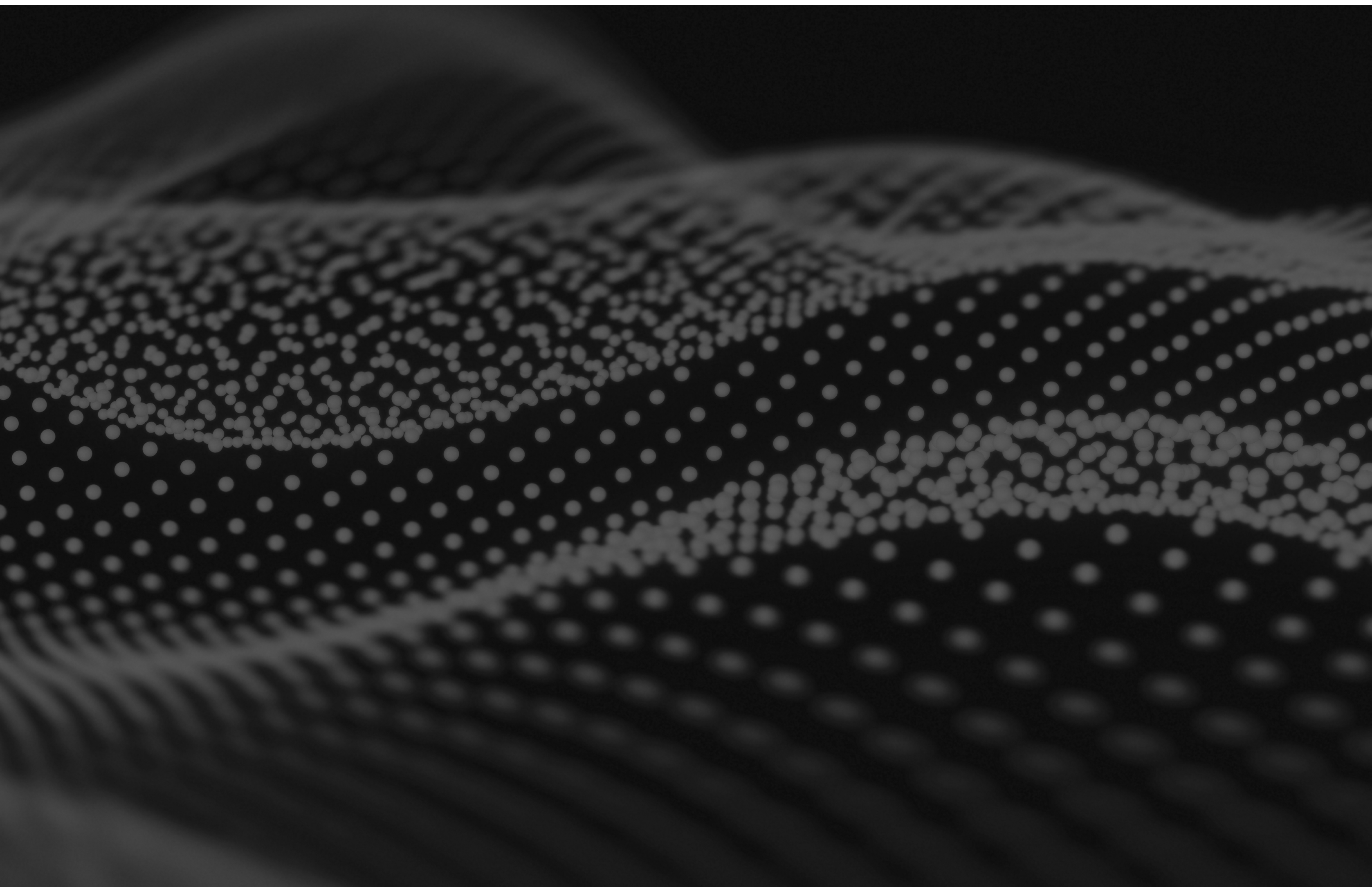
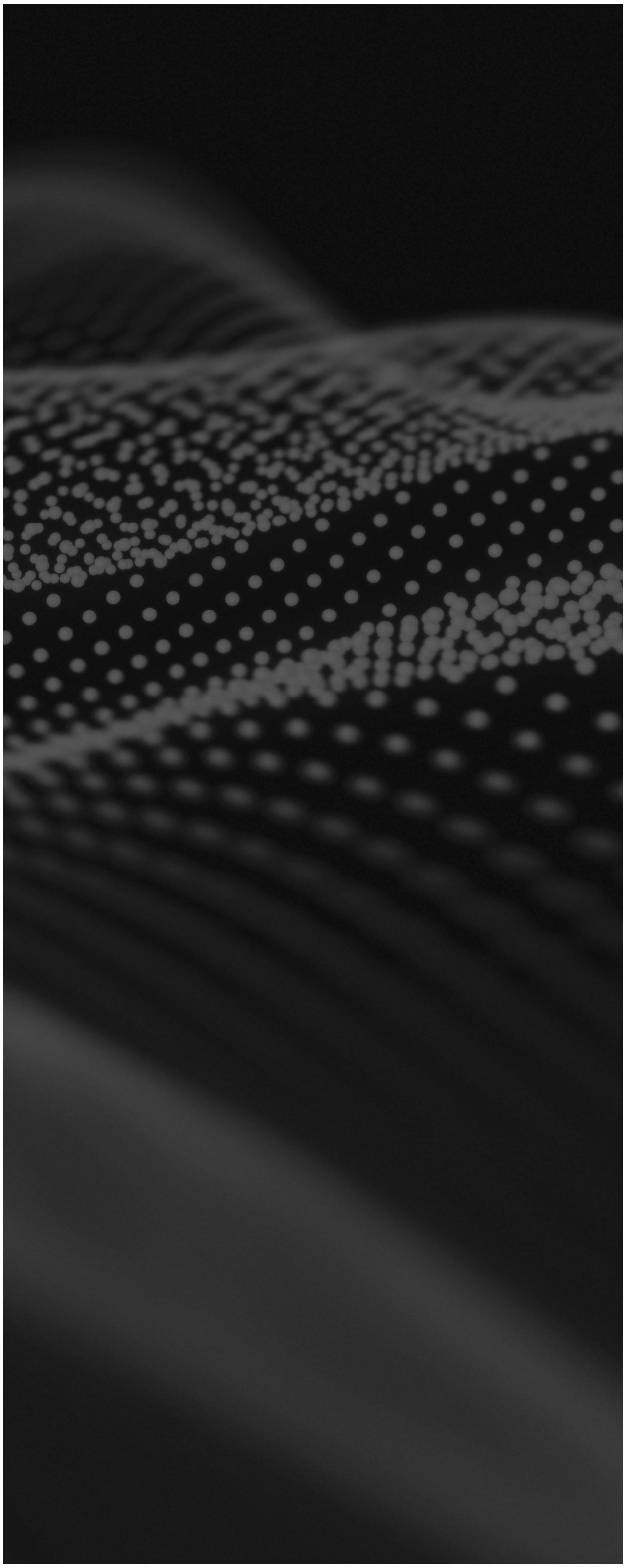
CAPCO

