WHAT THE WEALTH INDUSTRY NEEDS NEXT

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The Wealth Management industry (inter alia its service providers) is in crisis mode. It needs to stop being a mere custodian of third-party financial assets and reinvent itself as a true provider of value. Local, regional and global providers of "wealth management services" (private independent asset managers, private banks, national banks and the like) seem desperate to increase their own assets under management and outsource their technology and operating costs so as to improve their own efficiency ratios and profitability, but in the meantime their clients seem generally and helplessly resigned and destined to face the uncertainties and immense risks of the financial markets, despite entrusting their hard-earned money to their service providers with the original (but now, as has been proven, undeliverable) hope of shielding it against the daily onslaught of risks from all angles.

> *Service improvements and client wealth protection ought to be the wealth industry's central purpose*

This crisis is obvious from the publicly stated desire of most firms to grow by acquisition, or cut costs, or even exit the market totally. Firms are saying this in every market, including established markets like Switzerland and the ostensibly growing markets of Asia. This desire on the part of the industry for volume-based growth, or retrenchment to home markets, is a consequence of declining revenues and margins due to the preponderance of cash holdings, zero or negative rates and a lack of alternative fee-earning products and services. People seem to be paying most attention to attempts to improve or preserve the profitability of service providers rather than the search for service improvements and client wealth protection that is supposed to be the wealth industry's central purpose. This is analogous to hospitals trying to perform more operations per day more cheaply rather than trying to prevent illnesses and improve patients' chances of survival.

The industry has an efficiency ratio of between 75% and 95%, which leaves little leeway for declining revenues because of predictably volatile margins and the paralytic, frozen behaviour of the underlying clients. Ironically, one of the causes of more volatility in the markets is the continuous withdrawal of the larger service-providers from market-making and investment banking services in favour of the more theoretically stable wealth management business. In reality, the withdrawal of market-making services has indirectly increased volatility and earnings power in the very parts of the market that these investment-banking retrenchments were intended to protect in the first place. This is a zero sum game, where every participant's gain is balanced by another's losses.

What future, then, for the wealth industry? Should we expect more of the same, i.e. more growth by volume acquisition and cost-cutting, leaving clients' wealth preservation at the mercy of the volatile markets while wealth managers become mere operating custodians rather than managers of wealth? Or is there a better model with a primary focus on improving the survival rate of the patient (i.e. preserving the wealth of the client) - the official raison d'etre of the industry in the first place? Service providers the world over promise the latter every day (with dozens of pages of disclaimers to shield those service providers from law suits).

HISTORY IS NO GUIDE TO THE FUTURE

The majority of service providers, especially the private banks, are desperate for greater profitability (i.e. growth in their assets under management) at any cost; this is shown in their search for acquisitions, their desire to outsource even more costs, their exit from unprofitable divisions or regions etc. Now that the industry is regulated like most others (with compliance, tax reporting and the like) the focus is on profit preservation and growth for the service providers, irrespective of the consequences to their client franchise of miserable returns and declining prosperity. This is a flawed and short-sighted approach as it puts the service providers' profitability first rather than a genuine concern for the underlying clients who are essentially financing the service providers in the first place.

Even the firms that have grown through acquisition have found that clients have been deserting them and in turn this has spurred a drive towards even further acquisitions to offset the losses in revenue from those client defections. This viscous circle cannot carry on forever, as it omits the core client in its objectives. The client must be put first if the service providers are to retain loyalty and survive in the longer term. But how?

THE ROAD AHEAD

The industry faces many obstacles, not least the perceptions of its own shareholders that it is an extremely profitable, safe industry with low capital needs. Nothing could be further from the truth. It is declining in its profitability, costs are rising despite the cost purges that have been taking (and are to take) place, and it is likely to decline in profitability in the years ahead unless it makes drastic changes with the client at the centre. Clients generally pay fees, no matter what the outcome; this is a good model for the service providers in one sense but is ultimately short-sighted because it is not balanced and, in the end, induces the client to view it with distaste and search for alternatives. It is almost analogous to the legal profession earning fees in lost cases. The biggest challenges are really the dissatisfaction of the underlying clients whose wealth is hardly being preserved, let alone expanded adequately. Many clients are finding that it is much more rewarding and justifiable to invest their resources in real industrial or service industry businesses rather than financial assets. To do the former is to watch one's wealth decline while one pays for the privilege.

These challenges are hard to quantify by traditional management techniques as they occur over time and in small increments, but they are profound in their inevitability and certain theoretically. Consequently, another challenge is the short-sightedness of the leadership at private banks and other places in recognising the problem and acting upon it. As they find this problem baffling and see no quick way out of it, they are tempted to go down the road of 'short termism' - another unfortunate dead end. If it were publicly known how many patients suffered in a hospital, that hospital would be obliged to improve its performance and systems or shut down. There is little public exposure of the satisfaction level of clients at wealth firms, but anecdotal evidence and trends in asset accumulation suggest that the very core of the business is riven with problems.

> *Clients have even been deserting the firms that have grown through acquisition*

The biggest challenge therefore is to recognise the need to be 'client-centric' as a fundamental objective and then work towards this goal rather than remaining 'firm-centric,' as is the case today. Service-provider firms that realise this will win in the longer term and their shareholders must support such an approach. The only option is to pursue longer-term strategies.

POSSIBLE SOLUTIONS AND STRATEGIES

Like the low-cost airline industry and certain segments of the financial industry (payments etc.), de-novo enterprises can shed the past and start again.

The industry believes that its high salaries and bonuses are justified; there is no evidence of this at all

One of the biggest problems of the wealth industry is its belief that the high salaries and bonuses paid to the wealth management personnel is justified and necessary to preserve and grow and retain the wealth of the clients in their firms. There is no evidence of this at all. In fact, the industry is spoilt for reward at the expense of its clients and 'client performance' is not linked to continuing costs, especially personnel costs. The industry is conflicted by nature and design.

One option would be to experiment with a totally new business model that presents itself as a cheap but safe service provider. Superior or inferior fund performances have rarely been linked to higher fees - many times the opposite. One could consider a parallel organisation being set up to attract new and old funds under management with the scientifically hedged purposes of protecting wealth and charging nominal margins for this, as well as for growth. The clients would see their wealth protected (which is possible with the low hedging costs available in most markets) and then reward their providers with a reasonable but not excessive fee for positive growth. The courage needed for such an approach must be derived from a passion for the client and the longer-term survival of the client that in turn will ensure survival for his service provider.

Other possibilities include giving full discretion to the clients and becoming a true custodian of assets and exit wealth management and advisory. This sort of 'brokerage' approach will shield the providers from high costs and their providers from criticism for lacklustre performance. It would give clients access to all instruments and asset classes with full responsibility for the outcome. The current approach of hybrid risk management between the client and the provider is not only unclear but confused and expensive and has not shielded the providers from criticism in any case.

Imagine a low-cost platform that allows the client to perform what he wants, any time of the day or night, anywhere on the globe. This brokerage model can be extremely profitable if well managed.

The options we have mentioned here have one thing in common. Let the client be the centre of operations not the service provider.

The industry is in crisis. Clients are desperate to preserve their wealth and create more of it. The industry must reinvent itself with new, efficient models that place the client first in reality and not just in words. Clients are intelligent and want results from a fairly priced model. Solutions exist for the courageous and daring; the rest will struggle along with the vagaries of the market and probably die a slow death. Wealth will always have to be managed. If it cannot be managed well by the service providers or their successors, the clients will find alternative ways and cut out the middleman.

Long live the new wealth management industry. Long live client power!

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