

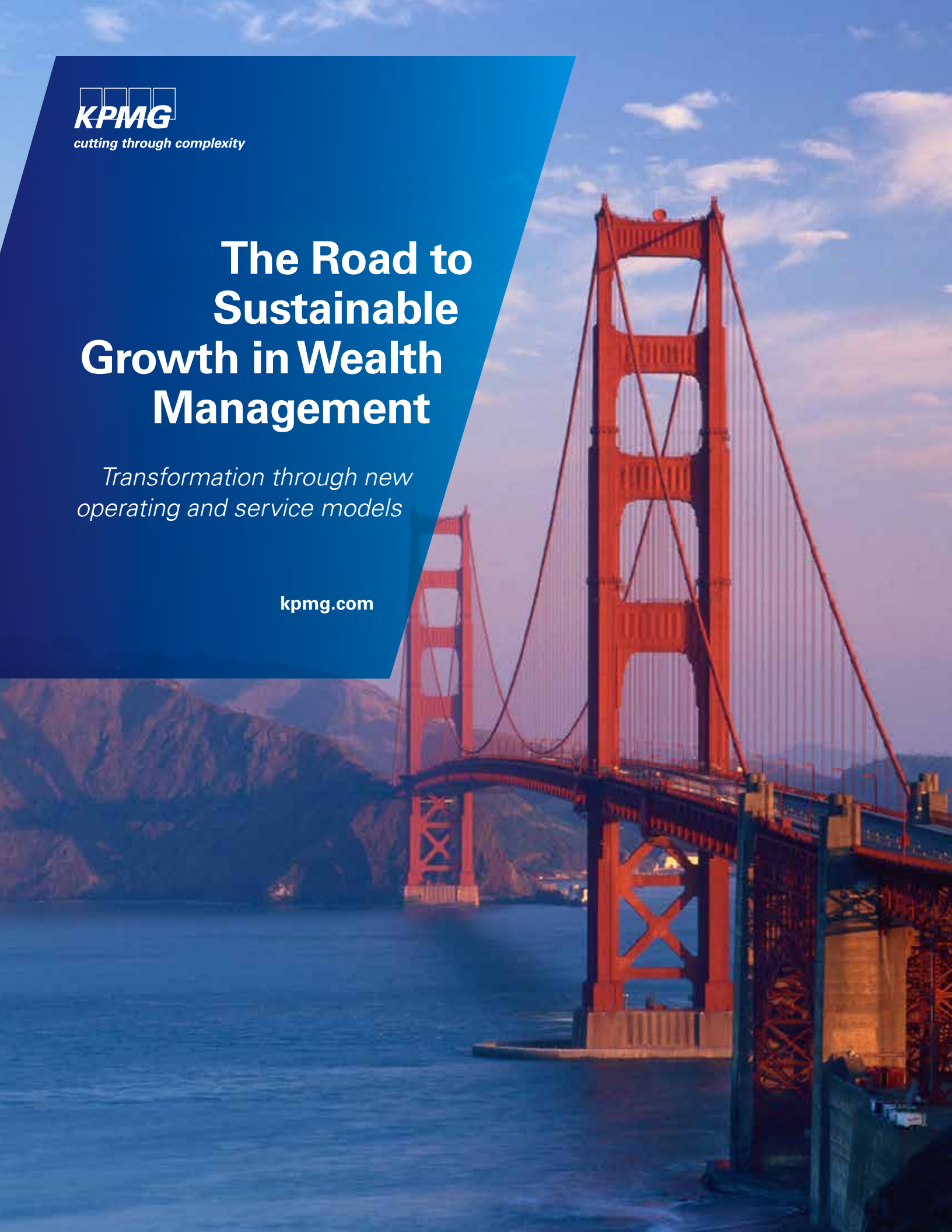


cutting through complexity

# The Road to Sustainable Growth in Wealth Management

*Transformation through new operating and service models*

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# Letter to Readers

At first blush, it may seem presumptuous to prescribe radical change for large, full-service wealth management firms in the United States, given that a cross-section of the largest delivered an average pretax profit margin of nearly 24 percent in the first quarter of 2014. But, shareholders expect higher returns, and we believe many firms can deliver them.

