
- The mind set adopted when dealing with a new outsourcing partner will determine the length of a successful outsourcing relationship - if the firm is able to move from being seen as a 'supplier' to a 'partner'.

GDPR – LET'S DO THE DETAIL

Expert: Ian de Freitas, Farrer & Co.
Facilitator: Alex Johnson

FARRER&Co

Key message

Wealth managers need to prepare for privacy challenges under GDPR and be fully compliant ahead of its implementation on 25 May 2018. Firms now must move away from asking consent from clients and examine their processes to ensure privacy has been considered across all of their products.

Headlines

- Tighter consent laws mean businesses should seek to re-permission data and move away from asking consent from clients.
- Ongoing system changes must give wealth managers the ability to track client data down to exact locations and firms should know exactly who is processing this data.
- Growing numbers of data access requests are expected from individuals who are set to be empowered by new privacy rights under GDPR.
- Relationship managers present a considerable risk for wealth managers in respect to complying with GDPR's new privacy measures.
- Companies should be looking to revise and re-issue privacy notices in light of updated data retention policies.

Key themes

Initial discussion centred on the background of GDPR (General Data Protection Regulation) and where the industry finds itself six months away from its implementation.

After almost four years of debate, the European Commission, Parliament and Council finally reached a consensus on GDPR in December 2015. As a consequence of the political compromise, not all the directive is consistent and there continues to be many issues as to how wealth managers can comply with parts of the regulation. Furthermore, it was noted that the Edward Snowden story which broke halfway through the bill's draft process had added 'bells and whistles' to GDPR.

Enforcements and sanctions for non-compliance under GDPR have increased significantly. Currently sanctions for data protection breaches typically carry a maximum penalty of £500,000, however, under GDPR, monetary penalties are set to increase to up to 4% of annual global turnover. UK businesses have to ensure they are fully compliant with GDPR before it comes into effect on 'Zero Day' – 25 May 2018. It is also apparent that Brexit will not stop the regulation coming into effect in the UK with the current Data Protection Bill set to enshrine GDPR into UK law.

According to a recent industry survey, the biggest area of concern relating to GDPR was found to be the 'right to be forgotten'. Several delegates highlighted the potential impact of complying with increased levels of D-SARs (Data-Subject Access Requests) would have on their businesses. Many GDPR observers expect growing numbers of D-SARs from individuals seeking to ascertain what personal data is being held about them. In fact, two delegates had heard rumours that the UK Information Commissioner's Office (ICO) is to launch an advertising campaign to educate consumers on their enhanced data protection rights under GDPR. One participant posed the question: "*Will this be the new PPI?*". Firms can no longer charge £10 for individuals to submit a D-SAR and companies must respond to these requests within a shortened timeframe of 30 days.

A couple of exceptions to disclosing certain information were highlighted during the roundtable. Conversations with lawyers cannot be disclosed while there is a need to balance employee rights against what can be disclosed on a personal level to clients. Tighter consent regulation also means that firms can no longer rely on employees consenting to having their personal data processed.

Data retention policies must be overhauled for GDPR in order to be short and more prescriptive for consumers. Discussion turned to common fears around re-permissioning existing client data with one delegate reporting an 8% hit-rate from clients when asking them for new permissions. Clients now have to opt-in to data retention policies rather than the current opt-out framework.

Businesses are also required to know exactly where client data is held and who is processing this data. One instance was raised of a company using thousands of data servers across different locations which rendered it almost impossible to track where data is held. Cloud providers were seen as an effective solution to this problem although prices for these services are set to rise next year. It was observed that GDPR now regulates both data controllers and data processors in respect to data security therefore data processors will expect to be compensated for any additional risk.

In terms of marketing, GDPR is not the only regulation coming into force. The latest set of Privacy and Electronic Communications Regulations (PECR) covering email and SMS marketing is expected to come into force next year although the text is currently being revised. One participant warned that businesses should also pay heed to their cookie policies to make sure they no longer record individual mobile and laptop IDs.

