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WEALTH & ASSET MANAGEMENT

CONSOLIDATION

One firm to advise them all?

There's plenty of M&A activity going on in asset management. How far can it really go without undermining customer service?

Ouida Taaffe

In April, Rathbones made headlines by announcing the acquisition of the wealth management arm of Investec, in a deal uniting two of Britain's biggest wealth managers and creating a business with more than £100bn in assets under management.

The mammoth tie-up came as no surprise to those in the industry, though. "Consolidation in wealth management has been going on for a long time, and if you look at the current round of deals they're no different," says John Somerville, head of financial services at the London Institute of Banking & Finance.

Nor are the main drivers particularly unusual. They include economies of scale, the need to invest in new technology, and the appeal that businesses with margins of up to 30% have to private equity firms.

But there are other factors at play that generate fewer headlines. The first is the consumer duty regulation, which will come into force in July. The Financial Conduct Authority (FCA) says that the duty "requires firms to act to deliver good outcomes for retail customers. Firms must act in good faith towards customers, avoid causing them foreseeable harm, and enable and support them to pursue their financial objectives".

With such a change on the horizon, any firms attempting consolidation are bound to face difficult questions about how they will meet this new bar for customer service. For example, as part of the new regulations, firms can only offer retail products that constitute 'fair value'.

In principle, that's something that might be easier to achieve when operating at scale, but a focus on fair value is also likely to shrink the margins that make wealth management firms attractive targets in the first place. And the fine detail of assessing customer needs requires face-to-face interaction and boots on the ground in regional offices – neither of which are a natural part of a high-margin, low-touch approach.

Nor will wealth managers be able to simply shrug off the consumer duty and carry on as usual. In a 'Dear CEO' letter in February this year, the FCA spelt out that it expects the rules to be a "top priority for [CEOs] personally" and that good outcomes for customers need to be central to business strategies and objectives.

In light of the new duty, it might be that some private equity buyers will start to reassess their holdings in wealth management. "You could get consolidation of consolidators, as some private equity buyers will not be where they wanted to be," says Ben Williams, an equity analyst at Shore Capital. Of course, looking after customer service is something that should come naturally for wealth managers. After all, this is first and foremost a people business. People do, however, tend to insert surprises into any spreadsheet, and they will likely prove a double-edged sword in consolidations. "A lot of advisers at a lot of firms are getting close to retirement," explains Somerville. "They want to sell up and move on."

But clients and their valuable assets tend to be attached to the adviser, not the firm.

"Client relationships are a very intense thing, and there is a lot of trust between client and adviser," says Williams. "Generally speaking, advisory works well when the people involved are similar. And the people in the UK with money tend to be in their early sixties."

> A lot of advisers at a lot of firms are getting close to retirement. They want to sell up and move on

There's no guarantee, then, that advisory relationships can be maintained or replicated following an acquisition. This means that clients, and the assets under management, could easily follow their old adviser out of the door if he or she decides to retire, or doesn't like the new regime.

"The really fascinating thing is that the number of independent financial advisers (IFAs) hasn't gone down, despite the high number of private equity consolidators," says Williams. What that shows, and what can easily be forgotten in the M&A frenzy, is that firms don't have to be huge to survive. The technology that promises to enable low costs and large scale can also help small firms that invest in the right platform to punch above their weight, says Williams.

"The technology is such that small firms, with perhaps a quarter of the size by assets under management of their competitors, can offer attractive things like sustainable solutions," he says.

Investing in technology, generally seen as a quick and easy way to scale up and cut costs, will likely be central to future consolidation strategies. Unfortunately, how well that squares with the idea of good customer service may be a point on which consolidators and the FCA disagree.

Somerville, for instance, points out that the consumer duty rules require advisers to avoid "foreseeable harm".

"It could be argued that a lot of people don't change that much annually, so providing the same service year after year is fine," he says. "But a death in the family, an illness, a change of employment – those are things that should probably trigger a visit from the adviser to make sure the plans are still right for that person."

As things stand, though, some firms are good at getting clients on board but are not offering a bespoke service.

"Firms will need to do more full fact-finds to see if things are still as they were," Somerville continues. "You can avoid 'foreseeable harm' when you see a client in person and ask the right questions. A machine, on the other hand, will struggle to realise that additional funds might have come from a divorce or a bereavement."

Somerville argues that, alongside investment in technology, consolidated firms will have to invest in more staff training to meet the new duty requirements and to ensure they keep delivering the service their inherited customers already receive.

"A lot of firms are fishing in a small pond of advisers," he says. "They'll have to train professionals who are very good at the data and technology elements and very good at providing advice and wealth management."

Staff who are savvy in technology and wealth management will make some small firms attractive acquisition targets. "A large firm that requires a better sustainable view in its portfolio could find it cheaper to acquire somebody who is particularly good at it already, instead of developing its own funds from scratch without a track record," says Somerville.

What won't work, if the duty does its job, will be tech-based automation designed to drive costs down and keep margins up. That is unlikely to be compatible with providing fair value and avoiding foreseeable harm – particularly as the population ages.

"If you are relying on technology, you can't at the end of the day look the consumer in the eye and judge whether that person has become vulnerable or not through some change in their circumstance," says Somerville. "People will be key."

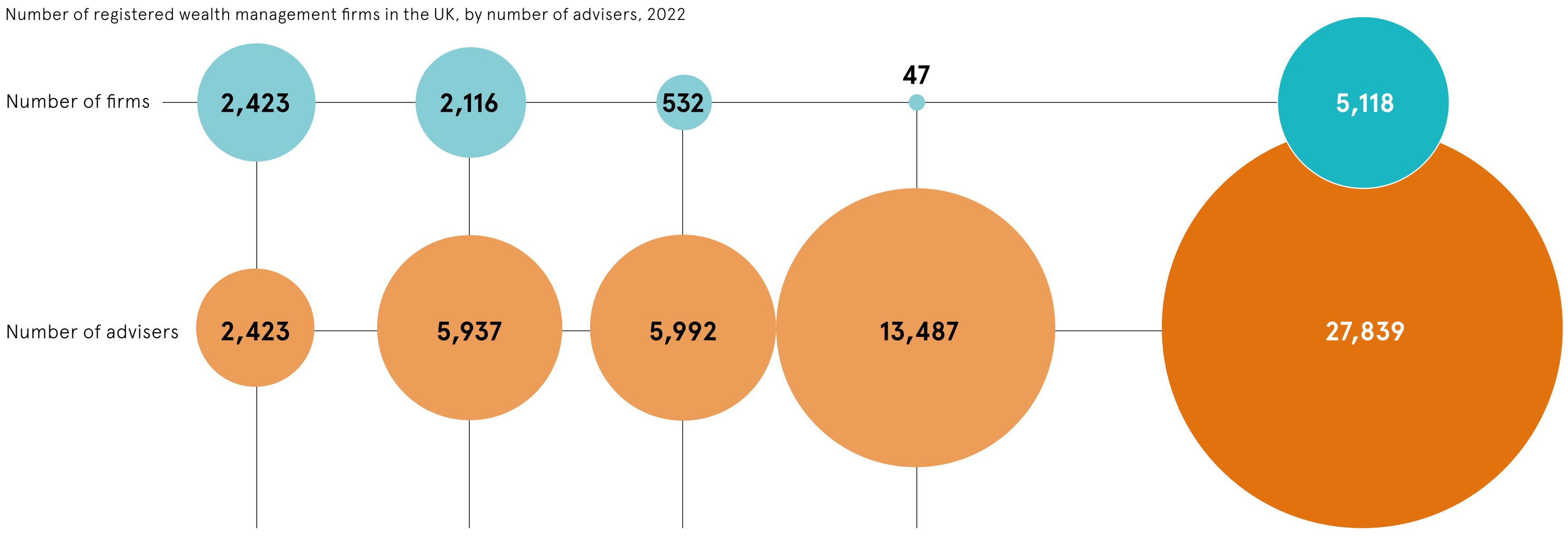
89%

of all wealth management firms in the UK have 5 advisers or fewer

FCA, 2022

SMALL FIRMS DOMINATE THE INDUSTRY, PROVIDING THE GIANTS WITH LOTS OF M&A TARGETS

Number of registered wealth management firms in the UK, by number of advisers, 2022



FCA, 2022

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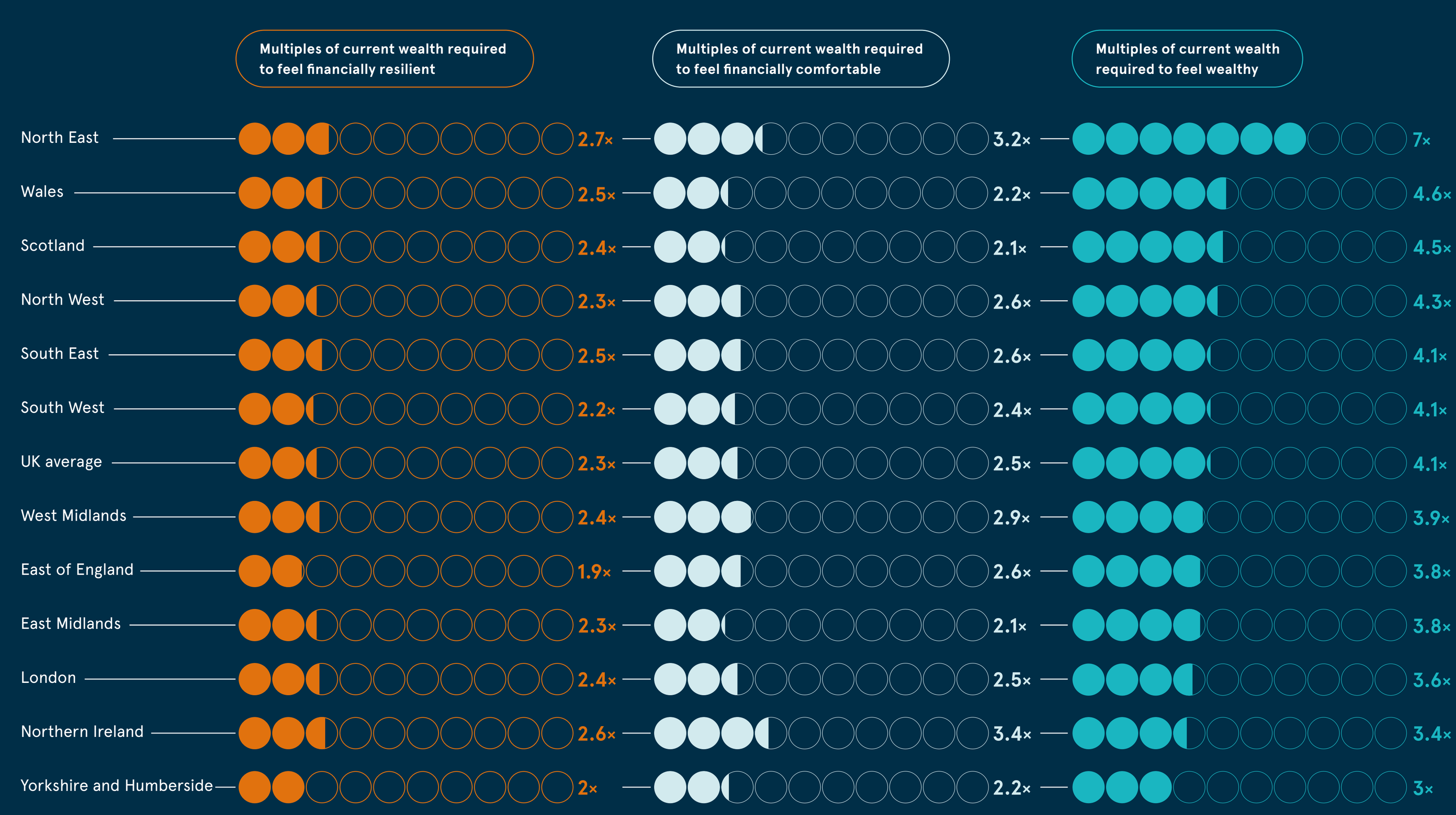
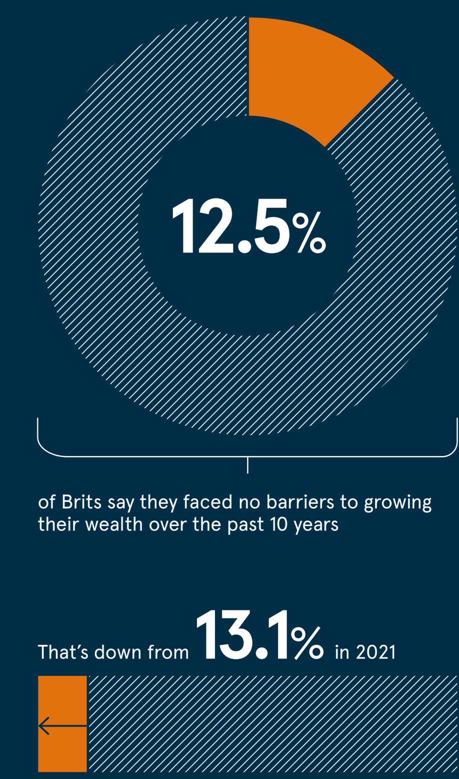
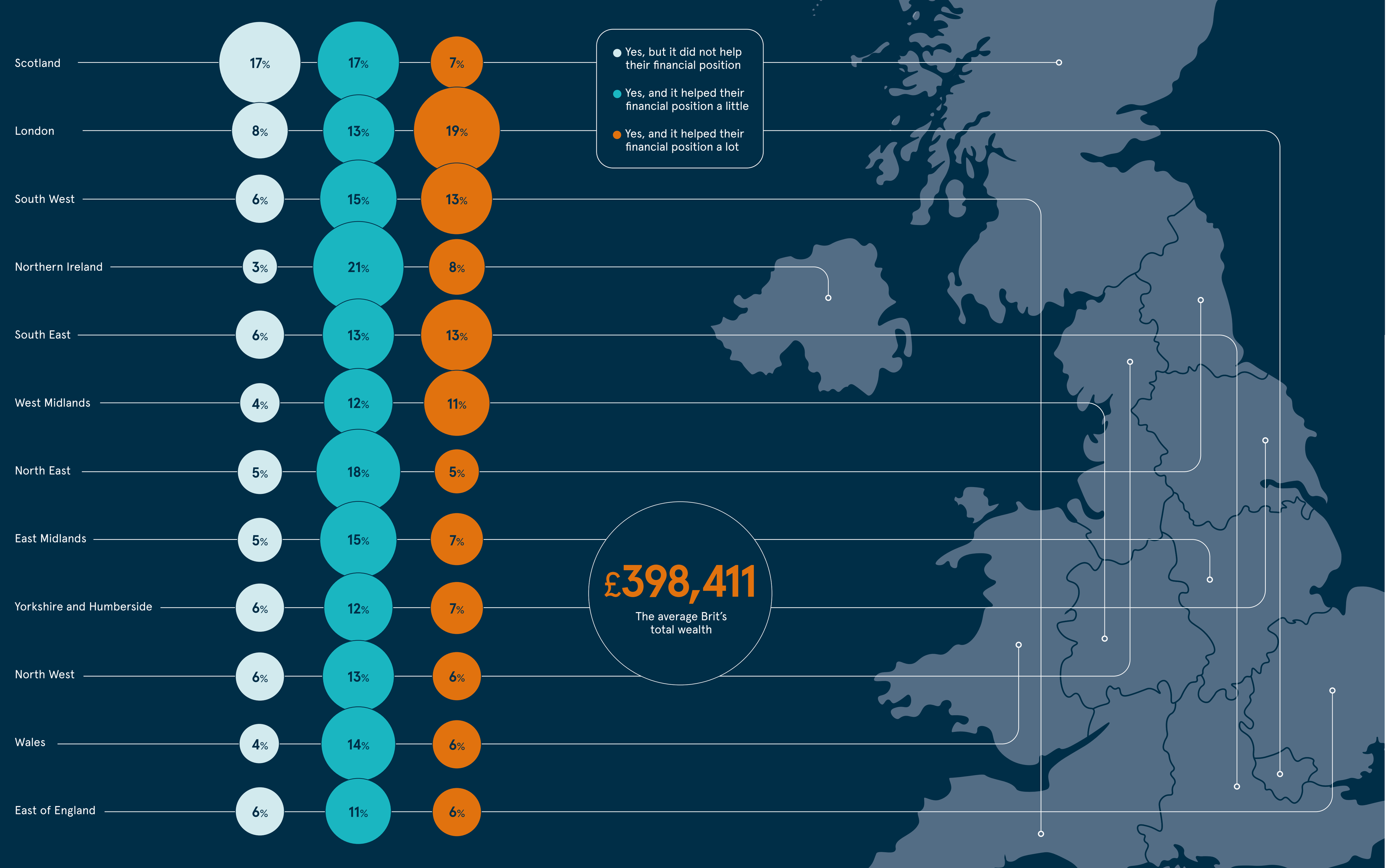


