

# The Wealth Landscape



## The Manager's Perspective

Survey and report prepared for Clearstream by

clearstream | DEUTSCHE BÖRSE  
GROUP

Goodacre

## FOREWORD

Recent industry developments continue to show an increase in regulatory requirements for transparency, ongoing structural change, and a heightened awareness of the importance of risk management. Wealth managers and private banks face a significant amount of these new regulatory requirements and face continuous market reform as a result of the efforts of policy makers and regulators to make markets safer and more efficient.



Of course, wealth managers continue to focus a lot of energy on investment performance, client service and distribution, and how to deal with the rapidly changing commercial model in which they operate. However, equally as critical now are the topics of client asset protection and operational efficiency and, having spoken to the regulators and understood what their regulatory agenda is looking to achieve, it becomes clear why this is the case.

With the Financial Conduct Authority (FCA) monitoring operational risk and asset protection ever more closely, wealth managers are under increasing pressure to prove they provide best-in-class fund processing solutions. Accordingly, we have experienced a clear trend for wealth managers and private banks to apply much greater rigour to the selection and monitoring of their service providers, and this has exposed high levels of risk and inefficiency embedded in parts of the current supply chain. Hence, many are using this regulatory trigger to question and amend their roster of partners and suppliers.

As a neutral market infrastructure, and as part of Deutsche Börse Group, the integrated exchange organisation, we position ourselves as a neutral, stable and low-risk solution in helping wealth managers meet these objectives. Clearstream is committed to delivering world-class levels of service to our customers and their end customers, whilst ensuring the highest standards of safety for their assets, through best-in-class operational models including asset segregation and DVP settlement. We are proud to work with the UK Wealth Management community in helping deliver safer, better markets to their clients.

**Philip Brown**

Co-CEO

Clearstream Banking

## EXECUTIVE SUMMARY

This Clearstream-commissioned survey based report from Goodacre examines how wealth management firms are coping with the current wave of new regulatory requirements and market developments which is encouraging a trend towards greater operational efficiency that will bring far-reaching changes to the securities industry.

The regulatory landscape was seen as the biggest challenge currently faced by wealth managers. A lack of operational efficiency, increasing competition across the industry, including from robo advisors, and cyber threats were also cited as areas of concern.

However, wealth managers also identified business opportunities over the next three years, notably in the area of new product development (client reporting, services for online devices and for operational risk monitoring) and the implementation of new investment fund processing technology.

Many companies felt that improved technology would be a major factor in reducing costs, lowering the operational headcount and generating efficiencies. Almost 70% of survey respondents stated that this could be achieved by using a single custodian and fund processing provider for all asset classes. Enhanced customer asset protection and risk mitigation were also seen as benefits of using a single provider.

Taking streamlined processing a step further, a large number of respondents agreed that integrated execution, settlement and custody services for all asset classes — in other words, outsourcing all operations — significantly reduces fixed cost overheads.

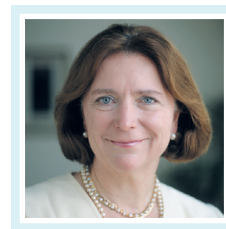
This survey indicates that post trade settlement activity will likely become an outsourced utility in the wealth management business in the future and replace most of the current 'back office' establishments in the UK which still rely on highly manual processes.

Some market infrastructure providers already offer streamlined processing — from order routing, centralised delivery versus payment (DVP) settlement, safekeeping and asset servicing to collateral management — across all asset classes with a high level of automation.

These centralised solutions can serve the growing need for efficiency and transparency in investment fund processing in line with regulatory developments and new rules on risk mitigation.

## OPERATIONAL TRANSITION WITHIN WEALTH MANAGEMENT BY ANGELA KNIGHT

Some pundits are predicting that the total assets under management (AUM) will grow by only around 1.5% per year from 2016-2019, compared to 11.3% from 2012-15, but even this will lead to a total of just under one trillion GBP by the end of the decade. Others think this might be more, as firms organise themselves for the changes ahead. Either way, few would disagree with the view that Wealth Managers are in for a tougher future, as a result of the likelihood of an extended period of low interest rates, slower or reducing growth in household wealth and the eventual impact of the vote to leave the EU.



As firms look for opportunities within these market conditions, they are confronted not just by the traditional issues of the concerns and questions of their clients, but also by a series of operational challenges which must be met to the satisfaction of the business and importantly the regulators.