PORTFOLIO ANALYTICS STRATEGY (PAS)





According to modern portfolio theory, when constructing a portfolio, investors endeavor to maximize the returns on their investments for a given level of risk or to 'optimize' their portfolio's risk-return. In order to build any optimized portfolio, one must first be able to quantify the amount of risk being taken on and the potential returns on investments. Therefore, a critical objective of all wealth managers is to understand risk and to make risk-informed investment decisions in their client portfolios. A robust, portfolio risk analytics strategy is essential.

Financial advisors use portfolio analysis to make risk-informed investment decisions. Quantitative risk analysis involves leveraging statistics to construct a risk model that quantifies the portfolio risk. Risk managers analyze results, leveraging scenario analysis, sensitivity analysis and other simulation analyses to make decisions that mitigate potential risks.

At large wealth management firms, portfolio risk analysis is typically a highly manual, time-consuming and sometimes frustrating process. Advisors often fall short in evaluating risk because of challenges and resource constraints. Wealth managers can overcome these challenges by leveraging big data and AI technologies. Fintech and data analytics companies are teaming up with asset management firms to build solutions that help gather, categorize, and analyze risk information in a more robust and sophisticated way than ever before – delivering actionable insights for client portfolios.

At Capco, we are observing increasing levels of investment in portfolio analytics capabilities among our clients, and we see emerging innovative portfolio analytics solutions as differentiators that are critical to client success. The first movers who have invested in portfolio risk analytics are benefiting their bottom line, their FAs, and their clients.

