CAPCO

HOW WEALTH MANAGEMENT FIRMS CAN WIN IN TURBULENT TIMES

COVID-19 has disrupted wealth management. Here's how industry leaders must adapt to win in the new normal.

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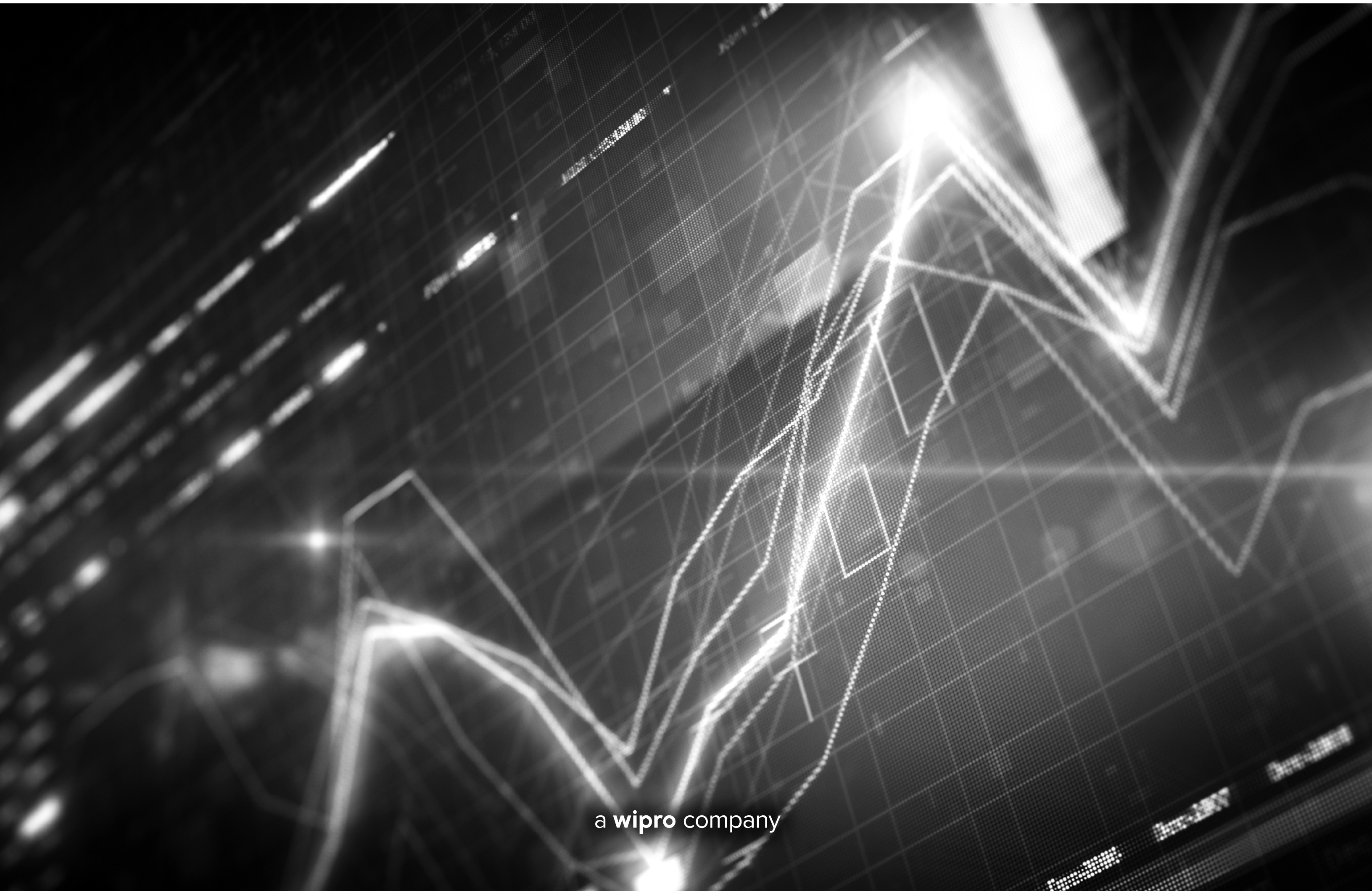

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INTRODUCTION

The wealth management industry witnessed major changes in industry structure and business models over the past decade. Technology, industry convergence, and the shift toward hyper-personalized digital solutions ensured significant shifts in the competitive landscape leading into the 2020s.

To put it mildly, the emergence of COVID-19 created an even more intense layer of complexity and change that will have a lasting effect on the industry.

In late 2020, Capco surveyed 100 professionals in wealth management to explore the current state of the market, the competitive landscape, and how the pandemic is affecting priorities and business model decisions.

Their verdict: The top three long-term effects on business operations are the expanded use of digital communication and engagement, accelerated investments into digitization, and added pressure on performance ratios. But their responses also signal belief that changes on wealth managers from here on in will be far greater than just making investments in new technology and learning to communicate effectively with clients over Zoom.