From a business perspective, companies need to ensure that:

- Their systems and processes are fit for purpose.
- Their operational infrastructure supports products at the front end of the business.
- The amount of work involved (and of course the associated costs) to meet the regulatory requirements are documented.

On all fronts, these changes can consume valuable management time and considerable expense will inevitably change the wealth management landscape and at least some consolidation is expected.

Against this background and over the last few years, management at many leading wealth management firms has been weighing up how best to move forward. The common pattern which has emerged includes reviews of operational processes and systems, to decide what are the appropriate infrastructures. A typical outcome from these reviews is the acceptance that many operational processes are common amongst wealth management firms and that undertaking them all in house, rarely provides a competitive advantage. The result is that an increasing number of firms are now engaging commercial outsourcing companies to provide this essential third party support.

Effective delegation of operational processes to suitable outsourcing organisations can deliver many advantages. The key to success is to get the Service Level Agreements in place with the right KPI's, with the principle objective being a reduction in fixed cost overheads.

It is accepted though that outsourcing for part or all of operational processes is not for every firm. Senior management at some companies may well perceive this as a loss of control and in a number of other instances, operational management can be resistant to the changes for obvious reasons.

But it is also interesting to note the increased involvement of global custodians within the sector. These organisations are responsible for the safe keeping of assets, usually by the custodian acting as the nominee. This means that the custodian has to provide effective systems, processes and an intimate knowledge of the markets and securities involved. By so doing, this has the potential to reduce both costs and risks, while assisting in driving growth and staying ahead of new regulations.

Clarity on the distribution of responsibilities though is essential. Wealth Managers who outsource custodian and other operational activities are of course obligated to retain their own internal controls, and are ultimately required to provide compliance assurances that all relevant regulations and statutory duties in every region are being met.

So what does the future look like? First is that, Fintech will be exploited both for the benefit of customer facing requirements and for support. Second, that more processes 'behind the scenes' (or as we used to be allowed to call it the "back office") are likely to be outsourced in conjunction with the support of international asset servicing organisations. And third, that these arrangements will help senior management focus on business expansion without the traditional weight of operational burdens.

### **Is the end of the back office in sight?**

**Angela Knight CBE**

Associate

Goodacre UK

## TOWARDS GREATER OPERATIONAL EFFICIENCY IN WEALTH MANAGEMENT

Clearstream commissioned Goodacre to conduct a survey of wealth managers to examine how they are adapting to this changing market and regulatory environment. This report takes a closer look at the challenges and opportunities currently faced by wealth managers and provides an insight into their strategies for increasing operational efficiency in reaction to these changes.

### Increasing Regulatory Pressure

Wealth managers are faced with an increase in regulatory requirements aimed at greater transparency and ultimately greater safety for the end investor.

The Retail Distribution Regulation (RDR), for example, requires firms active in the retail funds sector to prove that they have segmented their client bases and appraised the suitability of the retail funds that they market at these client segments. Where fund platforms previously put the focus on fund manager satisfaction, a move to focus on end investor and distributor satisfaction could mean they are compelled to invest in data improvement, automation, and more robust reporting processes.

The activation of the RDR's 'sunset clause', along with the Financial Conduct Authority's (FCA) latest Client Assets Sourcebook (CASS) rules, has also put pressure on wealth managers to review their post-trade processes and services. Following the latest changes to the CASS rules, any firm acting as an intermediary or providing custody or depositary services has to ring-fence clients' money from the outset. The custodians and platforms selling bundled solutions will be forced to unbundle and this should expose the high cost of third-party processing that so many wealth managers are enduring.

With the CASS rules already introduced, MiFID II scheduled for January 2018 and changing demands from investing clients mean that traditional operational infrastructures will need to be closely examined and probably enhanced or in a number of cases, replaced.

An increasing number of companies are chasing clients with up to £150k to invest, by offering cheaper services and robo-advice. This is increasing pressure on some of the more traditional providers who offer more personal (and more expensive) services.

The cost of doing business has increased as the regulatory environment has placed demands for tighter controls and more stringent reporting. All wealth managers face obstacles to acquire new clients and assets, while making sure their service offerings keep pace with customer demand, particularly in terms of delivery of information and reporting.

MiFID II is likely to place a considerable burden on smaller or boutique firms who may be forced to operate under the umbrella of larger firms or simply, become acquired or adopt more appropriate operating methods, e.g. via third party service agents.