In publishing ***The Road to Sustainable Growth in Wealth Management***, KPMG's Financial Services practice advocates that leading full-service wealth managers revamp their operating and service models to build for tomorrow's realities. Though many firms are gaining strength and are on a path to improved margins in 2014, the ability to sustain growth and margin improvements will be challenging for firms that choose not to adapt.

We identify in this paper some of the key forces in play and share our thoughts on how firms can meet the subsequent challenges. We offer the following observations:

- » With increased competition, continued pressures on fees, and increased regulatory and compliance costs, many firms are finding it increasingly difficult to increase net new assets and improve operating margins to the levels expected by shareholders.
- » Many investors are much more sensitive to fees relative to the level of advice being offered. With the emergence of digital wealth management providers, offering lower-cost advice alternatives, traditional full-service firms need to examine and redefine their value propositions.
- » Many of the "givens and truths" on customer needs and interaction preferences held by the industry's prototypical advisor (now in their mid-50s) actually are no longer valid in today's environment. With the "consumerization" of the financial services industry, even the advisors' existing "Boomer" clients are seeking greater access to information and advice on a multichannel, "anytime/anywhere" basis, normally considered needs only of the Generation X and Y population.
- » There may be cultural resistance to embarking on a bolder transformation and change agenda across many parts of the organization, even though operational effectiveness and overall profitability will deteriorate without transformation.

While there can be no question that many organizations have begun the work of transformation, much more work remains to be done. We believe that sustainable growth and margin improvements can only be achieved by adopting an integrated approach to transformation that couples bold new strategies with rapid execution.

In offering our ideas on how full-service wealth management firms can transform their operating model, we expect debate. We encourage it, in fact, and we look forward to your feedback.



**Robert McGraw**

Principal, Financial  
Services, Advisory





An unsettled economic environment, changing customer buying patterns, disruptive technologies, and regulatory pressures have made today's business climate exceptionally complex and, at times, unnerving for our clients. To capitalize on these disruptive forces, a substantial majority of companies are transforming their business and operating models - as well as key functions to create agility, deliver new products or services to the market, and maintain a competitive edge.

*—Stephen G. Hasty Jr.  
KPMG partner and U.S. Innovation Leader for Advisory*

## Strategic context



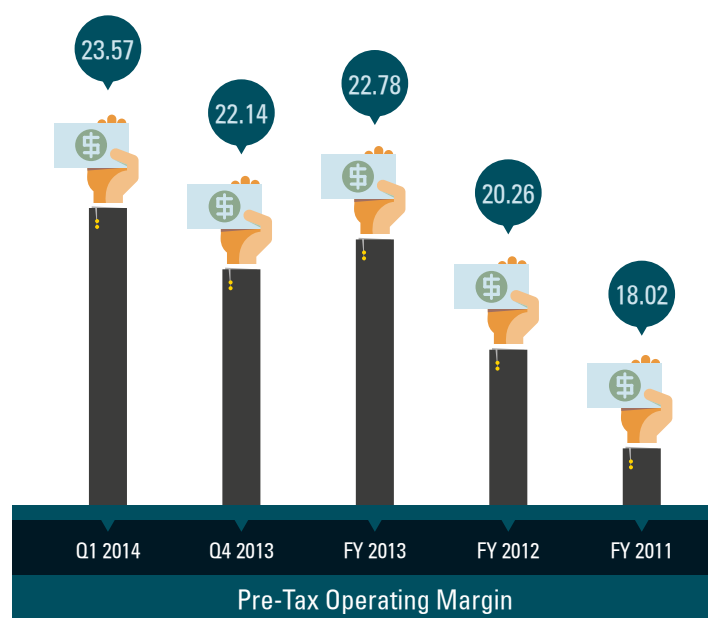
Meeting shareholder expectations on higher profit margins in the postcrisis environment presents formidable challenges to traditional, full-service wealth management businesses in the United States.

