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PAPER

# Trends in Wealth Management in EMEA (Europe, the Middle East and Africa)

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## Introduction

Prospects for the wealth management industry appear bright. A recent survey of wealth and investment managers conducted by Advent Software<sup>1</sup> found that 77% expect net wealth around the world to increase in 2010, although it will be a “rebuilding year” rather than a record-breaking one.

Furthermore, figures from a recent Capgemini and Merrill Lynch Global Wealth Management report<sup>2</sup> show the global population of high net worth individuals (HNWIs) reached 10 million in 2009, a rise of 17.1% for the year. Their combined financial wealth also grew during the period, expanding by 18.9% to US\$39.0 trillion.

However, the challenges facing wealth management organisations as they seek to service this client pool should not be underestimated. The financial crisis not only battered asset bases, but has provoked a far-reaching re-evaluation in how those assets are managed. That is putting pressure on firms to up their game when it comes to the quality and type of services they provide to clients.

Many wealth managers will struggle in this changing environment. Nevertheless, for those with the proper skills and support infrastructure it can prove a time of great opportunity.

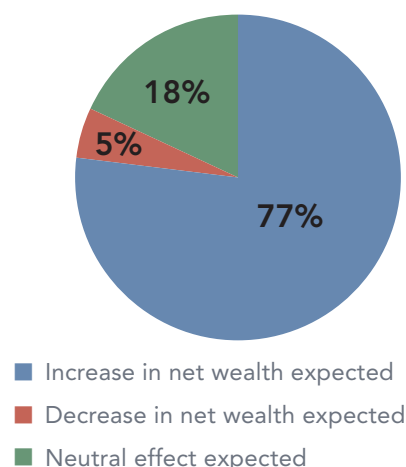
## 1. Increasing Regulation

One overriding theme that has emerged from nearly all of Advent’s recent discussions with clients is the impact that new regulations—and amendments to existing ones—will have on the industry.

Whether governments simply pay lip service to financial industry reform or write new legislation with far-reaching effects, some kind of expanded regulation is a virtual certainty in the months and years ahead. However, at this stage no one is sure exactly what form all the prospective alterations will take, or what their long-term effect will be. Nevertheless, what is clear is that changes to the regulatory landscape will mean additional investment for wealth managers, be it for staff, training, or technology.

### Wealth outlook for 2010

Q: What effect do you expect this year to have on net wealth overall? (n=120)



<sup>1</sup> Advent Software EMEA surveyed 120 Wealth and Investment Managers across Europe, the Middle East and Africa between 25 March and 23 April 2010.

<sup>2</sup> World Wealth Report 2010, Capgemini and Merrill Lynch Global Wealth Management, <http://www.capgemini.com/insights-and-resources/by-publication/world-wealth-report-2010/>

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## 2. Rebuilding Trust

According to Capgemini and Merrill Lynch's latest World Wealth Report, 2009 saw a global recovery in both the number of high net worth individuals and their wealth, recouping much of the ground lost during 2008. Yet while HNWI's may be enjoying a revival in fortune, it does not signal easy times ahead for wealth management firms.

Many wealthy investors were bitten hard by the financial crisis. As a result, clients are now more wary in their selection processes, and more demanding in the services they receive. This is translating into more intense competition among firms to attract assets, and greater pressure on the fees they are able to charge for managing them.

As the Merrill Lynch/Capgemini report observed: "Post financial crisis, HNWI investors are now much more engaged in their financial affairs. HNWI clients are re-evaluating their current wealth management provider relationships and moving assets to firms that can clearly demonstrate a more integrated approach to meeting their needs."

To attract money and be successful in this environment, therefore, wealth managers need to improve the services they offer. But how do they do that?

### a) Transparency

According to the Merrill Lynch/Capgemini report, 59% of HNWI's said they have regained trust in their advisor over the past year, and 56% had regained trust in their wealth management firm. That signals an improvement, but the situation is fragile, with 25% saying they only somewhat agree with the statement. And it leaves a sizable minority who still have not regained that sense of trust.

Without trust, clients and potential clients will be understandably wary of handing over their money, so rebuilding this vital commodity must be a priority for wealth management firms.