Privacy by design is another topic of particular relevance to wealth managers under GDPR with far-reaching implications. The concept of privacy is now required to be built into new products and services from the very outset. It is also mandatory for wealth managers to re-evaluate their existing products with privacy in mind. Moreover, firms will need to keep paperwork to demonstrate they have built privacy into their processes through these actions.

All participants agreed that staff on the ground were a considerable risk for wealth managers in respect to complying with privacy policies. Relationship managers commonly keep their own repositions of contracts and typically push back on any efforts to centralise these although this will soon be the case under GDPR. A culture change will need to happen in order for relationship managers to relinquish their own individual books of contacts and staff may need to be trained to reflect this.

The roundtable concluded with discussion on the wider impact of GDPR across the industry and the immediate challenges that firms are facing. GDPR is not just an EU issue but a global problem as US firms will have to comply with the directive when it comes to their EU clients. Firms should already be re-negotiating existing contracts with data processors and identifying where all their client data is currently kept. Participants were also advised to revise and re-issue privacy notices along with making preparations to deal with increased data requests from clients.

Conclusions

- Contracts with data processors should be re-negotiated and systems updated to ensure firms have a clear line of sight into where data is stored.
- Staff may need to be trained as part of a culture change to ensure privacy is built into every product and service from the outset.
- Re-permissioning data to move away from consent will still allow firms to control aspects of client data under legitimate business interests.

THE SCIENCE OF FINANCIAL ATTENTION

Expert: Steve Utkus, Vanguard
Facilitator: Tasha Vashisht

Key message

There is a direct correlation between digitalisation and customer experience. If digital is transformative, then customer experience will inevitably follow suit. This roundtable focused on the emerging trends in the science of financial attention, including what drives digital engagement and how this works to enhance user experience.

Headlines

- Financial attention is defined as the notice taken of information regarding one's financial affairs. This attention is not always for a prolonged period. More generally attention sessions are short. However, it is not just about looking at information and reports on one's holdings - It is the emotional response to this data.
- The science of financial attention is the emerging discipline arising from the convergence of digital data, psychology and experimental science; involving the rise of randomised controlled trials used to test user experience.
- The Ostrich Effect is when investors are less attentive towards their money during market stress. It is an extremely prevalent notion that explains the fluctuations in digital engagement.
- Any myths supposing a strong link between older generations and decreased digital engagement should be disregarded. It is the case that there are high volumes of older clients along with millennials who are digitally attentive.
- Ensuring clear and transparent access to clients of their investment holdings online is helpful but to significantly improve customer experience, digital platforms and interfaces must tell clients a story, contextualising the data and explaining factors that are pertinent to them.

Key themes

Financial attention can be defined as the notice taken of information regarding one's financial affairs, particularly when in digital form. This includes clients accessing their online account or portal provided by their wealth manager.

The Vanguard expert opened the discussion by explaining that the average number of attentive days per year largely exceeds the average number of trading days per year. This suggests that financial attention is fast becoming a fundamental and extremely prevalent economic activity.

"Logging on and checking your money is the adult equivalent of shaking your piggy bank."

The Ostrich Effect is the underlying concept that explains the fluctuations in financial attention. It is the idea that in months where the economy is said to be doing well, individuals are more likely to look at their investment data but in months with frequent "down days" individuals are less likely to log-on and look at their money.

This highlights the fact that individuals are *"enormously responsive to the impact of the news"* as well as the powerful psychological effects economic news can have on an individual's financial attention.

One delegate added that it is important to ensure that clients are able to differentiate news and updates from a long-term financial planning strategy, arguing that this is where the human interaction element is necessary. *"CNBC and Bloomberg are really showing short term changes relevant to traders rather than what affects a long-term plan."*

The research presented shed light on the attention volume disparities across various client segments. DC (Defined Contribution) investors are far more engaged than retail investors and male attention seems to exceed female attention. Yet surprisingly, delegates were informed that both millennials and older clients demonstrate that they are digitally attentive in relatively equal measure.