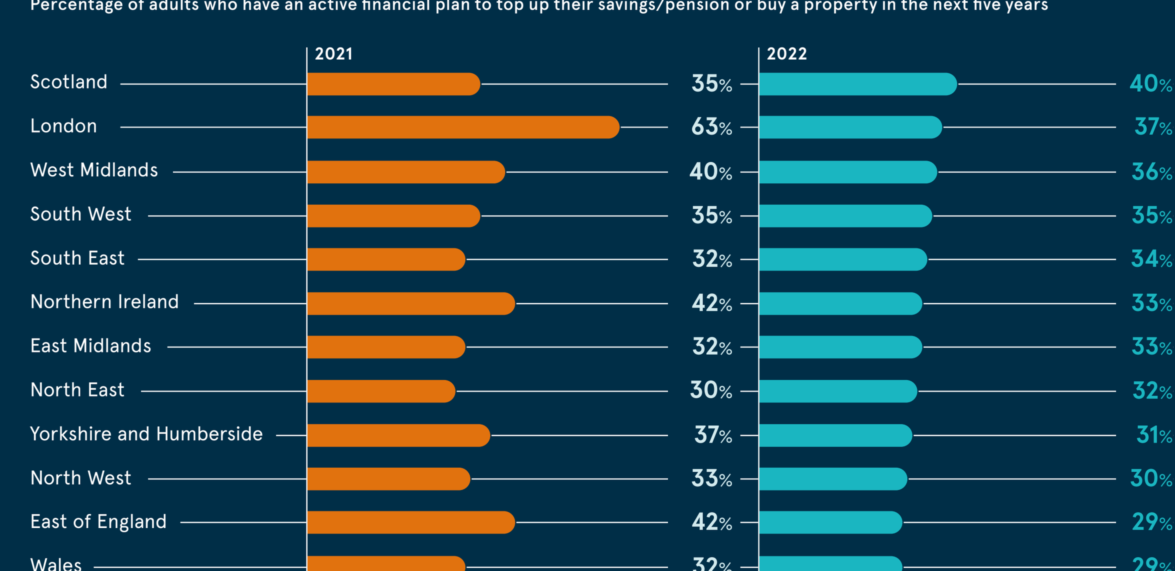




BRITAIN'S ADVICE GAP

Wealth is not distributed evenly in the UK, and the contrasts are becoming more extreme. A frequently overlooked aspect of this issue is that access to financial advice is not distributed evenly either. It's a problem that wealth managers will want to keep an eye on. After all, underserved customers equal untapped business opportunities

Opinium, CEBR, 2022



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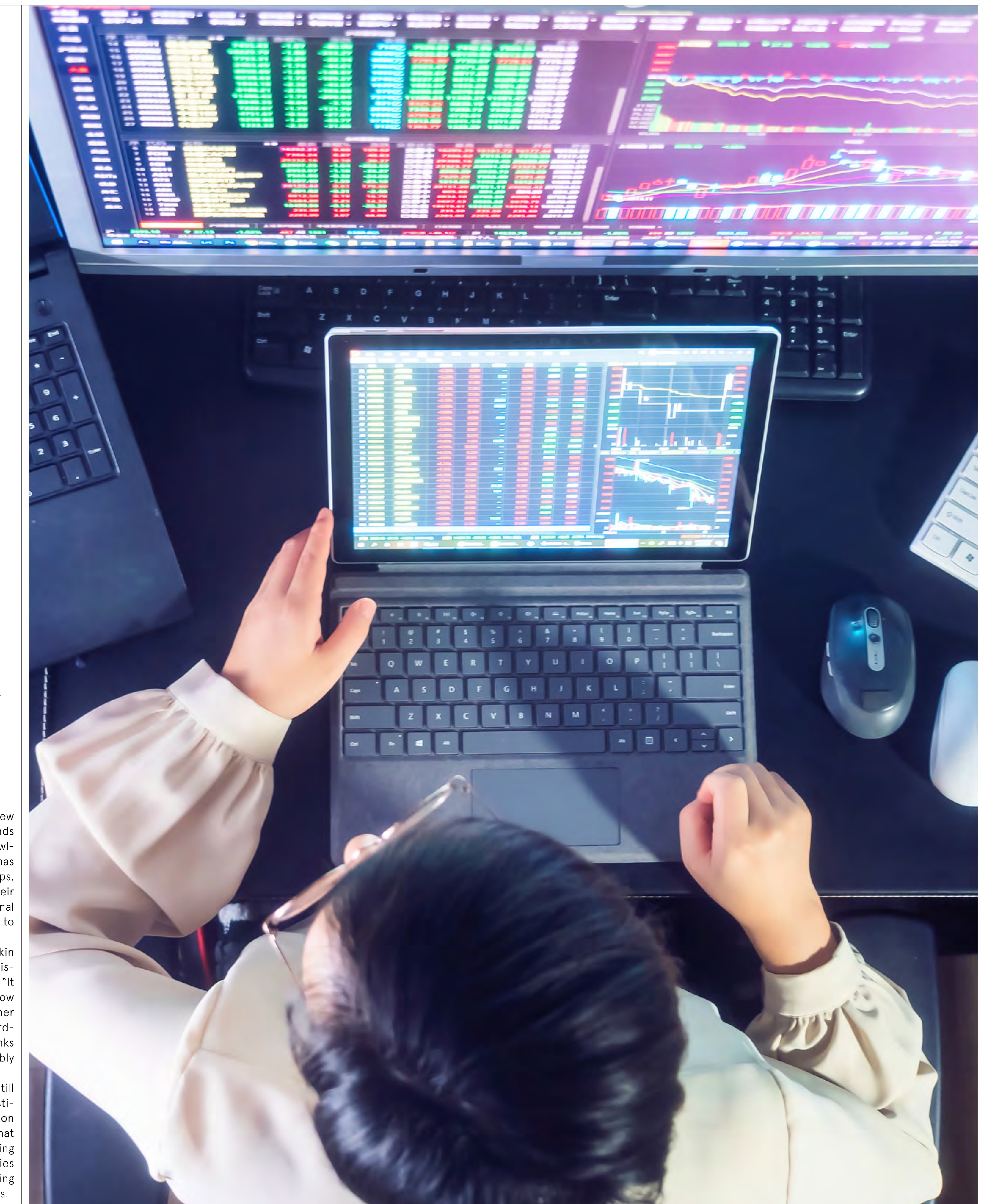


Why AI promises a wealth of changes

With artificial intelligence looking set to transform wealth management, finding a partner who understands both the technology and the industry itself will be key to embracing the disruption

The wealth management industry has changed beyond recognition over the past two decades, as changes to technology, processes and user behaviour have ushered in an era of huge improvements in client experience and service.

Costs have been driven down thanks to innovations such as dematerialised holdings, alongside the advent of open banking. And all of this has been reinforced by the move to outsourced investment administration platforms.

These platforms handle the efficient processing of transactions and the secure safeguarding of assets, freeing up wealth managers and advisers to focus their efforts on servicing clients' needs.

And with the latest wave of consolidation and M&A activity in wealth management driving greater centralisation of operating models in the sector, investment administration platforms are enabling consistent investment processes to be delivered to clients across the merging firms. That consistency provides solid foundations for both wealth and advice businesses to scale.

According to Ian Partington, group chief executive officer at platform provider Third Financial, the move towards greater automation and 24/7 accessibility is all a product of wealth firms' need to find operational efficiencies, coupled with changes in client expectations and fuelled by advances in technology.

This transformation has taken more than 20 years, but even so, Partington suggests it will be nothing compared to what we will see in the next five to 10. "While it isn't exclusive to the wealth management industry, everything we have experienced to date will be dwarfed by the next shift on the horizon – artificial intelligence," he predicts.

But Partington warns: "If AI is the new superpower, it needs to be in trusted hands to be a force for good." This, he acknowledges, is because wealth management has always been built on trusted relationships, and just as a client puts their trust in their wealth manager or adviser, that professional must also be able to trust any partners to deliver a reliable and secure service.

He likens AI's arrival to something akin to the extinction of the dinosaurs, a seismic event heralding a whole new era. "It is interesting that conversations are now being had everywhere about AI – whether it's around watercoolers or within boardrooms. But it's key that management thinks about how to incorporate AI safely, sensibly and strategically."

Partington concedes that there is still huge uncertainty about the ultimate destination on AI, but he believes the direction of travel is clear. "It is absolutely right that people should be interested and asking questions. We are seeing the possibilities offered by tools such as ChatGPT causing deep discussion across many professions.

"People are having lots of fun trying out its immense capabilities, but for wealth management and advice this is serious business, and it requires serious thought and serious actions to ensure people have trust in AI's future role."

