

The Transformation of Wealth Management— Part I

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Transformation

Huddled around a conference room table heaped with reports and empty coffee cups, a private bank's executive team is doing some corporate soul-searching. They're wrestling with how best to capitalize on the sizeable opportunity in the growing wealth market. Having invested considerable capital to diversify their investment offering, recruit talented relationship and portfolio managers, and install a new customer relationship management system, they're now evaluating their progress and considering additional measures. The CEO proposes the addition of financial planning services and an animated build-versus-buy discussion ensues. The COO wonders if family philanthropy services might be attractive to wealthy clients. All ideas are entertained—from marketing campaigns to new product offerings. The stakes are high and the competition is fierce, for this same conversation is taking place in conference rooms around the globe.

Opportunity is not an issue; there's plenty to go around. Globally, the number of high-net-worth individuals (those with more than \$1 million in financial assets) grew at a rate of 8.3% to reach 9.5 million in 2006¹. The Boston Consulting Group estimates that global assets under management will grow to \$115.8 trillion by 2010 (up from \$88.3 trillion in 2005)². This growth, combined with the way people think about their wealth and the increasing complexity of dealing with it, opens up interesting possibilities for wealth managers. In their very thorough 2005 World Wealth Report, Merrill Lynch and Capgemini³ argued that people with investable assets in the range of \$5 to \$30 million are dealing with complexity similar to that of their much wealthier counterparts. Their challenges include wealth planning across the entire family, global investments and business dealings, as well as greater risk management. And, while we've found that those with investable assets in the \$1 to \$5 million range aren't yet facing all the same issues, they do see them on the horizon.

¹ Capgemini & Merrill Lynch, *World Wealth Report 2007*, p. 2.

² Boston Consulting Group, *Taking the Client's Perspective: Global Wealth 2006*, pp. 7, 9

³ Capgemini & Merrill Lynch, *World Wealth Report 2005*, pp. 14-19

Ultra-high-net-worth families⁴ meet such challenges by establishing family offices, which handle everything from knowledge gathering to advice and execution. But even the \$5 to \$30 million set generally lack the resources needed to keep a family office running. Consequently, they end up juggling a host of specialist advisors and product providers. They value the expertise of those specialists, but they are frustrated by the juggling act. They'd prefer a *trusted advisor* and integrator who could find all the right experts and get them to collaborate; integrate the *disparate knowledge* and activity; turn it into useful advice; and act upon a client's well-informed decisions. Furthermore, they want all of this well-orchestrated advice oriented around what's happening in their lives, not just what's happening in their portfolios. It's a tall order, but it can be filled.

Trusted Advisor and Integrator

While most wealth managers serve their high-net-worth clients very well, we believe few have stepped fully into the role we're recommending: that of trusted advisor and integrator. To describe what we mean by trusted advisor and integrator, we'll take each word—each aspect of the role—in turn.

Trusted: We know great brands are built on trust, but what does it take to be trusted? Trust is a function of believing that a person or entity is competent, has one's best interest at heart, and can be relied upon. To earn this reputation in the wealth market, wealth managers must:

1. Marshal all the expertise needed to deliver sound, objective advice. This may require skills and experience that is not available in the wealth manager's firm (e.g., philanthropy or family business issues). Therefore, the wealth manager may need to create a network of relevant experts beyond the walls of the firm.

⁴ People with investable assets greater than \$30 million.

2. Demonstrate that they have the clients' best interests at heart by orienting the entire business around clients' needs. Examples include discovery processes to explore clients' life goals; global products and practices, applications that take a comprehensive view of clients, and partnerships that enable more and better services. This is a significant undertaking which we'll address throughout this article and in future publications.
3. Consistently follow through on every promise large and small, spoken and implied. Execution and transparency matter here. Seamless processes, powerful technology, real-time information and high standards are critical. Also implicit in the promise to help clients succeed is the commitment to prepare them for future challenges and opportunities. Thus, wealth managers need to develop and use their knowledge of clients and the market to predict and satisfy emerging needs.

Advisor: Wealthy clients—especially those identified as Baby Boomers and New Wealthy—want more than a wider selection of products. They value advice, which is a process as much as a result. It entails understanding the client's needs and life goals, gathering and analyzing information, developing viable options to attain the goal(s), and communicating the pros and cons of each option to facilitate better decision making. These relationships are not about selling products, it's about promoting success for clients in their lives and their work. Innovation is an important factor in this process, as

satisfying clients' life goals and emerging needs may push the wealth manager beyond what they can deliver today.

