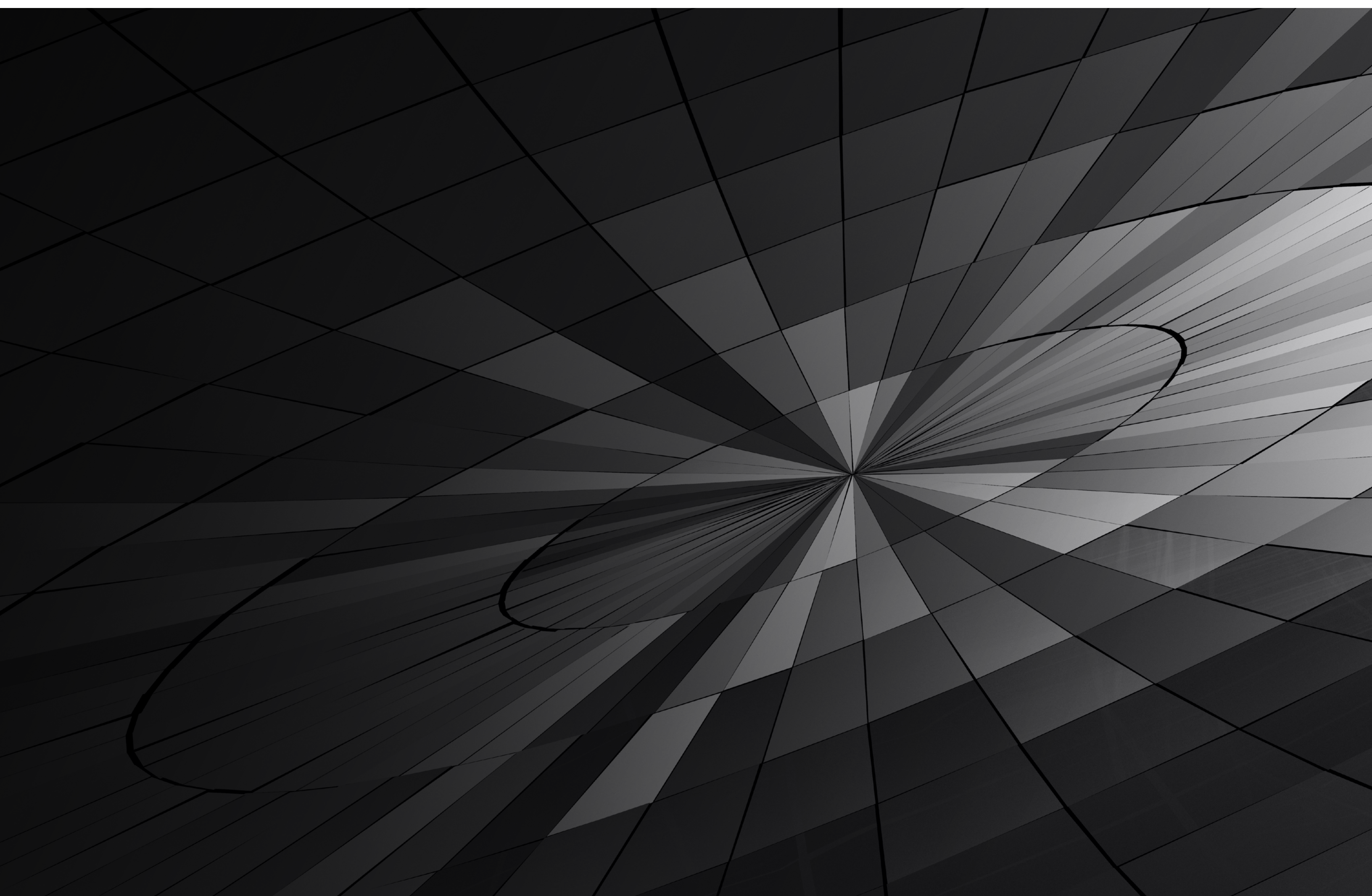
CAPCO

US WEALTH MANAGEMENT TRENDS FOR 2021



INTRO

Despite the unprecedented challenges presented by COVID-19, wealth managers adapted to effectively serve clients while navigating an uncertain economic and financial market environment. Stable fee-based revenue combined with an increased demand for advice during the pandemic underscored the value proposition of a modern wealth approach.

Following a severe, albeit short recession, emerging trends quickly accelerated as financial advisors needed to embrace a digital engagement model to serve the clients' evolving needs in a multi-channel ecosystem.