The industry is being disrupted, and firms are at a make-or-break moment to either get stronger in the next three to five years or be swept aside by new competitors.

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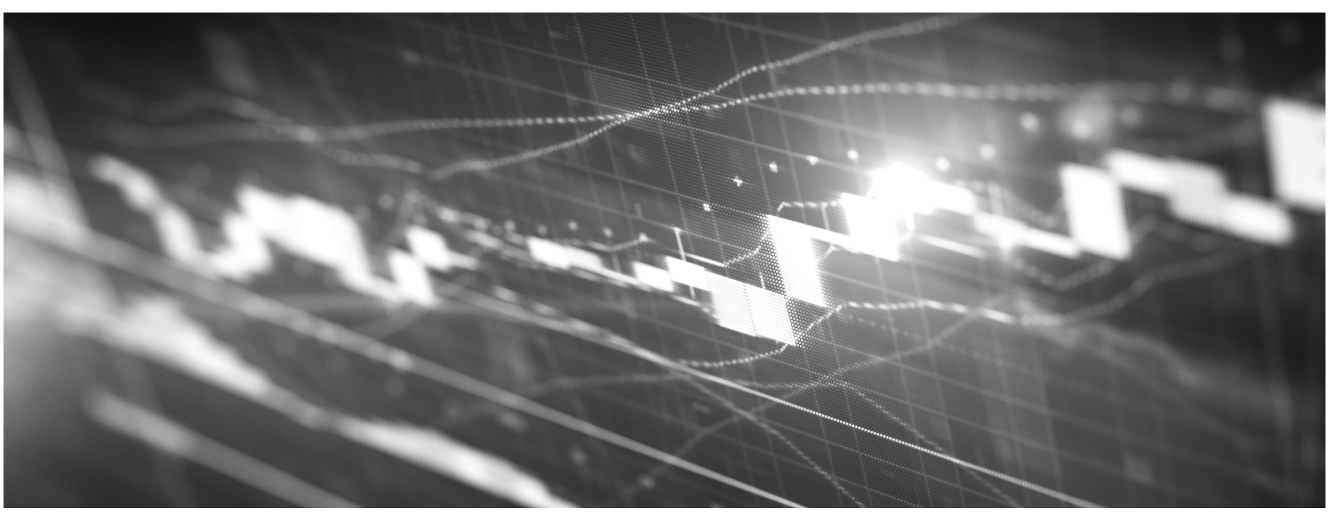
This report, produced in collaboration with the School of Business at Stevens Institute of Technology, presents the top trends identified in the survey results and offers strategy tips on how to adapt to the industry's new normal.

This report answers these questions:

1. What is the current state of the industry? How have firms responded to COVID-19 disruption?
2. How have client expectations changed and how is the industry trying to meet those expectations?
3. What major steps do firms need to take in terms of capabilities development, organizational design, strategy, and technology implementation to be positioned for winning competitively over the next three to five years?



A DEFINING MOMENT

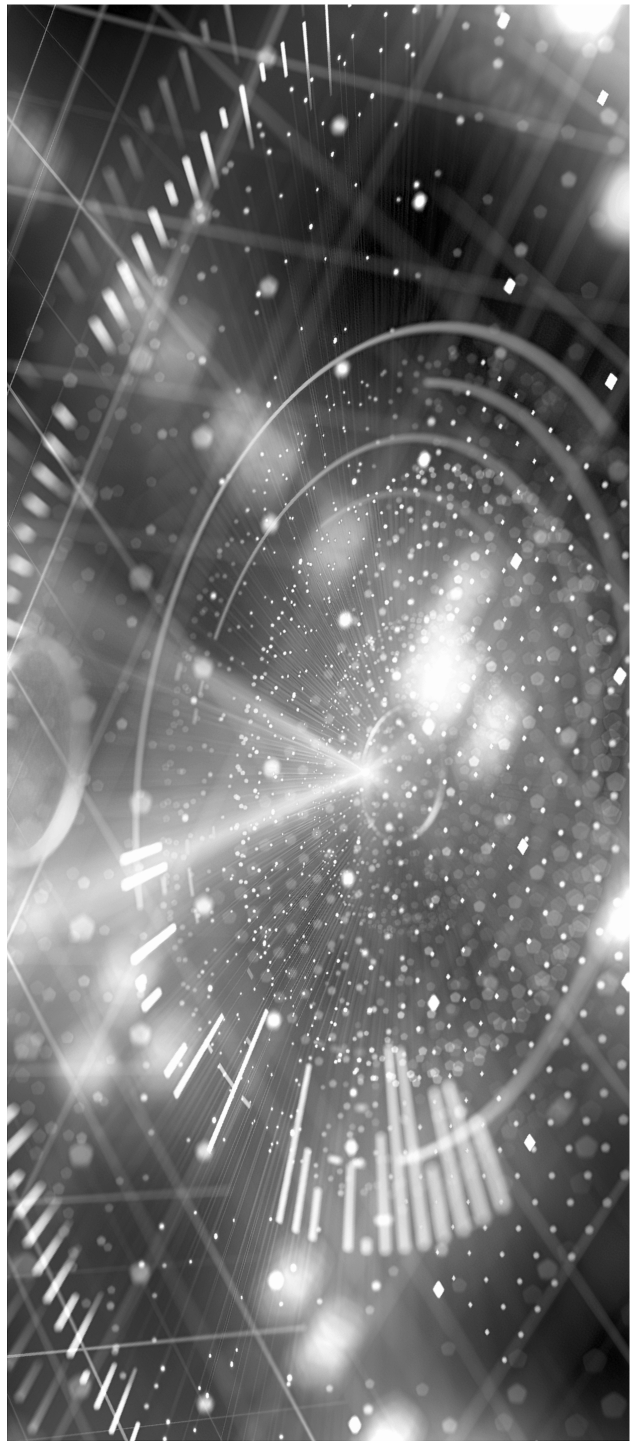
The collision of already ongoing digital transformation with the arrival of the pandemic made this is a defining moment for many wealth management firms, especially smaller players. For firms under-invested in digital technologies, COVID accelerated the imperative for transformation. Those already invested heavily in digital were able to better react to the uncertainty and win a competitive advantage.