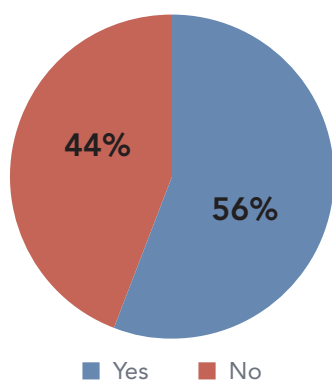
One prominent shift to have emerged over the past couple of years in response to this breakdown in trust has been an uptick in interest in managed accounts. Their attraction comes down to the three features of TLC: greater Transparency, Liquidity and Control—features found to be sorely lacking during the financial crisis. As a result, more than half the managers in Advent's wealth management survey reported an increase in demand for managed accounts.

### Communicating Transparency

Wealth managers do not necessarily have to offer managed accounts to satisfy their investors' primary concerns, but an ethos of transparency is essential.

## Managed Accounts

Q: Are you seeing an increased demand for managed accounts in the current climate? (n=120)



One of the issues that became evident during the crisis was that many investors realised they had not entirely understood the investment strategies their managers were pursuing, or that there was a drift away from the original strategy agreed. In addition, since there was insufficient transparency into the actual portfolio positions, investors had limited ability to see where investment performance was achieved, or to understand the levels of risk they were facing.

With the benefit of greater transparency, however, investors gain more visibility into fee structures, the investment decisions taken, and the risk profiles of those investments.

Yet transparency entails not just giving investors more information, but providing them with explanations. As a result, wealth managers face more pressure to communicate:

- ▶ Why they have made and are making the investment decisions they have.
- ▶ Why those investments performed the way they did.
- ▶ Why the clients are being charged the fees they are.

"HNW clients want increased 'Transparency and Simplicity' and 'Improved Client Reporting' so they can better understand products, valuations, risks, performance, and fee structures," noted the Merrill/Capgemini report. "HNWIs are reviewing product disclosure statements and investment risks before even conferring with their Advisors. They also value better reporting and more frequent updates after being blind-sided during the crisis, when they lacked a real-time view of what was happening to the value of their investments. And increasingly, the type of products they seek out are the ones they can understand."

## b) Risk

Along with transparency, another major development to come out of the financial crisis is a heightened focus on risk. This emphasis includes both a greater awareness of the risks industry participants face, not least around issues such as counterparty risk, and a need to control risk in all its guises more effectively.

In this environment, wealth managers will need the ability to offer clients:

*Scenario analysis . . .*

*. . . to demonstrate in a transparent and comprehensible manner the risks clients face by pursuing proposed asset allocation strategies and from investing in different products.*

However, providing clear explanations is not always easy when dealing with investors not versed in complex risk topics. In such situations, some degree of investor education will be needed, to teach clients

about the types of risks involved, and what impact they have on expected and actual returns.

*Performance attribution reports . . .*

. . . detailing the risks associated with the investments made, so clients can see the risk-adjusted return figures achieved. Going forward, regulators may also help drive this trend, by mandating investment managers to deliver risk-adjusted information to end clients.

### 3. Achieving Returns

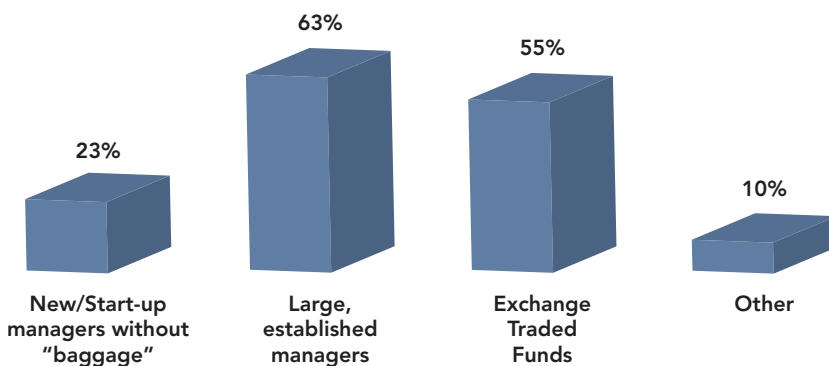
Over the last decade the investment management industry as a whole has seen a surge of interest in passive investing, as clients sought to take advantage of vehicles offering buoyant market returns with lower fees.