Collecting such metrics fuels the growth of digital data. The Vanguard expert referred to data collection in the previous month based on ten million clicks on their digital platform and 1.5 million online sessions. A session can range from one minute to one hour but the conclusions drawn were that *"people who look a lot don't look for very long - digital attention is generally quite short."*

One delegate responded that there is a psychological phenomenon surrounding client consumption of data but a major issue is getting clients to understand such data. This delegate noted that they have a rich online portal which contains clients' investment performance data and also contextualises this information to aid client understanding. Storytelling and data customisation are two important ways that wealth managers can help improve client engagement.

"We really wanted to extend beyond and ask: "Why do people invest in the first place?" People shouldn't be investing aimlessly; they should be working towards some cause so they can see if they are progressing. Contextualising what they see will ensure they are not worried when they aren't doing so well; perhaps it's to be expected in a long-term strategy. It's really about supporting them so they are comfortable with risk."

A response from another delegate emphasised the importance of contextualising data, with their focus being to ensure the data is actually of interest to their client -

"It's all about breaking it down and making it something that meets their interests and goals".

For wealth managers, the next step in improving financial attention is to use the data to revolutionise the client journey. This can be done by making connections based on the information collected of what clients are clicking on. The data can also be used to help evaluate strategy to enhance user experience by finding out what is successful and what is not.

"This process is definitely where financial institutions are heading towards, whether it is done internally or it is outsourced."

The delegates were reassured that whilst tracking client behaviour can produce some really interesting and useful insights, there is also a level of 'creepiness', so it is imperative that using journey data is done in a non-intrusive way.

Delegates questioned the volume of digital data that can be feasibly obtained. Some found that only a small percentage of clients actually log on to the online portals and a huge percentage are not even interested. But

overall delegates agreed that we are moving into a more interactive world and wealth management firms must be prepared for that. Interestingly, one delegate suggested:

"We could use the trends of when people are logging on to alert private banks that clients are attentive and engaged. This could really enhance the client relationship by targeting those who are really looking to engage."

Many delegates remained unconvinced on the extent that digitalisation will dominate the wealth management industry. They were increasingly uncertain of what existing technologies such as "Siri" and "Alexa" would look like in ten years' time. One delegate spoke about a millennials forum they held whereby the overwhelming conclusion was that not everything should be digital. Their contention was that within the wealth management industry clients do want some human interaction on top of the messages in the data.

"Ultimately the process should be as personalised as possible. I don't think the human is dead yet – unless we have an immense continuous speed up in A.I. progression."

Conclusions

The fundamental idea is that financial institutions will increasingly rely upon this emerging science of tracking financial attention to optimise client experience. The more insightful the online investment data becomes, the more likely investors are to engage with their money.

This will in turn improve investor decision making and outcomes. That being said, it was clear from this roundtable that although increased digitalisation will improve user experience, some clients will always require a more dedicated face-to-face proposition, particularly when it comes to reassurance and explanation of their investment portfolios.

THE TICKING "RES NON DOM" TIME BOMB

Expert: John Haley, Utmost Wealth
Facilitator: Stuart Cummins

Headlines

- Introduction of the domicile rule for all tax purposes - those who have lived in the UK for 15 of the last 20 tax years.
- For domiciled individuals, clients have the ability to rebase foreign sited assets for capital gains tax purposes.
- The ability to clean mixed funds for non-dom clients who have previously claimed the remittance basis of assessment.
- An introduction of Inheritance Tax rules where UK residential property is held within a corporate, partnership or trust structure.

Key themes

The new non-domicile rules are now in force and they take retroactive effect from April 2017. This follows the Finance Act 2017 which is expected to receive Royal Assent.

The latest sets of provisions for non-dom clients are complex. *"There has never been a more important time to provide a bespoke client service program,"* said one associate in the session.