Chaos always provides new opportunities for growth, resetting the competitive landscape and potentially creating new winners and losers. The winners are those who use the disruption to forge new collaborative ways of working, build powerful engagement with users, and deploy technology to drive down cost while speeding up innovation.

Meeting this challenge will be difficult for many in the industry, where structural barriers to change include an over-regulated environment, increasing product complexity, and longer launch times than found in other industries such as retail and fashion.

Can wealth management firms shake off the old ways of working fast enough to remain competitive? Can they build capabilities in areas such as artificial intelligence (AI), innovation, and user experience? Or will they be overwhelmed by fintechs, competitors from other industries, and behemoths fed by industry consolidation?

That's not really a question, of course. Embracing the digital era and overcoming the pandemic's effects is not a choice anymore. It's a requirement; table stakes to stay in the game.



CURRENT STATE: HOW FIRMS HAVE RESPONDED TO COVID-19 DISRUPTION

Years before COVID-19 began its noxious global spread, many industries, including wealth management, were already in technology transformation. The arrival of digital technologies, such as mobile, cloud, and AI, fundamentally changed how business is conducted and raised expectations for what services consumers demand from their favorite brands.

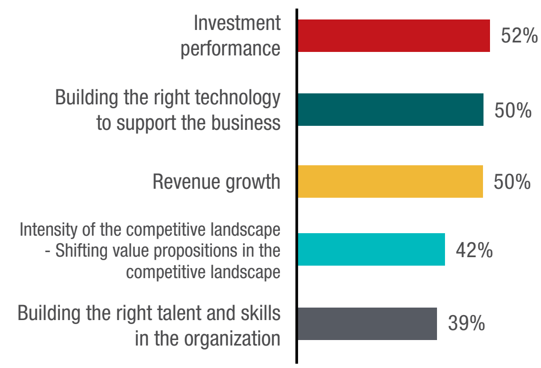
Thanks to digital, leading companies were learning to work more productively and efficiently and deliver products to market more quickly. They had to change because their customers were demanding it. 24/7 online access, easy ordering with fast delivery, and smart phones that underwrite a new mobile economy reprogrammed consumer behavior. Firms that didn't up their digital game were left behind.

Even in high-touch industries like wealth management, firms experienced changing customer expectations as their clients began to enjoy the benefits of a digital lifestyle. Couple this trend with the incursion of digitally savvy fintechs and tech giants, the industry was faced with significant enough challenges to begin to modernize. By the end of 2019, many wealth management firms had initial efforts underway to provide more services online, target new customer segments, and boost IT security.

And then came the virus.

> *"Suddenly, advisors departed the office to work at home. All poll respondents indicated that call volumes jumped at least 20%. Advisors were meeting clients by video rather than face-to-face, a trend the industry had resisted previously."*

TRENDS THAT KEEP LEADERS AWAKE AT NIGHT (Q7)



Firms located in the West and East were the first to transition to work-at-home operations, learning their lessons about new approaches months in advance of peers in the South and other parts of the United States, where masking and lockdowns arrived more slowly.

If wealth managers had already thought digital transformation was arriving too quickly, COVID-19 only stepped on the accelerator. In our survey, 89% of respondents agreed the pandemic sped up the pace of change or introduced new forces and behaviors for delivering services to customers. And, 64% were considering the possibility that the face-to-face model was about to change in some way.

