

Thursday 16 June 2016 - The Berkeley Hotel, London SWIX 7RL

THE FINDINGS

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The Findings

Thursday 16 June 2016, The Berkeley Hotel, Wilton Place, Knightsbridge, London SW1X 7RL

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I. Summary

The nineteenth Meeting of Minds Wealth Management and Private Banking took place on 16 June 2016 at The Berkeley Hotel, London. This document summarises the key issues raised in the topics discussed during the roundtables that took place on the day.

At the Meeting there will be two streams of roundtables – the CEO stream focusing on those matters overarching the private banking and wealth management business model; the CIO stream reviewing investment strategies.

Participants enjoy access to strategic insight, active involvement in shaping the industry and networking at the highest level.

These Meetings are a blend of boardroom style sessions addressing a pre-researched and pre-agreed agenda with open discussions led by objective professional moderators; keynote presentations provided by external speakers whose remit is to spark debate and encourage fresh and original thinking; all topped off with networking – both structured and unstructured.

The next Meeting will take place on Thursday 17 November 2016 at The Berkeley Hotel in London.

To find out more about taking part, please contact: Simon Black on 01483 861334 or email him at simonblack@owenjamesgroup.com.

2. This Report

The Roundtable Sessions were moderated by the following at the Scorpio Partnership team:

- Simon Lough
- Lance Peltz
- Glen Ward
- Cath Tillotson
- Caroline Burkhart
- Alex Johnson
- Annie Catchpole

We are very grateful for the time and energy they have expended on making A Meeting of Minds Wealth Management & 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 and on the day.

3. The Strategic Partners & Sponsors

We would like to thank all our sponsors, without whom the event would not have been 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; and
- To talk openly with these business leaders with a view to ensuring that their businesses are strategically aligned.

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4. Preparing for MIFID II and SMCR and monitoring the radar for future regulatory impacts





Experts: Naheed Tapaya & Haney Saadah, EY and Andy Peterkin, Farrer & Co

Key message

With a year-long extension to the implementation of MiFID II having been recently announced, advisers were keen to talk through the impact, the challenges and the opportunities presented by the extended deadline.

EY punctuated the discussion with succinct presentations on some of the biggest changes anticipated on the regulatory landscape, and by responding to several concerns and questions from the delegates

Headlines

- The extension of the MiFID II deadline to 2018 offers an opportunity to make more ambitious changes to the client experience.
- Attendees are worried about MiFID II reporting requirements and how to align these across multiple geographies.
- Advisers must dismantle silos within their organisations and communicate with clients with one
 voice on regulatory change, only once they are sure of the message they wish to broadcast.
- BREXIT should have no impact on your MiFID II implementation strategy.

Key themes

I. Implementing the Markets in Financial Instruments Directive (MiFID II)

The challenges of implementing MiFID II were discussed in some depth by delegates. The largest asset managers, have already completed their impact assessments and are moving into the planning phase to determine how to take this forward.

Some smaller players reported that they are still trying to make sense of the noise and understand the overall implications of MiFID II to their businesses, given the wide scope.

With a recent extension to the implementation deadline to 2018, many advisers feel they should now be making wholesale improvements to their processes to make the overall client experience more positive. Experts agreed with the delegates that that while MiFID may initially have been treated as a tactical play by asset managers, the extension offered a chance for full-scale business model review. At least one delegate confirmed that they are using the extra time to replace core technology in European offices.

"The regulator has granted businesses an extra year. For some this will be an opportunity to put their heads in the sand for a bit longer. Momentum dropped before the extension and it seemed like when we had the 2017 deadline, many were planning to merely put a sticky plaster on the IT architecture. Now that there is an extension to the timeline, our clients are rightly planning more strategic changes."

Attendees were encouraged to think about how to deal with compliance costs in an era of declining reserves; whether the directive could bring about revenue-enhancing opportunities; and if there is a clear road-map of direction afterwards.

2. Reporting challenges

A few delegates were concerned about new reporting requirements and how this would be handled in non-European markets. One discussed the problems that have arisen in trying to align reporting standards in third countries, for example, Switzerland and some of the Asia-Pacific markets. Another attendee mentioned that his firm is struggling to align MiFID reporting across the Channel Islands, Italy and the UK.

Expert contributors reassured attendees that there is a lot more maturity and instances of 'gold-standard' reporting in the UK than in other markets. Advisers were encouraged to consider the lessons of implementing changes to the reporting standard for PRIPS when adapting their approach to MiFID II.

"There are some pockets of clarity. Transaction reporting has stormed ahead, so now we're seeing a lot of discussions around products. Clients have questions around profitability."

3. Communicating with clients and partners

The conversation progressed to how regulatory change should be conveyed to clients in the context of their other wealth management relationships. A few delegates discussed their experiences during the Retail Distribution Review (RDR), where communicating with clients at the appropriate time had proved important to helping them understand the changes.

"We need to think about what the client impact is and how the changes could benefit the client. Most clients are multi-banked so we're seeing many wealth managers apply for LEIs on behalf of their clients."

In reality, picking the right time to communicate changes with clients will also depend upon the readiness of internal systems, such as mid-office platforms and having up-to-date data-sets. It also means reviewing distribution channels and thinking about the schedule for terms of business updates.

Another delegate commented:

"We had a similar discussion around the time of RDR. We don't want to communicate with clients too early to avoid annoying them. But there needs to be a strong education process, including providing industry fact-sheets for clients. You only want to hit clients once with all the relevant information in a coordinated way."

There was some discussion of what conversations had taken place to date with third party providers — most delegates confirmed they had not yet been approached to discuss the opportunities. More needs to be done to initiate these conversations. There is lack of clarity around what is happening in third countries, where there are offices selling into the EU.

4. Implementing the Senior Managers Certification Regime (SMCR)

Finally, the SMCR has been the subject of discussion among financial institutions for some years. The certification regime will need to be ready at the beginning of 2017. Some asset managers have already gone through the process of identifying who the certified senior managers within their organisation will be.

Given the implications of certification, the number of senior managers is likely to be limited to two to three per organisation, with specific and defined responsibilities. One attendee discussed the

experiences of the process, which threw up some complications, including defining the different divisions (e.g. asset management, investment banking) that make up these organisations.

Conclusions

The round-table served as a reminder that implementing major regulatory change entails both opportunities and challenges. If used wisely, the extended deadline to MiFID II could be used for a strategic overhaul of many aspects of the client experience rather than tactical plays, to the benefit of the end investor. Advisers were encouraged to take the time to break down siloes within their business so that they can communicate in the most effective way when the time comes to convey those changes to clients.

5. Align with your clients' expectation and ensure their experience of engaging with you online is a positive one



Expert: James Barker, Backbase

Key message

The many interpretations afforded by the phrase 'online client experience' was reflected in a wide spectrum of conversation, touching upon issues as varied as on-boarding strategies and robo-advice, to artificial intelligence and cyber-fraud.

Most attendees observed that the online client experience was an area of growing focus in their organisations and that they hoped to use the session to share and learn best practice from one another.

Headlines

- A blended delivery model, combining self-service and advisory, should be offered to deliver to different segments profitably.
- Online client communications need to be targeted and timely; it must therefore be supported by a holistic client data-set.
- Concerns around cyber-crime may discourage some from using online offerings.
- Advisers are currently unsure of the full potential of FinTech in the industry but see opportunities to partner for efficiency gains.
- Digital marketing should share quick snapshots of relevant information with clients that they can
 access on-the-go.

Key themes

I. Self-service model

The discussion began on the topic of cost effectiveness, with delegates exploring different ways for advisers to use their online strategy to service client segments profitably.

For example, a low-cost, self-service advice option can be used for mass affluent/affluent clients, while those who are older or at the higher end of the wealth curve generally prefer having a choice between self-service and face-to-face.

A comparison was made with the health sector, where pre-appointment interaction is increasingly moving online to gather patient data effectively prior to face-to-face consultations. The same principle could be applied to wealth management, with technology being used to streamline account opening and providing a portal for viewing information, with the option of meetings in person for some clients.

For some delegates the challenge centres on encouraging take-up of the online solution once it has been implemented. Walking clients through the platform and demonstrating how to use it has proved effective for one adviser in convincing people to try it out.

2. Client communication channels

An excellent digital proposition is integral to the high-net worth experience, improving the efficiency of client interactions. Delegates commented, however, they sometimes come across internal push-back when proposing this view, with some Relationship Managers worried that their role is put at risk, rather than enabled, by digital communication.