Integrator: The quality of people, products and services comprising a wealth management offering are critical, but the transformational element is integration of the sort many family offices deliver. Most wealth managers are not set up to do this today—at least not in any scalable way. Let's be clear: we're not just talking about consolidating technology or opening up the investment architecture. What we're proposing is a collaborative network of experts, capabilities, products, services, processes and supporting technology all dedicated to helping clients use their wealth to achieve their goals in life. It's the synthesis of all components that makes the difference.

Many wealth managers embrace this role in principle, but have a difficult time putting it into practice. Much of the difficulty lies in the fact that the traditional wealth management business model doesn't support it. In fact, a transformation is in order.

Business Transformation

Unfortunately, the word *transformation* is overused to the point of meaninglessness. But in its true sense—to change in composition or structure; to become something new and different—*transformation* is exactly what's required. The four broad categories of the wealth management business that must be transformed are described below:

CATEGORY	TRANSFORM FROM	TRANSFORM TO
Business infrastructure	Fragmented, country-specific business processes and technology	<ul style="list-style-type: none"> Fully-integrated, complete business processes Comprehensive global technology Relationship (vs. account) orientation High level of collaboration, communication and learning
Sourcing strategy	Familiar buy-build-partner options, where partnering usually takes the form of acquisition or outsourcing	Co-sourcing, which refers to highly collaborative, strategic, flexible partnerships designed to achieve sustainable growth by enabling critical capabilities
Client relationships and value to clients	Selling financial products built around current needs to as many clients as possible	Satisfying emerging, life-based needs of a well-defined market segment
Products and services	<ul style="list-style-type: none"> Investment-only products Menu of proprietary products or combination of proprietary and non-proprietary products 	<ul style="list-style-type: none"> Integrated financial and non-financial, life-oriented components A client goals-based approach to investing Model portfolios based on deep knowledge of target market's needs Using best proprietary and non-proprietary money managers

We'll focus on the first two transformations in this paper—business infrastructure and sourcing strategy—and we'll address the remaining two transformations in Part II of this series, which we'll release later this year.

Transforming Business Infrastructure

We use the term infrastructure to describe a wealth manager's processes and supporting technology—the backbone of its operation. At the height of its popularity, the goal of reengineering was to achieve greater efficiency for the organization by streamlining its processes and automating functions. But given the wealth market's desires, reengineering won't be enough. The goal of infrastructure transformation, on the other hand, is to make wealth management more valuable, meaningful and straightforward for clients. To become the *trusted advisor* and integrator for wealthy clients, a firm's infrastructure must enable wealth managers to:

1. Adopt a relationship orientation rather than an account orientation. The account has long been the organizing unit in wealth management: transactions post to accounts; performance is measured by account; and statements separate information by account. It's common, however, for a single client to establish multiple accounts for specific family members or special circumstances. Therefore, a more appropriate organizing unit is the relationship, an orientation that enables both client and wealth manager to see the complete picture of the client's wealth and progress toward life goals. This is one of the most critical design principles of a global wealth business infrastructure.
2. Easily and continuously gather, organize and analyze information about clients and prospects to provide insights into current and emerging needs. Today, with loosely-connected applications and staff that are often separated by organizational or geographic boundaries, it can take a heroic effort to gather current information about one client, let alone look for trends across groups of clients.
3. Communicate and collaborate with clients and a network of experts. Suppose a wealthy client is ready to sell the successful family business and launch a charitable foundation. The array of experts needed to accomplish this goal may include tax accountants, estate planners,

investment advisors, and experts in philanthropy and the dynamics of family business. Whether those experts reside inside or outside the firm, they need to see the client's whole wealth picture and interact with one another to develop recommendations and execute against the client's decisions. The infrastructure must therefore promote collaboration through communication technologies like alerts, information feeds, online meetings and more. It must also transcend boundaries between business functions, geographic regions and even selected external entities.