A huge opportunity for change

Partington explains that the wealth management industry has already changed so much, but there's much more to come. "The commonly stated fear at the moment is whether your job is going to be replaced by AI," he says. "The fashionable riposte is that you won't be replaced by AI, you'll be replaced by someone who knows how to use AI.

> Everything will be dwarfed by the next shift – artificial intelligence

"That is probably closer to the truth for the immediate future at least, so it's really important the industry acts early to understand what's coming. Bosses must place themselves, and their firms, in the best possible position to take advantage of the groundbreaking opportunity heading our way."

Partington highlights ChatGPT as one use of AI which is already showing huge potential. He cites a medical study which claims to show ChatGPT providing more accurate, detailed and empathetic responses to patients presenting with a range of symptoms. He also raises how, in an academic context, it is showing itself capable of passing "supposedly difficult law and business exams".

AI's role in the wealth field, Partington explains, already includes attempts at building higher-performing risk-adjusted portfolios for clients, compared with those investment managers would build when acting in isolation. But he states there has not been enough time yet to measure their success. "In any case, there's a selection bias at work in the models that are being publicised. We're simply not hearing about the failures."

But Partington kicks back against some of the negativity, including arguments that these attempts are inherently flawed because they are backward-looking in analysis terms. "Human stockpickers can't see the future either," he adds. "The coming evolution of AI into AGI (artificial general intelligence) will nullify that argument, as it will have more human characteristics."

If wealth managers are to use AI in stock selection, it will need to be based on explainable AI (XAI), he believes. "If a client's portfolio value falls through the floor, no discretionary investment manager would want to have to explain to the client, or the regulator, that a black-box system had stated the selections were a good idea."

He adds XAI will also be useful as it can show how algorithms delivered any conclusion, allowing the manager to layer their own skills and experience into the investment decision-making process.

A rapidly evolving technological landscape

Looking ahead, Partington suggests that AI will be introduced into multiple aspects of the wealth industry in the coming months. Third Financial is already harnessing it on a limited scale with a dedicated team, some of whom have Master's degrees in AI and are developing next-gen client solutions.

Eventual use cases could include embedding it throughout the client lifecycle, from onboarding to tax planning to portfolio rebalancing. Behind the scenes, it will also be the foundation of firms' cyber defences, offering more flexibility and early-warning systems to adapt to evolving threats.

Partington has form when it comes to transformative change in wealth management. He introduced the UK's first retail cash management platform in 2011, and his current role heading up Third Financial has seen him successfully transform a company with a rich heritage in wealth management software into a leader in the investment platform market.

In the past few years, Third Financial has seen very strong revenue growth, and its combined investment platform and software-as-a-service model now manages more than £50bn in assets. According to Partington, such commercial achievements make it possible for the company to fund the level of R&D needed to remain at the forefront of a rapidly evolving technological landscape.

"In the immediate term, we see much more real-world applicability for AI in such applications as our recently-trialled AI HelpDesk tool, where we apply AI to our own datasets," he explains. "Similarly, there are likely to be near-term developments around generating tailored investment reports for clients using a combination of proprietary and public data."

Partington is clear, though, that the key to early success with AI across the wealth management industry will be advisers acknowledging they can't go it alone. AI is not something to be bought off-the-shelf, he says; it cannot simply be attached to current systems in the way some did with the simple software tools of the past. "Like any significant IT tool, if it is to genuinely add value then it needs to be thoughtfully incorporated into your organisation's strategic plan, and its use embedded into your culture."

Partington argues that a partnership model is the only sensible way forward. "Critically, that partner must fully understand wealth and advice, not just understand the new technology," he adds. "This is going to be a time of great change, so it's more important than ever for wealth managers and advisers to find a partner with a proven record of developing and incorporating technological change in this industry. They must have a deep-rooted understanding of the sector we all operate in."

Staying out of the data trap

Although Third Financial's roots are firmly in technology, Partington believes the launch of its regulated platform service in 2016 has placed it in a unique position relative to its peers. "Perhaps counterintuitively, Third Financial has actually enhanced its reputation for developing and delivering innovative wealth management and adviser software as a result of our decision to launch the investment platform," he says.

"It means we are the first users of our software. We're subject to similar regulations as our customers when it comes to managing and protecting client assets and data, and we share similar frustrations with some of the practices we see in the market."

Partington believes passionately that owning its own technology is the key to agility for Third Financial, allowing it to respond to emerging market trends and client needs. It can also evolve the software and use it to solve new problems as soon as it sees opportunities first-hand.

But he cautions that the industry must not fall into the same data trap with AI that many users have seen when interacting with the tech giants in recent years – for example, "throwing data into an AI black hole", with no idea what is going to happen to it. This is especially true, he says, when there is no oversight as to who will access it, or what its true value will be.

"We need to bring AI to the data rather than the other way around. In wealth, it is absolutely crucial that client data is sacrosanct."

Everything has an impact

Partington admits that the industry has been plagued by the idea of computers replacing people for years, but many of the so-called robo-advisers have, in fact, fallen by the wayside. "Many of these new entrants fell short in how they were dealing with real people; these are investors who tend to value a holistic approach to their wealth and genuine human interaction."

He believes this means there is now a similar need for strong relationships between wealth managers and the platform providers. Third Financial's customer service capabilities see it search for graduates with "a strong work ethic and an enthusiasm to solve problems and help clients".

And in an interesting twist, early in their careers, its client-facing recruits attend a two-day course at the renowned drama school RADA. This is designed to build confidence and improve communication skills, essential for good relationships.

"We believe the only truly sustainable competitive advantage a firm can have is the ability to continually adapt to change," Partington explains. "That's true whether the change is increased regulation, advances in market infrastructure, evolving client behaviours, or as now, the introduction of AI."

He recalls many changes over the past couple of decades which were "supposedly going to transform the wealth industry", including the introduction of retail service providers ("supposed to make dealers obsolete"), ETFs ("going to kill funds") and blockchain ("would eliminate central share registers").

"Everything has an impact, but not necessarily as predicted," he says. "It is also never as comprehensively disruptive as the doomsayers might initially claim. The innovative platforms that can handle change, support the evolution of wealth firms and foster trust will be the winners"

"I am confident AI will be the biggest change of them all," he adds. "At least until quantum computing arrives anyway."

To find out how an investment platform can support your business, please visit thirdfin.com/experts-wealth

Six due diligence must-haves

Knowing what to look for in a partner, and what to ask, is paramount when involving one in your wealth management and advice operations, says Partington. That, he explains, is the only way for companies to avoid costly mistakes with dead-end technology or unwittingly stepping into a regulatory minefield.

Here are the six fundamental questions he believes any wealth firm should ask before signing with a platform.

1 **Is the platform firm stable?**
These are long-term partnerships, so it is crucial you know a firm is going to be here for the long haul, and that it has the resources to invest in developing the product. Key to validating this is checking audited accounts. Is the firm profitable? Or are they reliant on a third-party or parent organisation to fund them?

2 **Do they have independently-verified assurance reports?**
Do these indicate sound operational and IT controls? They're not the most exciting reading materials, but you have a duty of care to ensure you're not exposing your clients' assets or data to unnecessary risk.

3 **Are their CASS audit reports reassuring?**
The CASS regime is at the heart of any platform's operations. Alongside a reassuring report, you also need to check out the credentials of the auditors themselves.

4 **Can you speak to a wide range of their staff?**
This is important to gain comfort that they are knowledgeable in their areas. While technology lies at the heart of a platform, it's the people that make the difference. Don't be afraid to ask to meet them and quiz them on their roles. Do they reassure you?

5 **Will they allow you to pick any of their existing customers to talk to?**
Again, this is about the service provided. Speaking to users, chosen by you, is a crucial part of due diligence. Ideally the chosen firm(s) would be of a similar profile to your own.

6 **Do they own their own technology?**
If not, who does? And can you speak to that supplier to determine their controls, their development plan and the adequacy of their funding?

INTERVIEW

'Capitalism has a hoarding habit'

Excessive wealth not only fails to make us happy, it's also undermining social cohesion. That's according to ex-wealth management insider **Stephanie Brobbey** – and her Good Ancestor Movement has a plan to fix it by helping the super-rich 'deaccumulate'

Oliver Balch

In her decade as a private wealth lawyer, 37-year-old Stephanie Brobbey was too busy cutting property deals, exploiting tax loopholes and arranging offshore investments to give much thought to the rights and wrongs of wealth itself.

But a few years ago, finding herself increasingly troubled by the reality of Britain's growing income gap (Britain now has more food banks than McDonald's outlets, she notes), she decided to quit.

In a career turnaround worthy of Robin Hood, she then set up a non-profit organisation called the Good Ancestor Movement. The purpose of her grant-funded creation is quite simple: to promote the idea of "responsible wealth stewardship and radical redistribution".

In Brobbey's view, our economic model is fundamentally biased in favour of the few (read: the holders of capital) and against the many (read: unskilled workers, marginalised groups, the global south, and so on). Not only is this unfair, she argues, but the divisions it creates are working against capitalism's own interests.

The latter point is one that a growing number of economists and corporations are coming around to. Take a new report on inequality from the Geneva-based World Business Council for Sustainable Development. It argues that eroding trust in democracy, fuelling civil unrest and constraining economic growth are just some of the deleterious knock-on effects of today's income gap.

Brobbey's solution? Help the super-rich to actively 'deaccumulate'. Crucially, that doesn't just mean donating large sums of money to charity. Private wealth-holders need to actively divest their fortunes via projects that promise to make the economic system fairer, more inclusive and more ecologically sustainable, she argues.

As she explains: "We're in an economic system that is fundamentally extractive and exploitative. The more you can mitigate this by putting your wealth into things that are regenerative for the planet and will contribute to social equity, the better."

It would be tempting to dismiss such thinking as the rantings of a disaffected radical. Yet Brobbey's star is rising. She organises a three-month education programme on the downsides of excessive wealth accumulation, for example, which has already attracted dozens of high-net-worth individuals.

Since it was set up in September 2021, the Good Ancestor Movement has advised super-rich individuals on how to actively manage their assets in an intentionally negative direction. "We work with a financial planner to help them figure out how much they actually need," Brobbey says. "People are looking to set a cap and then identify what they are going to keep and what they are going to give away."

Tellingly, Brobbey was included in this year's *Spear's Power List* of the 100 most influential people. Others on the list include Bernard Arnault, the billionaire owner of luxury brand LVMH, and Andrew Bailey, governor of the Bank of England.

"They had to invent a new category for me – responsible wealth stewardship," she comments. "For me, that's indicative of how fast this is moving."

There is also an element to which the movement is tapping into the wider zeitgeist (the movement itself takes its name from pop philosopher Roman Krznaric's best-selling 2020 book, *The Good Ancestor*). Under the Giving Pledge, for example, high-profile billionaires have committed to give away the bulk of their fortunes. Similarly, under the banner of the Patriotic Millionaires, groups of uber-wealthy progressives in the US and Britain are now advocating for a more equitable tax system.

Brobbey intends to set up a formal investment advisory service dedicated to high-net-worth individuals who are looking to redistribute their assets to what she calls "non-extractive projects".

Her vision for redistribution differs from traditional philanthropy in that it focuses on disbursing an individual's net capital assets rather than the interest on those assets (as with typical charitable foundations). She is also dubious of these disbursements generating any financial returns, as per impact investing.

She gives the examples of a social enterprise that may need to buy a building, or a civil-society organisation that wants to reclaim a community asset. "These organisations can't access capital easily, so we're trying to fill that gap by testing a new form of advisory practice where people with excess wealth can invest for no [monetary] return."

The term "movement" in her organisation's title plays an important role in Brobbey's thinking. She has no illusions about the size of the challenge ahead, nor of the contribution that her services can play in reversing capitalism's excessive "hoarding habit", as she puts it.

Effecting change of this kind, she reasons, will require a huge mindset shift. Wisely, her preference here is for measured debate rather than finger-wagging. Hence the Reimagining Wealth programme, which counts numerous high-profile academics and thinkers among its speakers' list.

"It's a kind of immersive learning experience that is both collective and individual. It's about people's individual journey but at the same time it's about bringing together wealth holders," she explains.

> It is not always true that clients want to accumulate as much wealth as possible, at all costs

Much of the initial interest has come from the heirs of substantial fortunes, she says, although a growing number of self-made super-rich are also coming forward. What started as a UK-based movement is spreading further afield, with participants joining from the US, Canada, Austria and Germany.

A tougher nut to crack will be persuading her ex-colleagues in the wealth management industry to get onboard. As a former insider, she knows all too well the default assumption that their clients want "to accumulate as much wealth as possible, at all costs".

"But in reality, that is not always true," Brobbey insists. "There are now more people who are pushing back against that."

The Good Ancestor Movement recently published a 92-page report to alert wealth managers to this shift in attitudes. The research includes recommendations that include greater regulation of tax advice, the introduction of pro-bono advice for the non-wealthy and the prioritisation of climate risks in financial forecasting.