But as the crisis demonstrated, these come with the potential for enormous losses. Having experienced the painful lessons of recent years, there is a shift back towards actively-managed funds, driven by an alignment of interest between managers and their clients.

<b>Investors</b>	<p>Want to protect and rebuild/grow their net worth. Therefore seeking strategies that combine:</p> <ul style="list-style-type: none"> <li>▶ better downside <b>risk protection</b></li> <li>▶ search for <b>alpha</b></li> </ul>
<b>Managers</b>	<p>Keen to demonstrate they have <b>investment expertise</b>—either in-house or by picking third-party funds—that provides value to clients and differentiates their services.</p> <p>Opportunity to move up the product value chain in search of <b>higher margins</b>.</p>

### Allocating Money

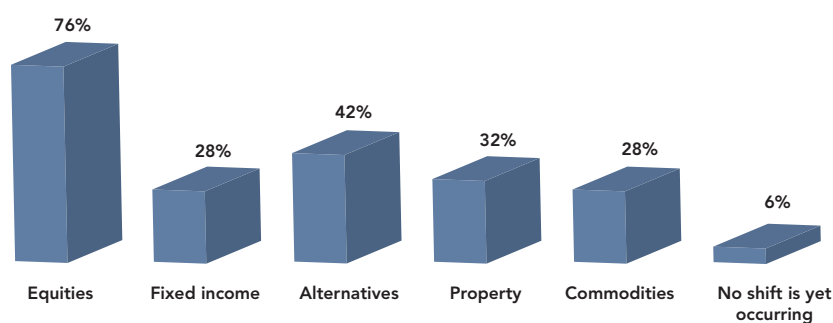
Q: In the current financial environment are the fund managers you consider likely to include: (n=120, several responses possible)



The findings of Advent's *2010 Wealth Management Outlook* underscored the growing thirst for returns, as opposed to protection. The survey found that, following the shift to cash witnessed post-crisis, 76% of wealth managers are now seeing a swing to equities. Of the equity markets, 77% thought emerging markets will gain in 2010, ahead of the US (58%) and Europe (37%). Alternatives proved the next most popular asset class, with 42% of respondents starting to see a return to the sector.

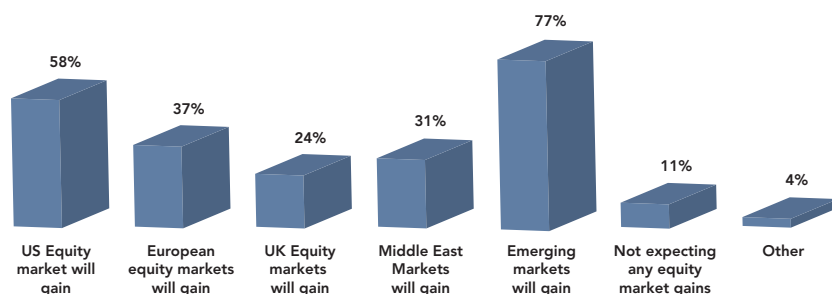
## Shift in Asset Classes

Q: The last two years saw a high proportion of portfolios shift to cash. Are you beginning to see a return to: (n=120, several responses possible)



## Equity Markets Outlook

Q: Looking ahead, what are your current expectations of equity markets for 2010? (n=120, several responses possible)



## 4. Improving Client Service

### a) Know Your Client / Communications

Capturing, storing and analysing client data—to better segment customers and provide the right products to meet their needs at any given time—is becoming ever more crucial.

*Historically . . .*

. . . firms segmented clients according to:

- ▶ Investable assets.
- ▶ Broad risk tolerance categorisations (conservative, moderate or aggressive).

The losses sustained during the financial crisis, with the evident lack of effective downside risk protection, exposed the shortcomings of these traditional client approaches.

*Today . . .*

. . . risk analysis is putting more emphasis on:

- ▶ Client goal assessment.
- ▶ Behavioural finance approaches to better understand those client goals.