Many of the large, traditional firms were able to realize margin improvements over the past several years through cost optimization and strong market performance in 2013. A deeper examination of peer group performance highlights a significant gap between market leaders and firms in earlier stages of transformation.

An analysis of a cross-section of U.S.-based, full-service wealth management firms shows pretax profit margins rising from the preceding quarter and from full-year results in 2012 and 2011. Still, on average, they remain below precrisis levels, when pretax margins routinely were at least four points (or more) higher.

Our discussions with industry leaders indicate that full-service wealth management firms already have begun to address cost inefficiencies and gaps in attracting, serving, and retaining investors. But we also believe that much work that much more can and should be done to improve operational efficiency, boost revenue, reduce complexity and costs, and drive top-line and bottom-line growth.

Improving business performance is a board level issue as many financial services organizations are counting on their wealth management units to deliver a greater share of future earnings growth—to reduce the earnings volatility in a less capital-intensive business.



These are the average pre-tax operating margins (expressed as a percentage) of a select group of major, U.S. based full-service wealth managers. While the averages have grown steadily from 2011, the levels achieved remain below those in the pre-crisis era.

Source: Barron's Top 40, Edgar, S&P Capital IQ/May, 2014





In our view, many large, full-service wealth management organizations are not content with the speed of their transformation and are searching for smarter ways to improve their operating model and enhance their service and product delivery methods.

We believe sustainable growth and margin improvement can only be achieved by adopting an integrated approach to transformation that marries bold new strategies with ruthless execution. Doing so can heighten customer trust and confidence and loyalty, reduce operational costs and complexity, and improve risk and compliance controls.

The approach we advocate begins with a penetrating assessment of the business—including the profitability of business and customer segments, the identification of barriers to deepening customer relationships, and an exhaustive review of information technology (IT) and operational structures.

Architecting any successful transformation must also include the design of a target operating model that captures the organization's strategic growth and marketplace differentiation decisions that are necessary to execute its business strategy—and drive the firm's vision, values, and capabilities.

At its foundation, transformation demands that the business's leadership understands the organization's current strengths and weaknesses, and then defines how the business needs to adapt to drive sources of future growth and market differentiation. Doing so will elevate the possibility of building competitive advantage in an industry whose status quo has been disrupted by rapidly converging factors.

Wealth managers are hardly alone in the demand for transformation in this rapidly evolving global economy. More than 9 of 10 U.S. companies are changing business models to meet customer demands, embrace and leverage disruptive technologies, and remain competitive in the global business landscape, according to a recent KPMG LLP (KPMG) survey of executives from more than 900 U.S.-based multinational companies across industries.

In issuing the survey findings, Stephen G. Hasty Jr., KPMG's U.S. innovation leader for Advisory, concluded that U.S. companies are facing "unprecedented challenges to develop operating models that can help them respond to and translate current marketplace pressures into competitive advantages." Hasty suggests that, "with a carefully considered transformation process, companies can also make themselves agile enough to manage the new, unforeseen challenges that lie over the horizon."

Leaders of full-service wealth management businesses are coming to the realization that they must take steps now to manage tomorrow's inevitable issues and opportunities. To be sure, the transformation work will not be quick or easy. Remodeling and transforming requires a bold, strategic bet in an increasingly crowded and high-stakes field. The wealth sector remains a lucrative business with significant rewards for firms that can adapt over the next three to five years.

## Headwinds on multiple fronts

As transformation pressures mount, the traditional operating models in this industry are proving to be outmoded, especially in the face of considerable headwinds:

- » Inadequate product and service differentiation as many wealth-management firms compete for the same investor base, using similar value propositions.
- » Downward pressure on fees, especially those associated with managed accounts. Moreover, some customers and prospects are questioning the organization's value proposition in comparison to lower-cost firms, including the emergence of a new class of digital wealth-management service providers.<sup>1</sup>
- » The need to grow and expand across demographic segments to build a broader customer base. In particular, full-service providers may find growth by enhancing their appeal with Generation X and Y investors—seeking greater access to information and demands on for anytime, anywhere interaction.
- » An aging advisor base—the average age of a financial advisor in North America reportedly is 51 years old<sup>2</sup>—with service approaches that may not be adequately designed to attract Generation X and Y investors.
- » The migration of some of the highest-producing advisors to competitors and some are striking out on their own, with the help of registered investment advisor (RIA) platform providers. Part of this migration is driven by advisors looking to monetize their books as part of succession planning
- » The escalating costs of regulatory compliance and reporting.
- » Suboptimal operational processes that impede advisor productivity and the firm's growth, exacerbated by under-investment in workflow and process optimization to drive a streamlined advisor, service associate, and customer experience.
- » The significant costs necessary to upgrade or replace technology platforms.

<sup>1</sup> "Emerging Players in Digital Wealth Management: Competing for the Everyman Investor," Aite Group LLC, February 2014.

<sup>2</sup> "Advisors Slow to Train Successors," CNBC.com, May 1, 2014.



The wealth management market has tremendous growth potential and our clients are placing bigger bets on this business as a source of future earnings. We believe that sustainable and profitable growth can only be achieved by making bolder transformational bets and streamlining the operating model to deliver a differentiated advisor and customer experience.

– James Suglia  
*KPMG's Alternative Investments National Practice Leader*



## The path forward: Integration of strategy and execution

Transforming an institution with long-held beliefs, cultures, and processes can only begin with the understanding that strategy and execution cannot stand apart. An integrated approach that blends strategy and execution increases the chances that a firm can make lasting progress and grow substantially.

While many firms are expanding profit margins, there are a number of challenges that could impede even better growth in wealth management, which remains a lucrative business.

Staying on top requires that senior leaders in these firms agree on a new vision for the future, embrace a culture of change, and accept that agility and transformation are hallmarks of the future state. They must acknowledge that traditional practices can no longer be relied upon for future growth and that they must retool their business and operating models, execute strategic changes skillfully, and sell the idea to external stakeholders.

If these firms' senior executives get it right, they can revamp their organizations to capture more market share—not to mention a greater share of "the money in motion." North American asset flows are predicted to increase exponentially in the next decade; industry observers forecast that a massive wealth transfer—estimated at as much as \$10-plus trillion<sup>3</sup>—will greatly enrich the Generation X and Generation Y and Millennial generations. These flows are both opportunities and asset retention risks for advisors.

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<sup>3</sup> "Millionaires and the Millennium: New Estimates of the Forthcoming Wealth Transfer and the Prospects for a Golden Age of Philanthropy," John Havens and Paul Schervish, Boston College Social Welfare Research Institute, 1999.





## Architecting successful transformation

### Execute transformation to new operating model

- Identify early wins
- Launch new teaming structures; build a suitable change-management program
- Create new incentive compensation configurations

### Assess current status

- Focus on the organization's structure, customers, financials, and technologies

### Communicate with customers

### Communicate with Customers

- Early and direct involvement with customers is critical
- Ensure that changes to the service delivery model across customer channels

### Execute transformation to new operating model

### Build Target Operating Model

- Use firm's vision, values, and capabilities
- Drive innovation through a compelling omni-channel customer experience
- Reduce complexity: Simplify, standardize, consolidate processes
- Enhance customer data/analytics capabilities
- Integrate regulatory solutions

### Assess current status





### *Assess the starting position*

Creating a more-nimble, more-profitable organization that connects more closely with today's and tomorrow's customers is predicated on firms realistically weighing important considerations relating to the organization's structure, its customers' preference, its financial profile, and its technology capabilities.

One of the first questions C-suite executives should consider is whether the organization can be everything to everyone. In short, does it make sense to operate a full-service firm? When faced with that question, it means that top leaders must consider the firm's capabilities and limits.

With such a baseline question in mind, organizations will often hit upon other, fundamental questions. Should we shed certain operations or service offerings? Ultimately, this exercise in introspection requires wealth managers to place strategic bets on specific future sources of revenue and identify potential areas of competitive advantage.