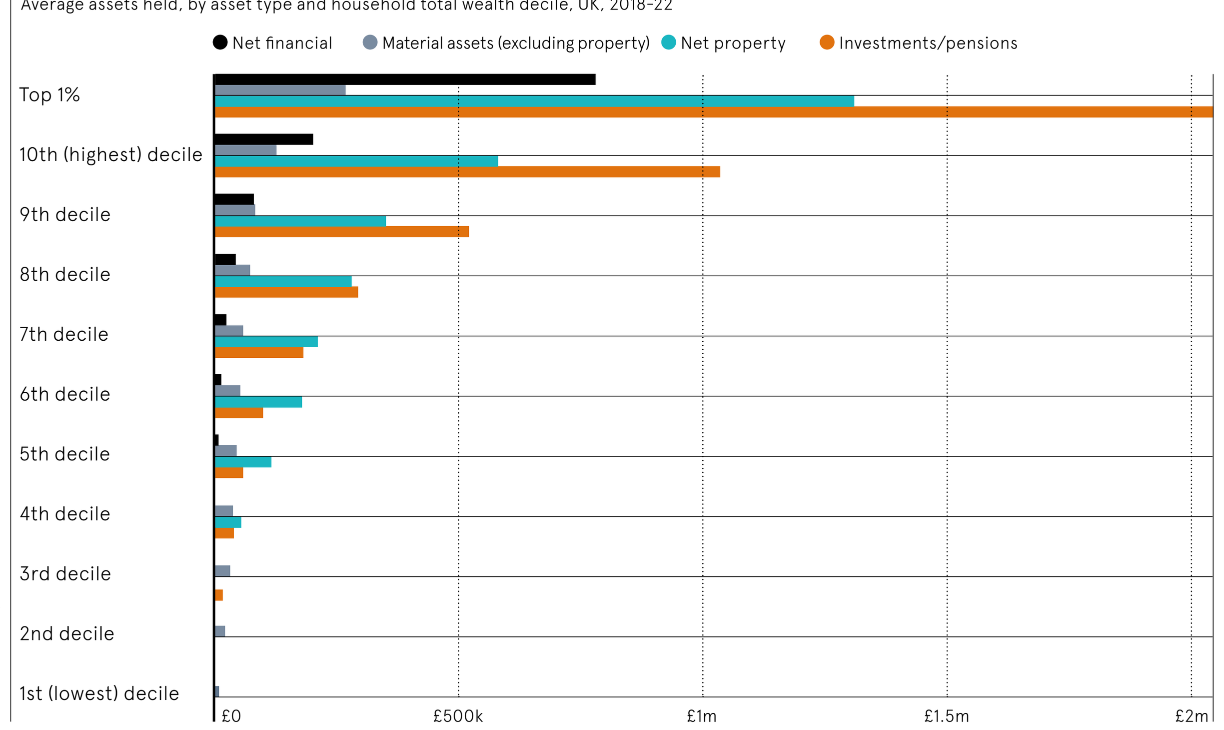
Brobbey's core message for her former colleagues is to drop the pretence that they are apolitical. As she argues: "Wealth is not being made or managed in a vacuum... there are always wealth transfers going on, whether it involves employees working on zero-hour contracts or people getting a tonne of money by minimising tax."

It's not necessarily an argument that will fly with many wealth managers right now, but in an age of melting ice caps and staggering wealth gaps, perhaps millionaires' minds are changing. If not, then maybe they should be – for anyone who wants to be a good ancestor, at any rate.

PROPERTY AND INVESTMENTS ARE WHAT SET THE 1% APART

Office for National Statistics, 2022

Average assets held, by asset type and household total wealth decile, UK, 2018-22



Daniel Balakov via Getty Images

FUND MANAGEMENT

Active managers remain under pressure

Most active managers underperformed benchmarks in 2022, even though market conditions were in their favour. How can they turn things around?

Bradley Gerrard

Active fund managers' raison d'être may be all about backing stock-market 'winners' and avoiding 'losers', but their much-espoused investment expertise, company analysis and awareness of the biases that impede other investors don't seem to have been having the desired effect of late.

Indeed, 2022 was a year when market conditions were theoretically better suited to active management. But a marked underperformance has given its arch rival, passive management, another point on the scoreboard. To make matters worse, this bruising performance was exacerbated by record outflows in some areas. For instance, £50.1bn of investor cash left UK-based funds in 2022.

Something, it would seem, has got to give if active management is to justify itself in the minds of retail investors. Active managers will need to diagnose the problem before they can look to improve performance.

Part of the problem was that the events of last year complicated the picture for active managers. Russia's invasion of Ukraine, surging inflation and a cost-of-living crisis created uncertainty and made identifying winners trickier than usual. Most stock markets were also down for the year.

But even so, as a much-watched report from index provider S&P set out, the conditions in markets were favourable for some areas under active management. "There were material opportunities to generate relative performance," S&P's Indices Versus Active (SPIVA) report asserted. "The prospects for skilled stockpickers in large-cap US equities were above average, and the tailwinds for even unskilled managers were unusually favourable."

The numbers back up this analysis. The average monthly dispersion on the S&P 500 – the maximum difference in returns between the stocks included in that index – hit its "highest annual level since 2009" last year, the SPIVA report noted, thereby creating more opportunities for active managers to outperform.

High stock dispersion was also evident in Europe, yet no fund sector covered by the SPIVA report showed most active managers beating their benchmark. The best performers were Nordic funds, where 35% of active managers outperformed, and UK small caps, with 33%. In the US, not quite half (49%) of large-cap US equity managers beat the S&P 500 index.

£50.1bn

of investor cash left UK-based funds in 2022

What, then, needs to change? Some industry insiders hope that active management's poor performance will prompt introspection by fund groups in terms of the products they offer, how they communicate what they do, and the charges levied. Sheridan Admans is head of fund selection at Tillit, an online investment platform that curates a list of what it believes are the best funds in the UK, is a case in point.

"I hope asset managers that have an active offering are making more effort to consider if they are adding value," he says. "They need to sit back, reflect and ask themselves certain questions, including whether their products materially offer a different outcome to a passive equivalent."

But all is not lost. Admans explains that there would have been some active managers who performed well last year and others might have had opportunities to buy shares in solid companies when they were falling in value (maybe unjustly), which could prove beneficial amid a market rebound.

The fact that active managers also have access to areas not covered by passives, such as private equity, and niche strategies such as small-cap value, will remain another bright spot for those with an active mandate, Admans adds. "I've always been a believer in blending active and passive, as they do slightly different things and can be advantageous at different times," he says.

Of course, that won't soften the blow for investors whose active manager lost money in 2022. And those managers may now be searching for ways to explain their performance to investors.

Joe Wiggins is chief investment officer at fund analysis firm Fundhouse. He points out that a range of factors influence how active management performs. This includes how well small- and mid-sized companies are performing relative to their larger peers. If the former is doing better, the majority of companies in the market will be outperforming. Active managers tend to have a small- and mid-cap bias and should be able to take advantage of that.

Alternatively, if too few companies are driving the performance of an index, this can be problematic for active management. "That's the worst possible situation for active managers. If not many stocks are outperforming, and if those few companies make up a large percentage of an index, then active managers will often be underweight in those names relative to the market," Wiggins says.

But while trying to explain to investors why a fund underperformed could help active management's case, fees are bound to remain the elephant in the room in the wake of active management's poor year.

Passive funds' single-digit basis point management fees – the Legal & General UK Mid Cap Index and iShares Japan Equity Index funds charge an annual 0.08% management fee, for instance – are generally more attractive than an actively managed UK equity fund, which could have annual management charges of between around 0.6% and 1%. That could eat away at returns quite significantly over time.

"Fees matter, and active management fees are still too high relative to their success, so changes need to be made," says Fundhouse's Wiggins.

Once fees go down, though, it could be hard to raise them again, which may be why few asset managers seem willing to find out if there would be a first-mover advantage.

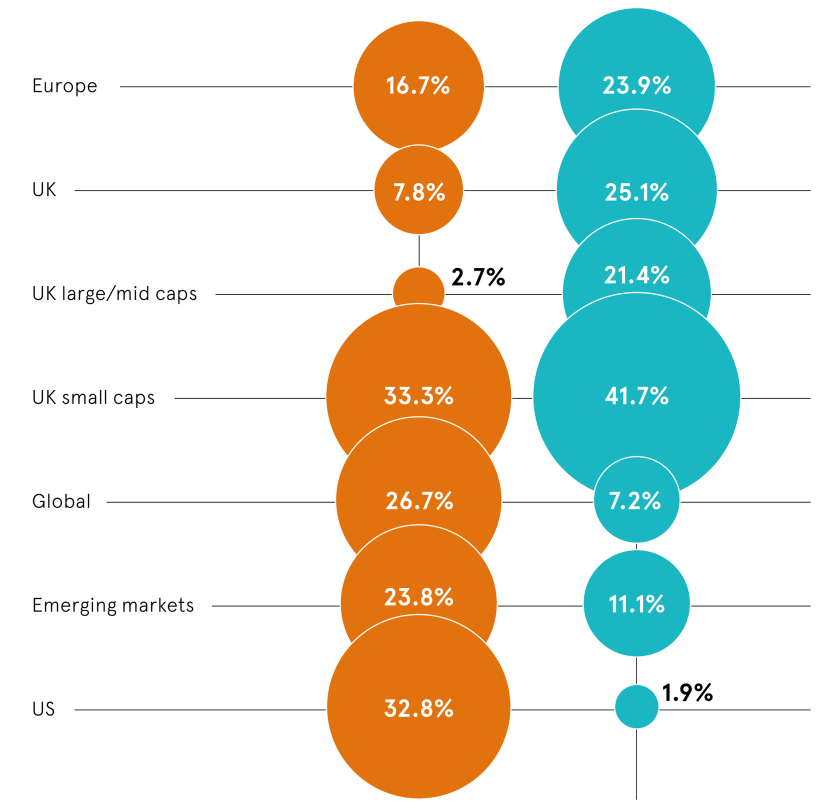
For James Sullivan, head of partnerships at Tyndall Investment Management, this situation is largely due to the rise of passive products, which have put active managers "under pressure for several years".

He adds that an "industry-wide shift to focus on client outcomes has not helped", as it has meant that wealth managers and financial advisers now tend to avoid trying to pick the right 'star' active managers in favour of using passive funds to deliver benchmark returns at lower cost.

Even so, he remains optimistic. "Active management will come through this challenge, perversely, better for it," he predicts. "It will be leaner, with fewer funds, and more efficiently priced, while the closet trackers (which charge active-like fees but tend to deliver benchmark-like returns) will be called out and wound up, and the bar will be reset much higher."

2022 WAS A PARTICULARLY BAD YEAR FOR ACTIVE MANAGERS ACROSS LOTS OF CATEGORIES

Percentage of GBP-denominated equity funds outperforming their benchmarks



S&P, 2023

Commercial feature

Why you should add whiskey to your alternative investment portfolio

As whiskey continues to rise in value, now may be the time for investors to consider adding it to their blend of alternative investments

Whiskey is one of the most exciting and fastest growing areas of alternative investment right now. Fuelled by investors looking for a safe bet in a turbulent market, investments in rare, exclusive Scottish and Irish whiskey have continued to yield significant returns.

For instance, according to industry body IWSR, Irish whiskey producers have been unable to keep pace with demand over the past few years, and the market is predicted to double in size between 2020 and 2030. A record 14 million cases were sold in 2021 alone.

Demand for single malts has also grown considerably in recent years, with Scotch outselling all other spirits, at 53 bottles sold every second. Such is its value that a 1975 cask of Scotch fetched a world-record price of £16m last year. With demand continuing to soar by more than £6bn a year and counting, driven by the recent 19% growth in the US market, the global market is forecast to grow by $8.02bn by 2027.

Added to that, rare bottles of whisky have been ranked as a top-performing alternative asset class by the Knight Frank Luxury Index, growing by 462% over the past 10 years, far ahead of traditionally popular alternative investments such as wine, fine art and watches. Casks have also proved a smart investment, with Scottish casks alone delivering consistently impressive returns in recent years.

+100%

The market for Irish whiskey is predicted to double in size between 2020 and 2030

Flight to safety

The boom in whiskey investment has been primarily driven by a flight to safety, given the current uncertainty in other markets. That's because it appears to be immune to the volatility and fluctuations in the financial markets.

"The financial market crash of 2008 left investors feeling a bit shaky," says Jay Bradley, founder of Whiskey & Wealth Club and The Craft Irish Whiskey Co., creators of the World's Best Irish Single Malt. "Then you've got the current downturn, the knock-on effects of the Covid-19 pandemic and both high interest rates and high inflation, which have left a lot of uncertainty in the markets.

"Gold continues to fluctuate in value after remaining relatively stagnant over the last decade. Nowhere is safe, and experts are now even forecasting that the property market will fall too."