In practice digital channels are being used to support client touch-points. One delegate suggested that the fundamental of good client communication was having access to a holistic data-set, from across the organisation, to make sure the content being sent out was sufficiently tailored.

"Communications need to feel personal, relevant, and contextual. They should feel designed for them, not for people <u>like</u> them."

A holistic data-set will be needed to understand the gaps between RMs and their clients. A challenge for advisers is that they are often less good at capturing and using so-called 'dark data', the soft information about their clients that needs to be centralised and shared with the rest of the firm. If done well however, this information can support advisers during the wealth journey – beginning with on-boarding but allowing them also to contact them at key events in their lives to help them handle change.

"We need to be wary of information greed as that will lead to client fatigue. Clients don't want to feel like they're in a mile-long origination process. We don't always need to ask clients what they want — we can use back-office analytics instead."

3. Cyber crime

For many HNWIs the immediacy of online is not only incredibly attractive, it can drive value in the face-to-face relationship too. Delegates talked about using technology to gather relevant client information prior to meetings – one way of ensuring those conversations stay focussed.

But many of the attendees were as concerned as their clients about the possibility of cyber-crime. The older generation particularly are most anxious about sharing sensitive details online or by email, resulting in a challenge to advisers:

"The most natural thing to roll out first on an online platform is statements – but in fact that also tends to be the most sensitive bit. The stuff that usually follows is research, portfolios and advice – all of which tend to be less sensitive."

4. The role of FinTech

There was some speculation as to how FinTech should be viewed, with delegates commenting that the industry is ripe for disruption from an Uber-style proposition. In the near-term, FinTech partnerships could help advisers streamline and automate back-office operations.

In the longer-term advisers do see the opportunity to upgrade their back-office and move away from legacy systems. The challenge remains choosing between 'quick-fix' replacements and entirely changing them.

"Given many wealth managers have a 36-month time horizon and are facing high client expectations, a replacement can come with considerable costs: the expense for smaller firms, the risks (e.g. of losing client data) for larger ones."

5. Digital marketing

For several delegates, the primary focus of the online experience right now is digital marketing. There was some debate as to the most successful strategy for posts and shares, with the learning that the effect should be non-intrusive, with a series of 'sound-bite' updates. These snapshots should pique client interest, encouraging individuals who want to know more to follow up.

Conclusions

During the discussion, it became clear that advisers are at different stages of their online client implementation journey. A strong conclusion from the session was that the online experience doesn't have to be segregated from the overall client experience – indeed it should be an integrated part of the client proposition. The key challenge for advisers is to align the digital strategy with how clients want to engage with providers in other parts of their lives.





Experts: Monica Miskelly, Multrees and Brad Young, Time Inc

Key message

How exactly can wealth managers' technology systems facilitate relationship managers in their engagement with clients? This roundtable's discussion focused on how wealth managers today need to fundamentally rethink the ways in which they can transform from an omni-channel operation, to a digitally-savvy, client centric, multi-channel organisation.

Headlines

- Wealth management firms need to adopt digital marketing strategies, teaching their relationship managers how to use technology to engage clients
- Adopting a digital strategy is beneficial not only for clients, but for advisers as well it can help gather important and relevant data
- Content production shared through digital mediums such as social media channels is essential in grabbing the attention of targeted potential clients

Key themes

A major challenge facing wealth management firms today is the pace at which technological innovation is moving. However, with challenges come opportunities to grow and strengthen – and as such, there is a huge business opportunity to enhance client engagement by helping relationship managers improve their technological capabilities.

In this day and age, a firm's digital presence becomes the face of the brand – it is one of the first things clients (and potential clients) will see. In this sense, firms have to ask themselves big questions before posting anything online – what do you want to say as a brand? What do people want to hear? If digital performance is poor, clients will soon associate the same poor performance to the face-to-face relationships offered by the firm.

And although diving into the digital deep end may sound daunting, the roundtable was reassured that amongst these constantly shifting sands, achieving high levels of digital satisfaction is in fact very possible and easily achievable. Delegates discussed the multiple benefits that technology brings with it – not only does it drive engagement on the client side but it can also help advisers manage their work and gather client data as well:

"The key word is time – time, because an improvement in technology leads to fast digital delivery to clients. And fast digital delivery to clients frees up investment managers' time to meet new clients; this freed-up time ultimately then also creates new leads."

Be that as it may, experts emphasised that it was important to remember that technology cannot substitute face-to-face expertise – tech can be used as a complimentary tool in engaging clients, but first, advisers need to fully understand how to provide rock-solid, expert diagnosis to their clients.

Discussions were then veered towards better understanding the profiles of clients that higher levels of digital engagement would interest, and how exactly relationship managers could tailor their

propositions to these individuals. Several delegates agreed that the digitally-savvy client group were those under 40.

"The beauty of technology is that it allows flexibility — you can provide the right aspects to different clients. In other words, you tailor your tech offerings — offering it only to the clients who are interested. At the end of the day, it is all about behavioural economics and knowing your client."

Advice was sought from the experts as to the best ways to approach digital transformation. In-house content production was heavily recommended as an easy and cheap way to reach out to clients, leveraging expert knowledge and demonstrating multi-channel proficiency.

Delegates were keen to understand what type of content most readily attracts clients' interests. Contrary to popular belief, wealth management clients do not necessarily want to read about financially-related topics. It was argued that HNW individuals are most drawn to firms that can demonstrate creative and insightful knowledge in their shared content. Thought leadership pieces or articles focusing on specific issues such as entrepreneurship for example, are commonly noted as topics of keen interest.

Similarly diversification in content output vehicles is critical to standing out. It was noted that video content is very positively received, which is why financial services firms are increasingly investing in YouTube accounts. Using Twitter and Facebook is becoming more common practice across different firms because of their effectiveness in providing a platform on which firms and advisers can deliver immediate commentary on market trends. Being engaged with real-time events demonstrates informed and up-to-date expertise. Social media access is becoming imperative; in fact, many social media compliance rules are now changing, in order to accommodate this (i.e. Financial Promotions Act).

Content released on social media can also be targeted to specific groups – this allows firms to direct certain posts towards their desired target client group (i.e. institutional clients). Additionally, measuring success of business also becomes easier with social media – many of these websites enable a 'percentage of engagement monitor', which analyses how popular firms' posts have been with their clients/readers.

Beyond the content question, numerous delegates had queries regarding the infrastructure needed to support relationship managers as they embark on the path to digital transformation.

"Clients are already far down the tech progression food chain; it is the investment managers that are resisting..."

However, success in these online strategies goes beyond mere digital presence. Delegates discussed the tactics needed to get smart about digital client engagement. For example, identifying key times to contact clients is essential – times between 9am and 5pm are becoming increasingly irrelevant, due to the fact that clients are most probably at work and generally busy. The strengthened relationship between an adviser and a client can be attained by engaging outside of work hours or on weekends through usage of other instant contact platforms (i.e. WhatsApp). Advisers need to learn about engaging with clients on their terms.

Conclusions

It is an exciting time to be in the industry – wealth management firms now have the opportunity to guide their relationship managers into the digital era, teaching them about seamless online to offline transitions. Clients want multi-channel operational relationships; leveraging both digital and personal interactions will inevitably lead to stronger adviser-client relationships, experience and business outcomes.

7. Preventing 'Farmergeddon' - What happens when you can't recruit or retain rainmakers?





Experts: Mark Somers, Somers Partnership and James Davies, Beyond Search

Key message

There is a concern in the wealth management industry that the ratio of farmers and rustlers to hunters is out of balance. This roundtable discussed the strategies which can be adopted to solve the problems this trend brings, including recruitment from other sectors and further training.

Headlines

- With digitalisation spreading through the wealth management industry, would it be better for firms to harness skillsets for the new generation internally or from other sectors?
- Perhaps a hybrid individual with a skillset which encompasses both hunting and farming could be more valuable
- Training and development is a good retention tool, although how can employers prevent the risk of employees leaving after the company has invested huge amounts in them?
- It is easier to recruit someone with the talent to be a rainmaker and teach them technical skills than the other way around
- Money is usually not the reason why employees move the quality of opportunity matters more

Key themes

McKinsey research shows that investment returns will be harder to maintain in the next 20 years than the last 30 years. This fact combined with the expert's view that organisations have, over time, shifted from being client centric to going out of their way to attract and retain rainmakers, brings several key themes to this session.

An introduction by one of the experts revealed the current sentiment is that there are not enough hunters. There is also uncertainty on whether the right frontline people are employed. To pursue this further, the floor was opened to discuss whether private banks should start recruiting talent from different industries, namely the tech industry due to the recent digitisation of wealth and what delegates are currently struggling with in their business.