Other questions naturally follow: How can the business differentiate itself in an increasingly crowded marketplace? How do we offer added value to customers? How does the firm distinguish itself? Is outsourcing a viable option—particularly with an organization that has better technical or digital capabilities? Where will innovation dollars be best spent?

We suggest that organizations break questions out into certain categories as they prepare to launch a transformation effort:

#### **Structure**

- » How effective is our current organization/client coverage model in proactively addressing unmet client needs?
- » Are the current forms of teaming/collaboration across consumer and commercial banking, investment banking, and wealth divisions sufficient to drive the level of specialization and experience required to deepen existing and new relationships with customers?
- » What is the appropriate multichannel customer engagement model to increase market share in the mass affluent and high-net-worth customer segments?

#### **Customer**

- » Does the organization have a clear understanding of what drives customer value and service differentiation by segment?
- » Does the organization have clear and actionable insights to fully assess customer lifetime value, generational needs, and servicing preferences?
- » How do customers prefer to interact with the firm for advice and service across the branch, call center, and digital channels?
- » What changes to the service delivery model need to be made to attract and retain Generation X/Generation Y customers?
- » Have traditional asset-under-management-based approaches to segmentation and service "tiering" failed to cultivate customers among entrepreneurs and young emerging affluent professionals?
- » How well do our communication channels strategies meet our customers' needs?



## Financial

- » Do we have a complete picture of product and customer profitability by segment?
- » Based on our understanding of actual customer and product profitability, can we help optimize the costs associated with offering certain products and services?
- » Where are the opportunities to convert fixed costs to variable costs for non-value-added services through Information Technology (IT) and/or operations outsourcing?

## Technology

- » Do we have a digital strategy that is capable of delivering innovation and service differentiation to our advisors and customers? Are we planning for and delivering the right multichannel capabilities to meet the needs of the next generation of investors and drive higher levels of customer engagement and loyalty?
- » Are there opportunities to convert regulatory and compliance remediation efforts into *strategic solutions* to improve advisor productivity and client experience?
- » Does the advisor workstation platform support sources of future business growth and areas for firm differentiation?
- » Are we delivering IT services in a cost-competitive manner or are there opportunities to reduce costs and fund innovation through strategic sourcing arrangements?

## Build target operating model

While there are more than few definitions of a target operating model, in our view it is a visual representation, captured in a series of documents and artifacts, of an organization's "continuing" design decisions that are required to execute its business strategy.



**Vision, values, and capabilities.** An organization's target operating model is formed by incorporating an enterprise's vision, values, and capabilities, while typically comprising its:

- » Structure: The organization's governance model and organizational design
- » Function: The required specialization of resources to perform activities
- » Relationships: Those that are inside and outside the organization, and form the foundation on which to build the business.

The target operating model also captures business-, operating-, and economic-model components. In focusing on business model components of a transformed and optimized organization, full-service wealth management firms must make hard decisions on their targets—the markets, customers, and segments—given the new realities of the industry:

- » What products and services (the organization's newly defined value proposition) are going to be offered to the targets?
- » What channels and service delivery capabilities will be utilized to deliver the products and services?
- » How is the firm leveraging digital channels to drive higher levels of customer engagement, collaboration, and self-service?