There are many non-doms clients who may be able to benefit from the cleansing provisions but there needs to be a quick reaction to this, given the complexities of many people's affairs, in order to disentangle what can be cleansed. *"Ideally all clients should keep their capital, income and gains separate."*

For client financial planning, these statements allow taxpayers to move ahead ready for the un-mixing of clients' accounts and for those who qualify for the rebasing of foreign assets, to calculate the tax implications of any disposals.

"As the deadline is April 2018, the quicker you and your clients start, the easier the "res non-dom" time bomb will be to defuse."

Meanwhile, distributions from trusts can be made before next April, in order to reduce the gains taxable on UK beneficiaries, by distributing to non-UK resident beneficiaries.

"The wealthiest clients are internationally mobile, so it doesn't matter where they are based. They can take advantage of the next offshore status."

The provisions in relation to income tax and capital gains tax (CGT) are very similar to one another, but some of them come into play retrospectively from April 2017, others from April 2018. The changes affect both individuals and trusts.

Equally for trust protections, there should be protection from tax for trusts created by non-dom clients while they are not deemed domiciled (with certain exceptions). "*Clients need a big enough pot to make it worthwhile, transitional features are not that helpful."*

Foreign income and gains in offshore trusts created by a non-domiciled people are only taxed when distributed. Aside from UK residential property, these trusts still shelter the assets held from inheritance tax (IHT).

Conclusions

- Global clients continue to come to the UK. Clients are identifying enough advantages at the moment - currency, fiscal responsibility and prime property prices to name a few.
- Wealth managers have not seen a 'brain-drain' that some businesses were expecting or predicting.
- These measures have had an important impact on client portfolios. In more complex client situations there will always be examples that cover every aspect of complexity.

LET'S TAKE A LOOK AT THE INVESTMENT HORIZON FOR FIXED INCOME

Expert: Tina Adati, PIMCO
Facilitator: Stuart Cummins

PIMCO

Headlines

- Monetary policy, exchange rates, fiscal policy, trade and geopolitics are key risks affecting market sentiment.
- After a circa 30 year period of steady rates, the markets are factoring in an interest rate correction.
- A nominal rate rise in the UK would tighten investment grade and high yield spreads.
- Core bond strategies can still play an important role in portfolios; however it is important to be active to manage risks.

Key themes

Long term interest rates are near multi-year lows. The Federal Reserve and Bank of England are expected to raise interest rates two to three times by the end of next year. The European Central Bank is expecting to slow down the asset purchasing program by the end of next year and follow with an interest rate rise thereafter.

Meanwhile the Bank of Japan expects to raise the 10 year yield target by 20-30bps in the second half of next year and emerging market Central Banks are expected to cut rates as inflation slows.

Overall, this impact of Central Bank rate corrections and the ending of balance sheet expansion would have a direct impact on volatility, spreads and economic growth. The geographic economic landscape is set to a moderate expansion trajectory. However the "market is not pricing in all these rate increases".

The table's discussion then turned to individual outcome scenarios and the impact on fixed income markets. With continued economic expansion the expert's theory maintained that if expected rates remained at current levels there would be further tightening of spreads and lower levels of volatility.

In a situation where Central Banks remove policy accommodation too quickly and choke the global recovery, rates again rise, spreads widen and there is growing volatility in markets. However the best case scenario put forward would be for a gradual removal of policy accommodation. In this event rates rise gradually and spreads remain at current levels.

Conversation amongst the delegates explored the impact of credit spreads at below historical averages.

"With growing pressure to begin fiscal easing, what is the 'new neutral' going to be? The yield's direction of travel (especially given what Central Banks are saying) is upwards."

The in-house expert view, which focussed on five key areas affecting the ongoing stability of the economic growth rate were monetary policy, exchange rates, fiscal policy, trade and geopolitics. Alongside these, the table then began to explore the impact of normalising policy on their investment portfolios.

The experts were then keen to explore three sets of hypotheses impacting the UK investment markets (for illustrative purposes only), this "scenario analysis provides a nice way to quantify future outcomes."