One example: the shift to remote communications. 79% of survey respondents reported making additional investments to support remote work processes, such as video tools, upgraded network services and security, and automated customer service. According to Celent,[1] annual wealth management spending in IT is estimated to grow from $21.4B in 2020 to $24B annually in 2023, a 5% compound annual growth rate (CAGR).

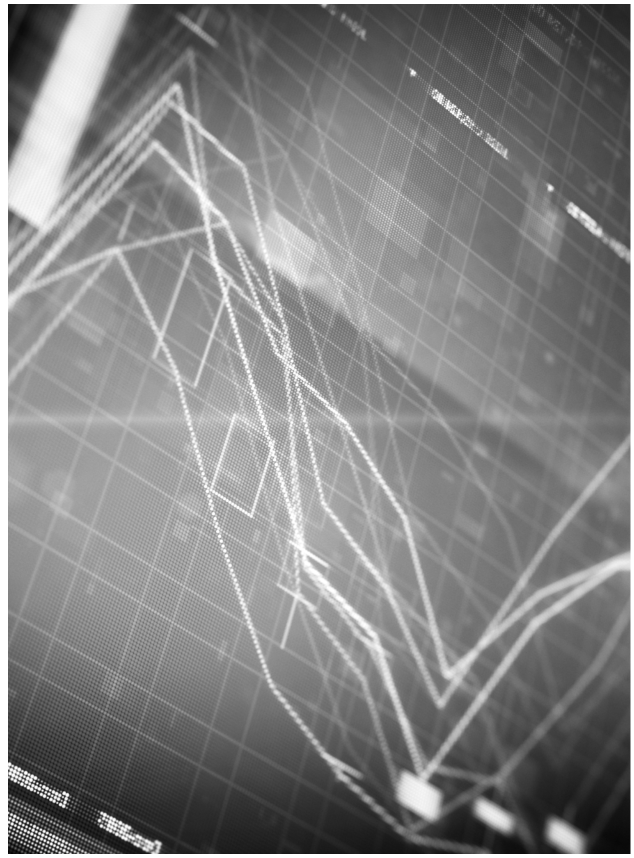
To accommodate the client's growing expectation for hyper-personalization, 67% of respondents said they have taken major initiatives in AI and data analytics to support decision-making and automation for investment management.

Turning on new technology wasn't the only response necessary in the industry. With offices and branches shut down for an extended period, 70% of respondents said COVID disrupted traditional methods for client acquisition and business development. The industry has long prioritized face-to-face prospecting, but 86% of respondents said their approach to client interactions would shift to remote communications or hybrid models that mixed the two.

To find new customers, leading firms cast their net more widely by using data gained from cross-collaboration between advisors, marketing, and digital media to turbocharge lead generation.

For example, Bank of America launched Life Plan in October 2020, "a new digital experience through which clients can set and track near- and long-term goals based on their life priorities, and better understand and act on steps toward achieving them." Because clients use the bank's mobile app and online banking platform to participate in Life Plan, there is a substantial opportunity for Bank of America to collect data from across the organization and cross-sell financial products and services, including wealth management.

On the institutional side, it has become much more difficult for fund wholesalers — a vital source of potential investment options for customers — to get face time with advisors and asset managers. This is likely to result in dramatic rearrangements in the way wholesaling will be done. As with consumer prospecting, expect a much tighter interaction between wholesalers, advisors, marketing, and social to get things to work. Firms are thinking of ways to give wholesalers digital tools and materials necessary to approach advisers and institutional investment managers, but also ways to provide that information back to the client.



The good news for firms that invested early and heavily into digital before the pandemic, and that enabled advisor, inquiry, and collaboration capabilities, was steady growth over the course of the last 18 months. Firms behind the curve lost business even as they tried to quickly standup capabilities, such as virtual meetings, virtual whiteboarding, and virtual chats.

These effects on how wealth managers do business are not temporary, our survey-taking executives said:

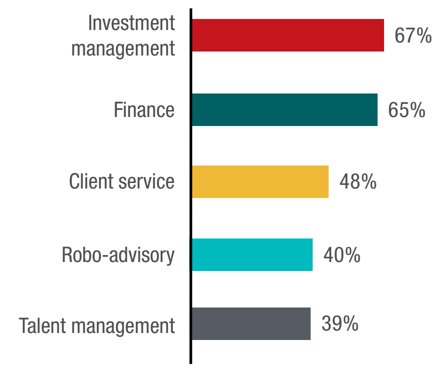
> "*64% believe the new interaction model (non face-to-face) will be permanent.*"

HOW THE PANDEMIC CHANGED CLIENT EXPECTATIONS AND HOW THE INDUSTRY IS RESPONDING

According to a recent survey by fintech firm Broadridge Financial Solutions,[2] 57% of investors said communications with their advisor had changed because of being remote. And 62% of that group expect to entirely or partially maintain their new methods after the pandemic ends. Face-to-face is not dead, but virtual relationships are here to stay.