Companies with limited access to working capital may find that the increased costs of operations force their hand in terms of a financially stronger ownership structure.

Firms who use 'conventional' operating models relying on systems and processes they have used for a long time will need to upgrade their infrastructure to remain compliant and be able to offer the higher service levels now in demand by investing clients.

## Trends towards Consolidation

Firms with AUM of under £8bn are likely to become open to acquisitions until mid 2017. The reasons for this are:

- Larger companies which are looking to expand their businesses, recognise that acquisitions will be one of the most effective methods, to achieve their objectives.
- The more 'vulnerable' firms may prefer to be acquired rather than face the challenges of installing new operational infrastructures.
- Stakeholders of companies in this range may want to crystallise the value of their businesses without further capital expenditure.

This trend in acquisitions has been increasing over the past two years. In 2015, 124 companies were involved in mergers and acquisitions in the sector, compared to 83 in 2014. Interestingly, the total AUM involved in 2015 was less than previous years. This confirms the view that smaller firms may find it harder to remain in business.

2016 has already seen considerable merger and acquisition activity in the sector, with deals including:

- Tilney Bestinvest acquired Ingenious Asset Management.
- The LGT group took a majority stake in Vestra Wealth.
- Société Générale acquired Kleinwort Benson.
- Tilney acquired Towry in a deal that combined two private-equity owned groups.
- The client book of Arjent Limited was acquired by Beaufort Securities.
- Interactive Investor is reported to acquire the shares of TD Wealth Holdings and TD Bank International, which make up TD Direct Investing. It is said that this will create a group with £18 billion of assets and 300,000 customers.
- Cazenove Capital Management reached an agreement with C. Hoare & Co. to acquire its wealth management business. C. Hoare & Co. is a London-based private bank with a 300-year history of providing banking services, expanded its business over the past 10 years by offering into wealth management services to approximately 1,800 clients and £2.2 billion of discretionary assets under management.
- Old Mutual Wealth Private Client Advisers, acquired Cheshire-based JW Financial Planning. This follows their acquisitions earlier in 2016 of DQS Financial Management and Beaumont Robinson.

Once the UK has withdrawn from the EU and MiFID II has been implemented, companies offering wealth management services which have successfully overcome these obstacles are likely to continue under their same ownership. It seems likely therefore that the overall number of wealth management firms will reduce but the size of the companies will increase.

## Threats and Opportunities

Companies face different threats and opportunities depending on where and how they are situated. Key factors include the range of services being offered, operational efficiency, management of risks and cost effectiveness.

Many fund platforms wealth managers are using might appear highly automated and efficient, but a quick look below the surface still reveals highly manual processing hubs. Efficient alternatives are available in the market that will offer high STP rates across these processing segments, such as full automation across order placements, DvP settlement and asset servicing. Apart from cost savings, these funds processing alternatives also offer a series of management benefits.

For many years a number of participant companies have under invested in their operations and systems. Technology is now a major consideration and dated legacy processes and systems will be consigned to history.

## The Investor's Views

In addition to ensuring compliant and effective operating systems, clients are looking for enhanced online information and reporting coupled with prompt and high quality levels of customer service. From other research, a summary of views, opinions and comments from investing clients includes:

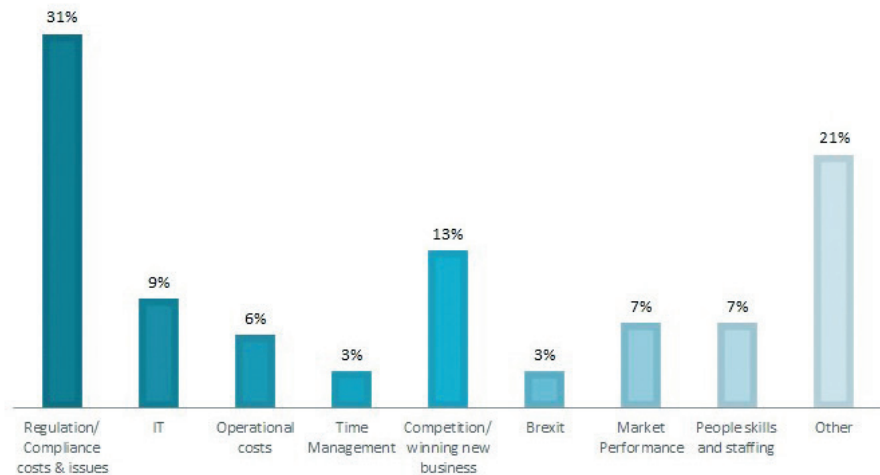
- Reporting methods from many firms was said to be inadequate.
- The level and depth of online reporting was in a number of cases said to be unsatisfactory.
- Discretionary wealth management advice was considered to be too expensive.
- Some advisers are unfamiliar with the changes to regulatory obligations on their wealth management companies.
- A number of investors were considering a move away from Discretionary or Advisory services to a DIY approach, using online platforms.
- There was significant interest in robo advice although clients who were using this were critical of performance.
- Investors preferred communications by email, rather than post or telephone.
- Marketing material was “too wordy”.
- Forms were difficult to complete.
- Telephone helpline staff were dismissive and patronising, from some firms.
- Websites were difficult to use.
- Access to customer support only available weekdays.
- Printed records and valuations arrive late.