Three key scenarios were assessed – (1) UK nominal rates rise by 100bps, (2) UK spreads widen by 50bps (in other markets 25-125bps) and (3) a combination of the above. Delegates were keen to examine the impact these scenarios had on the correlation to other risk factors, namely developed and emerging market equities.

With these scenarios in mind, the roundtable concluded that solutions to improve the immediate pricing impact and the 12 months expected returns should focus on a number of key outcomes put forward by the expert:

a. Practice an active bond investment strategy. These strategies can play an important role in portfolios to manage risks. The aim is to provide lower volatility and limited downside risk against other financial assets.
b. Reduce portfolio interest rate sensitivity.
c. Add alternative sources (credit) of portfolio yield - increase and diversify sources of yield.
d. Focus on absolute return or consistent income with outcome focused strategies.

Conclusions

- Central Bank rate corrections and balance sheet contraction will directly impact volatility, spreads and economic growth.
- Investors have the option to become more active – evidence suggests that unlike equities, active bond strategies have generally outperformed passive peers.
- Targeting lower duration strategies comes with trade-offs.
- There is the opportunity to diversify interest rate risk by shifting to credit.
- Finally, build in greater flexibility in to the portfolio – adjust exposures dynamically given macroeconomic views.

HOW DO YOU DECIDE WHICH PLATES TO KEEP SPINNING?

Expert: Jamie Sinclair, BlackRock iShares

iShares by BLACKROCK

Key message

BlackRock's third annual European survey of private banks and wealth mangers shows that regulation, technology and margin pressure are the top three concerns this year. The discussion revolves around which plates are necessary to keep spinning, and which can be a lower priority.

Headlines

- Large banks cannot offer the bespoke service HNWs need and incur high costs serving the mass affluent
- Smaller firms provide a high focus on the client's needs and have no burden of large, cumbersome organisations but find challenges in building their infrastructure, branding and reputation
- There is a huge gap between these small boutiques and large players which can be filled in with consolidation of smaller firms or spinoffs of banks into boutiques
- Complying to regulation is important although keeping the business moving forward cannot be forgotten either
- Robo-advice need not just be for low value clients – it can also serve high value clients so firms can focus on those elements that allow them to charge their premium prices

Key themes

The purpose of the discussion is to determine which proverbial 'plates' participants are making extra efforts to keep spinning and which can be dropped for the time being.

A participant who left a large bank to start their own investment firm is familiar with both sides of the story for established incumbents as well as boutique firms.

While larger firms can offer a holistic view, front office staff often find that due to the volume of regulation-related tasks they have less time to fully service their high-net-worth clients. The increasing margin pressures also mean it is increasingly costly to service the mass affluent.

On the other hand, smaller firms have no legacy issues and can deliver a specialist and independent service to their clients but face challenges in building infrastructure, brand and reputation. They also cannot afford to do the frills.

A participant who previously worked at a large global bank mentioned prioritisation was a problem and it was difficult to balance client needs as well as regulatory requirements. A need to centralise the investment proposition and adapting to use technology and risk management systems was suggested. One of the participants revealed they have 70 portfolio models whilst others had approximately 3 and recognise the need to simplify.

It was concluded that there exists a huge gap in the middle which can be filled by consolidation of smaller firms or spinning off divisions of large firms into boutiques.

A key finding from the BlackRock survey addresses these issues by encouraging firms to be very clear in their target market and then aligning their service proposition as they cannot serve everyone on the same amount of resources. Also, if regulation was stricter it would cause an increase in minimum investment across the board – forcing further segmentation of clients. When asked how long before the client base changes, many firms say it has happened already.

The expert also emphasised that MiFID II is unsustainable without technology and advisors need to be armed with tools so they can reduce the amount of time spent on paperwork.