A variety of responses followed through, due to the diversity of delegates' backgrounds. However a theme surfaced on a hybrid hunter/farmer model. Is the best model a combination of hunter and famer? Or should there be separate business divisions for hunters and farmers? Are firms equipped to help farmers transition into hunters? What about hunters who now find themselves farming 80% of the time?

Delegates revealed they are already experimenting with strategies such as recruiting from different industries and establishing an in-house academy to nurture talent. One challenge arising from recruiting talent from various other industries is the team culture. It takes time to integrate everyone into the private banking culture as well as smoothly meshing together old and new culture. It is said that the difference between an average and great employee is the level of culture fit.

The general consensus was that is it easier to recruit someone with the talent to be a rainmaker and teach them the technical skills rather than the other way around. Rainmakers are seen as people with drive and who can create a great workplace culture, while also having enough thirst to boost consultative sales.

When recruiting, the delegates in their positions as employers specified that they are looking for entrepreneurialism and a large AUM. It was also mentioned that money is never the reason why an employee would move – it is more along the lines of the quality of the opportunity and cultural match. It was mentioned that the industry is lacking in sophisticated CMOs, who are key in attracting talent.

The dilemma for a lot of delegates was how to prevent professionals from moving on to another firm after substantial investment has been put into training them. As the concept of a job for life is now almost non-existent, the dilemma consists of either training employees and seeing them leave versus not training them and having them stay. It is found that people are more likely to leave if they are trained, in the pursuit of career progression. Therefore to increase retention, a company must have a suitable career plan for their employees.

Hybrid hunter/farmer models may benefit the employer as well as the employee themselves. Hunters, although high calibre, are often found struggling when working under people. Open equity structures may incentivise them but are employers willing to take this step? One delegate says definitely. It is important to build relationships at the beginning and move farmers up over the course of time.

Other than hunters and farmers, rustlers also exist in the industry. These are people who move around companies and take assets with them while doing so. Twenty years ago in the insurance industry, the problems caused by rustlers were resolved by embedding others into the client relationship. With a team including specialists, client relationships where there are many touchpoints can be sustained even when one member (especially the RM) decides to leave. Teams are found to be rated higher than RMs in the US specifically, leading to higher client engagement.

Shifting our focus to clients now, it was mentioned that the easiest time to hunt for new clients is when teams in other companies are changing, especially if the main contact leaves. According to a family office, the best way is to embed clients more into the firm and listen to the opinions of younger staff more. These youthful staff are also needed to understand new clients and maintain experienced farmers in the business.

All in all, a Farmergeddon could also be an opportunity to refresh the business. It could turn into a period where hiring and retention strategies are revised, propelling the business to the top.

Conclusions

The wealth management industry may be close to Farmergeddon, with its closed off hiring strategies and distinct hunter/farmer personalities. It is time for the industry to explore hiring from different sectors, especially technology, in this rise of the digital age. Firms may also want to nurture hybrid workers who can take over farming or hunter responsibilities whenever needed.

8. Getting the best out of technology in your business



Expert: Paul Bayliss, SEI

Key message

All players in the wealth management industry have to some extent developed a digital interest in the recent years. A digital presence can improve client experience satisfaction scores, reduce costs/improve efficiency, and reduce risk. We would now need to start thinking of technology in the context of value, and decide between investing in the front office or back office.

Headlines

- A focus on front office technology investment could bring greater value than a focus on the back office
- Client-facing staff are spending too much time on administrative work
- Project management capabilities need to be improved for implementation to happen and in a timely manner
- Challenges delegates face relate to regulation, which takes up the time and budget for technological solutions
- Cloud technology could be considered as the cost is low and fixed

Key themes

A diagram was presented at the beginning of the roundtable, with the x-axis starting from 'impacts value/front office' to 'less impact on value/back office'. The y-axis increases in 'end client perception of value'. The line on the chart suggested that focusing on front office tech investments will bring greater return than investing in the back office.

Our expert set the scene with the insight that clients no longer value the technology used for online advice. Instead, if firms can simplify what they put in front of clients using technology, instead of an Excel sheet, then it would be much more appreciated.

A variety of reasons were heard around the table for investing in technology:

- Lowers the regulatory risk, especially tax compliance and suitability
- Automates the process so that there is a good trail of previous discussions and in one delegate's case, save 12 weeks of time annually
- Reviews asset allocation continuously
- Frees up sales staffs' time from administrative work to focus on value creating tasks
- Getting an elegant solution from the wealth manager to the client
- Cuts out paper
- Ensures that fees charged apply to the service offered and not for admin work

- Leverages technology-led distribution
- Decreases number of human errors
- Caters to younger generations' tastes

One delegate spoke about how the industry is over-servicing their clients, causing a large amount of administrative work. Thus, the value from investing in the back office could be passed on to clients and drive front office value creation as one-third of client-facing staffs' time is spent on administrative/regulatory work.

The current situation seems to be all talk/no action. One delegate brought to light the fact that there is sometimes cynicism at the senior management level. As they are more distant from administrative work, they lose sight of how much time is spent on it and thus do not necessarily perceive as high a value-add as those on the frontline. There is also the fear of going first when trying out new technology. People want to wait and see the impact of digital solutions on other firms before committing time and money into implementing it themselves.

As we move on to the problems which delegates wish technology could resolve, application programming interfaces (APIs) and stale data were discussed., API relates to the need for 'systems to talk to each other' and stale data speaks about problems such as having five different phone numbers for the same client.

There is also the dilemma between buying versus developing technology with in-house capabilities, with the common belief in the room was that developing solutions is going down a dark hole. Interestingly, the major issue seems to have shifted from what needs to be fixed to how to project manage technological implementations. As one delegate said:

"You think something is being done but perhaps due to communication breakdowns it is not always the case."

One challenge experienced by most delegates is that regulation gobbles up the time and budget for technological advances. In the words of one delegate:

"Regulation will hijack everything. There may be some glossing over at the back end but it is better than humiliation in the public eye for regulation related negativity."

This is also why RegTech is emerging and why some believe it will always beat FinTech.

Processes which do not add value could be outsourced to cloud technology, where the cost is low and fixed. It could be a great option should wealth managers choose to embrace it, However there are fears of cyber security and leaks, especially in the wake of the Panama Papers as the work could be sub-contracted to 3-5 layers.

On a final note, an insightful delegate offered that the solution may well be to get rid of the back office.

Conclusions

Technology is on everyone's mind, however the problem now is no longer what needs to be fixed and how. It is time to focus on the project management capabilities of wealth managers. Time is needed to implement these innovative solutions and add value to firms by cutting the amount of time client-facing staff spends on administrative work and by boosting client experience.

9. How are global events impacting your investment decisions? Can you ever connect enough dots to predict future economic outcomes?



Expert: Paris Karasso, Calamos International

Key message

It is difficult to allocate assets to negate the impacts of global events, but maintaining a balanced and flexible portfolio asset allocation can help. In that regard, convertibles have a role to play, which behaves like a fixed income holding in bad times, and an equity holding in good times.

Headlines

- Predicting short-term investment outcomes is hard to do. There is no one indicator that is good for predicting short-term movements.
- Volatility is an inevitability of being in the market. It can be tempting to time markets and factors but this should make up a small portion of a portfolio.
- Asset diversification and risk management works.
- Convertibles provide an opportunity for investors to have flexibility and diversification at the heart of their strategies.

Key themes

The roundtable discussion began with acknowledgement that there are numerous investment styles deployed to seek alpha and simultaneously reduce risk — price-driven, event-driven, asset class preference-driven, sector-driven and fundamentals-driven. Each of these styles has flaws, whether it is timing or flexibility or both.

The reality is that all these styles require asset diversification and risk management in order to deliver stable and safe returns.

One investment class worthy of consideration in this light is a convertible. Convertibles are corporate bonds with maturities of between five and seven years which come with an embedded option to exchange for equity if the company does well.

In that regard, they 'behave like an equity when things go well and like a bond when things go down'. Convertibles are the only asset class with a skew which can convert to both upside and downside.

Yet the market for these investment products is not big. In fact at the current time, there are about USD300 billion in convertibles available with smaller players being the major distributors. Pre-crisis that figure was closer to USD500 billion where a lot of financial institutions issued them.

Technology and pharmaceutical players tend to issue convertibles now, as it is a relatively inexpensive way to raise capital. The price of them is based on three aspects – the price of the underlying asset, the spread and the volatility.