## THE SURVEY

### Obstacles

**What are the biggest obstacles to overcome in order to meet your company's objectives?**



The increasing regulatory pressure and escalating costs are creating new challenges to wealth management firms and to their stakeholders. The majority of respondents said that these were the main obstacles to overcome.

At a high level, the combined effect of much of this regulation will put pressure on firms to automate their funds processing; it will increase the frequency and require more granular and aggregate data for reporting.

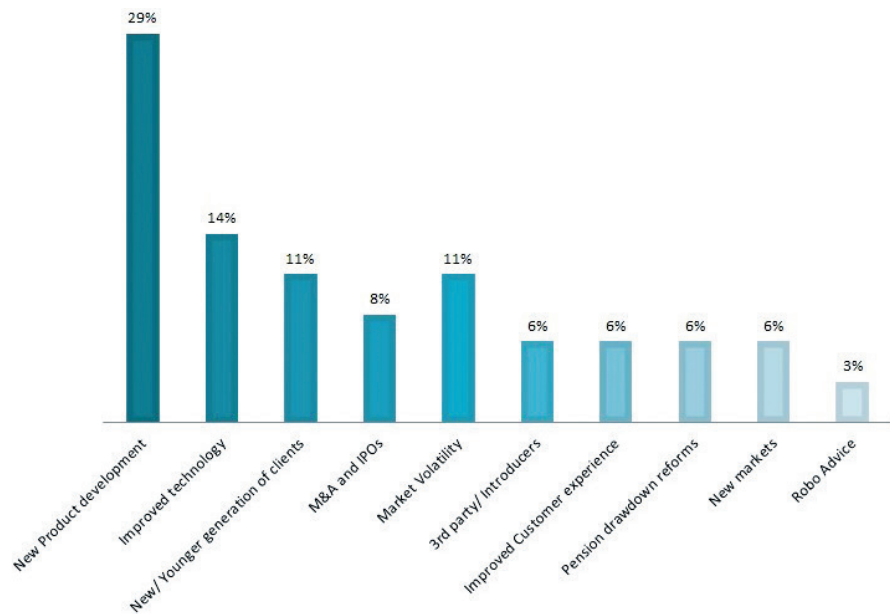
A lack of investment into the post-trade arena of many wealth management firms or highly manual processing hubs are now becoming exposed. For example, the automation offered by fund platforms may not extend beyond order routing with many post-trade processes still handled manually. Efficient alternatives are available in the market that offer high STP rates and full automation across order placement, DvP settlement and asset servicing.

Competition was mentioned by a lower number of firms than expected. This may be because respondents were considering similarly structured competing services. However, with the rise of Robo Advisors, greater confidence and awareness in IT and online services, new advisory and discretionary models have emerged. Many investors think differently about advice and have different attitudes and expectations.

A number of companies are also worried about cybersecurity threats. As the number and range of online services increase, so will the possibility of a cybersecurity attack. Cyber criminals are learning where the wealthiest targets are and although it is relatively well known that banks such as HSBC suffered a failure due to an attack in January 2016, reports of problems within the wealth management sector are rare. Whether this is because wealth management firms have such strong 'cyber resilience' or whether any difficulties have simply been kept under wraps is not certain. Going forward cyber security will become and remain a major challenge.

## Opportunities

Where do you think the greatest area of opportunity for your business lies over the next 3 years?



Commitment to new product development was by far the most popular response; ‘robo’ type products attracted little support. From respondents interviewed, new products focused primarily on improved client reports and the delivery of services on required online devices, to improve the customer experience.