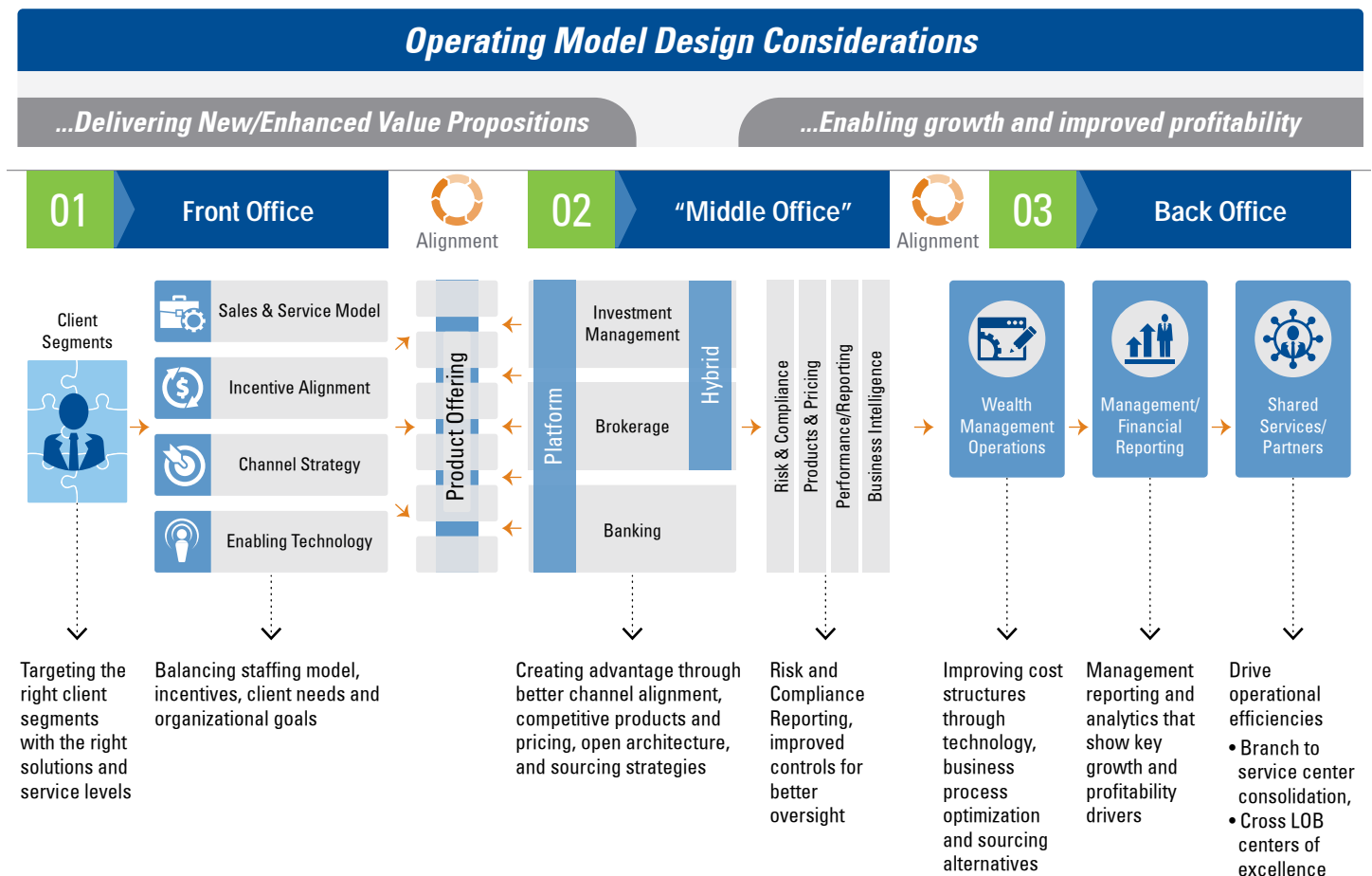
From an operating-model component perspective, wealth managers must coordinate six inter-related elements:

- » Services, functions, and processes
- » Organization and governance
- » Technology
- » Sourcing and location strategy
- » Performance management
- » People and skills.

Making transformation efforts “stick” means that wealth managers must start with a target operating model that defines the scope of the desired change.

Taking into account business strategy and changing market dynamics, a firm’s target operating model should:

- » Be highly automated, cost effective, robust, and scalable.  
**See chart below for a visual representation of design considerations when attempting to optimize front, middle, and back-office operations.**
- » Combine functions across products/services to eliminate silos.
- » Allow for potential joint ventures, consortia, or outsourcing arrangements that combine in-house capabilities, processes, and functions with another firm’s capabilities, scale, and cost structures to deliver greater benefits.



**Reduce complexity.** Transformation also needs to address product/service, process and platform simplification to reduce internal complexity and costs, and drive improvements to the customer and advisor experience.