The Broadridge findings also highlight the dramatic shift customers are making to social media to connect with advisors. For example, 86% of Gen Z and 87% and Millennials said they were comfortable having their advisor follow them on social media to offer a more customized experience.

WHERE COMPANIES ARE MAKING TECH INVESTMENTS TO ENHANCE DECISION-MAKING AND AUTOMATION (Q23)



COVID has changed our customers in another way, and to the advantage of wealth managers.

When the pandemic arrived in early 2020, markets dove 28%, people lost jobs, and health was under siege. As happens in most life-altering events, people suddenly reassessed their own situation. How protected against the new risks were they?

Did they have adequate access and control of their assets? How should they think of wealth preservation and growth over the next few years? Have their personal goals changed? Have their professional goals changed?

There was another phenomenon benefitting wealth management firms. With fewer expenses during lockdown, individual savings rates went up. So did purchases of life insurance products. The real estate market in many communities soared. People focused more attention on financial planning, even exploring lifestyle alternatives like new (cheaper) places to live and financial opportunities offered by cryptocurrency. Financial advisors of all stripes were ready to help.

4 STEPS TO POSITION YOUR FIRM FOR WINNING COMPETITIVELY OVER THE NEXT 3-5 YEARS

Our poll results with wealth managers reveal they believe, and we agree, that wealth management firms must position themselves for competitive success in four major areas: strategy, organizational change, capabilities/competencies, and technology. We intentionally listed technology last on the list not because it is least important, but rather because the tools selected must support the other three areas.

STRATEGY RECOMMENDATIONS IN A POST—COVID WORLD

Wealth management firms must position themselves for competitive success in four major areas:

1 **STRATEGY**
A shift away from product sales to relationships

2 **ORGANIZATIONAL CHANGE**
Customer at the center

3 **CAPABILITIES DEVELOPMENT**
Talent acquisition and retention is vital

4 **TECHNOLOGY**
To reduce costs while improving revenue

1 STRATEGY

Business models are changing to meet increasing customer expectations and address new competitive threats.

The rise of the advisor

One shift from the pandemic is firms reducing their reliance on a product-led strategy for growth, rather emphasizing holistic planning and advice. A meeting with a financial adviser, for example, can easily lead to discussion of the importance of healthcare planning and long-term protection.

Attracting underserved customers

To find new growth areas, wealth advisers need to attract younger clients and target underserved markets. There’s widespread agreement that the mass affluent market will continue growing, with 90% of respondents saying they expect to see a continued expansion of services offered into banking, insurance, and other financial service products.

Cerulli Associates projects that nearly 45 million U.S. households will transfer a total of $68.4 trillion in wealth[3] to heirs and charity over the course of the next 25 years. Firms would be smart to target second-generation and extended families with easy to access and understand wealth preservation advice and related banking and investment services.

The rise of the one-stop shop

Even before the pandemic, financial service firms were shifting towards becoming a one-stop shops for clients, with wealth management advice leading the purchase of other financial products tied into the ecosystem, such as banking, mortgages, and insurance. Robinhood, an online discount brokerage that offers commission-free investing and trading, has now introduced banking products;[4] online payment provider PayPal is considering a stock-trading platform.[5]

While 27% of all customers say they want more one-stop-shop options[6] for all their finances (as do 66% of investors under age 30), relatively few firms actually offer them today, presenting a sizeable opportunity.

Some of these offerings can be provided with in-house resources, but increasingly firms are looking to partner with other providers and acquiring early-stage fintechs to provide services in areas they may lack, such as financial wellness, financial education, or automated bill pay. And it gives traditional players who have typically targeted high-net-worth customers a chance to penetrate the largely underserved mass markets with more sophisticated offerings than just robo-advisers.

An example of this dynamic in action was Morgan Stanley's $13 billion acquisition of E-Trade in 2020. Although there was some clientele overlap in those businesses, E-Trade's direct-to-consumer digital channel and strong brand would strengthen Morgan's wealth management offerings, the company believed. (Continuing the M&A dance, Morgan sold off E-Trade's custodian registered investment advisor custody business to Axos Financial six months later.)

As clients come to expect a holistic approach to their financial lives, a seamless digital experience will provide an advantage in an increasingly competitive market, according to our surveyed managers. Silicon Valley's most prominent names are well positioned to offer that experience. 92% of respondents agreed that Big Tech, such as Amazon, Apple, Facebook and Google will enter the market, and 50% believe these companies will create significant disruption in the wealth management industry.

The new landscape for opportunity

Changing conditions are also expanding business opportunities for regional banks, who have traditionally prospected in their own backyards. Thanks to technology and the willingness of customers to move geographies, location matters less and less. This means regionals don't need a retail bank footprint to serve wealthy clients anymore — they can follow them as they move, or prospect in entirely new areas. And technology can be a great equalizer, allowing small firms to compete with the majors.

2 ORGANIZATIONAL CHANGE

Traditional hierarchical organizational structures are now too slow and too bureaucratic to guide organizations through today's rip currents.