Given the regulatory and market infrastructure change over the next few years combined with continued downward pressure on costs and the increased focus on operational risk, market participants are expected to invest in new fund technology to improve capabilities for the processing of investment funds. This includes new transparency reporting capabilities to clients or regulators to meet particular compliance requirements or new tools for operational risk monitoring.

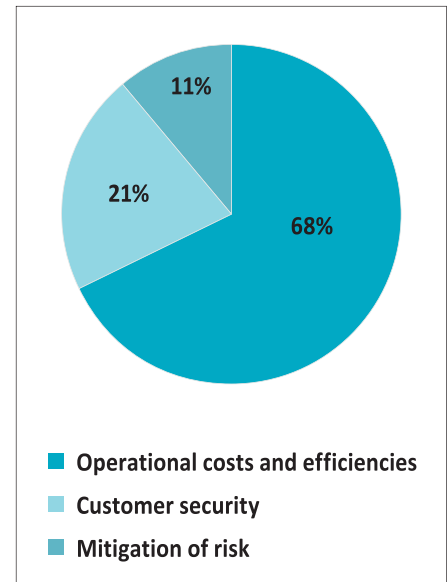
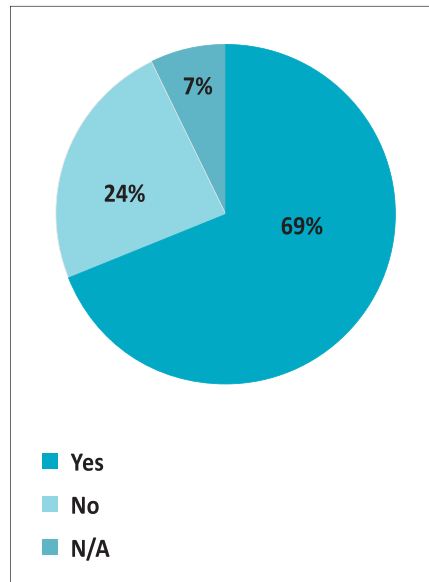
Many companies felt that improved technology would be a major factor in reducing costs, lowering operational headcount and improving efficiencies.

### Comment from a robo advice company on opportunities ahead:

*“We welcome competition as it increases awareness of robo-advisory services, which filters down to our retail customer base.”*

## Added Value

**Do you see any added value in using a custodian/service provider?  
If yes, what are the main reasons?**



Of the participants who saw an added value in using a custodian/service provider, lower operational costs, higher efficiencies, customer security and mitigation of risk were cited as the main reasons.

Some wealth managers are now recognising the high levels of risk and inefficiency embedded in their existing providers' custody networks and operational procedures — and are taking steps to put better arrangements in place.

Wealth management firms saw the benefits of safety for customer assets as a key factor, particularly where the service was being offered by a major market infrastructure provider. These ensure the highest standards of safety for customer assets, including asset segregation and DvP settlement. There was also a good deal of supporting comments for the level of expertise and professionalism available in the market from such services.

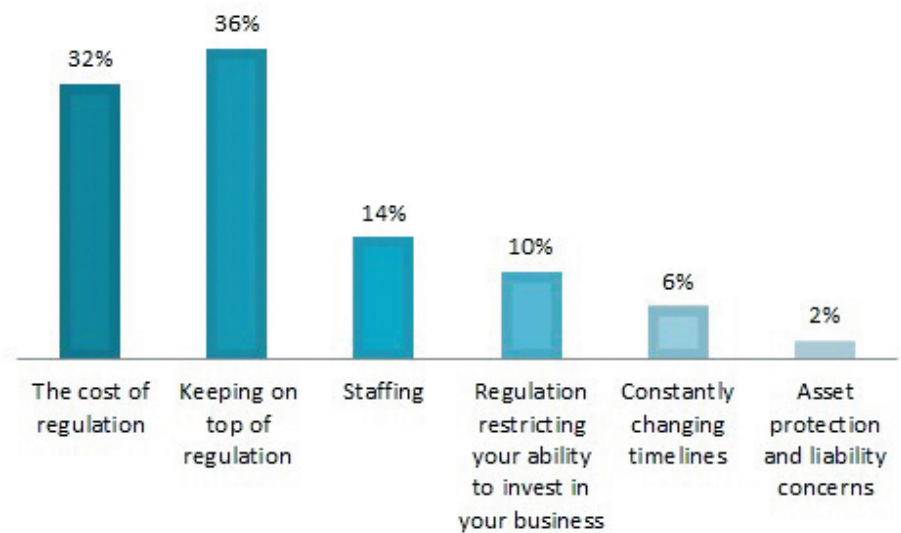
Apart from improving efficiency and automation in the funds sector, clients are increasingly looking to bolster the security of their financial infrastructure.