*That requires more comprehensive Know Your Client (KYC) information . . .*

. . . to enable wealth managers to understand clients' needs and desires, and thus help them formulate more appropriate financial plans. Going forward, firms will also be better placed to target relevant products and services at individual clients.

And, crucially, the emphasis in the financial services industry is shifting away from explicitly pushing products, as was the case pre-crisis, to building a reputation as a trusted advisor. Communicating with clients to obtain detailed knowledge of their needs and wants will help firms achieve that role, and thus hold on to and develop those relationships.

### b) Advisory

Hitherto clients typically gave their managers a mandate to invest on a discretionary basis. However, the hangover of investor distrust from the crisis means that, in many cases, customers now want to be closer to their assets, and more involved in the investment process.

Therefore, those wealth managers that have, or can develop, strong advisory capabilities, often in addition to discretionary asset management services, will be better positioned to meet client demand.



To provide high quality advisory services, firms must be able to track all their interactions with customers. The reason is:

- ▶ It ensures they remain in **compliance** with their regulatory obligations, for example under the European Union's Markets in Financial Instruments Directive (MiFID).
- ▶ By providing a recorded history of everything discussed with each client—the services they are interested in, why they were sold certain products and not others, how their financial situation has changed over time—the firm can maintain a continuity of **relationship** and be in a position to best meet their needs for the future, even if the point relationship manager leaves the organisation.

Meanwhile, web-based solutions can facilitate a two-way exchange of information. For example, it gives clients a portal through which they can learn about products on offer or emerging trends in the industry, while providing the wealth manager with a fast and cheap means of communicating with clients.

### c) Business Expansion

Wealth management firms are facing:

- i. A less loyal and harder-to-please client base.
- ii. Heightened competition for assets.
- iii. Pressure on fees.

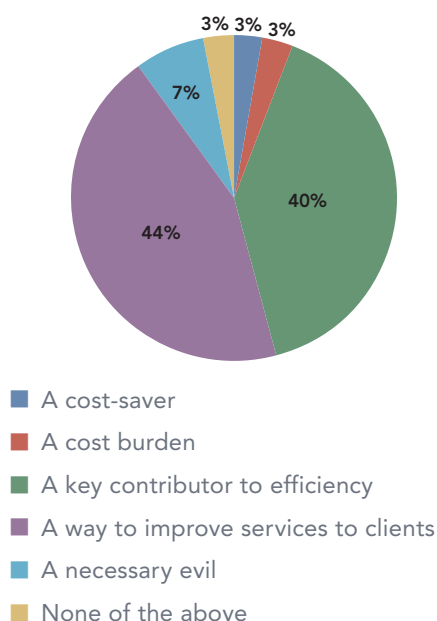
Given these challenges, one obvious response is to expand into new areas in a bid to source assets and boost/diversify revenue streams.

Five years ago the wealth management market was characterised by a large number of niche players targeting particular client segments, be they mass affluent, high or ultra high net worth individuals, or family and multi-family offices. Today, many markets are seeing greater convergence in business models, as organisations seek to broaden their customer base and create more scale by spreading out to new markets.

However, to move into new business territories firms need a flexible operating platform that allows them to offer differentiated services to each segment. And with more firms going after the same pools of money, improving operating efficiencies is increasingly important.

## IT

Q: Within your organization, do you see IT principally as...? (n=120)



## 5. Leveraging Technology for Greater Efficiency

With assets and revenues tanking during the crisis, the financial services industry as a whole had no choice but to squeeze costs wherever possible. That cost control mentality will remain with us for a long time to come.

Nevertheless, many wealth management organisations are struggling in this area. According to Scorpio Partnership's latest annual private banking survey,<sup>3</sup> average cost/income ratios are continuing to rise, up from an average of 72.4% the previous year to 78.2%, signalling a deterioration in banks' efficiency.

### Lack of Automation

An obvious way to tackle the problem is through automation. Indeed, recognition of the benefits technology can offer were evident from Advent's wealth management survey, which found that 44% of respondents seeing IT principally as a way to improve services to clients, while 40% view it as a key contributor to efficiency. Only 3% thought it a cost burden.

Yet many wealth management organisations remain burdened by significant manual intervention in their operational processes, with the high staffing costs and error rates that go with it.