The difficulty seems to come when classing what asset bracket convertibles fall in to.

"There is a Merrill Lynch study which suggests it is its own asset class. Funnily enough, we know having spoken with Merrill Lynch, that in the past, their investment platform has flagged portfolios where convertibles have been used. Why? Because ironically, they have been coded as an equity holding — meaning the portfolio management tool has called the allocation in to question based on a client's risk parameters."

Concerns were expressed about what may happen in the event of a default or bankruptcy – where do convertible bond holders sit in the creditor line pecking order? Convertible bonds in that sense are considered as regular bonds, so holders would be the first in line.

Most present suggested that convertible bonds would be of interest – but for specific relationships.

"I think convertibles may be of interest to us on an advisery basis. Clients may come to us with questions about equity alternatives and convertibles may work in that regard. I can see value for certain kinds of clients."

Indeed for some, there was doubt as to whether if you held a discretionary relationship, if you even needed to communicate your intentions to use convertibles within a client portfolio or otherwise.

"If you're a discretionary manager, perhaps you don't need to communicate with clients. It's a simpler product to understand than a hedge fund — I've used these in the past. We bought a lot of these after 2008, because it was a fundamental issue in the market, which provided a very specific opportunity which doesn't occur very often. We categorised it as 'Other' within risk management. We can add up to 20% of 'Other' in to an investment portfolio which is essentially anything that doesn't fit."

The bigger concern held by many of the delegates at the round table surrounded a lack of in-house expertise around convertibles as an investment product and how the asset class could be leveraged for end-client portfolios.

"We don't have a dedicated in-house expert with relation to convertibles. We favour alternatives through hedge funds, although this wouldn't sit in alternatives. We'd manage it through the fixed income/equity investment line."

Conclusions

Ultimately, the decision to use convertibles requires wealth managers to have an appreciation of the product, a willing client base and strong portfolio and risk management services.

With only USD300 billion in convertibles available, the market is relatively small, but it does represent an opportunity for alpha generation in an era of low interest rates and a steady investment opportunity when market conditions are volatile.



Experts: Stuart Laidlaw and James Mertek, Cyberlytic

Key message

With the continued danger posed by hackers, cyber-terrorists and criminals, cyber security is of paramount importance to the wealth management space. Despite its importance, the unfortunate reality is that cyber-attacks are becoming more, not less commonplace. Firms will need to have multiple layers of depth to protect the most important client data.

Headlines

- Cyber-crime is an incredibly lucrative industry and is only likely to become more so as coding and scripting because a core part of education.
- It is incredibly hard to prosecute as hackers base themselves out of jurisdictions with no extradition agreements.
- Attacks are not just increasing, but they are becoming increasingly more difficult to counter, with some attacks requiring the immediate removal of affected computers and platforms from networks.
- It is absolutely critical that firms know precisely where their crown jewels are, to ensure they are protected to the utmost.

Key themes

Every year, it is estimated that USD445 billion of money is stolen as the result of cybercrime – but it is not just money which can be stolen with intellectual property also being at risk.

Of the incidents of cybercrime which occur, 75% of them happen across five industries, with finance and insurance being the most affected, followed by manufacturing, information and communication, retail and wholesale and health and social services.

The reality of cybercriminal activity is that it is cross-border in nature and it is not easy to prosecute people as a result.

In the UK alone, last year, there were 7 million reported cybercrimes – one every 4 seconds, with hackers and criminals from up to 50 countries at any one time attacking the UK's cyber infrastructure.

Yet despite the obvious threat posed by those from outside of the UK and the difficulty in tracking those responsible down, the most likely to attack are insiders, specifically disgruntled employees.

There are any numbers of different ways that hacking is carried out but one of the most recently developed and most insidious types of attack is ransomware. As the name suggests, the hack itself effectively holds a server or computer network to ransom, insisting that money is paid in order to preserve the integrity of the server.

To further highlight the level of sophistication this type of attack has developed, ransomware developers have even started to set up payment hotlines to expedite ransom payments!

And the challenges don't just stop there. With increasing user numbers, social media and professional networking sites make it much easier to gain information about the types of scripting and coding platforms used by various financial services institutions.

One such case came to light recently after a Bangladeshi bank worker's LinkedIn profile revealed that they worked using SEQUEL coding. The subsequent hit on the bank saw them lose GBP80 million as Chinese nationals in a casino in the Philippines monitored the bank's close of day behaviour to siphon off funds.

There were questions asked about whether it was a good idea to use cloud providers or outsource cyber security.

"It's important to know where your crown jewels are. There's not one answer for everything. You may have cloud computing for some aspects of your operation (and have outsourced security for those items) but equally, you want to keep the most critical stuff in-house."

That said, outsourcing for some firms in this regard makes sense given the expense of building an inhouse team and to develop and constantly update several lines of defence. In that sense, it is cheaper to look for an external provider.

Although, without being able to vet the staff of those firms, there is a trade-off with regards to who is accessing your data and how you can monitor their behaviour.

There were also concerns about response times around hacking and cyber-attacks. 203 days is the average length of time it takes to work out that a company has been hacked and a further 60 days to remediate the situation.

Conclusions

Wealth managers and private banks need to look at ways to protect the most valuable data they possess – client data. By building multiple layers of security, firms stand a better chance of preventing single attacks bringing their business to the ground. If done correctly, security of data and information can become a differentiator



Experts: Lorna Robertson and Gavin Ward, Invesco

Key message

Alongside robo-advice, the other major theme developing in the US is the debate around active versus passive investments. The overwhelming majority of investment professionals struggle to beat the benchmark consistently, which is adding to passives allure.

Exchange-traded funds (ETFs) are one investment product which is helping to move investors towards a passive environment.

Headlines

- There are commonalities in the US and UK, but ultimately, investment performance boils down to two key aspects, fear and greed.
- Estimates suggest that in Europe, there is approximately one trillion dollars in ETFs, which puts Europe ahead of the US at this stage in the evolution of the space.
- The preference of investors to choose passive funds means investment houses can focus on other aspects of the investment process for differentiation.

Key themes

The first key trend in the evolution of asset management from active to passive began with the introduction of the first ETF launched in the US in 1993 and 2003 in Europe. In many ways, ETFs were the first and most successful FinTech disruptor as they brought asset diversification and investment risk management disciplines in a single wrapped product.

The subsequent growth of the ETF market has come from three distinct areas: new money allocated to it, new client books tending to be ETF oriented and strategic asset reallocations from individual equity holdings.

"In many ways, it's like football. It's very difficult to find the Ronaldo's and the Messi's, although they do exist. However, investors are coming to view that it's increasingly difficult to beat the benchmark both before and after fees, consistently. ETFs offer an opportunity to share in market returns and mitigate much downsize."

One aspect worth considering is how in the past, ETF's have struggled to be integrated into some firms' investment platforms. In fact, ETFs used to show up as an equity holding at one large US-based institution. As a result, relationship managers and clients were being warned about being overweight on equities, despite these products offering far greater risk management and asset diversification opportunities.

Yet what, initially drove conversations in the US and the subsequent trend towards ETFs was performance. Fees tended to become an amplified issue in times when investment performance was weak.

"If you start an investment conversation around fees, you're in the wrong spot. The real question should be 'What are you trying to accomplish in your portfolio?' Then go from there."

ETFs are cheap and pragmatic as a way to get to where clients want to go, as such the question often gets asked, 'why would you pay for an expensive and often underperforming human when your portfolio can be automatically updated through changing the underlying holdings in an ETF?'

There are some theories that despite the original intention of the retail distribution review to regulate the IFA and advice space, it may well have hurt asset managers more. Ultimately, the person who owns the client relationship holds the reins.

But this doesn't mean to say that IFAs can move further up the value chain necessarily. Unless they are prepared to outsource money management, tension may well develop.

"The industry's challenge is that it currently asks advisers to do two things: manage money and people. There is conflict baked in to it. RDR in my view, is the clarifying moment which should be forcing advisers to choose which they would rather do."

Some advisers concurred with this opinion and felt that ETFs made value propositions much cleaner even if the client relationship evolved a bit as a result. RDR has increased transparency and so people know what they're paying for along the value chain. In this context, under-performing investment managers need to justify every basis point charged.

Of course it's not all plain sailing as there are key questions about the suitability around ETFs for clients.

Finally it is worth considering that though there has been an explosion in ETFs, there has been no correlated reduction in the need for advice. On the contrary, if you were starting an RIA today, while you could outsource significant aspects of your business, you'd still be the person responsible for the goals-based investment conversations.