We believe that wealth managers have a near-term opportunity to competitively differentiate themselves through investment in sophisticated portfolio risk analytics capabilities. We believe there is a limited window of opportunity to act, and that in five years, this set of capabilities will be 'table stakes.' We recommend that wealth managers work now to develop a portfolio analytics strategy and drive significant business benefits for the clients, advisors and the wealth managers and to avoid falling behind the competition.

1. CHALLENGES OF THE STATUS QUO

Conventional approaches to portfolio analytics are usually not scalable. They are often prohibitively resource-intensive and produce sub-optimal results due to their limitations.

1.1. COSTLY APPROACH

Even at large wealth management firms, portfolio analytics is a manual, time-consuming and expensive process.

The tasks of gathering data, assembling client information in a model, conducting the analysis, and interpreting the results are completed manually by analysts. These tasks are taken on by individuals or teams, often without streamlined approaches. The process is frustrating, and the results inconsistent. Leveraging findings to make risk-informed recommendations and communicating insights to clients are also time-intensive challenges that are not scalable. These require the time of a dedicated investment specialist trained in portfolio optimization. The manual processes involved take up valuable time that could be spent with clients or working on sales leads. This expertise is generally not accessible to retail investors.

Because these approaches are not scalable, only advisors that have a team of analysts can leverage portfolio analytics and usually only for their largest clients. Due to these constraints, portfolio analytics are not accessible to many clients and financial advisors.

1.2. LIMITATIONS TO SOPHISTICATION

Even when portfolio analytics is accessible to advisors, they base models on overly simplistic assumptions. Data and computing limitations restrict the scope and sophistication of risk models used. The result is a sub-optimal risk analysis:

- Modeling is done at the asset class-level, not taking into consideration sector/region/product/ position-level characteristics that could create a more robust analysis.
- The models base assumptions on historical performance and volatility rather than forward-looking factors and current or emerging risks.
- Risk is rarely calculated at an aggregate portfolio level, incorporating assets across multiple institutions.

Oversimplification limits the effectiveness of the models in accurately assessing portfolio risk and drawing meaningful and actionable conclusions. Improvement in these areas will make the portfolio analytics more robust.

1.3. DEFICIENCY IN RISK INSIGHTS

Due to these impediments, key stakeholders in wealth management are missing out on the opportunity to understand and make risk-informed decisions:

- **Wealth management firms** have a limited understanding of risk across their financial advisor books of business and product platforms.
- **Financial advisors** have a limited understanding of their clients' risk exposure and struggle to articulate risk to clients.
- **Clients** have a limited understanding of risk across their investment portfolios with a limited holistic view of risk and knowledge of how the portfolio aligns to their needs.

2. THE INVESTMENT CASE FOR PORTFOLIO ANALYTICS

We are observing increasing levels of investment in portfolio analytics capabilities to derive and realize the benefits in two distinct but interrelated ways:

- **Qualify to compete:** Risk-informed decisions improve core capabilities in the area of portfolio construction and risk management, resulting in enhanced performance.
- **Competitive differentiation**: Integrating a streamlined, easy to use portfolio analytics capability with other areas of the value chain can benefit a wealth manager in diverse ways: increasing sales, client retention, revenue, client engagement, and recruiting talent.

2.1. QUALIFYING TO COMPETE – 'DEFENSIVE' STRATEGIES

Wealth managers can use portfolio risk analytics as a competitive differentiator, creating a more informed decision-making process with regards to the firm, financial advisor and clients.

2.1.1. WEALTH MANAGERS

At the wealth manager firm-level, analytics capabilities support a data-driven strategy, including:

- Enhancing supervisory risk monitoring.
- Supporting the evaluation of financial advisors.
- Ensuring overall product and platform-level risk optimization.
- Assisting with regulatory compliance.

2.1.2. FINANCIAL ADVISOR

Portfolio analytics can facilitate financial advisors' success, helping them to make risk-informed recommendations for their clients and to manage the level of risk across their book of clients and to manage the level of risk across their book of clients. By incorporating portfolio risk analytics into their client conversations and by effectively communicating the findings with their clients, advisors will build trust with clients while also presenting opportunities to sell investments. Analytics can be used as a tool to grow relationships and ultimately increase sales revenues for the advisor.