Bradley is referring to the unreliable appreciation in the gold market seen in the last decade, which at its highest was valued at €1,366 an ounce in October 2012. By January 2020, it was still close to the same price, at just €1,350 an ounce.

"Lately it's started to go up a bit, but it's unpredictable and not the safe haven some would lead you to believe it is. An eight-year period during which you'd tie your money up and afterwards see no return makes no financial sense to me."

Genuine alternatives, then, are a valuable commodity among investors. "Investors are looking for sensible places to put their money," says Bradley. "In my opinion, that's whiskey. It's where I invest the vast majority of my money."

Once the preserve of the select few because of its high barrier to entry, now almost anyone can invest in whiskey. You don't need to be an expert to do so, but it's important to do your research in terms of what to look for in a whiskey investment.

There are two main types of whiskey investment: by the bottle and by the cask. The key to investing by the bottle is to seek out limited releases, from reputable producers with "world's best" type awards under their belts. With casks, the aim is to buy from reputable brokers who have wholesale contracts with the right distilleries, with a limited production, and then simply watch the value of the product appreciate over time. Your buy price is key to a successful investment.

"Compared to other asset classes, cask whiskey is a far safer investment than wine for example, which can go off as it ages in the bottle. Whiskey doesn't age in the bottle, but it does in the cask, which is great for investors, as its value appreciates the longer it's left in the barrel."

However, not all whiskey rises in value at the same rate. It depends on the distillery, its reputation for producing a quality product, and how much whiskey it has sold in casks versus how much it bottled in that particular year.

With such an array of whiskey investment opportunities available, how can investors choose wisely? Which whiskey investment companies can you trust? And what are the red flags to look for?

What to look out for

People have been investing in whiskey for decades, but the industry has really taken off in the last five years. By and large, it's made up of reputable businesses. However, whether intentionally or through lack of knowledge, fundamentally inaccurate comments have been circulated recently in articles and radio shows about regulations in the whiskey industry. These have caused confusion and reduced trust. For example, it has been stated that there is a need for delivery orders. While this was a requirement several years ago, it was actually repealed in 2006.

"There's so much to know about this industry, but many of these guys don't know the first thing about it," says Bradley.

One of the prime considerations for any whiskey investor is making sure you have the correct insurance in place. "If something goes wrong, such as the cask getting damaged, and you haven't got the right insurance, you can lose your entire investment just like that," says Bradley.

"Then there's knowing how to select the right type of cask wood that's going to give the whiskey its level of quality and flavour. Most people have no clue about this part. So you must choose people who are highly knowledgeable about whiskey, operate in this space day in and day out, and are passionate about it. Avoid brokers who just buy and sell but have no clue as to the quality of the wood or the condition of the cask. They don't have the same buying power or contacts at the best bodegas and vineyards that companies like ours would, because we buy those same barrels in bulk at competitive prices for our own award-winning whiskeys."

That's why it's important to choose a company that is well-established, fully compliant, stable and has a proven track record in the industry, both in terms of investment and the whiskey itself, such as Whiskey & Wealth Club. The business is registered with HMRC through the Warehousekeeper and Owners of Warehoused Goods Regulations, and it also has an in-house compliance team and all the necessary documentation to ensure clients are the full beneficial owner of their casks.

> **Investors are looking for sensible places to put their money. In my opinion, that's whiskey**

Bradley advises any would-be whiskey investor to start by researching the business, who the directors are and what their experience is. Then look at the quality of the brands they invest in and whether they buy direct from the distillery or incur extra agent fees, he says. A good indicator of the quality of their service will be the reviews and ratings they receive on the likes of Trustpilot.

"Look at the people who run the business," says Bradley. "How long have they worked in the industry? What are their specialisms and knowledge of the industry? How invested are they in the industry? In other words, are they whiskey experts? Are they passionate about whiskey or are they just in it for the quick buck? I myself will do this for the rest of my life, even if I was to do it for free. It's what I love.

"Then look at the size of the company. How long has it been in business? How do its results compare against its competitors? What awards has it won? What is its reputation like? How transparent is it? Are they ensuring they have the correct financial crime practices in place?"

Doing your homework upfront can pay dividends further down the line with a safe and secure investment that provides a healthy and consistent return. That's why it's vital to choose a company that knows what it's doing when investing in whiskey and is run by "whiskey people".

For more information please visit whiskeywealthclub.com

Commercial feature

End of the bull market prompts investors to appraise their equity strategies

Active managers can help investors better navigate market uncertainty caused by rising rates and high inflation

With over a decade of strong markets and a bull run that seemed unstoppable, investors are assessing the changes brought about by post-lockdown economies, the return of the much-feared inflation and, subsequently, rates normalisation.

Low rates globally, booming tech stocks and the strong engine of growth in Asia have come to a halt. More importantly, the biggest adjustment for investors is to adapt to the rate of change in market conditions.

"Investors had become accustomed to a world where zero rates were the standard, inflation was not an issue, and Asia was a significant engine for global growth," says Fella Khelifi-Arnulphy, head of UK advisory solutions at EFG Private Bank Ltd. "As the world re-emerged post-pandemic with acute monetary and fiscal issues, investing had to change – re-thinking portfolio construction and adapting to new market dynamics became more important than ever."

This requires a change of mindset over what risk means in this new era of high inflation and interest rates. Spooked by the market turmoil over the past year, many wealth management clients have taken a no-risk approach to wealth preservation, cutting their exposure to risk assets across the spectrum and instead seeking the safety of cash. While waiting for the storm to pass might seem like a safe move in an inflationary environment, sitting on the sidelines for a prolonged period also means wealth erosion.

"The conversation we are having as advisers is 'cash may look attractive now, but staying in cash is not a strategy,'" says Khelifi-Arnulphy. "What we're saying is, you can take market risk in this environment, but you need to be smarter than just having a passive investment strategy or just doing the same things that have worked over the past decade. Solutions are available now in both the bonds and equities markets."

One strategy that's likely to gain further traction in this environment is the rotation away from growth sectors – such as US tech stocks – and into so-called value sectors. These include utilities, consumer staples such as food and beverage businesses and telecoms companies.

"Those sectors typically do well as yields start rising and discount rates on future growth become much higher," says Oisin O'Leary, a fund manager at EFG Asset Management. O'Leary delivers solutions to clients by actively investing in defensive companies globally and has a particular focus on the UK market.

In the coming years, investors will need to adapt to the external factors affecting how they evaluate their investment options and where growth and income can be derived. "Quantitative easing is being unwound, while interest rates will likely remain at more historically normal levels. People are also going to have to learn to live with inflation again", says O'Leary.

"That is going to warrant a higher allocation to value in portfolios in the future than asset allocators have done over the last decade," he says. "The companies that have led over the last 10 years are not necessarily the ones that will be leading over the next 10 years as we move into this new regime."

That doesn't mean investors need to cut out growth stocks entirely, but it does mean adopting a more blended approach which hasn't been the standard practice in recent years.

"You have to be a lot more selective," Khelifi-Arnulphy continues. "Whilst you could have benefited from the growth trend even in passive strategies because everything was rising, today, it's about getting the style, sector and company selection right. That is where specialists with robust selection processes like Oisin come in."

> You can take market risk in this environment, but you need to be smarter than just having a passive investment strategy

"The time for passive investing has come to an end," O'Leary adds. "As we move into a period of heightened uncertainty and rising market volatility, that is really the time where active managers can shine." As equity volatility increases, active managers who are skilled bottom-up fundamental stock pickers and great risk managers will be primed to step up to the plate.

This backdrop also means equity income will become increasingly important as stock market growth slows. Home to a number of companies that have high-free cash flows and defensive balance sheets that would form the core of an equity income portfolio, the UK is a particularly attractive option as it is.

"The UK is the premium market in the world for dividend stocks," he explains. "Investors are always hunting for yield, and you can get attractive 4%+ yields out of really strong, resilient businesses that should hold up earnings through market downturns or a recessionary scenario."

Given that most constituents in the FTSE 100 are not dependent on UK consumers for their earnings, O'Leary reminds investors to disentangle the UK's economic prospects from UK equities.

Most large-cap UK equities predominantly derive their revenues from international markets. It is important not to confuse the UK macro environment, which remains relatively weak, with the UK equity market, which last year was the best-performing developed market in the world, according to O'Leary. Recognising that distinction is crucial.

He also expects dividend payouts to remain healthy, even amongst more cyclical stocks, such as energy companies that have historically been more likely to reduce dividends during a downturn.

O'Leary says: "The world is still relatively supply constrained in terms of energy and will likely remain so given the lack of investment in recent years. Energy companies are currently generating huge cash flows and have strengthened their balance sheets, so dividends are very well covered this time round."

Even in a world where the only certainty is uncertainty, investors still have options to put their money to work. "Working with advisers helps balance out risks and opportunities," says Khelifi-Arnulphy.

For the last 30 years, EFG has been building portfolios for UK and international clients. Its teams of advisers have the local and global knowledge to advise clients during periods of uncertainty. She concludes: "Our advisers' role is to have conversations with clients who may feel nervous about these 'new' market conditions. It is also their role to guide on how to enter or re-enter markets adapting to their needs. There is no set way for all. We start by listening and build their investments accordingly."

EFG leads clients in the right direction, earns their trust and builds long-term relationships. Visit efginternational.com/uk to find out more

EFG Private Banking

GLOBAL INVESTING

Reassessing China: is it still a good bet?

Qilai Shen/Bloomberg via Getty Images

The reopening of China's borders has sparked an outflow of capital. But might foreign investors be keen to try going against the tide?

Rich McEachran

Since China reopened its borders in January, there has been an outflow of not just travellers, but also of wealthy people looking to move their money abroad.

According to a report by French investment bank Natixis, published in February, tourism data points to an unofficial and unrecorded flight of capital.

So, as China's richest look to move their wealth into equities and real estate overseas, could the country become an attractive play for foreign investors intrigued by the prospect of trying their luck in China?

Of course, this isn't the first swing in sentiment regarding China in recent years. Chinese markets saw an exodus of foreign investors during the pandemic, when tight restrictions placed on the economy and civil society triggered worries about the country's prospects.

On top of this, President Xi Jinping was cracking down on the country's technology and internet giants, such as Alibaba and Tencent, after years of them enjoying fast, free-wheeling expansion.

Xi's re-election to the presidency last October saw him install loyalists in key positions – considered a power grab to deepen control. This heightened fears about what his third term could mean for the country's technology industry and manufacturing entrepreneurs.

But the tide started to turn this January, after Xi suddenly lifted the controversial 'zero-Covid' restrictions that had been in place since the pandemic began. Equities rebounded, while support policies boosted the real estate market, which had been crippled by falling prices and mounting developer debt.

A further boost came in April, when the latest gross domestic product (GDP) data showed the economy had grown by 4.5% between January and March. Despite warning signs that have been flashing – manufacturing activity unexpectedly shrank in April – the strong GDP data has cheered investors.

"Due to its late reopening, the Chinese economy is at a different stage of the economic cycle than most of the world. While the US, Europe and most of Asia are slowing, the Chinese economy is on an upswing," says Arup Raha, chief economist for Asia at the consultancy Oxford Economics.

Beijing has set a growth target of "around 5%" for 2023, significantly above the 3% the Chinese economy grew by in 2022. And it has a good chance of achieving it.

"The combination of rising growth and steady-to-lower interest rates bode well for both equity and bond prices," adds Raha.

Indeed, the improving economy has been boosting sentiment towards China's bonds. Yet given the prospect of global rate cuts outside China later this year, other countries' fixed income assets may end up offering more attractive yields.

For wealthy individuals thinking about investing in China through equities or fixed income, "there is plenty to pique one's interest", says John Redwood, chief global strategist at wealth manager Charles Stanley.

For starters, there are indications that Beijing wants to use technology and innovation to stimulate growth and alleviate any concerns foreign investors may have about the government's control of the industry.

"Bulls will point to China's strong position in electric vehicles, batteries and renewable energy technology. They also assume that policy will allow some further modest relaxation of money, credit and fiscal stance to boost growth," says Redwood.

Yet the bull case depends on China not invading Taiwan and the trade war between Beijing and Washington not escalating. Neither is certain.

One argument that bearish investor present for not putting their capital in China is that, while Xi may be keen to promote growth, "it's unlikely foreign investors will come high up his list of deserving causes", adds Redwood.

Despite the geopolitical risks that are at play, China "remains open for business", according to Christian Edelmann, managing partner for Europe at Oliver Wyman.

The global management consulting firm hasn't seen a fundamental repositioning of plans regarding China, but the "captive nature of the market makes it tough for new entrants to break in", Edelmann stresses. This means there are "less than a handful of established firms in the market". Wealth managers are continuing to hire for their offshore businesses, though, with a focus on Singapore, he adds. Others are entering India to capitalise on opportunities there.