To be effective, wealth management firms must become nimble, speed decision making, and, most importantly, put the customer at the center of all they do. Opening an account shouldn't take days, it should happen instantaneously, as fintechs have proven. To be this agile, firms will need better technology - but more importantly, they need a mindset change towards becoming less risk adverse.

Here are several ways organizational design must change.

Innovate and iterate.
New products and services must be introduced in months, not years, and constantly improved based on cycles of customer feedback. Fail fast is the new mantra. In 2020, even as many financial services firms considered cryptocurrency too risky to build services around, PayPal introduced support for cryptocurrency payments[7] in Bitcoin, Bitcoin Cash, Ethereum, and Litecoin. PayPal is partnering with Paxos Trust Company, a regulated provider of cryptocurrency services.

Put the customer first.
Creating an engaging user experience (UX) is just as important as building great products because customer experience (CX) promotes loyalty at a time when clients face few barriers to jumping to a competitor. And customers aren't just consumers; they should also be brought in to help design offerings. Being customer-centric instead of being led by product development will be a major mind shift for the industry.

Consider leapfrog tactics and strategies.
Although the industry has made initial investments in artificial intelligence for improving risk analysis and marketing initiatives, the bigger bet is to use AI and machine learning to vastly enhance the customer experience. (See "Put the customer first" above.) For example, while fintechs use technology to *remove* human advisors from client interactions, we believe the goal should be to *promote* the value of personal advisers by providing them with comprehensive and up-to-the-second customer data that enables customized solutions at the time when the client is ready to make a decision.

3 CAPABILITIES DEVELOPMENT

Wealth management companies must ensure their employees are equipped with the technology skills needed to support an enhanced digital experience. Survey respondents said the biggest obstacles to undertaking digital transformation within their companies are skill gaps in areas such as technology and digital processes.

Talent acquisition and retention

62% of respondents expressed a higher level of concern for employee retention during the pandemic. The highest turnover was seen in finance, management, and wealth advisor positions. Firms must develop strong human resources incentives to educate, promote, and compensate their top performers. On the recruiting side, wealth management companies should be active on college campuses attracting digital analysts, quantitative analysts, data scientists, programmers, and software engineers.

Training

The pandemic forced companies to adopt new training methods to administer remotely, with 75% of respondents noting an increase in e-learning. Introducing new training for employees to upskill quickly will allow wealth managers to keep their workforce on the cutting-edge amid digital transformation.

When it comes to external training, the majority of respondents said they are pointing employees to certificate programs (56%), rather than full master's programs. These programs are more focused, so an employee can get the specific training they need in a matter of months instead of years.

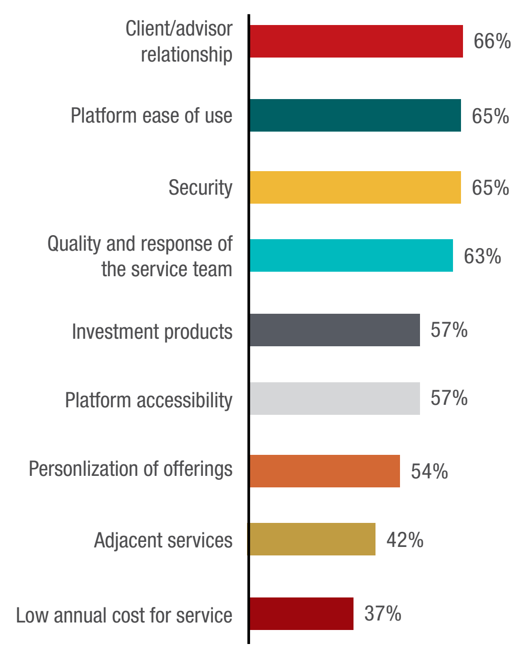
Ensuring the workforce is built out to support these digital initiatives and capitalize on novel opportunities will only serve to benefit those looking to remain competitive in the market.

Partnering and M&A

To meet ever-changing customer expectations and create new revenue sources, firms will need to find business partners. Companies may create their own digital ecosystems and invite partners to join, or they may choose to become part of ecosystems created by others. Identifying, analyzing, and negotiating those partnerships require special skills.

When looking to introduce a new capability, you need qualified experts to ask and answer these questions: Does it make sense for us to build that capability organically and have something unique to offer? Or should we acquire a company with that expertise? If the capability isn't a core requirement, is a marketplace partnership a possibility? Who should we target, and will they be an organizational fit for us? What are the negotiation parameters and financing options?

WHAT CAPABILITIES ARE MOST NEEDED TO WIN IN THE MASS MARKET?(Q8)



User Experience

In order to drive lasting loyalty with clients, firms need to create compelling UX in every interaction. UX not only delivers information, it collects user behavior data that can then be used to improve the experience even more. (Unfortunately, too many companies outsource UX, losing the ability to learn more about their customers.)