A transformational program touches everything from IT processes and internal controls, to product development, and regulatory compliance reporting. Operations may not be revenue centers, but the duplication of processes and inadequate risk management and control functions often have a negative bottom-line impact. The cost of lapses in risk management and other failures—and the public transparency of failures in these areas—are now far greater than in the past.

#### **Investments in customer & advisor-facing technology.**

It is not uncommon for firms to manage a collection of advisor applications with varying degrees of workflow, data, and application integration. The delivery of a differentiated client experience may require significant investments in client- and advisor-facing technology:

- Firms need to prioritize optimization of advisor workstation investments across branch-based platforms and mobile devices, including tablets and smart phones
- The typical areas for greater workflow and business process improvement are in helping advisors acquire new business and deepening existing client relationships. Specifically targeting a more interactive and digital experience to support client needs analysis, sales and proposal generation, goals-based planning, portfolio modeling and rebalancing, and conducting relationship reviews centered on helping clients achieve their goals.

**Back-office operational improvements.** Many times, the front-office pain-points and productivity hits are a direct result of underinvestments in operational improvements within the back office. Some of the higher impact areas for back-office operational improvements are:

- » Improving the data quality for client reporting/performance—often requiring investments in improved reference data and a relentless focus on minimizing processing errors/adjustments
- » Streamlining client on-boarding across all product/service types—building in stronger workflow automation and data integration and processing controls through intelligent forms and CRM integration. Leveraging disruptive technologies to support richer client due diligence to enable regulatory mandates including Anti-Money Laundering, Know-Your-Customer (KYC), and FATCA

- » Embedding stronger risk and compliance controls into core advisor and service team applications to reduce the need for manually intensive follow-ups
- » Improving client data management and ownership—a more critical area for improvement with a heightened focus driven by global and North American regulators.

**Enhance data analytics capabilities.** Getting better at organizing and analyzing customer data continues to get even more critical to this industry. In addition to the consumer side of the equation where identifying targets and trends can boost sales and profitability, having rock-solid data helps measure the health of the transformation program in terms of advisor adoption and engagement, improved operational decisions.

Harnessing the business potential of an analytics-led organization to measure advisor, customer engagement, and business performance is now a senior executive level agenda item for most wealth firms. Business and technology executives need to partner closely to define the key business decisions and outcomes that require improved information and analytics. Industry leaders are now combining internal data sources and with structured/unstructured information across internal sources, digital channels, and external sources coupled with enabling technologies associated with “Big Data” to drive greater insights into markets, advisor, and customer behaviors.

The real value in this discipline comes from making smart investments in predictive analytics to deliver deeper insights into the drivers of performance and to identify new market opportunities. Some questions to consider here are:

- » With changing market volatility, interest rate scenarios, and other global trends, how can we establish a first mover advantage in helping advisors and clients exploit new opportunities across market cycles?
- » Where within the distribution network do we see higher degrees of cross-selling effectiveness?
- » How do we systematically measure campaign effectiveness and apply these insights to future campaigns?
- » Do we have measurable and actionable metrics to assess advisor and client experience improvements?



As wealth management firms redefine their operating model and go-to-market strategies, it is important to have the right management reporting to assess performance and change management adoption across the transformation program. For example, as more firms embrace an outcomes-based customer engagement model, having the right metrics to understand:

- » How many client relationships within the advisor's book of business have been reviewed?
- » What client goals and objectives have been addressed, and how complete is the advisor's understanding of the client's full set of needs compared to other relationships within this segment?

**Integrate risk and regulatory solutions.** The relentless stream of regulatory requirements, especially in the area of regulatory reporting, has had a deleterious cost and operational impact in many wealth management firms. They have increased regulatory compliance headcount or have assigned additional compliance and remediation-related responsibilities to existing employees—impacting productivity and costs.

Our experience has shown that many firms are still in the early stages of streamlining and automating the higher risk operational processes.

Embedding stronger risk and compliance controls into core business processes (for example, KYC, client suitability, investment policy statement generation, and maintenance) is the only way for most firms to ensure consistent execution and reduce regulatory burdens over the longer term.