> Due to its late reopening, the Chinese economy is at a different stage of the economic cycle than most of the world

Together, China and India are forecast to make up half of global growth in 2023, according to the International Monetary Fund. India, which overtook China as the world's most populous country in April, is expected to achieve growth of 5.9% this year.

Possible reasons for increased interest in India are minimising exposure to any contagion should China invade Taiwan or trade relations with the US deteriorate further.

For wealthy individuals unsure about investing in China, there is "a middle ground", says Redwood – funds that stand to benefit from the Chinese recovery without the need to invest directly in Chinese equities.

"Various Western companies will benefit from higher sales into China or from serving more Chinese tourists as they travel again," says Redwood. "And the world economy as a whole will be assisted by China's reopening and an accelerated growth in demand." ●

How Hong Kong hopes to lure family offices

Three years on from the Chinese authorities asserting control over the city state, Hong Kong wants to encourage ultra-wealthy individuals from around the world to redirect their capital to the city, with a target of landing 200 new family offices by 2025.

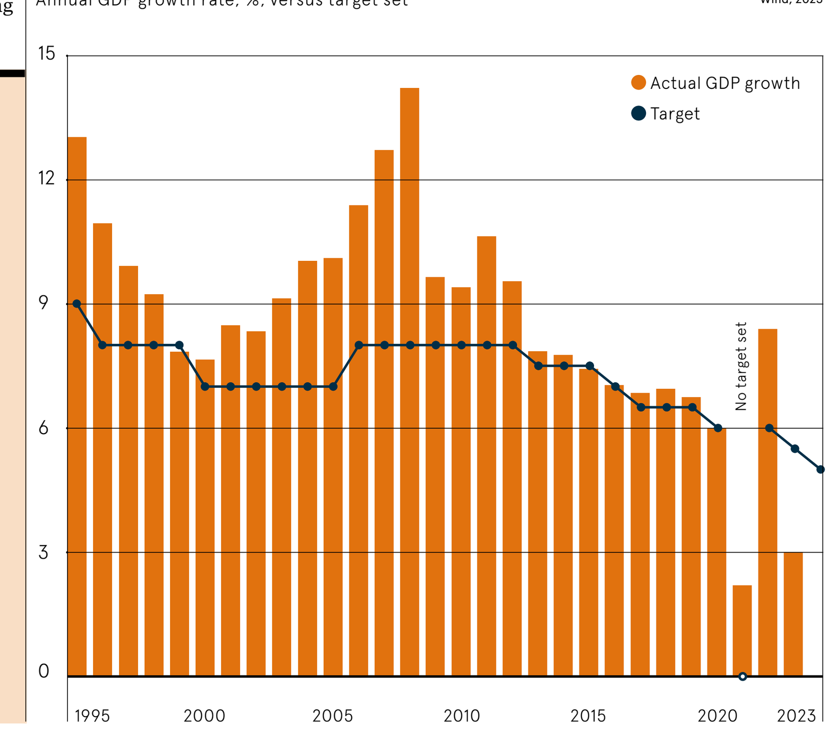
"Developing the family office business will be conducive to pool capital from around the world in Hong Kong, bolstering our financial market as well as the asset and wealth management industry," Hong Kong's financial secretary Paul Chan said in a statement.

A series of measures announced in March to attract wealthy families includes a revamped residency scheme for investors, tax concessions, and plans to set up art storage facilities at Hong Kong's international airport.

CHINA'S BOOMING GROWTH HAS STEADILY DWINDLED OVER THE PAST 20 YEARS

Annual GDP growth rate, %, versus target set

Wind, 2023



Morsa Imagesvia Getty Images

REGULATION

The model of a modern wealth manager

The new consumer duty rules put the customer's needs first. To deliver on that, wealth managers might need to modernise their processes

Elizabeth Anderson

Firms that provide investment advice to retail customers will need to pay particular attention to the new rules coming in from July. The consumer duty, as set out by financial regulator the Financial Conduct Authority (FCA), requires firms to put customers' needs first on everything from making it easier to switch or cancel investment products, to bringing an end to rip-off fees, long waiting times on the phone, and lengthy and unclear terms and conditions.

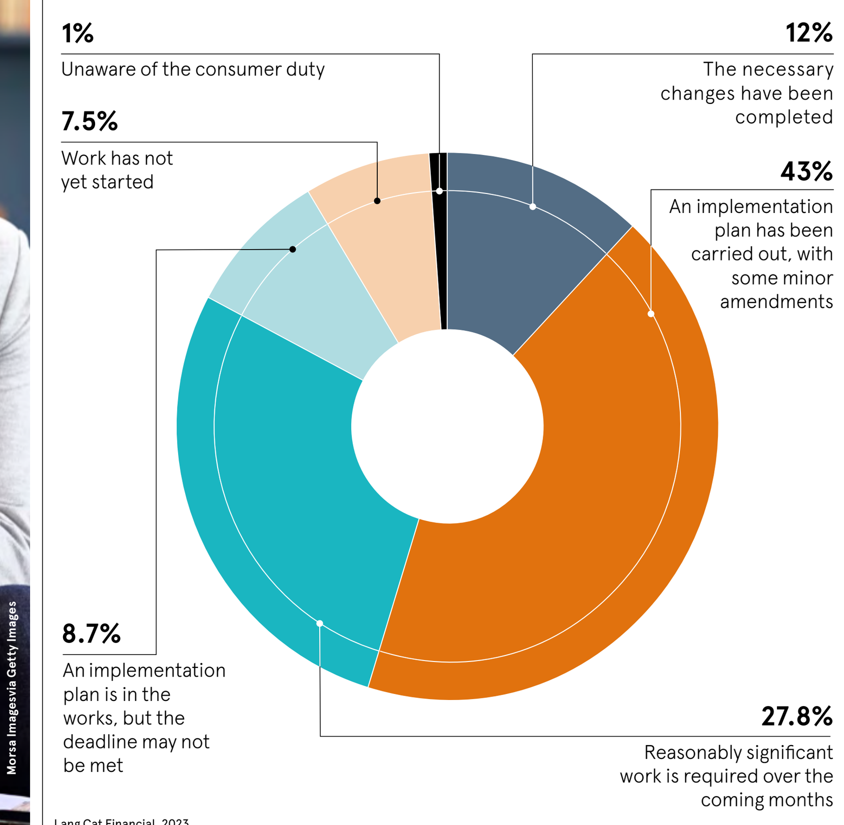
The new rules will come into force from 31 July for new and existing products or services that are open to sale or renewal. Closed products or services that are no longer marketed or distributed to retail customers, nor open to renewal, have an extra year before the duty comes into effect.

For consumers, the benefits are obvious. If you invest money, it should be clear what you are paying your provider for. Likewise, if you have a financial adviser it should be easy to see whether your adviser is acting in your best interests.

But are wealth managers ready for the changes? Chris Jones is proposition director at Dynamic Planner, a technology platform which is used by more than 40% of UK investment advice firms. He is concerned that the consumer duty will require a significant cultural change in the industry, even if many of the practical changes are in hand.

SOME FIRMS ARE IN A BETTER PLACE THAN OTHERS WHEN PREPARING FOR THE CONSUMER DUTY

Preparedness for the consumer duty among UK financial advisers, January 2023



Lang Cat Financial, 2023

"Most of the people we interact with are completely aligned to the new duty and already act in good faith. But there are a lot of habitual business practices, systems and controls that haven't really changed in 50 years. This is what the FCA calls 'sludge' – the cause of most bad experiences in financial and other services. It will take time to modernise these systems," he says.

Day to day, wealth managers' mindset will have to shift from focusing on gaining new customers and then upselling by convincing them to buy more or new products. Instead, their focus should be checking whether their products are genuinely suitable for the customer buying them. If not, the customer should not be sold them.

"Many firms, either through the design of their apps or via aggressive communications, try to get customers to trade too frequently for the purpose of increasing their profits. But this may not be in the best interest of customers. This is the type of behaviour that will be looked at under the consumer duty," says Karan Kapoor, global head of regulatory risk and consulting at Delta Capita.

But the most significant change will be in client segmentation. Customers will be grouped by need and circumstance rather than wealth. There will be an emphasis on the better use of client analytics to understand each client's needs and their investment journey. Companies will have to understand a client's lifestyle in order to identify the trigger points where the client might need advice, at the right time and the right price.

Those with self-invested personal pensions (SIPPs) who are approaching retirement should be contacted by their adviser and have their retirement options fully explained. Likewise, a client with a junior investment ISA should be contacted when they turn 18 and their junior ISA is about to be switched to the adult equivalent. They should receive clear information about their choices, even if that involves explaining that they could transfer the money elsewhere.

Much of the focus will also be on how advisers identify and communicate with vulnerable customers, such as those who are in poor health, have a cognitive impairment or poor literacy or numeracy skills. Firms must provide communication guidelines to staff to promote awareness, and training must be given so that staff are capable of handling and spotting vulnerable customers.

> A lot of business practices, systems and controls haven't changed in 50 years

Companies will also have to get better at communicating with their clients more generally, especially in terms of talking in clear language, increasing customer engagement and explaining investment products in a clear and concise way – either through text or video.

Hugo Bedford, CEO of wealth management firm JM Finn, says that all his 310 staff are receiving training so that they know what they're heading towards. "The key is engaging staff along the journey, through seminars and other formal training. Some elements of the duty have evolved over the past few months and as we get nearer the July deadline we'll develop and implement even more ideas. The whole firm is involved."

But many wealth managers say they already operate in good faith with their customers, and that consumers are unlikely to see major changes. Two-thirds of advisers say they will not be changing their charges for services or products, according to a recent survey of 600 advisers and planners by financial services consultancy Lang Cat Financial.

The same survey revealed that 61% of advisers expect minor changes to information communicated to clients, with 27% seeing no change at all. Just 6% said they expected significant changes in their client communications in the coming months. Almost 70% said they expected no changes in their approach to their vulnerable customers.

But there's no room for complacency. Dean Gough is head of operations at wealth manager Financial Planning Corporation and warns that firms mustn't fall into the trap of seeing consumer duty as a box-ticking exercise. The duty will raise the bar for the industry and the expectation of clients, he says. Those who haven't heard from their adviser in years, have no idea what their fees are paying for, or how their investments are helping them to meet their objectives should expect to see a change.

What's more, this may be the first of a series of changes as part of the FCA's three-year plan to boost consumer confidence in the financial services industry. It's prioritising real transparency and that consumers are getting value for money.

As firms adjust to embedding the customer perspective at the heart of their business model, they'll need to get used to the idea of overhauling their processes. The FCA has promised to call out firms that aren't complying with the rules from the end of July. Wealth managers should start to change their practices now, if they haven't already. ●

INSIGHT

'Policymakers need to use a scalpel, not a sledgehammer'

Amid a huge wave of change in the wealth management industry, careful progress on regulatory reforms is the only way forward, says PIMFA's **Liz Field**

Business as usual simply no longer exists for wealth managers. After all, the wealth management industry has experienced a huge amount of change over the past few years – much of which has been beyond our control.

For example, since the pandemic, our industry has moved at speed to innovate and adopt various technological solutions – as have we at PIMFA, in launching our WealthTech platform to support firms as they select and integrate new technologies. This move towards digitalisation has been driven by the fact that Covid changed the way clients want to interact with the industry, as well as the way the industry looks at itself and conducts business.

And there's more change to come. This year will see the implementation of both the consumer duty and the government's Edinburgh Reforms, which seek to reframe financial services regulations following the UK's exit from the EU. Further reforms are also looming, with the Financial Conduct Authority (FCA) having recently announced reforms to stock-market listings and declared its ongoing commitment to improving diversity and inclusion within the industry.

These come hot on the heels of other regulatory moves, including the FCA banning claims management companies from 'phoenixing', minibonds being brought into the regulatory perimeter, and the repealing of the '10% depreciation' rule.

Of course, of the changes on the cards, the consumer duty almost certainly ranks as the most far-reaching. The FCA has repeatedly warned the industry that it must take this reform extremely seriously, describing its introduction as a "watershed moment" at our conference earlier this year. The duty will result in a substantial uplift in consumer standards and rules from July. Among its requirements is the need for firms to document and evidence consumer outcomes, which the FCA hopes will help firms review and make further improvements for their clients in the future, as well as promoting fundamental changes in behaviour.

Similarly significant are the Edinburgh Reforms, which the government is using as an opportunity to review and potentially remove any European laws and regulations which negatively impact UK financial services. Here PIMFA is working with policymakers to create new regulations that work better for the UK market and the clients we serve. For instance, we were pleased to see the government announce the repeal of the Packaged Retail Investment and Insurance Products (PRIIPs) regime, which required firms to bombard their clients with reams of content most don't read when they buy an investment product. That said, we would urge policymakers and regulators alike to use a scalpel rather than a sledgehammer when considering the removal of certain European laws. Many of those laws took several years to implement and led to fundamental changes that do not necessarily need to be undone.