In the wake of the pandemic, firms will continue to grapple with headwinds including a slowing economy, turbulent markets, shifting regulatory environment and managing their balance sheets as they adapt to the new normal. We examine how wealth managers have demonstrated resiliency in 2020 and explore key strategic considerations for firms to transform their business in 2021.

TRENDS

PRIORITIZE THE DIGITAL CLIENT AND ADVISOR EXPERIENCE

Delivery model digitization efforts accelerated this year as firms were forced to reimagine how Financial Advisors connect with clients and deliver advice. According to the J.D. Power 2020 U.S. Wealth Management Mobile App Satisfaction Study, customer satisfaction lags other financial apps such as retail banking and credit cards despite increased utilization during the pandemic.[1] The mobile app is the cornerstone of the digital client experience, representing the 'entry way' for many clients to the firm or advisor. In response to the accelerated digital transformation and underwhelming study results, wealth managers should consider the value in a redesigned platform that addresses client needs and creates a seamless experience.

Similarly, less than half of advisors surveyed say the core financial planning technology their firm provides is 'very valuable,' suggesting a disconnect between wealth firms' technology capabilities and value.[2] As clients increasingly prefer digital engagement methods, firms should prioritize enhancing their digital infrastructure, thus enabling advisors to serve clients at scale efficiently. Firms that create a fully integrated client/advisor experience will win wallet share.

THE INTERSECTION OF BANKING AND WEALTH MANAGEMENT

Traditional banking, characterized by low-interest rates, unnecessary fees, and antiquated technology, is ripe for disruption. Enter Wealthfront and their new service, Autopilot, to automate a client's savings and investment strategy. Launched in September 2020, this represents the first iteration of Wealthfront's longer-term vision of Self-Driving Money. Self-Driving Money will leverage software to optimize every dollar a client earns and automatically take the most appropriate next best action based on their unique situation. Similar to no-cost trading, robo-advisors are again challenging incumbents to innovate.

Alternatively, banks are establishing wealth management offerings driven by robust growth potential and stickiness of advisory-based relationships. According to Cerulli, 49 percent of wealthy clients say they would prefer a single financial institution to serve most of their financial needs, yet only one-third of clients are engaging a firm in this manner.[3] The gap between client interest and execution presents a major opportunity for wealth managers and banks to consolidate existing client assets.

With financial wellness increasingly at the core of all client relationships, wealth managers and banks that can develop a holistic digital offering will meet clients' growing hyper-personalization expectations and be well-positioned to consolidate client assets.

INCREASE HIGH-NET-WORTH CLIENT ENGAGEMENT

Wealth managers should prioritize efforts to engage and deepen relationships better with high-net-worth (HNW) clients, accounting for more than 43 percent of total U.S. investable assets.[4] The impact of COVID-19 has shifted the needs of HNW investors, focusing on prioritizing capital preservation, tax optimization and environmental, social and governance (ESG) and socially responsible investing (SRI) in addition to tailored goals-based planning solutions.

According to Cerulli, Registered Investment Advisors (RIAs) and Multi-Family Offices (MFOs) are winning market share in the client segment from traditional wirehouses and private banks. RIAs and MFOs have done this by focusing on personalized financial and superior technology, catering to the evolving investment preferences of HNWI. To combat the attrition of client assets, incumbents should connect with emerging HNW clients – particularly within households they currently serve – early in their wealth accumulation years.

With Millennial and Gen X investors set to inherit approximately $53 trillion over the next 20 years, firms that build relationships with client's potential inheritors, leverage client insights and understand trends to inform product and service offerings will stand to benefit in the current environment.[5]

CHANGE IN ASSET LANDSCAPE

Socially responsible investing continues to gain momentum as investors are increasingly interested in understanding and directing their investment portfolio's social and environmental impact. According to Morgan Stanley's Institute for Sustainable Investing, nearly 95 percent of millennials are interested in sustainable investing, while 75 percent believe their investment decision could impact climate change policy.[6]

As firms consider an evolving asset landscape where ESG and SRI are centerstage with bonds and equities, they need to understand how preferences are changing, returns are modeled and identify the data required to support these efforts.

According to a 2020 report produced by the US SIF Foundation, ESG assets now total over $17 trillion, accounting for one-third of the total U.S. AUM.[7] Despite the tremendous growth to become mainstream, ESG is still in the early stages of development. Wealth managers that can effectively partner with asset managers to provide transparent portfolio construction data and measurement tools will stand to benefit and capture market share.