And while ETFs were helping to move the needle on active to passive investments, the other elephant in the room, technology and robo, are continuing to disrupt the marketplace. In that sense, although this trend continues to develop, the wealth management space in the US, contrary to popular belief, is no further ahead than the UK or Australia, based on the tools available.

Conclusions

ETFs represent an opportunity to focus on client service rather than asset servicing. In doing so, advisers have a chance to go further up the value-chain to offer advice around life goals investing and wealth planning – areas which provide significant value add and enable clearer differentiation in the marketplace.

This will mean that providers of ETFs and other investment solutions will need to continue to develop distribution channels, building strong relationships with advisers and bring down costs to access them. This is good news for the end-client but represents a real challenge for the industry long-term.

12. Can human-based advice compete with robo-advice? The age of robo-advice has arrived – mimic it, differentiate from it or join it!



Experts: Sim Sangha and Tessa Lee, Sammedia

Key message

Robo advisers have accumulated assets at a rapid pace over the past four years by attracting a high level of demand from mass market clients. Traditional wealth managers can capitalise on this opportunity through adding complementary digital capabilities to their services with the prospect of "bionic" advice appearing as a favourable solution.

Headlines

- Robo advisers have generated swift levels of asset accumulation with heavyweights Charles Schwab and Vanguard successfully leveraging their distribution networks to capitalise on the growth trend.
- Technology can never fully replace the nuances of a human adviser although there is a niche for robo advisers, particularly within the mass market space.
- A hybrid solution where digital technology can complement the abilities of a human adviser is likely to be a winning approach, as evidenced by the success of Personal Capital.
- Cost and regulatory requirements are considered as barriers to entry although clients will
 increasingly demand digital solutions from their traditional wealth managers as robo advisers
 develop.

Key themes

The session opened with discussion around the general definition of robo advice and the various operating models that have been grouped under this term. Robo advice models are generally defined as online money managers with whom clients can invest without the need to see a physical adviser. Robo advisers have rapidly accumulated assets over the past four years with Vanguard and Charles Schwab attracting sizeable assets onto their online offerings through their substantial distribution networks.

Some delegates questioned the difference in terms of suitability requirements between a pure robo-adviser and a 'guided sales' platform such as Hargreaves Lansdown's HL+. Furthermore, the boundary between advice and guidance still constituted a grey area within the FCA's regulation for a number of delegates.

Discretionary robo-models such as Nutmeg and Wealthfront have attracted a high level of demand from mass market clients, many of whom have fallen into the 'advice gap' following the implementation of RDR in the UK. The majority of delegates acknowledged the huge demand among clients for robo-advice, however, delegates were split on the scale of the threat it poses to traditional wealth managers.

One delegate likened robo-advisers to Boots in the sense that people could self-diagnose needs and then shop at Boots for a simple remedy. Nevertheless, a conventional doctor (read: traditional wealth manager) would be needed for more complicated ailments or concerns.

In terms of current capabilities, most delegates saw robo-advice in the context of traditional wealth managers as simply a complementary distribution channel to their existing businesses. Wealth managers tend to cater for a more diverse range of clients where different channels can serve different needs. For example, clients could use a digital platform for basic reporting functions and contacting advisers through social media. One delegate highlighted the fact that "tech can never fully replace a conversation" and that nuances around complicated issues could only be fully communicated by a human adviser. Indeed, Nutmeg has even moved to hire human advisers as part of their "digital branch" strategy this year.

Another topic of discussion was the cost of client acquisition among robo advisers and the real profitability of the industry despite the breakneck speed of asset accumulation. One delegate mentioned that an independent operator without a distribution channel such as Nutmeg typically has to spend hundreds of dollars to acquire a client. Industry stalwarts such as Schwab and Vanguard can typically acquire a client for around eighty dollars. Another delegate also used the example of Schroders' acquiring a stake in Nutmeg to understand its digital marketing strategy rather than the underlying technology. Moreover, robo-advisers mainly use the same algorithms that turnkey managers in the US have been using for years. Therefore the technology is not innovative in itself.

Some robo advisers have moved to differentiate themselves as innovators with so-called "bionic" offerings which complement digital technology with face-to-face advice. Personal Capital was given as a case study where clients can use its account aggregation tool to have a complete picture of all assets held with different firms. Subsequently, its technology can analyse the health of a client's portfolio and determine whether capital is being held in underperforming investments or in overcharged accounts. If a sizeable sum of client assets is held in these accounts then a human adviser can prompt the client to discuss their investment strategy with them. The success of Personal Capital comes from providing a complete dashboard of a client's financial life and as one delegate put it:

"If you control the interface, you control the relationship".

Other industries have led the way forward with this kind of business model with disruptors such as Airbnb and Uber providing an interface rather than a direct service. A number of delegates noted the opportunity for independent wealth managers to have a first move advantage in this area as they can request third-party information to build a comparable online interface. However, some delegates alluded to barriers to entry around cost and the additional regulatory requirements that could come with such a solution. While undoubtedly an account aggregation tool would appeal to many clients, research has shown that clients do not want to pay the same price for digital advice as they would do for human advice. Therefore it is a question for wealth managers as to whether they join a race to the bottom in cost or whether they can justify an AMC of 1% through conventional services?

The session concluded with a quick round of future thinking on how robo-advice would evolve over the next two to five years. A number of delegates foresee more acquisitions in the robo-adviser space as traditional wealth managers seek to buy technology rather than build it themselves. Furthermore, some delegates expect the big four banks in the UK to provide a robo-mass market offering in the aftermath of FAMR. It was noted that Santander have recruited dozens of advisers in the UK this year with the high street bank seeking to capitalise on its strong brand and existing client base. Delegates were split as to whether the pace of robo-adviser asset growth could continue at its current rate but there was agreement that there will be a place for robo-advisers in the wealth management industry.

Conclusions

Robo-advice has proven to be a successful business model within the wealth management industry although the technology needs to develop further in order to be considered as a true disruptor.





Expert: Michael Gruener, Co-Head of the Blackrock iShares EMEA Sales Team

Key message

In order to successfully visualise how a wealth management business is likely to look in five years' time, it is imperative for business leaders and firms as a whole to re-engage and reconnect with their clients, while tackling development in areas including clarity of fee communication and technological innovation.

Headlines

- Regulators pushing for higher fiduciary standards have effectively imposed fee-based models within the wealth management industry.
- Fee-based models are growing globally; however the industry is struggling to provide a
 justification to clients for charging a fee.
- The uneconomical nature of offering fee-based solutions to all clients has contributed to the 'Barbell effect' in investments passive + active Alpha seeking.
- Technology has reengineered distribution through the emergence of automated advisers. The
 wealth management industry needs to embrace the technology opportunity rather than ignore
 it.

Key themes

The round table discussion focused across three topics:

1. Shifts in pricing structure resulting from REGULATION

Regulators have pushed for higher fiduciary standards for the global wealth management business, demanding that the industry improve fee transparency for clients as well as ensuring a strong alignment of interests between clients and providers. Such pressures have caused the growth of fee-based cost structures.

Providers are rapidly moving away from existing 'fee-sharing' models into providing customised solutions tailored to their individual client price points (fee-based). However, as one delegate acknowledged...

"The moment you charge a fee — you must justify a reason for the fee — it is no longer 'transaction based' which was universally understood by clients and providers."

Early adopters of fee-based solutions were able to justify the introduction of fees by significantly expanding their product line and service capabilities. These firms achieved an expansion of their proposition by integrating in-house asset management capabilities with their wealth management business.

Institutions that did not have in-house capabilities looked to acquire or partner with third party providers to develop their own integrated asset-wealth management solutions.

"In-house asset management capabilities bring major issues. We are all operating in a low trust world and the introduction of third party providers has to be handled and communicated carefully. Their number is slowly diminishing as any potential increase in demand for third party providers is offset by pricing pressures."

Not all delegates agreed with the merits of asset and wealth management integration. Business leaders cited the potential inability of in-house asset management capabilities to match the standards and reputation of external providers.

These delegates went onto identify that fee-based solutions could be justified by effectively communicating to clients the value-add of the services provided and client experience they receive. There is unanimous agreement that in the wealth management industry today there is a strong need to revisit the existing client interaction process, particularly in the UK. One delegate commented...

"One of the biggest drivers that engages and provides value for clients is keeping it simple. However, simplicity is one of the hardest things for our industry to achieve."

Participants also recognised that the roles of wealth managers and financial advisers have evolved from "explaining or selling products" to being an empathic, engaged and client orientated professional focused on goals based investing and advice.