4. Globalize the business. With clients all over the world and the increasingly global reach of clients' businesses, financial and personal endeavors, wealth managers must be able to do business in all pertinent languages and currencies, and comply with the many complex, regional laws, regulations and cultural norms. Globalization affects a firm's entire infrastructure—from business processes to technology platforms. To avoid redundancy and achieve scale, processes and technology must be consistent across all geographic regions, client segments and organizational boundaries. Take, for example, the MiFID⁹ regulations in the European Union. It would be both inefficient and risky for a global wealth management firm to entrust its regional offices with the interpretation and implementation of the directive.
5. Operate holistically and seamlessly. To operate holistically, a wealth manager must consider the broad impact any decision may have on a single client and/or across all clients and the organization. To operate seamlessly, all process gaps and handoffs must be eliminated. Both operating principles are important to clients, in that they ensure a more complete and higher-quality solution to any particular problem or request. They're also important to the wealth manager who wants to improve efficiency, create greater value for clients, and reduce risk. A micro-level example of this principle is the client who wants to trim her exposure to oil companies. At a minimum, the portfolio manager should be able to see and adjust the client's holdings in those companies across all her accounts without having to examine each account individually and issue individual trade orders (see point #1 above). That's the seamless part. But the portfolio manager should also be able to readily evaluate different scenarios

5 Markets in Financial Instruments Directive

Strategy

for executing the change and the impact each would have on the client as a whole. For example, the portfolio manager will want to evaluate the most tax-effective way of handling this reduction without violating any individual account restrictions. It may be preferable under certain conditions to remove all oil company holdings from one account only, but that can only be determined by looking at all accounts. That's what we mean by holistic. At a macro-level, suppose the firm needs to reduce exposure to a particular holding across all clients. In some wealth management firms, individual portfolio managers handle evaluation and changes for their own clients as they see fit. A better approach is to build the business rules guiding evaluation and execution directly into the wealth management firm's client processes and underlying technology. Thus the reduction could be evaluated in terms of its impact at every level—from individual portfolios to the entire firm—and executed efficiently, consistently and fairly.

Transforming Sourcing Strategy

It is possible for wealth managers to assemble a collection of systems and business processes to enable these capabilities, but the resource drain may preclude sustainable, scalable success. We believe most private banks will need to engage partners to undertake the transformation and succeed in the role of *trusted advisor* and integrator. While sourcing strategies are not new to wealth managers, they too must be transformed.

The business transformation we've recommended cannot be accomplished through acquisition or lift-out. Even if the acquiring firm can overcome the assimilation problems so prevalent in these relationships, a critical advantage is lost once the acquired firm or

group has been absorbed: that is the innovation derived from single-minded immersion in an area of expertise.

Nor can the transformation be accomplished through traditional outsourcing, which can be defined as the purchase of necessary products or services from an outside provider in order to increase efficiency. We've already argued that the goal of this transformation goes well beyond achieving efficiency.

Ultimately, the partners a wealth manager selects to help transform the business infrastructure (and the rest of the global wealth business) must demonstrate the key competencies expressed in its design—collaboration, communication and learning; global outlook; and a holistic, seamless approach. In addition, the providing partners must take on much of the integration that wealth managers will pass on to their clients. That resource drain we mentioned earlier is not so much a function of having to maintain and enhance individual components of the infrastructure (applications or services they've outsourced or built themselves). It's the integration of those components—forging them into a meaningful, seamless whole—that's the challenge. Therefore, a wealth manager should look for partners who can address whole processes rather than just discrete functions; bring experts and capabilities to the table; and integrate all of these into the wealth manager's organization and operations.

What we're proposing is a new partnership, which we refer to as co-sourcing. The term, co-sourcing, can be found in a host of publications, none of which seem to agree on a definition. We use the term because the co- prefix hints at the type of sourcing relationship we're recommending and, frankly, because we have not found (or invented) a more suitable one. While we wrestle with semantics, we'll define co-sourcing by contrasting it with outsourcing, which is generally well-understood as a sourcing option.

Outsourcing vs. Co-Sourcing⁶:

CATEGORY	OUTSOURCING	CO-SOURCING
Scope	Tackles fairly discrete functions considered non-critical or peripheral to core business	Addresses complete, continuous business processes critical to organization's growth
Approach	<ul style="list-style-type: none"> Buyer gives a business function to a provider to run (e.g., copy center), and/or Buys a product or application to perform a specific function (e.g., accounting program) 	<p>A collaborative and strategic effort:</p> <ul style="list-style-type: none"> Provider understands buying firm's business goals Two firms create strategy for combining their skills and resources to meet the goals Collaboration continues through all stages of progress toward the business goal Provider continually addresses changing needs and circumstances
Relationship	<ul style="list-style-type: none"> Transactional relationship Provider paid for delivering a service, whether or not buying organization reaches its business goals Roles of parties involved are generally well-defined and stable 	<ul style="list-style-type: none"> Provider is directly accountable for skills and expertise it brings to the enterprise Provider is jointly accountable with buyer for achieving specific business goals Pricing model reflects that accountability, e.g., a revenue or profit sharing arrangement Requires an unprecedented degree of collaboration, sharing and learning Roles adjust to changes in the buying organization's needs and circumstances
Skills & experience	<ul style="list-style-type: none"> Provider excels in its area of expertise and performs a particular function consistently for the life of the contract Provider interacts with buyer's liaison to ensure service requirements are fulfilled 	<ul style="list-style-type: none"> Provider is best-practice expert in its field Provider is a skilled collaborator, strategic planner and business process expert Provider can consult, innovate, integrate and adapt its expertise to each buying company's needs without adding cost Provider practices what it preaches, co-sourcing with other providers to ensure buyer gets a complete process
Benefits	<p>Chief benefits are:</p> <ul style="list-style-type: none"> Cost reduction (operational efficiency) In some cases, risk reduction (through automation, for example) may free up resources, but they tend to be less strategic and can't always be deployed to higher-value functions 	<p>All outsourcing benefits, plus:</p> <ul style="list-style-type: none"> Special expertise of buyer and provider are integrated into complete, continuous business processes Increases buyer's value to clients and differentiates buyer from competitors Frees up strategic resources (people and money) to focus on creating greater value for clients Learning gathered throughout relationship is highly valuable to both parties

Wealth managers are already feeling the pain of trying to coordinate multiple outsource providers. In fact, the wealthy client's desire for integration and advice is reflected in the wealth manager's own challenge to coordinate multiple providers and organize their expertise into some meaningful whole. Yet some wealth managers are wary of involving partners so deeply in their business. We agree that co-sourcing will require a degree of trust that is unusual in business today. The onus, therefore, is on co-source providers to demonstrate the character strengths so critical to trust—competence, devotion to the client's best interest and reliability.

⁶ The work of Peter Keen on Business Process Co-Sourcing has influenced our definition of the sourcing relationship we're recommending. While Keen's definition of co-sourcing is not entirely consistent with our own, his writing on the subject helped us distill our thinking, for which we are grateful. See <http://www.peterkeen.com/recent/articles/cosourci.htm>.

Conclusion: Take Heart and Take Stock

We've given an overview of two of the four categories of transformation we believe wealth managers must undergo to capitalize on opportunities in the wealth market. The undertaking is not a simple one, but wealth managers everywhere should take heart. They already have in place two of the variables so critical to success in this market: their brands and their existing client relationships. With the help of co-source partners they can create the business infrastructure that will enable them to satisfy the new demands of the wealth market.

The first step is to gather the executive teams and take stock:

- Is the business infrastructure capable of supporting the role of *trusted advisor* and integrator?
 - Are business processes fragmented? Are hand-offs, manual interventions and complex interfaces the norm?
 - Are processes and technology oriented around clients' needs or are they primarily aimed at making things easier for the wealth manager?
 - Is the infrastructure built around client relationships or individual accounts?
 - Does the infrastructure enable the integration of experts, business processes, products, services and functions?
 - Does the infrastructure enable learning and sharing knowledge?
 - Does the infrastructure promote collaboration with clients and outside experts?
 - Are the business processes and technology global? Is it possible to do business around the world and enable clients to do so?

- Are partners capable of co-sourcing?
 - Do partners consider entire business processes, or are they simply providing a service or product to address a particular function?
 - Do partners understand the wealth manager's business goals and clients?
 - Are partners collaborating on a strategic level?
 - Are partners adept at integration? Do they bring integrated processes to the wealth manager? Do they integrate their special expertise and resources with those of the wealth manager?
 - Are partners committed to helping achieve the wealth manager's business goals? Is this commitment reflected in joint measures of success and the pricing agreement?
 - What kinds of benefits arise from the partnerships? Can any business growth be attributed to these partnerships?

The global wealth market's growth is not in question. The numbers are there. Through the transformation we've begun to describe, wealth managers can become the *trusted advisor* and integrator wealthy clients want. In our next installment, we'll cover the final two transformations: client relationships and products and services.

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