DEMOCRATIZATION OF DIRECT INDEXING

As clients increasingly seek customized portfolios, there is growing sentiment that direct indexing is a viable alternative to compete with low-cost ETFs. Wealth managers have taken notice and made bold acquisitions in this space, including Morgan Stanley and Charles Schwab acquiring Eaton Vance and Motif, respectively. BlackRock's acquisition of Aperio also suggests they will add direct indexing to their product suite.

While traditionally targeted for HNW investors, advanced technology, low trading fees and the proliferation of fractional shares have opened access to mass affluent clients further down the value chain.

According to Cerulli, 67 percent of asset managers believe direct indexing represents the most immediate opportunity to manage both tax and ESG factors.[8] The value proposition of offering tax optimization at scale and providing valuable data insights is a significant opportunity for wealth and asset managers.

CONVERT DIVERSITY AND INCLUSION INTO A COMPETITIVE ADVANTAGE

The wealth management industry has largely underserved minorities related to the employee workforce, particularly financial advisors. As a result of social injustices this year, diversity and inclusion has taken center stage and wealth managers have an opportunity to turn their commitment to change into a competitive advantage.

With nearly 40 percent of advisors set to retire in the next decade, the new cohort of advisors should reflect the client demographics they serve more closely.[9] In order to attract and retain next-gen clients, firms should consider doubling down on the short-term agenda of diversity and inclusion with balanced longer-term initiatives to improve business performance.

Merrill Lynch is striving to be the industry leader in D&I and became one of the first firms to release data on advisors' diversity. Similar to Bank of America, Merill is looking to provide transparency and establish a strong training program to increase diverse representation in the advisor role. As firms are being required to diversify representation among advisory boards and senior leadership teams, focusing on the industry's future leaders can offset the imminent talent shortage.

OPPORTUNISTIC CONSOLIDATION

In addition to digital transformation efforts, wealth managers continue to lean into opportunistic consolidation via merger and acquisition and strategic partnerships to increase scale and efficiency while unlocking long-term growth potential.

Despite the pandemic's challenges, wealth and asset managers have elected to buy instead of build as they prioritize acquisitions of firms with a strong brand and niche focus. Two recent examples include Morgan Stanley's acquisition of Eaton Vance aimed at direct indexing and ESG offering enhancements and Vanguard's entry into private equity via a strategic partnership with HarbourVest.

As the broader supply chain gradually becomes vertically integrated, we expect to see more acquisitions including downstream platforms and technology.

ACCELERATE NEXT-GEN OPS TRANSFORMATION

Many wealth management firms are not equipped to support new products and applications due to a lack of technology infrastructure investment. Consistent trading outages plagued many firms in 2020 as investors ramp up self-directed trading volumes. While consistent revenues and asset growth have mask deficiencies in legacy infrastructure, we believe firms should prioritize operating model enhancements to streamline cost savings following the pandemic.

For example, UBS is currently undergoing major technology upgrades, part of an ongoing $3.5 billion overhaul which is expected to be completed in 2021.[10] Furthermore, one-third of staff could permanently work remotely including advisors according to their COO. Amidst the current work-from-home environment, firms are assessing which roles should return to the office. With a hybrid approach likely, continued engagement and adoption of digital-driven processes among advisers is critical as is increased cybersecurity and data to support a remote working model.

RETIREMENT SERVICE PROVIDERS SHIFT FOCUS TO LEGISLATION

Retirement services providers turned their attention to the CARES Act when the coronavirus pandemic hit but will turn their attention back to initiatives including implementing SECURE Act provisions in 2021. The refocus will include educating plan sponsors on financial wellness and innovation via automation. Additionally, service providers will need to grapple with implications for defined contribution product development and distribution initiatives.

Furthermore, the defined contribution plan managers will need to manage potential regulation from the Department of Labor (DoL), which would decrease the adoption of ESG products.

REGULATORY IMPLICATIONS IN NEW POLITICAL LANDSCAPE

Under a Biden administration, the regulatory landscape brings Regulation Best Interest (Reg BI) and the DoL Fiduciary Rule back in focus. Potential changes to the fiduciary standard, new rules governing advice in retirement accounts, and higher taxes for the wealthy demand wealth managers and advisors' attention.

Wealth managers should prioritize educating advisors on estate planning, tax planning and charitable donations to navigate the potentially changing tax code while revisiting business models to assess readiness to manage potential conflicts of interests.

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