Talent, inclusion, diversity and equity also remain key focus areas for the wealth management industry. The FCA has made it clear that diversity and inclusion in financial services is a regulatory priority. It is vital that we reflect the clients we serve and embrace a cognitive diversity that will only strengthen our industry and help create better outcomes for consumers. To champion this approach, PIMFA has been undertaking various initiatives such as our Diversity & Inclusion Awards and our 'make it.' campaign, designed to encourage people from diverse backgrounds to consider a career in wealth management and financial advice.

These are just some of the latest changes in what remains a transformative period for the wealth management industry. So far, the changes we have seen in our industry in recent years have been overwhelmingly positive. And if we scan the horizon, we can see helpful reforms coming, including to the way in which the Financial Services Compensation Scheme is funded. There's also more work to be done to protect consumers from fraud through the Online Safety Bill. Let's hope, then, that we'll continue to make good progress on these fronts too. ●

Liz Field
Chief executive, PIMFA

INTERGENERATIONAL WEALTH

Are you ready for the Great Wealth Transfer?

Millennials and gen X are set to inherit vast sums over the next couple of decades. Savvy wealth managers are building relationships with them now

Fiona Bond

Over the next 20 to 30 years, it is estimated that £5.5tn will be passed down from parents and grandparents to their descendants – in the UK alone. Globally, the figure is expected to reach around £54tn, in what has been dubbed the Great Wealth Transfer.

By 2030, the share of global wealth held by millennials and generation X will surpass that of baby boomers for the first time – generations that have come of age in a far more interconnected, globalised and digitally savvy world. It's a development set to have consequences for future generations and the wealth management industry itself.

The ability of wealth managers to remain successful in this new era will depend on their ability to respond to the opportunities and risks that this impending wealth transfer presents. According to Schroders, more than 80% of advisers believe that intergenerational planning is the biggest opportunity in the industry, yet just 9% are facilitating conversations around the transfer of family wealth.

"The wealth transfer is a huge opportunity for the wealth management industry but if it fails to prepare to take advantage then it could be a serious risk for some businesses," says Jenny Davidson, commercial proposition director at wealth management group Quilter. "Financial planners and investment managers must now establish relationships not only with clients but also with their spouses and children to retain clients and assets under management."

Davidson, who is responsible for Quilter's investment propositions, says firms should capitalise on opportunities such as annual review meetings to forge relations with a client's close family and discuss intergenerational wealth transfer planning.

"By proactively engaging with clients and their families, advisers can create trust and become the go-to professionals in this area of financial planning. In turn, this will help wealth management businesses continue to evolve and grow," she explains.

What is clear is that wealth managers cannot rely on relationships springing up fully formed with their clients' offspring. In fact, analysis by Schroders reveals that 65% of inheritors do not intend to continue using their parents' financial adviser after they receive an inheritance. Unless wealth managers actively integrate the next generation into their conversations, they might find that business disappears.

"Relationships won't evolve naturally in all cases, so financial advisers need to be proactive," says Davidson. "That means focusing on building relationships with potential inheritors through various approaches. Put insurance policies in place for younger generations, help them create savings strategies or give other small but impactful financial tips that engender trust and value."

Stefani Williams, partner at financial advice firm Holden & Partners, says her firm encourages clients to include the next generation as part of their financial planning. "It gives the next generation the opportunity to gain an understanding of finance – something not often taught in the education system. It also helps them to understand how to manage the finances that they are due to inherit," she says. "We also often see that parents and grandparents want to structure their assets in a way that meets the objectives of those who will inherit their wealth."

The differences in outlook between generations will be a key factor that wealth managers cannot afford to overlook. The circumstances, priorities and investment goals of younger generations will often be at odds with their predecessors, and communication and investment propositions will need to adapt accordingly.

For instance, younger generations are used to on-demand, digital interactions. Firms will need to be flexible in how they communicate and recognise that outreach will need to be tailored for different age groups.

Investment propositions will also need to evolve. While baby boomers are typically conservative investors, younger cohorts are increasingly favouring higher-risk investments. A report by the Financial Conduct Authority found that emotions and the thrill of investing, as well as social factors such as the status from a sense of ownership in the companies they invest in, are key drivers for younger investors.

Alongside this willingness to experiment is a growing awareness and passion for sustainable investing. According to RBC Wealth Management, younger investors are almost twice as likely to adopt an ethical approach to investing as older investors, with four-fifths of younger investors viewing ESG considerations as increasingly important.

Steven Cameron, public affairs director at Aegon, says sustainability is a priority for younger generations and firms should keep this front of mind.

"We are at a critical time for climate action and younger customers are often acutely aware of how the decisions taken today impact their ability to have a safe and equitable future," he says. "Wealth management needs to evolve to understand these impacts and bring them into advice processes and investment decisions."

Williams echoes the sentiment. "The landscape has changed so much and it's important for advisers to recognise this and keep up. Often, the younger generation assume that an ESG portfolio is 'standard' rather than an option."

Wealth managers are having to act fast to show they're up to speed with ESG investing. The Association of Investment Companies says that 74% of advisers now offer an ESG investment proposition.

> Relationships won't evolve naturally in all cases, so financial advisers need to be proactive

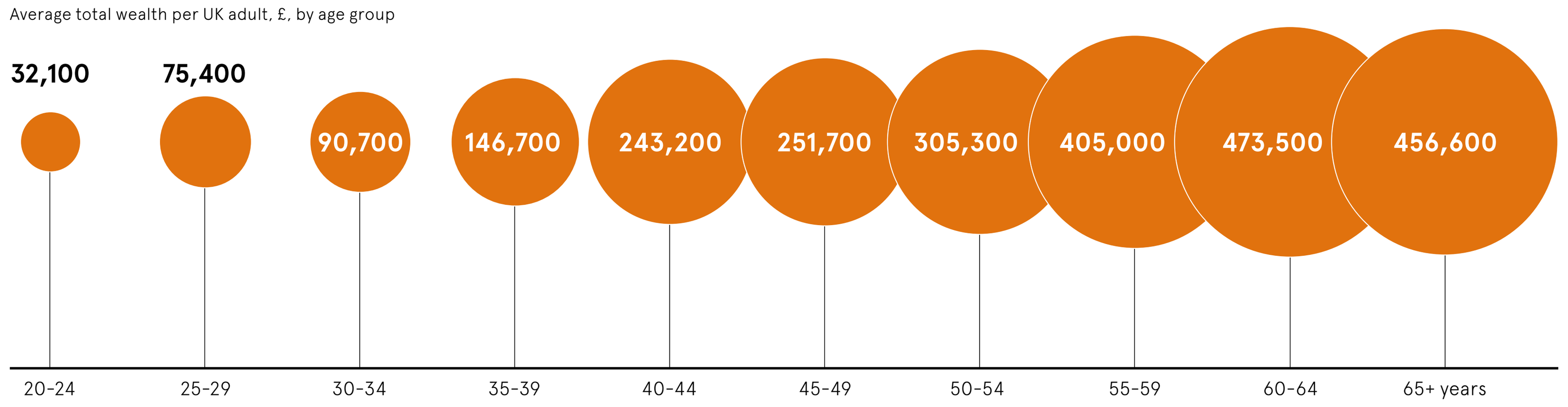
One other, often overlooked, factor in the coming generational shift in wealth is that women are likely to play a more prominent role. A survey by WealthiHer Network found that 51% of women want to take a more active role when it comes to looking after their money, and 82% want to engage and invest in sustainable and socially responsible investments and institutions. It's important that wealth managers respond to the needs of this demographic and make them feel welcome.

Crucially, if the wealth management industry can stay in tune with the nuances and needs of future generations and engage with them before they inherit wealth, there is a huge opportunity. As Cameron puts it: "If the industry is willing and able to adapt to the needs of this generation, it will continue to demonstrate the huge value of advice and wealth management to generations to come."

And if the industry's not willing to adapt? Well, the laggards should prepare to be left in the past.

CONSIDERABLE SUMS ARE DUE TO BE PASSED DOWN IN THE COMING YEARS

Average total wealth per UK adult, £, by age group



NimbleFins, Office for National Statistics, 2023

Qi Yang via Getty Images

TECHNOLOGY

All in on AI?

AI is set to revolutionise wealth management, but it will introduce new risks alongside the many opportunities. What do wealth managers need to know before diving in?

Simon Brooke

It will come as no surprise that AI is creating a significant buzz in the world of investment management. That's because it offers wealth managers and their clients the potential for improved portfolio management and customer service, with the technology theoretically enabling better investment decisions based on a more effective reading of large data sets.

But that's not all. AI can also tailor advice to each customer's specific needs and can even predict those needs before the customer becomes aware of them. For instance, when it comes to client onboarding, AI tools can help wealth managers to make more accurate assessments of a client's risk appetite and investment objectives. Natural language processing (NLP) can help here, by trawling through recorded conversations and other unstructured data, alongside the more traditional questionnaires.

Faster, more accurate compliance, anti-money-laundering and know your customer checks are also possible, thanks to AI-powered facial recognition tools, which help to verify identity.

So, who even needs a human wealth manager anymore?

"AI can help our customers take an insights-led approach to ensure they make the most of their money and it can reduce the cost of serving clients," says James Hewitson, head of investments, wealth solutions and insurance at HSBC UK. "It is, however, important to note that in a highly regulated environment such as wealth management, these applications still require human supervision to ensure the right outcomes are placed in front of a customer."

Perhaps doing away with the humans isn't feasible, then.

Hewitson believes that AI will improve the wealth management industry in two main ways. "Generative AI increases the breadth of the data sets that can be analysed, and the speed with which that can be performed, reducing the cost of producing content and insights. Predictive AI has broader applications, which include forecasting how much one can save based on spend, and optimising client portfolios."

According to Hugh Coughlan, CTO for data and applied intelligence at Fujitsu UK, there's a significant competitive edge to be gained here. "By joining diverse data sets and running multiple risk scenarios, investors can gain a competitive advantage and market share over their peers," he says. "New investment strategies can be quickly transacted using predictive execution algorithms to create new alpha-generating ideas for clients and potentially offering higher returns."

Of course, few firms can achieve any of this just yet.

Rhodri Preece is senior head of research at the CFA Institute, a not-for-profit organisation that provides investment professionals with finance education. "We're seeing a huge amount of interest in AI," he says. "But it's not yet being adopted at scale across the industry. Timing your investment in this technology is hard to judge. Just look at the difference between ChatGPT-3.5 and ChatGPT-4, for instance. Many firms are taking a wait-and-see approach."

There are several questions yet to be answered, too: whether the regulators can keep pace with the lightning-speed innovation in the AI space, and whether the adoption of AI threatens to undermine consumer trust in their wealth managers. If mishandled, these two factors could have a chilling effect on the rate of AI adoption in the industry. After all, the Competition and Markets Authority has just opened an initial review of competition and consumer protection considerations in the development and use of AI foundation models, and the EU is working on the so-called AI Act, which seeks to protect and reassure consumers. The regulators are bound to take an active interest in the use of AI – and will look to clamp down on perceived misuse – even if they are not yet fully up to speed.

> We're entrusted with the life savings of our clients, so the bar for handing over control to AI systems should be incredibly high

The dizzying speed of its evolution aside, AI brings with it other distinct hazards. As other sectors such as healthcare are discovering, the quality of the data used in these algorithms is vital to make the correct calculations and conclusions. It isn't only humans who are guilty of making assumptions; ChatGPT is only as good as the data it is trained on.

All that data swirling about presents problems too. "One of the main risks of AI in wealth management is the potential for security and data breaches," observes Martin Jordan, director of innovation at digital transformation consultancy Equator. If they're to be given access to sensitive financial data, AI algorithms must have robust security features to protect against cyber-attacks. "The current pool of AI tools is wide open, mostly untested and owned by third parties on overseas servers."

No matter how many tasks AI and its related technologies carry out, it will still be wealth managers who bear the legal responsibility. "If relevant information is overlooked, or if the recommendations are flawed in some other way, liability for any adverse consequences will almost certainly fall on the wealth management business that adopted and passed on those recommendations, rather than the developers of the tool itself," explains Will Richmond-Coggan, an expert in privacy and technology issues at law firm Freeths. "This presents a real challenge because often it's only the developers who have any insight into how the AI tool has chosen what information to prioritise, or what recommendations to make."