Asset safety has also become a key concern among participants in the investment fund industry. This is a reflection of recent developments on the EU regulatory agenda, such as the implementation of the Alternative Investment Fund Manager Directive (AIFMD).

Whilst wealth management firms remain obligated to ensure continuing compliance, there was obviously significant comfort by employing regulated custodian services from market infrastructures which could constantly provide assurances that beneficial ownership is recognised in the markets where their assets are held. This gives customers of infrastructure providers the assurance that they will recover their assets even in the unlikely event of an insolvency of these highly regulated institutions.

## Regulatory Challenges

What is the biggest regulatory challenge for your firm?



The cost and keeping on top of regulations were confirmed as the greatest concerns in respect of challenges in this sector. Compliance is obviously an essential element of running a regulated business. In addition to charges levied by regulators, additional costs incurred through professional advisers were major factors.

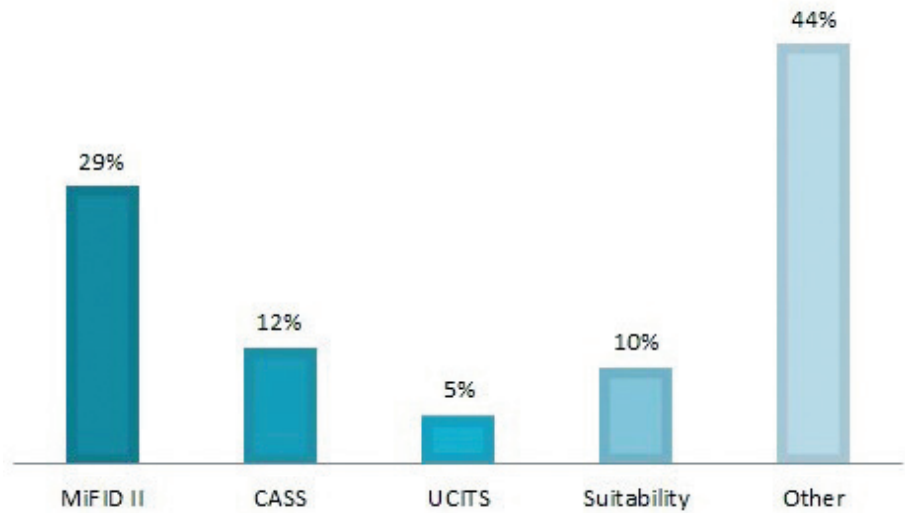
The increased cost of compliance personnel was also mentioned including those taking on the responsibility of a CF10a (which includes very strict and attributable personal obligations including severe personal financial penalties) where base salaries upwards of £130k are becoming the norm.

### Comment from respondent:

*"The cost of regulation restricts our ability to invest in the business."*

## Regulatory Concerns

What are the top pieces of regulation that are of greatest concern to your business in terms of fund processing?



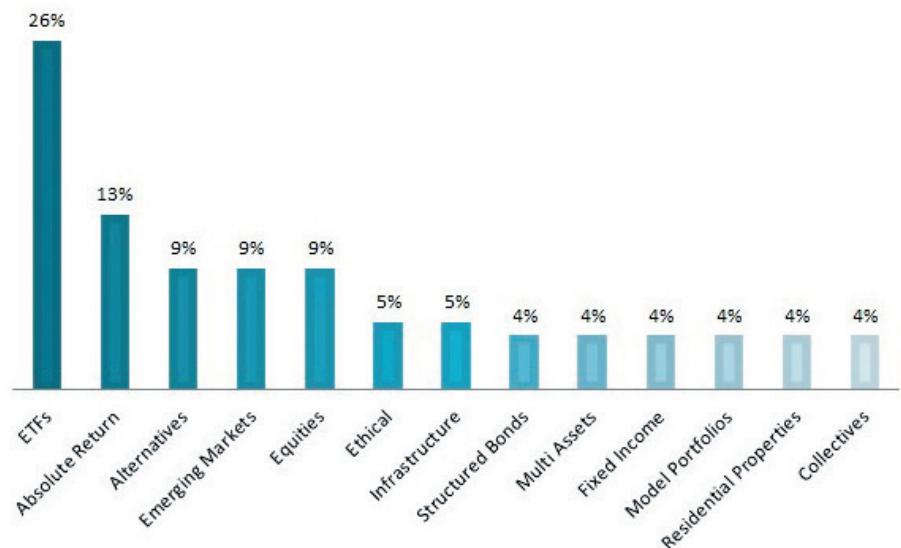
All UK firms will require some kind of MiFID II “equivalency” reforms which must be implemented. What ever happens, this will remain a concern for regulated firms. The MiFID II regulations were a hard enough challenge before the referendum. Now, seeds of uncertainty about the specific content may begin to be sown.