"The role of a Financial Adviser in the eyes of a client is to tell them about what they need in order to achieve their life goals. Our role is no longer necessarily limited to just explaining or selling products."

"As long as all outcomes remain focused on putting client goals front and centre — many clients have shown a lack of interest in how to achieve those goals or the details in getting to the goals."

Clients indicate that they want their wealth managers "to do a little bit more". It was widely accepted within the room that the success of justifying fee-based cost structures depends on the ability of an institution to understand what that little bit more is and communicating it effectively. Clients are willing to pay as long as their financial adviser "gets them".

2. Fee-based models driving the BARBELL EFFECT

The growth of fee-based models has had immediate knock-on effects within the global asset management market, most notable of which being the 'barbell effect'. Michael Gruener, Co-Head of the iShares EMEA Sales Team, described the barbell to be the new 'normal' for asset distribution within the global market space.

"Assets are moving away from 'Core Active' (mutual funds) and towards 'Speciality Active' (outcome based investments with high alpha) and/or 'Passives' (ETFs/Index). This has been driven by the rapid growth of fee-based models, however it is uneconomical to offer fee-based to all clients."

All delegates seemed in agreement that it is difficult to offer personal fee based advice to clients below certain thresholds (several cited USD1 million in investible assets). These clients are serviced through 'managed solutions' which are easily commoditised and predominantly passive.

Delegates were quick to identify that...

"The US has already had this in place for the past 15-20 years; it is only just emerging in Europe."

Although there is a shrinking in asset base for Core Active investments (down USD390 billion NNB between 2012 to 2015), there was wide consensus that innovation opportunities existed across the entire asset product spectrum.

Speciality Active, focused on outcome based/goals based investments is expected to show growth into high-conviction/unconstrained, multi-asset and multi-outcome orientated products. Core Active is set to see an innovation shift into further utilising factor investing and smart beta to remain relevant within the global market space.

3. Opportunities through AUTOMATED ADVISERS

"The reason why new firms such as Wealthfront have succeeded is because they have managed to keep the message and product simple. They have identified that the product they offer (not too dissimilar from what we offer) is bland and it should not take up that much time — however it can be as detailed as an individual wants or take as long as they want — this level of customisation was achieved through the use of technology."

Automated advisers are perceived in the world of wealth to be tech companies that are not confined by legacy, enabling them to primarily focus on developing a dynamically evolving, simplistic and fully customizable client experience when it comes to an individual managing their own finances.

Conversely, traditional wealth managers and financial advisers use legacy, brand and reputation to enhance their value proposition — "a client should feel as if they are buying not just a product but an entire experience."

"The beauty of firms such as Hargreaves Lansdown, Wealthfront, Betterment and so on, is that they do not have a legacy but provide and capture client experience. Right now, our industry is trying to balance legacy with that of client experience demands and expectations."

Many participants were sceptical about whether direct to consumer, automated advisers would ever achieve sufficient distribution, but several delegates felt that they would be targets for takeover or partnerships with traditional wealth management firms, perhaps within the next 12-24 months.

"Many of these firms [automated advisers] will either fail, become partnered or be bought out by existing big name firms."

Traditional institutions view automated advisers as a lucrative, high growth avenue into client pools who would typically be stranded within commoditised managed solutions. (Charles Schwab seeing USD5 billion in asset growth in the US within 2 months while Vanguard saw USD32 billion over 12 months.)

Automated advisers and the technology that they have developed is starting to be viewed as a powerful enabler within firms to empower financial advisers, allowing top producers to continue generating USD5 million to USD6 million in revenues while still being able to service a wide array of clients.

"Using technology to leverage the power of the Financial Adviser is the way to go."

Automated advisers are seen in the present day as a method of creating new layers of interface with clients. Meanwhile, in the same timeframe, the role of the financial adviser is expected to evolve towards providing advice to facilitate clients to meet their goals and not the pushing of products and services.

It was widely accepted within the room that the main challenges for the wealth management industry over the next few years do not lie primarily with the competition from automated advisers or with adaptation to regulator environments — it is rather improving the client experience as one delegate summarised —

"How do we deliver a bit of open entertainment [to our clients to reconnect them to our value add]?"

Conclusions

Delegates ultimately pondered several questions which stood out as crucial to answer before any business in wealth management can begin picturing what it might look like in five years' time.

"How do we allow clients to interact with us?"

"How best can we utilise the power of new technology and automated advisers to adopt, evolve and reconnect with clients using tools that we can either develop or acquire?"

[&]quot;How best do we show value for fee-based solutions?"

[&]quot;How or in which way can we create an emotional attachment between clients and a product or service which in low return markets can look rather bland?"

14. Tax and the death of client confidentiality – how will Panama reshape regulation and risk?



Experts: Andrew Hunt and David Kilshaw, EY

Key message

The II.5 million files that were leaked from Panama-based law firm Mossack Fonseca has reignited a fiery moral debate on tax avoidance/evasion, and client confidentiality. Delegates at this roundtable discussed the ways in which wealth management firms can better prepare and guard their clients' information, whilst providing accurate, country-specific advice on a case-by-case basis.

Headlines

- There needs to be more consistency across advisery and financial firms in how forms, documents, and client data are reported
- The court of public opinion has stigmatised all offshore related activities and a drive for transparency could provide more clarity over the legitimacy of many offshore structures
- Educating clients on the proper definitions of 'tax avoidance' and 'offshore centres' is essential, in order to avoid misconceptions of what is legal and what is not
- Firms need to focus less on global coverage and more on ensuring an accurate comprehension of country-specific structures, in order to advise clients to the best of their abilities
- CRS (Common Reporting Standard) and FATCA (Foreign Account Tax Compliance Act) implementation is going to lead to an influx of client data that firms will have to manage and track

Key themes

The session's discussions were guided by the initial question posed – how will the Panama Papers affect the wealth management industry and offshore jurisdiction globally?

When the floor was opened to delegates, it was almost unanimously agreed that tax planning has shifted significantly in recent years with regulation changing the way that individuals can engage with optimisation structures.

Due to FACTA and the Panama Papers scandal, clients have become severely concerned about confidentiality when it comes to their financial affairs. Most delegates argued that clients should be able to expect privacy in financial matters for security reasons.

The role of advisers in both the physical management of clients' tax affairs and their concerns over financial privacy must be held to a very high standard. As such, many are undergoing significant cost and compliance shifts.

The roundtable's participants agreed that the ideal move from an industry perspective would be to generate a more collaborative approach to best practice in compliance:

"Ideally all advisery/financial firms would come together to ensure fluidity and consistency across all forms and documents. Although a stressful period of change, a standardised process across different institutions will result in better results for all."

Discussions then moved on to FATCA and its effects on wealth management more widely. One member of the roundtable stated that in their view,

"FATCA has become the Trojan horse of cross-border tax evasion. It completely changed the wealth management environment."

This contribution led attendees to discuss issues of tax transparency, and the ways in which the Panama Papers became a sort of reality check for tax initiatives. The scandal unveiled essential questions, that had somewhat been ignored up until the jolt caused by this confidentiality breach.

Even though not all actions of those involved in the Panama Papers were criminal, a general sense of distrust emerged nonetheless. And as such, there has been a huge call to action for all areas of business – whether front, back or middle office – to understand and implement robust processes to maintain compliance, client trust, secure data and privacy.

With regards to tax avoidance in offshore accounts, the delegates agreed on three different categories – jail, evasion, and mitigation. However, there was a strong consensus that although the legality of each of these categories drastically varies, the government and press have now blurred distinctions between these.

In fact, many now associate tax avoidance more widely to illegal activity, even when this is not the case at all (i.e. people can simply be taking out money from an ISA yet the press will automatically label this as tax avoidance, when it is actually mitigation):

"There was an ethical tax outrage."

This led the discussion on to outlining what is considered allowable in the court of public opinion. Due to the fact that attitudes towards tax have fluctuated so much, especially following defining events such as the Panama Papers, firms need to understand how to better educate their clients on how dangerously inaccurate these volatile representations of tax can be:

"The media and government's tax portrayal is an infantile, knee-jerk reaction lacking proper knowledge of tax. Discussions about tax in these contexts have been used as a piece of political currency."

Debate around tax should be encouraged between wealth managers and their clients – the more people know, the less tiptoeing there will be.

And in an attempt to move towards this transparency, an increasing number of companies are requiring compulsory completion of CRS & FATCA forms from their clients. However, globally, there now seems to be much reluctance to abide by such requirements due to the fear and risk of information being sold.