Where once firms focused most of their innovation on new products, today's digital technologies have changed the game. In areas like the retirement income marketplace, winning strategies focus less on product development and more on digital wrappers and integrations that combine existing products and services in user-friendly packages.

4 TECHNOLOGY

98% of respondents believe the pandemic will continue to make expense reduction a significant priority. 66% of respondents said it had a significant effect on both revenue and profitability. Technology can help both reduce expenses and boost revenue.

IT investments to consider include:

Robotic process automation (RPA) to cut transaction costs and speed tasks, such as account setup, implementing workflows, and meeting regulatory review and reporting requirements. RPA is one of the least expensive technologies to implement while delivering the quickest return on investment.

Artificial intelligence and machine learning software to hyper-personalize offerings for customer segments, guard against network security threats, and assess risk. Most firms won't go as far as Wealthfront,[8] which proudly boasts that all its services are offered through software-run programs. Most wealth management firms are following a hybrid approach, teaming some percentage of AI smarts with human advisors. Morgan Stanley's Next Best Action system employs machine learning to alert human advisors to possible investments for particular clients. Just how humans and technology are blended will depend on a firm's overall goals, the investment types they recommend, and tech tolerance of its clients. Decisions with high emotional content will always be better handled by an actual advisor.

Cloud computing technologies, such as big data analytics, predictive analytics, and test and development. According to our industry survey, providing digital access to a range of products and services for customers will be the top differentiator for winners in wealth management over the next two years. To most wealth managers, this observation comes as no surprise. In fact, most firms have been upgrading their web platforms and online services for several years. What is new is that firms have to become better users of the data this technology provides to create powerful customer targeting and personalization of services — another key differentiator for the survey respondents.

The problem: Many traditional wealth management firms still operate with legacy IT systems, spit-and-bailing wire patchworks of bolted-on hardware and out-of-date applications. They are costly to maintain and come with security risks. In truth, many companies lack the IT firepower required to develop and build systems capable of delivering compelling solutions in this regard.

SUMMARY: WEALTH MANAGEMENT'S NEW IMPERATIVE

A wealth management organization built on traditional practices and tools cannot win in today's environment. The waters are moving too fast. Black swan events, like COVID-19 and climate change, seem to appear more frequently. Customers are constantly raising the bar about what they want and how quickly they expect delivery. Technology advances, while welcome, are also costly to install and require organizational changes that upset the status quo.

The biggest problem for wealth management firms is that to succeed in the new normal, they must act quickly to change — and this is not an industry built for speed. Organizations must be nimble, innovative, and able to pivot on a dime as client expectations move in new directions. A transition of this magnitude requires top-to-bottom organizational commitment directed from the CEO and board downward, even as 46% of our survey-takers point to a lack of buy-in from executives as a primary obstacle to change.

To begin, here is some advice that won't cost a cent to implement and perhaps most will agree with. Embrace reflection.

When the playing field shifts as constantly as today, wealth management leaders need to consistently re-evaluate what they're doing. Roadmaps are good only for as long as the road they are driving remains the same. It rarely does. Firms must be willing to constantly re-evaluate their strategy, resource investments, and capabilities to make sure they still are still valid. Act quickly to make changes. Then validate again.

If there is one lesson we have learned from the pandemic, it's this. Success is difficult, painful, and hard won. And it could be lost again tomorrow. But organizations will most certainly not win unless they create a new playbook for their future. Delivering the status quo is no longer an option.

RESEARCH METHODOLOGY AND DEMOGRAPHICS

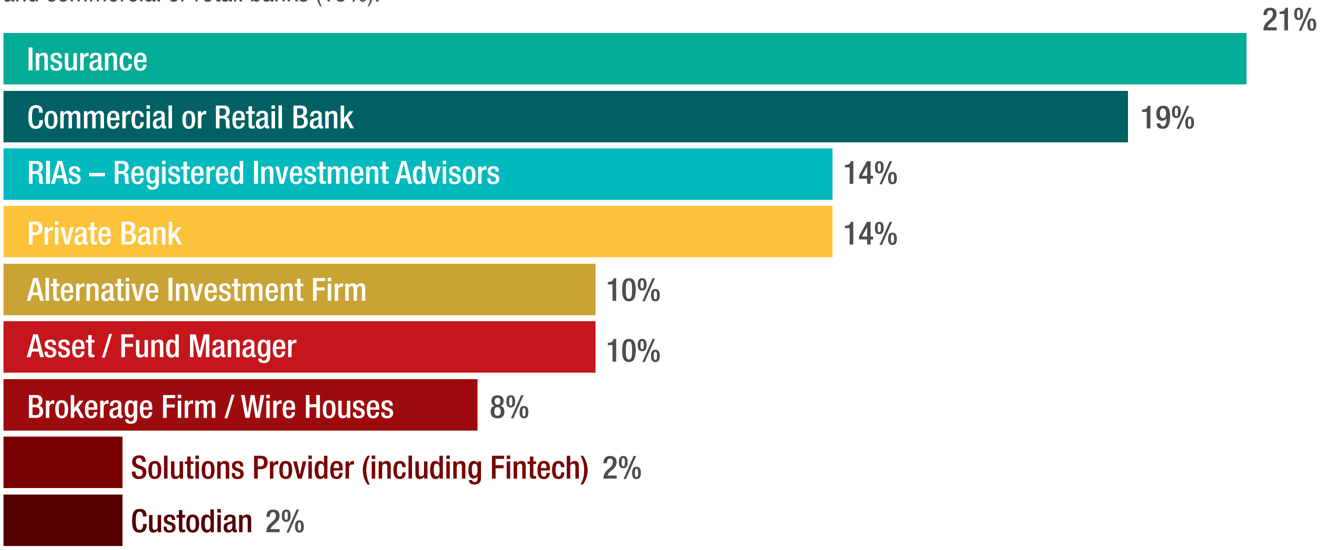
Capco surveyed online 100 wealth management professionals in November 2020 to explore:

- **The current state of the wealth management market**
- **The competitive landscape**
- **How the COVID-19 pandemic is affecting priorities and business model decisions**

The Stevens School of Business partnered with Capco on the survey's design and provided data analysis and insights:

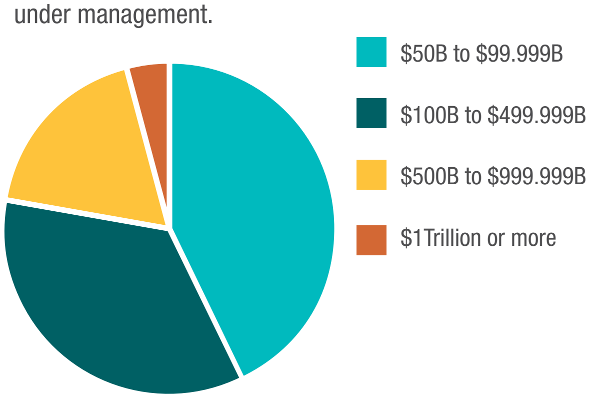
SURVEY RESPONDENTS BY INDUSTRY SEGMENT

Survey respondents came from nine segments of the wealth and asset management industry, with the majority from insurance (21%) and commercial or retail banks (19%).



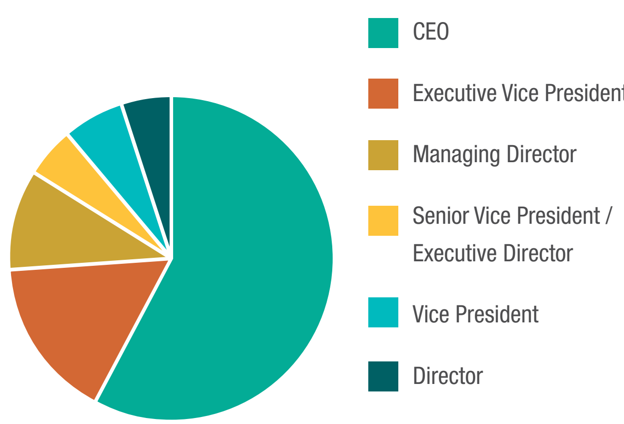
FIRM SIZE–ASSETS UNDER MANAGEMENT

The majority of firms surveyed, 43%, had $50 to $99.999 billion in assets under management. 35% of firms had between $100 to $499.999 billion in assets under management.



RESPONDENT TITLES

The majority of respondents were senior executives. More than half, 58%, were chief executive officers.



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ABOUT THE STEVENS INSTITUTE OF TECHNOLOGY

Stevens Institute of Technology is a premier, private research university situated in Hoboken, New Jersey. Since our founding in 1870, technological innovation has been the hallmark of Stevens' education and research. Within the university's three schools and one college, 7,300 undergraduate and graduate students collaborate closely with faculty in an interdisciplinary, student-centric, entrepreneurial environment. Academic and research programs spanning business, computing, engineering, the arts and other disciplines actively advance the frontiers of science and leverage technology to confront our most pressing global challenges. As Stevens celebrates its 150th anniversary, the university continues to be consistently ranked among the nation's leaders in career services, post-graduation salaries of alumni, and return on tuition investment.

ABOUT CAPCO

Capco, a Wipro company, is a global technology and management consultancy specializing in driving digital transformation in the financial services industry. With a growing client portfolio comprising of over 100 global organizations, Capco operates at the intersection of business and technology by combining innovative thinking with unrivalled industry knowledge to deliver end-to-end data-driven solutions and fast-track digital initiatives for banking and payments, capital markets, wealth and asset management, insurance, and the energy sector. Capco's cutting-edge ingenuity is brought to life through its Innovation Labs and award-winning Be Yourself At Work culture and diverse talent.

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