### Comment from respondent:

*“MiFID II is the biggest concern for our firm.”*

## Growing Asset Class

What do you see as a growing asset class?



Respondents confirmed the popularity of Exchange Traded Funds. ETFs, as a group, have never experienced annual outflows since they were introduced some 26 years ago. Despite the increased volatility prior to the referendum, ETFs attracted net inflows of 1.6 million Euros.

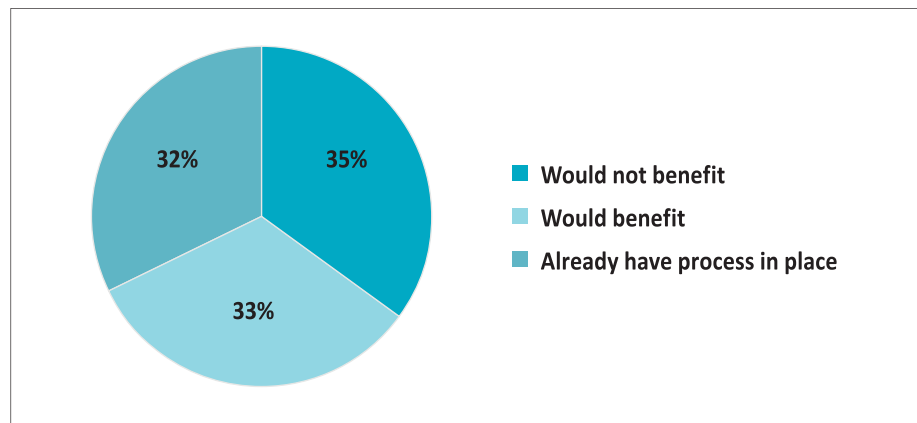
The survey confirmed that ETFs are an increasingly popular asset class. However, the growing demand is curtailed by settlement and realignment challenges within the fragmented European market when traded cross-border. Market participants expect the overall volume of ETF assets to increase even more significantly once the key issue of fragmentation in the European ETF market is solved and an efficient international infrastructure is in place.

International market infrastructure providers are, for example, well placed for the issuance and settlement of multi-listed ETFs. An international ETF post-trade infrastructure provides issuers with an efficient framework for cross-border traded ETFs, and alleviates operational risk and capital burdens. Under this issuance solution, both settlement and distribution take place in the international infrastructure resulting in simplified inventory management and cost-effective trading between different venues.

In addition and as ETFs are enjoying growing popularity, investors are increasingly seeking to combine ETFs and mutual funds in a single portfolio. Global fund processing platforms meet these needs by enabling ETF trading on an OTC infrastructure basis.

## Integration

**How would an integrated execution, settlement and custody service across all asset classes benefit your firm?**



Of the participants who acknowledged it would benefit their firms, enhanced operational efficiency and cost reduction were seen as chief benefits.

However, outsourcing dealing and settlement operations for UK firms still divides opinions. Approximately one third of respondents remain opposed to using services from an external provider with reasons that range from a perceived lack of control, through to the fear of poor quality of service. Many of these attitudes have roots which go back a number of years and service providers, having significantly enhanced their propositions and performance, struggle to convince many participants.

Economically, outsourcing operations has the benefit of a significant reduction of fixed cost overheads. The level of operation staff and IT support can be reduced and replaced by a charging structure geared towards business volumes, AUM or both.