> *"They always say the UK is ahead of the curve but I'm not sure it's a curve anyone wants to embark on."*

One concern around MiFID II is that it does not cover market stability and competition. The regulation itself is seen to reduce competition and is difficult to plan for. While complying is important, thinking strategically about how to keep the business moving forward also keeps these key stakeholders awake at night.

The conversation moved on to mergers and acquisitions and subsequently the talent pools at firms. Participants agreed on the need for a balance between staff who are skilled at managing people and those who excel at client management, and that the new blood provided by mergers is useful for this purpose.

When it comes to hiring, employers face the dilemma of choosing between a Relationship Manager and an Investment Manager, and also how many Relationship Managers to hire. Is it better to hire a small group of

quality RMs then give them the tools to scale? This may cause an increase in fees which is hard to justify. Or is it better to hire a larger quantity of RMs with mixed skill levels?

This naturally leads to the topic of robo-advice, which was agreed that it need not just be for low value clients. It can also service high value clients while the firm focuses on what allows them to charge their premium prices. On the development of this technology, participants mention that there is a second mover advantage here by letting others invest, develop and make the mistakes first.

Conclusions

There are multiple spinning plates and it is proving difficult for the industry to conclude on which should be dropped and which to prioritise. At the highest level, it is essential to work on complying with regulation while also keeping the business running.

ARE THERE ANY LESSONS YOU CAN LEARN FROM THE CHALLENGER BANKS?

Expert: Philip Nordenfeld, Backbase
Facilitator: Annie Catchpole

Key message

The challenger banks have disrupted the retail and mass affluent market and while their presence has been felt at this level, there has been little direct impact on the higher wealth sector at this point. However they are causing the entire industry to rethink its approach to servicing and communicating with clients and how the client experience can be improved on, in an increasingly digitised environment.

Headlines

- The wealth industry is slowly coming around to understanding that digitisation is a hygiene factor for businesses rather than a 'nice to have'.
- While the challenger banks have disrupted the lower end of the market, they have their own issues in terms of maintaining growth rates and continuing to attract clients.
- There is evidence that the challenger banks are moving on from purely focussing on a single service and are starting to push into the advice space.

Key themes

Participants of the session acknowledge that digitalisation is on their agenda. Some came to understand how worried they should be about digital disruption. Others were interested to see how they can be inspired by the digital banks.

"Challenger banks have massively disrupted high street banks."

The discussion started with a scene setting from the experts:

"*The paradigm has changed to working with customer needs first, and build the service based on that.*"

Challenger banks identified early that mobile is going to be the main channel of interaction between client and service and focused on delivering this experience.

However, the issues are coming up with building a financially viable business model while being a digital disruptor. There is an example in the Netherlands where a challenger bank came up with a lot of free services available to customers. However, within a year they became the most expensive bank among ING, ABN Amro and other major banks in that market.

"*It's all about Next Gen, the clients of tomorrow.*"

Digital is something that younger clients are looking for/used to. Despite the fact that digital is discussed as a standalone topic, it is not a substitute, it's a complimentary service. It becomes a hygiene factor.

Digital disruptors are starting to break into the advisory sphere and this is illustrated via a case study of a digital firm that transformed into a real bank. However, they started by offering a digital investment portfolio service. Digital disruptors are breaking into the advisory business via robo-advice.

"Digital disruptors are taking over the lower wealth client segments, pushing firms to shift their proposition to higher wealth clients."

However, some participants believe that while digital engagement works for lower wealth clients, the business model starts to break down at higher wealth levels.

Disruptor banks have forced the retail banks to step up their game but they have not had as much impact on the wealth industry. There is little uptake from the ultra-high-net-worth clients, but there's also a generational factor at play. However younger clients like security, and arguably prefer more of it as wealth can be a burden for them.

The industry observation from the experts was that some firms in the financial space prefer to focus on financial products, become a warehouse, and then another firm can perfect the client experience and add value that way. Financial firms are looking to improve the on-boarding process through a digital service, and the second big area is advisory. Developments in advisory services are focussing on suggestions/recommendation features, which need to be powered up by a good "engine".