## *Execute transformation to new operating model*

**Identify early wins.** Maintaining momentum on what may be a two- to three-year transformation program requires the identification and realization of early wins to energize executives, advisors, and employees charged with making changes.

One way to do this is to define and execute the transformation initiatives into a “release plan” that aligns the launch of new capabilities and operational improvements.

### **Build a suitable change-management program.**

Senior executives need to agree and communicate a new vision for the future, embrace a culture of change, and accept that agility and transformation delivery speed are key success factors in determining which firms will dominate the North American wealth management market three to five years from now.

The transformation journey should define at the program’s inception the key stakeholder impacts for each major milestone or capability release. The communication strategy needs to define and communicate the benefits at each phase of the transformation. The head of wealth management must proactively address stakeholder concerns about any implications affecting the role of people in the organization.

Stakeholders need to know in advance what is changing organizationally, from an advisor/service team and customer perspective. This is especially important as firms re-examine and possibly re-invent key aspects of the customer and channel strategy. The classic fears of advisors being marginalized with

the introduction of stronger multichannel customer servicing capabilities is an issue that needs to be addressed up front.

Since the transformation journey is multiyear in nature, the plan will need to be revised over time. It is imperative to integrate into the transformation program a system that captures organizational feedback to allow for course corrections along the way.

**Create new incentive compensation measures.** Defining the right measurement and reward programs to support both the transformation program execution phases and delivery phases takes research and planning, and should not be an afterthought.

It is important to align the key performance indicators in each functional area to support the firm’s goals around growth, innovation, improving customer loyalty and retention, and operational excellence. Constructing the incentive compensation measures must start by setting realistic targets around key milestones to build positive momentum and longer-term stakeholder commitment.

In our experience, we have seen several organizations place large bets on driving increased revenues through cross-selling across lines of business. As part of these initiatives, new approaches to referral management and executing sales and marketing campaigns were implemented with mixed results. Without realistic targets and strong operational metrics in place to baseline pre- and post-campaign results, these organizations could not address the root causes for underperformance.

### *Communicate with customers*

With thorough customer engagement and collaboration across digital, branch, and call center channels being a core focus of this industry's transformation efforts, it is crucial that wealth management organizations involve customers early in the transformation design by reaching out to them to learn how they want to interact with the firm and advisors.

The purpose is simple: There must be no organizational ambiguity about drivers of value and service differentiation.

Early involvement can sharpen the focus and priorities of key aspects of the transformation effort and heighten the chances that these priorities are converted into a differentiated service experience.

For years, many wealth management firms have relied on indirect methods to gather input, often using customer surveys or using advisors and specialists as proxies for defining customer needs. Given that investor service expectations are being

largely shaped by their service interactions with other consumer organizations that are more advanced with their omnichannel capabilities, it is important to capture the customer needs directly to understand how to best integrate innovation and superior service into the fabric of the service strategy.

Since most high-net-worth and ultra-high-net-worth clients have relationships with many wealth management providers, it will be important to highlight how a firm in transition is driving a new (and differentiated) service experience. Successful execution will increase the chances of achieving greater investor loyalty, increased asset flows, and longer-term commitment to the firm.



## Next steps: pick up the pace of change



For many firms, the case for change is not the question. The open debate centers on how bold the transformation program needs to be and at what pace the organization can execute to capitalize on market opportunities.

We believe the window of opportunity to establish marketplace leadership will remain open only for a relatively short time period—perhaps five years, at most.

Full-service wealth managers that expect to be relevant in the marketplace simply must not wait to get started on the road to sustainable growth. Competitive pressures already evident in the marketplace will only increase in the immediate future.

The positive momentum experienced over the last couple of years in operating margin improvement can quickly erode for firms that do not adapt. Given the current choices in the industry, and customers' willingness to switch providers, firms must embark on bolder transformation programs to enable sustainable growth and profitability.

We believe that there are real opportunities for firms to leap frog their competitors in delivering stronger value propositions by leveraging innovation and the disruptive technologies that are being applied in other sectors of financial services and the broader consumer marketplace. These opportunities will only be turned into results when firms integrate strategy with execution.





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