Beyond the categories of tax evasion, many delegates had questions on the future of offshore centres. Jersey and Guernsey were used as examples. It was asked – when investment structures are transferred, and more assets come in, what will be the long-term impact? Which jurisdiction becomes prominent? In both Jersey & Guernsey, it was noted that clients have felt uncomfortable with regards to tax discussions:

"The Panama Papers were a mortal blow to offshore centre reputations."

Following the scandal, wealth managers have been scrambling to reassure offshore clients by offering third party asset and wealth management services.

Yet, firms cannot realistically continue to attempt to provide expert knowledge globally. It was agreed that being a global player is becoming increasingly too complex – wealth managers need to be experts in country specific structures (rather than scratching the tax surface on a wider global scale).

Ultimately, delegates continued to refer back to the definition of the word 'offshore' and its negative connotations as the root of the problem.

Indeed, similar to tax avoidance, 'offshore' has acquired an undesirable reputation and is often associated with tax evasion. A delegate noted that the UK government always raises a red flag and investigates further when they see offshore countries appear on statements (i.e. Marshall Islands).

As well as causing a compliance headache for wealth managers, the implementation of FATCA and CRS will require the relevant tax authorities to handle an overwhelming amount of data. Many anticipate that the authorities would not have the resources to meet this challenge.

Conclusions

Regardless of the complications of tax data confidentiality, most agreed that in order to ensure sustainable businesses it would be essential to manage client trust better. Wealth management firms will need to identify the best ways to assure their clients that disclosing all tax-related concerns and documents at the start of the relationship will be beneficial in the long-term.

15. Is Fixed Income a broken asset class? What should investors do and what opportunities does this create?



Expert: Mark Dowding, Bluebay Asset Management

Headlines

- Managers need to develop skills and identify opportunities through proprietary research and process to achieve alpha.
- It is becoming increasingly difficult to realise strong returns from consensus trades.
- Historical trends in Eurozone bonds have returned 6.5% on an annualised basis over the past 20 years.
- In the corporate bond market liquidity has all but disappeared with investors seeking out the alternative sub asset class with fixed income like features.

Key themes

Is there still value in the bond market?

In the current climate with a large proportion of government bonds now yielding less than 1% and the consequent impact on credit yield means that portfolio managers are buying bonds on behalf of clients but they can virtually guarantee that they will be losing money, whilst charging a management fee. Does this define a broken asset class? As one member of the table pointed out – the past 20 years of performance will likely determine the next 20 years. As a European investor over the last two decades, individuals will have achieved 6.5% in annualised returns.

"The beta in fixed income markets doesn't look as attractive as it once was. Investors have eaten their lunch for the next 7 years, in one go"

Quantitative Easing (QE) combined with the search for yield by investors has created a contraction in risk premium. QE has extracted returns by exploiting premium in fixed income markets and these cannot now be relied on to deliver consistent future returns. Although it is tempting to continue to try to extract returns from beta by lowering costs e.g. indexing, this can lead to unintended outcomes, notably that fixed income index constituents are weighted by issuance. This exhaustion of beta is pushing investors towards alternative asset classes with fixed income like features – property, infrastructure and direct lending. However "there has never been more debt in the world than today" – meaning the fixed income asset class is still relevant.

"In order to extract alpha, it now requires the right opportunity and the right manager's skill. Active management is crucial; passive fixed income investments are possibly the worst things to hold at the moment"

Whilst the opportunity set is narrowing, there are a number of aspects that would allow client portfolios continue to achieve alpha. Ensuring investors follow an absolute return strategy, focussing on alpha rather than beta, that managers are ready to adopt non consensus views and that the investment process is robust, risk weighted and offering non-correlated returns.

"If the industry goes into a vortex — yields will become flat, but volatility breeds advantages and opportunities."

Discussion around the table inevitably circled on the decisive factors that will determine future volatility. At the forefront is the EU referendum, continued central bank QE, market liquidity, wider political trends such as the populist vote and macroeconomic risks such as Japan's ageing population and China's debt bubble.

Conclusions

These risk inducing factors combined with a host of different financial instruments, currencies and issuers ensure fixed income markets remain inefficient. For investors to stay ahead it was proposed that a portfolio manager's 'investment edge' utilises proprietary research and process to identify useful insights for client portfolios.

In one final concluding remark a delegate summarised the discussion neatly:

"The perfect landscape is fast changing around us - although investors should continue to fix their portfolios."



Expert: Alistair Godrich, Lazard Asset Management

Headlines

- The opportunity and development of renewable energy is underestimated by the International Energy Agency and oil companies alike.
- Significant economies of scale in the manufacture of batteries indicate that the industry is close to a cost effective tipping point.
- The commodity Lithium provides a means to be more carbon efficient and is recyclable when compared to oil, gas or coal.
- Questions arise about an environmentally friendly method of mining Lithium.

Key themes

"Battery power will change the global industry as we know it"

There have been significant developments in renewable energy, battery technology, storage and consumer demand to signal a shifting paradigm in overall energy usage. These changes are most evident in the automobile industry, where people spend on average 10 hours a week in a car. However it is not mutually exclusive and these shifts are set to shake-up the transport and logistic industry, taxi industry, delivery industry and others.

"The market for lithium-ion batteries has a lot of untapped potential. Tesla, for example, is facing problems in meeting the demand for its electric cars due to shortage of battery packs, which is limiting its production capacity. This was one of the chief reasons behind its decision to build a large-scale factory to produce lithium-ion batteries."

Significant economies of scale mean that "the cost of batteries has fallen by 10-15% annually in the past five years". While at the same time battery energy density – the ability for batteries to hold power – has increased. This has given companies such as Tesla opportunities to develop and utilise renewable technology and battery storage units with high R&D spends.

"A Tesla's use of battery power means that its batteries have 80% degradation after 10 years, which remains very efficient compared to petrol run cars."

Automobile companies are finding it hard to meet fuel efficiency standards. By 2020 a significant proportion of car manufacturing company portfolios will need to be electric in order to meet carbon emission standards. "Norway to completely ban petrol powered cars by 2025" — "Volkswagen pressured to make electric cars as part of diesel emissions settlement".

Continued industry pressure ensures that the automobile sector is reaching a tipping point, not just on a cost basis, but a political basis. Autonomous driving, for example, is in the political interest. The self-drive car industry is being advanced by Tesla, amongst others, in the US market. In Europe it is a combination of governments and providers, while in China, where there are 5 million electric cars being driven, it is mostly pushed by joint venture agreements with Western manufacturers.

One interesting dynamic change questioned by a delegate is China's involvement in the electric car industry and if China would begin to export cars rather than import them?

At the moment approximately 70% of China's electric car market is made up of joint ventures with Western firms. The alternative to this solution would be to build your own, there is one such provider – "a shining light in the Chinese electric industry" – Geely, aiming for new energy vehicles to make up 90% of sales. The benefit of having joint ventures for Chinese or other automotive firms, means they start at a very low cost base (CAPEX) to those firms with large manufacturing spends.

Conclusions

Just like any commodity, such as coal or oil, Lithium is produced in specific locations around the globe - with volumes (excluding recycling) across Chile, the US and China. Questions still arise around the environmentally friendly way of mining Lithium, though these costs are partially offset by the CO2 efficiency compared to coal or oil when being used.

The actual costs of making up a Lithium battery are predominately from the cathode, anode, research and development and Lithium costs itself. Estimates suggest that there are 150 to 200 years of Lithium reserves; however is that enough time before oil runs out?

FARRER&Co

Expert: David Fletcher, Farrer & Co

Key message

Understanding cultural fit and motivations of the members of the agreement prior to the deal is essential for a successful M&A. It comes back to communication and the vision, and it's about clarity of language, particularly on acquirer's side, about what to do and where to go next.

Headlines

- There are three pillars of the acquisition clients, employees, data
- Good quality due diligence is at the core of the deal success
- Know the decision-making basis post-deal

Key themes

The discussion started with referencing cultural fit as one of the defining factors of post-M&A success. A case study of a series of acquisitions was referenced, whereby the absence of cultural fit has resulted in the advisers of the acquired firm leaving the new parent post-acquisition, and half the business was lost. The new parent changed their proposition and strategy straight after acquisition, frustrating both clients and new employees.

The discussion continued into the factors that make the difference between good and bad acquisition. From the point of view of the acquired firm, understanding culture is imperative, although it's hard to define. As a way to define whether the cultural fit is there, it is advised to try and have 2-3 advisers to work with an acquirer prior to acquisition.