2.1.3. CLIENTS

At the client-level, the enhanced analytics will support optimization of risk/return choices in portfolios. Clients will better understand the risks they are taking on and will be empowered to make decisions to protect their financial assets in unfavorable markets. Of course, note that the client segment targeted will expect differing levels of detail and communication styles.

2.2. OPPORTUNITIES TO COMPETITIVELY DIFFERENTIATE – 'OFFENSIVE' STRATEGIES

Building trust has always been critical in wealth management. Clients' financial lives are at stake, and they rely on their financial advisors to guide them toward achieving their investment goals. Today's clients have increasing expectations and expect their wealth manager to be digitally savvy.

Wealth managers can differentiate themselves with modern portfolio analytics to help them increase revenue, underpin client engagement, and improve overall business performance.

2.2.1. INCREASING ASSETS UNDER MANAGEMENT

Delivering meaningful insights to clients can help build trust and expand relationships. It can also frame discussions with new and existing clients to drive increased assets under management.

For a new client, a straight-forward approach to win assets would be to show shortfalls in current portfolios and provide a quantifiable improvement demonstrating the value proposition. Combined with the aggregation of portfolio data from various accounts and providers, this provides an insightful holistic view.

For existing clients, there is significant upside potential for converting existing accounts to advisory or using analytics to drive upselling to a higher level of advisory services. Risk insights offer the opportunity to expand relationships, offer new products and services.

2.2.2. INCREASING SALES EFFICIENCY

For larger wealth managers, the time to prepare materials for a more complex portfolio is time-consuming and lengthy with knowledge concentrated in organizational pockets. There is potential for a massive increase in efficiency in developing pitch decks and allowing teams to focus on value-add activities and spending time with clients. Given the availability of the platform, powerful tools and knowledge are not restricted to pockets of the organization.

2.2.3. DEMONSTRATING THE ADVISOR VALUE PROPOSITION AND CLIENT ENGAGEMENT

Translating analytics into meaningful and understandable solutions to leverage in client communications helps cement the value proposition of the advisor and provides peace of mind for the client. For example, a client might ask, “What is the impact of a major recession on my portfolio and ability to retire in ten years?” Stress testing capabilities can provide rapid and intelligent insight in a digestible format.

2.2.4. ATTRACTING AND RETAINING ADVISORS

Advisors are looking to provide their clients with digital channels and capabilities that frees them up to engage in meaningful conversations with clients. Most advisors understand the frustrations and limitations of status quo portfolio analytics processes. Offering a solution to advisors that saves them time and pain will help firms recruit top talent from competitors.

2.2.5. BUSINESS INTELLIGENCE

With portfolio analytics, clients can see the impact of a recession or other potential events on their goals and portfolios. If a recession or another unfavorable market event did occur, what would that mean for advisor revenues and profitability? An aggregated book of business views provides an efficient way to asses holistic risk at the firm level.

3. PLANNING FOR IMPLEMENTATION

As firms start to consider portfolio analytic initiatives, you must have several upfront discussions across the organization, and you must make key decisions to build resilient and effective capabilities that align with the business strategy.

Capco recommends that you consider two main decision points:

3.1. CLEARLY DEFINING THE PRIORITIZATION OPPORTUNITIES AND BUILDING A ROADMAP

The benefits to be derived from portfolio analytics are wide-ranging. Careful consideration and evaluation of each opportunity must be undertaken to decide upon initial focus areas. Attempting to complete all opportunities on the first release will not lead to a successful launch.

- Which stakeholder group should we prioritize? Advisor, client, investment management team, or home office?
- Is the focus on defensive or offensive strategies?
- What capabilities 'move the needle' and align with the business strategy?
- What can I realistically achieve given inflight initiatives, available time, resources and dollars?
- What level of change can the organization handle?

Building a roadmap will allow the organization to set a clear direction and measure success in a realistic and achievable manner.

3.2. DEFINING THE OVERALL PLATFORM STRATEGY, FA/CLIENT EXPERIENCE, AND UNDERSTANDING HOW THIS SHAPES THE SOLUTION AND VENDOR DECISION-MAKING

Assuming the firm pursues a vendor solution path, the vendor selection proves must be evaluated in the context of defined evaluation criteria which includes the overall experience of FA and clients and the level of control and customization the firm wishes to assert.