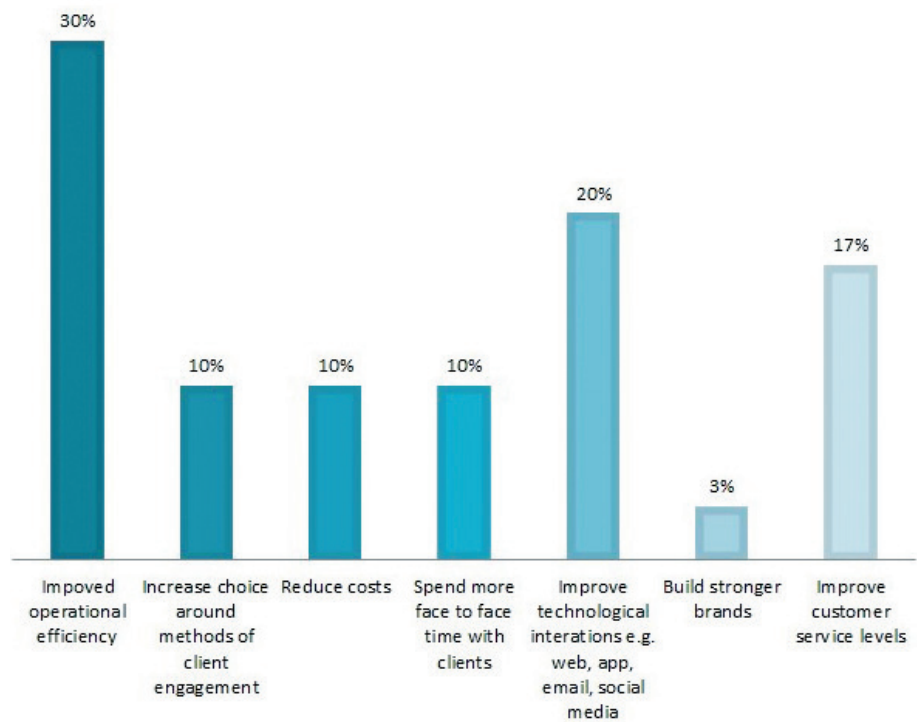
Over time, it is fair to predict that post trade settlement activity will become an outsourced utility and replace most of the current 'back office' establishments within the UK.

Some service providers of such an integrated service offering provide a single point of access for order routing, centralised delivery versus payment (DVP) settlement, safekeeping and asset servicing to collateral management. This allows customers to benefit from a streamlined process across all asset classes with a high level of automation.

Centralised solutions can serve the growing need for greater efficiency and transparency in investment funds processing, in order to comply with regulatory developments and new rules on risk mitigation.

## Single most Critical Factor

What is the single most critical factor wealth managers must change about their service in the next 12 months?



The majority of respondents highlighted the need to improve operational efficiency which emphasises the lack of attention and funding this aspect of their businesses has received in the past.

A number of firms continue to prop up their operations with manual support on the basis that the systems being used do not meet all requirements. The wide use of additional local IT applications (shadow IT) is also evident where users prefer to remove data from central systems and use a local application to achieve the desired result. The cost of shadow IT accounts for up to 30% of all system costs in some firms. The consequences for poor management of these local applications, especially where reconciliations are not properly organised, are dire.

Efficiency gains are mainly achieved through automation. Operational efficiency in the investment fund services areas is significantly increased through DVP settlement, the synchronous exchange of cash and investment fund shares. Automation is a powerful tool in the investment funds sector where many companies still rely on outdated methods.

### Comment from respondent:

*"We must implement systems to achieve a true STP environment."*



## Survey Methodology

This research has been commissioned by Clearstream. Senior directors from wealth management firms participated either through an online survey or telephone interview conducted by Goodacre. The results are based on the most comprehensive submissions from 100 participants.

### About Clearstream:

Clearstream is a global leader in post-trade securities services with more than €13 trillion in assets under custody, of which over €1.8 trillion are fund assets. Over 2,500 banks, wealth managers and financial institutions around the world use Clearstream.

Clearstream is recognised by the UK's FCA as a 'Commercial Settlement System (CSS)'. It delivers full automation across order placement, DVP settlement and asset servicing and is supported from the same platform as the servicing of customers' investment funds, fixed income, equities and warrants, thereby ensuring a streamlined process for all asset classes.

As a specialised fund-custodian, Clearstream delivers state-of-the-art solutions to standardise investment fund processing and to increase efficiency and safety in the investment fund sector.

With more than 190,000 investment funds of which 50,000 are hedge funds, Vestima is the world's largest cross-border fund processing platform.

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