The financial viability of digital disruptors is a challenge due to the need to maintain revenue growth rates, but for the wealth industry it is the actual costs of digitalisation that are more challenging.

"What's holding us back is the perceived cost of digitalization."

While the digital banks are focused on maintaining and perfecting the customer experience, other firms are faced with the challenge of having a branch network and supporting the network through digital developments.

"The *joy of the challenger banks is that they have no legacy infrastructure, but their issue is that they have no client base and need to build up their revenue stream.*"

It was suggested that the question should be reversed – what can challenger banks learn from the traditional industry? Customer acquisition is expensive.

From the regulatory perspective, however, challenger banks are punching above their weight. As one of the participants put it:

"*There is a trade-off between usability and hackability.*"

Data protection is high on the list of most important considerations. Data protection is a highly sensitive subject in the wealth industry, and the disruptors need to keep up with these high standards. There is also an issue of counterparty risk as wealth grows.

Conclusions

While the wealth industry as a whole may not have been disrupted, they have certainly impacted the lower end of the market and the challenger banks are giving considerable pause for thought. Much can be learnt by the wealth

industry from their approach, but the challengers will also need to be aware of the barriers they face to continued growth that private banks and wealth managers are very aware of. The biggest threat to firms is complacency.

"As an industry we are very complacent. We will probably look how things develop."

REGULATORY UPDATE – ARE YOU READY FOR MIFID II

Chair: Tony Maddock, Lazard
Expert: Ian Cornwall, PIMFA
Factilitator: Ben McNeil

Key message

While MIFID II is looming at the start of 2018, there is still a lot of uncertainty as to what is required. Key areas of concern are evidencing the cost breakdown of transactions, demonstrating suitability, reporting transactions and product governance.

Headlines

- Evidencing and reporting the complex cost breakdown of many transactions is a challenge for all firms
- There is a risk that in the process of demonstrating suitability, the trade can actually be delayed, potentially disadvantaging the client
- The guidelines on product governance are not clear around level of detail required

Key themes

The conversation started with industry players acknowledging that they need to communicate the regulatory changes to their clients in their own way.

Topic 1: Charges
"*One of the things you have to be ready for is to give the cost breakdown when you were asked about it.*"

Participants mentioned that the deadline to manage this from the regulator was a challenge for them. Some firms were asked to provide 3-5 years' worth of data but don't have enough time to prepare for this and as a result, are having to prepare an interim report for submission.

The other issue they are faced with is that product providers are coming back to them for back-filled data.

From the regulatory standpoint, the regulators are highlighting as important, the templating of delivery that allows for consistency of the approach in putting together costs, as the main goal. Advisory and execution-only services are trying to establish and make clear the costs upfront.

Participants of the conversation pinpointed that one can arrive at different results based on different assumptions. The recommendation in this case was that during the project, when making judgements and assumptions, it is necessary to record those, so that a firm can demonstrate why and how the assumptions were made, if queried.

Topic 2: Transaction reporting
An example of issues related to this topic from the industry players was how to treat an abandoned trust, for instance. One issue that regulators run into is that some firms' understanding of the contractual relationship is just not there.

The principle to follow should be "*No LEI, no trade.*"

However, in connection with this, there is a difficulty in obtaining the LEI (Legal Entity Identifier) when applying for it in a different jurisdiction. From the regulators' perspective, the LEI issue time has been speeded up because there were fewer applications than expected.

Topic 3: Suitability
The issues related to suitability were risk profiling, and practical issues such as extension suitability.

An example of a problem encountered by the industry: if an RM is speaking to a client on the phone, he can execute the transaction and provide the suitability report. But when if he's in the clients' home for instance, he has first got to get the suitability report approved, and then execute. The question here is how to reconcile this with the need to promptly execute on behalf of the client. From the regulatory standpoint, the debate in this area is what is covered by Terms and Conditions and what is not.