3.2.1. DOES THE FIRM WANT TO OWN AND BUILD THE OVERALL FA AND CLIENT EXPERIENCE?

Large firms tend towards owning the experience and building comprehensive platforms leveraging best of breed where necessary. Other with smaller tech budgets and capabilities are looking for more client/FA facing solution set which they integrate with existing other platform solutions.

3.2.2. WHAT ARE MY TARGET CLIENT SEGMENTS?

Communicating risk to clients will differ based upon the client segments. The desired complexity of the portfolio analytics and client expectations will increase with client wealth.

3.2.3. WHAT TYPE OF VENDOR AND PARTNERSHIP ARE WE LOOKING FOR?

There is a range of players that have emerged across the market. They come from different industries but are building marketable portfolio analytics solutions for wealth managers. We have categorized them into the following industry groups:

- Asset management firms, leveraging in-house analytical models to external offerings.
- Fintech's with big data and AI products.
- Data providers that are leveraging their proprietary data and data management capabilities to build external offerings.

Each has unique characteristics with an emphasis on different capabilities which may include a sophisticated risk engine, simplified and straightforward client risk score, intuitive FA scenario analysis or firm business intelligence functionality, proprietary risk models, etc. In many instances, they are teaming up to build more comprehensive solutions.

4. CRITICAL SUCCESS FACTORS FOR IMPLEMENTATION

Once the platform strategy and roadmap have been outlined, the real fun work starts in the implementation phase. Capco recommends the following best implementation practices:

4.1. FOCUS ON DATA AS THE NUMBER ONE FOUNDATIONAL PRIORITY

The platform requires complete and detailed data on accounts, positions, securities and users to perform risk analytics calculations. Data quality is paramount to ensure accurate results.

We recommend that data should be the initial priority irrespective of the scope and priorities of the implementation. As a first step, firms should perform a detailed current state assessment of the data to identify gaps. This leads to an implementation of data quality controls at source systems to address the root problem and implement long term process updates.

4.2. REGULATION AND COMPLIANCE – CONSULT STAKEHOLDERS 'EARLY AND OFTEN'

New platforms and client-facing reports must adhere to a range of internal and external regulatory requirements. Firms are looking to deploy risk analysis models, which drive the advice and reporting shown to clients. They require thorough, detailed internal reviews, with coordination and lead time.

We recommend an 'early and often' strategy. It's crucial to engage risk, legal, and compliance teams from the outset to ensure that the program adhered to all requirements and had buy-in from key stakeholders.

4.3. USER ACCESS AND ENTITLEMENTS ARE MORE COMPLEX THAN INITIALLY THOUGHT

Multiple classes of users need to access the platform (financial advisors, support staff, home offices users) with varied requirements for the accounts and data they need to access.

It is important to navigate the firm's entitlements framework to ensure that the correct data is shown to the correct users. This often requires working with the vendor to refine the platform to reflect the needs of the different types of users.

4.4. PHASE THE ROLLOUT AND BUILD FEEDBACK LOOPS FOR FLEXIBILITY

Given the scale the implementation and the broader range of scope possibilities, how can firms mitigate the risk of negative user feedback and ensure a smooth deployment process?

We recommend a phased rollout approach with incremental delivery that would maximize engagement and feedback. One option to consider is starting with the home office before moving to a pilot group of financial advisors and allowing time to adjust to feedback from the field.

4.5. INVEST IN ENGAGEMENT AND ADOPTION TO REMOVE BARRIERS TO SUCCESS

The program represents a significant change from how financial advisors currently work with risk and ensuring broad participation and adoption is critical to the program's success.