From the potential acquirer's position, it is important to establish motivation behind the deal of the advisers in the target firm. One of the potential concerns is that they might want to retire. When it comes to a merger, a potential commercial risk can come from the chemistry between the "star" players on each side. If the relationships are tense and possibly processes are different, the difference between their views can be significant.

Mentioning the word 'merger' has sparked a debate about whether there is even the possibility of a true merger in the wealth management business. One participant's view was that in couple of years after the deal, it becomes evident who bought whom. This view was supported by the participants, with the general consensus around the fact that there is no merger as there's always one person who writes the cheque, and another person who cashes the cheque.

Another important factor to be established preferably before the deal is the basis of decision-making.

"Known risk with an unknown impact: decision-making basis and clarity of thought."

The people factor becomes evident in a post-deal environment, as the people who are preparing the M&A are not the same ones who would execute tasks on a daily basis in the general course of business.

"Acquirers don't focus enough on the post-acquisition plan"

The discussion in the first half of the session referred to the first of the pillars to consider in wealth management M&A: employees. The second one is clients. One of the recommendations was to make sure that clients know about the deal before it is public, as it will result in a better retention. This factor ties back in to the employees – it is essential that the most effective advisers are in agreement to pursue the deal. By the 20/80 rule, the others will follow. It is generally considered a bad consequence of the deal if a client ends up with a different adviser as a result.

The third pillar is data.

"It can be disastrous; don't underestimate it."

Among the details to consider are aspects of IT systems integration (especially competing) and transitional systems agreements were also raised. Additionally, when buying books of business, the dormant account process could be a potential complication.

"Trying to get a few remaining shares out of the entity that is going to be shut down, which belonged to someone who one lost contact with (dead, for example), is one of the issues when buying the books"

All in all, the success of the coming deal comes back to the quality of due diligence. Assessing what the purchasing side is getting, how far back to look, what can be done with bought data for instance – these are the questions to carefully assess during due diligence.

Tied to that are questions around risks and liabilities and whether they will be carried over with the deal or not. It is linked with the warranty and indemnity cover and the latter is harder to obtain. Who is going to give it must be defined. The disclosures are imperative in defining who is providing the cover.

As it is all about preparation, how much time a firm spends before getting into the M&A process would affect the precision of judgement about the worthiness of the deal. When it comes to timings, it was mentioned that it takes approximately I year to establish internally that the deal has to go forward. Following that is the FCA approval process. In total, it's a 5-year process when selling a wealth management business.

"Cap your lawyers' fees. If litigation happens and something is wrong, then it's on the clock".

As the conversation steered into the regulatory space, the issue of Independent vs. Restricted advice came up. While some concerns were voiced about losing the notion of "Independent" post deal it actually has limited impact.

"You don't need to stay "Independent".

These notions were initially designed for the IFAs. At the moment, "conduct risk" is of utmost importance for the FCA. The definitions regarding "Independent" and "Restricted" and potentially different layers of "restricted" have been put aside, and it is advised to wait until MIFID introduces more clarity.

"An uncomfortable middle position prompts a fast-track move to scale up through acquisitions."

Talking about the M&A activity in the recent times, it was generally agreed that IFA consolidation will go on over the next 5 years. The biggest danger for the middle-sized wealth management businesses is IT.

Most of the discussion was about intra-UK specifics. In the discussion on cross-border and foreign activity, it was noted that some major US firms have already pulled out from overseas markets. The question left open was whether Asian firms would be taking the opportunity instead.

"Who here would like to be bought by a Chinese firm to be a part of an international conglomerate? What's the premium?"

Finally, when discussing PE-backed acquirers, it was mentioned that their own future isn't in their hands. This is potentially a source of complication for a target firm as it challenges the clarity of thought as to where to go post-deal.

Conclusions

The recent M&A activity in the UK wealth management space has brought to light multiple challenges that firms are facing both pre- and post-deal. Most of the issues could and should be resolved in the early stages of preparing the deal to avoid adverse consequence, such as employees and clients leaving the firm. Given the current state of the industry and the number of struggling middle-sized operators, the consensus is that UK M&A in wealth management will continue for the foreseeable future.



Experts: John Cole and Anthony Kirby, EY

Key message

The participants were contemplating several scenarios that the UK could end up in following Brexit. Mainly the implications on trade were assessed, with a particular focus on financial services' export capability of the UK. The UK economy would be expected to decline following a Brexit result.

Headlines

- While UK regulations are led by EU regulations, there are different possible scenarios post-Brexit
- Financial professionals accreditation and qualifications might be in question
- The landscape is expected to change considerably in the next 5 years, both in the UK and EU

Key themes

"Scary monsters in the shadows. How easy will it be to switch on the light and see."

There was a general consensus in the room about the fact that negotiating against the clock once UK formally notifies EU about its decision to leave, having a 2-year deadline for negotiations, is a bad idea. Participants in the session agreed that it was not clear which mechanism would be implemented following Brexit.

Neither is it clear which model the UK will pursue in a post-Brexit environment. The options are:

- 1. Nordic: single market conditions.
- 2. Swiss: in terms of financial services, it isn't a good idea, financial professionals in Switzerland think.
- 3. Turkey, Andorra: customs union. Applied for finished goods and agriculture, no financial services

Much of the confusion arises out of the fact that UK has a trade surplus in services which it exports. There is more clarity in terms of what happens under different scenarios in the finished goods market, such as autos since the UK exports cars too.

As a possibility, there exist tariffs of 2-3% for finished goods. According to WTO, 15% is charged on pharmaceutical goods. Yet nothing is mentioned for financial services. This led the participants to conclude there is uncertainty in many areas.

The consensus view was that there will be an economic slowdown for the UK post-Brexit. Moreover, there is a risk of parity between GBP and USD.

[&]quot;The issue is the EU has total ownership of trade deals."

"The UK has a surplus in services and imports goods. If the currency goes down, it'll get cheaper for Europeans to buy Range Rovers, but it would mean cheap services too."

In terms of regulation, it is unlikely that the UK will change any regulations concerning travel. When it comes to finance, only two options were referenced as a way forward: either MIFID in accordance with EU, or the likes of the US Dodd-Frank and Sarbanes-Oxley.

When imagining the possible scenarios, there was a debate around what could change. It was in general agreed that there's no certainty in the relationship with the EU. The presidency of the EU was supposed to go to the UK soon, but post-Brexit this is in question.

As to market infrastructure, there is a possibility that the UK might be free of the cap on pensions as a result of Brexit. As far as benchmarking regulations and general data protection goes, outsourcing wouldn't be clear legally. Payment services regulations implications aren't clear either. Participants agreed that there would be a need to hold back on regulations until the dust settled.

When talking about the nature of the relationship with the EU markets in the future and possible structures, the definition of Equivalence should be taken into account. Equivalence requires comparable markets, signed cooperation agreements and that the country shouldn't be on anti-cooperation list for FATF. As an example mentioned, Switzerland is partly equivalent.

The concerns were voiced about the British Overseas territories and whether there is a need for renegotiation. Currently, the Channel Islands follow the UK. It is an open question though what would they choose post Brexit – UK or EU.

Reputational losses were seen as a potential threat in case the votes in favour and against Brexit are close.

"When a definitive choice, that's a clear choice. What to do when the votes are so close?"

It was mentioned that the scenarios considered and discussed were all based on the assumption that the EU will stay the same. Entertaining the possibility that EU breaks down, a concern was expressed that the UK will be blamed for it.

"Let's wait for about 5 years and join the leaving party".

"It is very unlikely it is going to stay the way it is in the course of the 5 year horizon."

Yet another concern coming back to the UK's strength in financial services was that of complying with regulations around financial services. Namely, the participants were worried that financial professionals in the UK will no longer be automatically accredited to do specific kinds of jobs, and UK qualifications will not be viewed as equivalent to the EU anymore.

"They will probably not introduce tax on accounting, but they'll say "you're not wearing the right badge".

"We will no longer be able to do what we've been doing for 40 years".

On another note, the issue is open with international banks considering moving headquarters post-Brexit. The examples of Goldman Sachs considering Luxembourg and Frankfurt, JP Morgan debating Dublin and Credit Suisse contemplating Luxembourg were mentioned.

It was a general consensus that whichever way the vote goes, a political crisis will occur. This could possibly be exacerbated by border control reinstatement necessity, and whichever way Ireland would go.

Conclusions

The challenges will stem from the EU possibly having an upper hand in negotiations following Brexit. Uncertainty and the lack of understanding of how Brexit can be managed led to many concerns for the financial services industry, regulations, as well as the prospect of a political crisis.



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