Another area considered in this part of the conversation was about switching securities, identifying the cost-benefit and performing this analysis. Under RDR, the switching was not permitted, but under MIFID this is allowed.

Topic 4: Product governance
"*It is about what tools you have in your toolbox to execute a trade and/or make a recommendation.*"

In terms of product governance, what's unclear is the level of detail required. This is because MIFID II is owned by policy guides, not the supervisors. There has been good work done on this template, and also on completing the supporting documents.

The area of concern here is the information exchange; it's an exchange of **relevant** information.

From the regulator's standpoint, the recommendation for the firm is to make sure there is a review process of the T&Cs and has ownership in this area.

On **compliance**, it's all about the overall effectiveness of product governance.

Conclusions

To prepare for compliance with MIFID, recommendations for all firms are to make sure that the projects are in place to deal with the demands of the new regulations and that senior management are fully engaged with the process.

SUSTAINABLE, ETHICAL, ENGAGEMENT, IMPACT – WHAT IS THE DIFFERENCE?

Expert: Peter Michaelis Liontrust
Facilitator: Annie Catchpole

Key message

Client demand is growing for ethical investing, however many barriers such as confusing definitions, perception of lower returns and different approaches to due diligence persist. However, it is the responsibility of the industry to lead in this area and meet client expectations.

Headlines

- Traditionally ethical investing involved excluding companies from certain industries and returns usually underperformed the market - some of these perceptions still persist in the market
- Nowadays, the definition of ethical investment is much broader and involves robust due diligence, which can even lead to higher returns
- Confusion between different forms and definitions of ethical investing persist, however this can be avoided by discussing characteristics with clients
- Client demand is growing and for too long the industry has shied away from addressing the question of governance

Ethical investing is not a new term for investors anymore, yet much confusion persists in how it should be defined. In the past, the term 'ethical investing' was very much associated with the negative connotations. This

is because it traditionally involved screening out companies and industries labelled as "negative" such as tobacco or weapon industries.

The word "negative" was not only used when excluding industries, but also when discussing return. Ethical funds used to underperform the market and were seen as a form of financial "sacrifice" in exchange for values. Experts from Liontrust admitted that some clients still view ethical investing through this lens. However, they argued that contrary to past perceptions, their fund has outperformed the market. This is due to the focus on robust due diligence - next to ethical principles, other factors such as the viability of the business model and quality of its management are screened. The robust due diligence helps them to select investments that are more likely to be successful in the long run.

The experts admitted that the necessary due diligence is more expensive, but ascertained that despite this, their fund is competitively priced when compared to other actively managed funds. The expert also returned the question to the audience and asked if they believe that a fossil fuel or a renewable energy company is more likely to dominate the market in the future.

Further, the experts argued that for long the industry shied away from addressing the questions of governance: *"We are very good at managing money, but when it comes to governance, we just say that it is too complicated"*.

Whereas, nowadays the expert asserted, talking about ethical investing is like "knocking on an open door" as many clients are demanding investment products aligned with their values. The most visible demand is seen coming from younger clients and European clients, especially from the Netherlands and Scandinavian countries. One participant questioned the true size of client demand for ethical investing products. Instead, he suggested that it is more the case of the relationship manager having to raise the subject. This can get very tricky to do without indicating any moral judgement as nobody wants to be labelled as "unethical" and "not caring".

A way to avoid discussion about what is "ethical" is to "get away from buzz words and talk about themes". It is much easier to talk about waste reduction or renewable energy than ethical proposition. In this way any moral judgement is avoided and relationship managers can explore if the client is passionate about any of these topics.

Talking about specific topics or investment themes also helps to avoid the maze of different ethical, impact or sustainability definitions and rather the relationship manager can focus on explaining what due diligence is applied and what principles are used when selecting investments.

Conclusion

It is clear that client demand is growing, but many barriers still persist. However, the industry cannot ignore the trends and needs to be able to address client demand. As one participant noted:

"People do care about their investments and for too long the investment industry pretended that every company is equal."

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