Such situations will be unsustainable going forward. The staff reductions and cutbacks of the past 18 months will put wealth managers in a position of having to do more with less across the board—whether it is in the front, middle or back office. Since a return to pre-2008 staffing levels is not expected anytime soon, if ever, wealth managers will need to look to technology solutions that drive automation and enhance efficiency. Beyond traditional enterprise portfolio management systems, we expect, therefore, to see greater emphasis on automated solutions for customer relationship management (CRM), reporting, reconciliation and research management.

But, like everything, some technologies are better than others. So what should wealth managers be looking for from an IT platform?

#### a) Integration

Automation requires an integrated set up offering a complete, straight-through environment that can handle each part of the processing chain, from front to back office, with a minimum amount of human involvement.

<sup>3</sup> Global Private Banking KPI Benchmark 2010, Scorpio Partnership, 8 July 2010, <http://www.scorpiopartnership.com/>

Furthermore, integration is not just about achieving internal automated connectivity, but in linking to external providers. One notable impact of the financial crisis is that organisations are increasing their number of counterparties in a bid to diversify and dilute risks, and as they expand into new marketplaces. So it is imperative they automate the links to this expanding roster of counterparties in order to minimise error rates, speed up processing times and control operating costs.

## b) Performance Attribution and Reporting

Communication is crucial in rebuilding and maintaining investor trust. And clients—whether individuals, families, or institutions—want more frequent yet comprehensible updates that give a breakdown of their holdings, show the transactions conducted and returns achieved by asset type, and allow them to monitor income and expenditures.

It is imperative wealth managers can meet these service requirements if they are to be successful. To do this, they must be able to gather details on a complex array of financial and physical assets, some of which may be handled by a range of managers, so as to obtain an aggregate view of the client's holdings and positions.

## c) Research Management

As stated earlier, wealth managers face more pressure to communicate why they have made and are making the investment decisions they have, why those investments performed the way they did, and why the clients are being charged the fees they are.

Yet only 37% have a formal research management tool to keep track of all this information and have it available at the click of a button. Having such a capability presents firms with a great opportunity to gain a competitive edge.

## d) SaaS

Having an IT platform that incorporates these various pieces of functionality is ever more essential. Yet for some wealth managers implementing the requisite software in-house involves a substantial investment they are hesitant to take on, especially during a period of such market uncertainty.

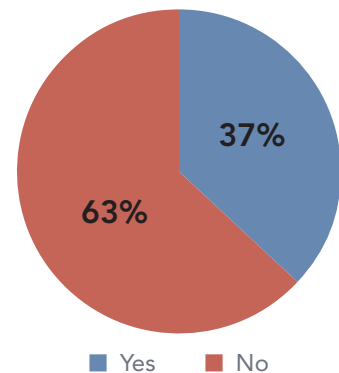
*Software as a Service (SaaS) outsourcing models . . .*

*. . . are becoming more widely available and may offer an attractive, lower-cost alternative.*

With a SaaS approach, wealth managers can leverage the functionality they require without having to implement and maintain the software internally. Furthermore, they will gain ready access to any application upgrades as they become available, helping keep the manager up-to-date with the latest technology developments.

## Managing Your Research

Q: Does your firm employ a formal Research Management System (RMS) to centrally store and manage all research related information? (n=120)



## Conclusion

The financial crisis has had a profound effect on the wealth management industry. It is reshaping the way investors think about their managers, while inciting firms to reconfigure the types of services they offer in return, and the manner in which they are delivered.

This shifting paradigm is summed up by the Merrill Lynch/Capgemini report, which noted: "HNWIs have seized a more hands-on role in their finances. Above all, they want specialized and independent advice, transparency and simplicity, and effective portfolio and risk management, and are looking for wealth management provider relationships that can clearly demonstrate a more integrated approach to meeting their needs."

For the foreseeable future, the emphasis for wealth managers will be on rebuilding trust, and working in partnership with clients to deliver risk-adjusted performance that meets their goals. Sophisticated, yet functional technology that provides operating efficiencies, better manages risk, helps generate investment returns and improves how firms communicate with clients will be a critical component in meeting those demands.

Those organisations that put the necessary infrastructure in place, and use it judiciously, will reap the rewards going forward.



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