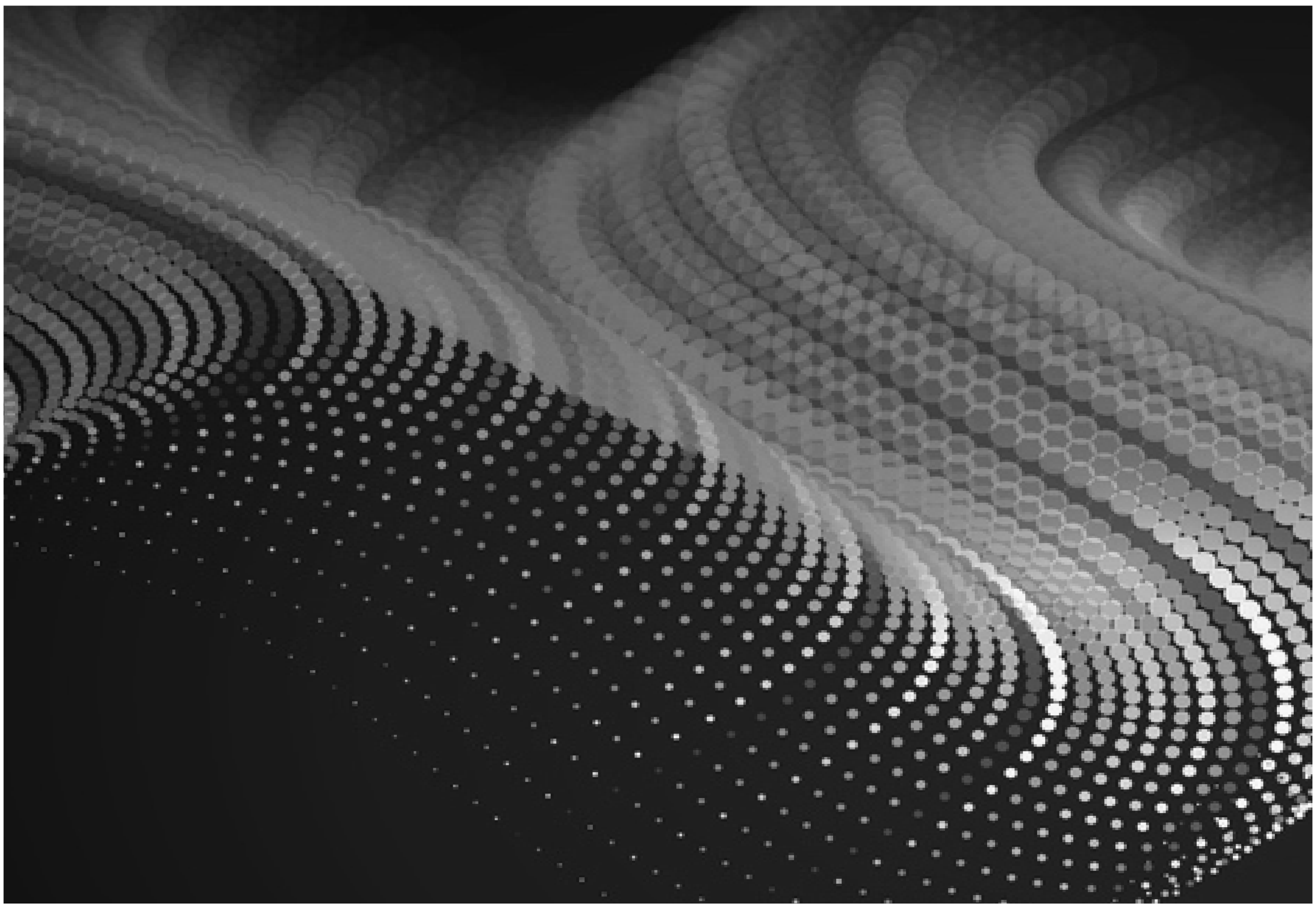
We often find that engagement and adoption is thought about late in the lifecycle or does not receive the necessary investment. We recommend engaging financial advisors from the beginning of the program to ensure that the platform was intuitive and met their needs. The implementation team must think proactively about users throughout the product development process, manage expectations and remove barriers to adoption. The team should develop a detailed, multi-channel training and communications plan with the various stakeholders that help users envision their success from start to finish.

5. SUMMARY – INVESTING IN PORTFOLIO ANALYTICS CAPABILITIES

The case for portfolio analytics is clearly defined and offers benefits for wealth managers, advisors and clients alike. We see an increasing level of interest and investment from firms in the industry and expect this trend to continue in the search for competitive advantage.

Momentum is building, and the question is not ‘if’ but ‘when’ wealth managers will invest in comprehensive portfolio analytics solutions. Those who act first will have a competitive advantage, while those who fail to act will pay more, in the end, to catch up. In order to be successful, key decisions are required around the prioritization, defining how the capabilities integrate with overall financial advisor/client experience and the laying out a clear execution strategy.

The race is on.



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ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward.

Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and asset management and insurance. We also have an energy consulting practice in the US. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

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