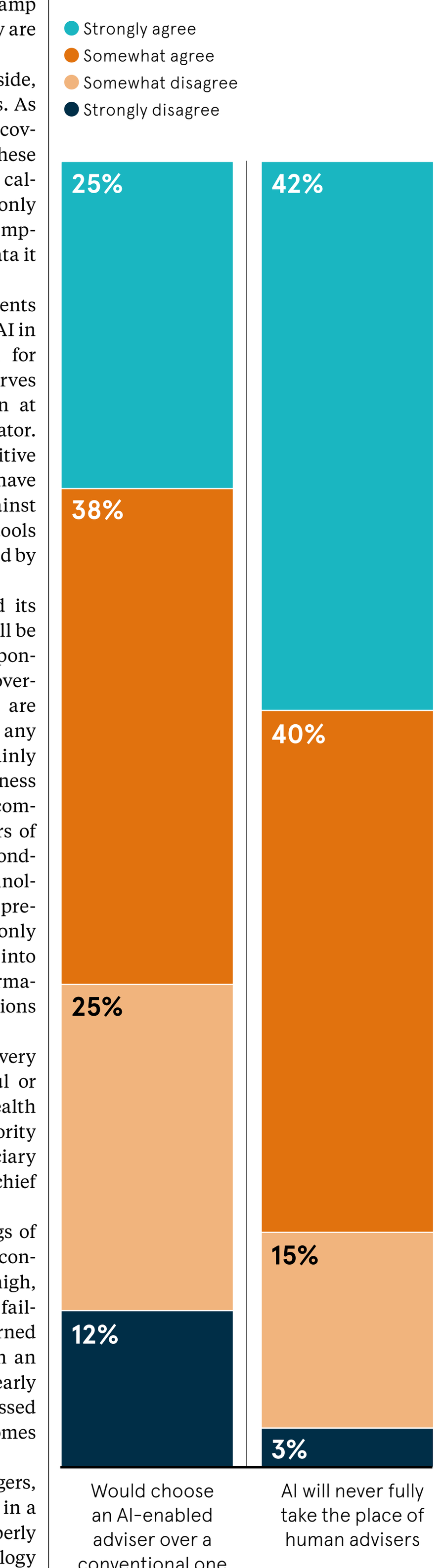
The regulatory environment is not very well developed to guide the successful or appropriate deployment of AI in wealth management, but the overarching priority for industry practitioners is their fiduciary duty. That's according to Kasim Zafar, chief investment officer at EQ Investors.

"We're entrusted with the life savings of our clients, so the bar for handing over control to AI systems should be incredibly high, with multiple lines of redundancy and fail-safe guards," says Zafar. "Trust is earned over a long period but it can be lost in an instant. So, while the potential of AI is clearly tremendous, it needs to be harnessed responsibly while keeping client outcomes front of mind."

One thing is clear, then. Wealth managers, tech experts and regulators need to act in a way that is not only agile but also properly coordinated to manage this new technology responsibly and safely. Customers will certainly brook no argument on that front.

ADDING AI IS GREAT, BUT CLIENTS WOULD STILL RATHER HAVE A STRONG RELATIONSHIP WITH A HUMAN ADVISER

Proportion of US investors who agree with the following statements



Morgan Stanley Wealth Management, 2023

Commercial feature

A silent digital revolution in wealth management

Despite slow initial uptake, clients are now benefiting from digital services, via user portals and AI

These days, customers have come to expect instant digital service. And while that has been the standard now for several years in sectors such as banking and ecommerce, the wealth management industry has long lagged behind its peers.

This is down to a range of factors. For instance, because investments are long-term by nature, traditionally there hasn't been the need for clients to readily access them. What's more, given an average age of 60 or more, many wealth management clients have been slow to adopt digital technology.

There are issues on the other side too. Some relationship managers have been reluctant to give up face-to-face contact with clients in favour of digital communication, there is a risk in providing access to performance without proper context and a reliance on weak underlying technology has in some cases held back their ability to offer digital services.

But that is changing now. In a bid to improve client experience, wealth management firms have been focusing on providing better information and reporting online, and enabling clients to place orders and give instructions through a client portal. The development of these capabilities was accelerated by the switch to digital during the Covid-19 pandemic, where firms were forced to adopt new technology such as digital signatures and video conferencing when they couldn't meet in person.

> Many clients want to have greater visibility and control over their finances, and this is now extending into investments

"Many clients want to have greater visibility and control over their finances, and this is now extending into investments," says Kenn Taylor, Director and Head of Wealth at Alpha FMC, a leading global provider of specialist consultancy services to the asset management, wealth management and insurance industries. "Tools that help clients understand the options they have, inform them of the impact of risks and opportunities, and aid them in seeing how their plans have progressed are popular now."

So far, the results have been encouraging. At Alpha FMC, a focus group study found that the biggest benefit of digital wealth management tools is providing information to help clients make better financial decisions and piquing their interest in investing.

Thanks to its versatility, artificial intelligence (AI) has been a key enabler of digital wealth management tools. A prime example is the way it can curate relevant content and information to help clients understand their investment options, or the way it can analyse choices by processing existing data and investment research to predict a range of outcomes. So far, few wealth management firms have grasped its full potential in this regard.

As firms have continued to invest in technology – with 50% now dedicating more than 10% of their operational expenditure to digital services, according to a recent digital survey conducted by Alpha FMC – so client satisfaction levels have risen too. This more mature offering has resulted in an increase in the proportion of clients who feel their expectations have been met or exceeded, from 8% in 2021 to 33% today.

Of course, this progress has not been without its challenges. Chief among them has been the difficulty of integrating firms' legacy technology with new digital interfaces, as well as a lingering distrust of the quality of the data these digital tools present.

Given the widespread availability of digital services these days, clients have no qualms about leaving a firm if they don't feel they are getting the service they want. Alpha FMC's focus group study found that 25% of clients have already moved providers because the digital service they received was poor. Among the main gripes was 35% saying they had been unable to open an account fully online in the past. A further one in three said that there was no instant password reset capability.

Wealth management firms are only now starting to realise the full potential of digital services, with most now putting it at the top of their agenda. As clients demand more and more from their providers and with Managers aging faster than clients, whilst they have made a start they will need to continue investing and find a way to address some fundamental blockers in legacy models and mindsets to keep up with what is now a moving target.

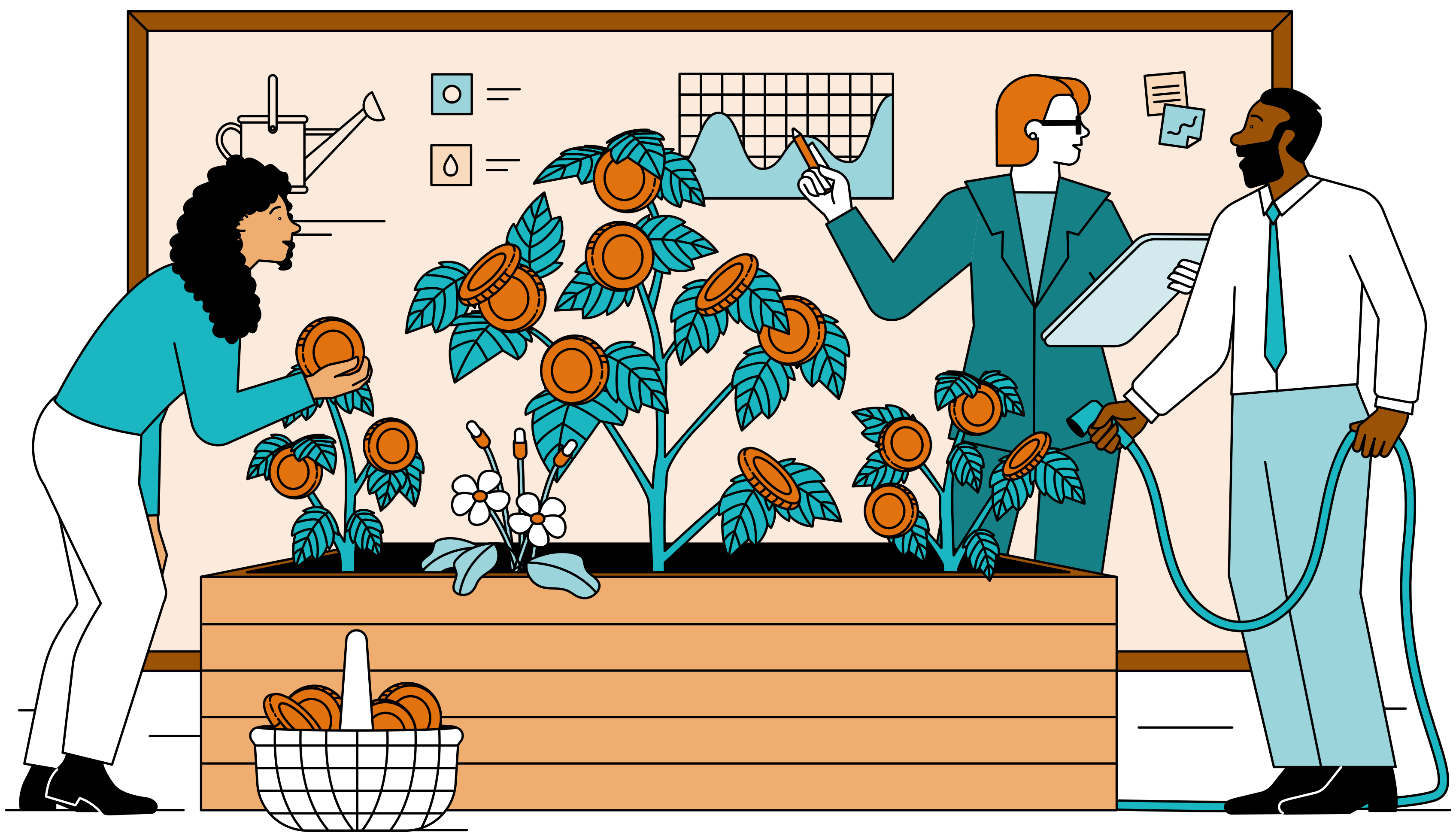
25%

of clients have already moved providers because the digital service they received was poor

Alpha FMC, 2021

Please for information please visit alphafmc.com or contact enquiries@alphafmc.com

Alpha



PARTNERSHIPS

Tap into workplaces for organic growth

More employers are helping their employees with financial wellbeing. Can wealth managers use this to their advantage?

Ruth Emery

As companies battle with the cost-of-living crisis, a new opportunity is emerging for wealth managers.

Indeed, employers are increasingly enlisting the help of experts to provide financial education to their workforce. At the same time, wealth managers are actively targeting employers to market services such as retirement and investment advice to employees. Done right, it could be a lucrative opportunity.

There are numerous reasons for this potential partnership. Most employers are not able to hand out inflation-busting pay rises at the moment, so instead opt to highlight their range of employee benefits, while adding financial guidance as a perk. They also want to help staff become more financially resilient at a time of high inflation. For the wealth managers, it potentially creates organic growth as employees are converted into new clients.

Alexandra Loydon, director of partner engagement and consultancy at St James's Place, talks of a growing trend. "Employers are engaging workforces in financial awareness programmes, which has been driving conversations with advisers as they look for qualified experts to talk to their employees," she says.

"Advisers also feel a sense of duty during the cost-of-living crisis to provide support and to help workers to increase their financial understanding."

Of course, this is not purely altruistic. Partnering with employers can produce lucrative leads for wealth managers. Loydon notes that some St James's Place advisers have seen "upwards of 40% of new referrals via this route". Financial wellbeing and retirement specialist Wealth at Work says demand for its advice offering from employees-turned-clients has "gone through the roof".

Tapping into employees as a growth channel is arguably part of a wider shift in the wealth management industry to service fewer wealthy clients, such as lower high-net-worth and mass-affluent individuals.

The US is further ahead on this than the UK. Across the pond, many wealth managers have already established partnerships with employers. Historically, this has often focused on providing tax and wealth advice to senior executives but some are now expanding. For example, Ayco, part of Goldman Sachs, rolled out a wider financial advisory service to workforces in 2019.

In the UK, wealth manager Evelyn Partners is gearing up to launch an employee financial wellbeing service. Jason Hollands, the firm's managing director, corporate affairs, says this will "enable employers to improve their engagement with their workforce and support their staff in gaining more confidence about their financial future".

The service will include a digital platform and coaching sessions and the employer will typically cover the cost. Hollands says employees who need personalised financial planning or tax advice can "engage us directly".

Other wealth managers active in this space include the robo-adviser Nutmeg, which has partnerships with businesses that include top accountancy firms and John Lewis, with the remit to provide investment management services.

There are numerous studies which show that improving financial wellbeing among employees can boost productivity and encourages staff retention. Providing financial literacy and investment education is a win-win-win for the employee, the employer and the wealth manager. But as Jonathan Watts-Lay, director of Wealth at Work, points out, the financial wellbeing agenda has been gathering momentum for a while. "It started during the 2008-09 financial crisis when employers couldn't afford to give pay rises but wanted to educate their staff about the value of their employee benefits.

"The 2015 'freedom and choice' pension policy [which allowed savers to access their pensions flexibly, rather than being forced to buy an annuity] was another catalyst, as employers called in experts to explain the retirement choices to their staff." Now the high cost of living has reinvigorated the demand for financial education at work.

The explosion of financial products in the workplace is another driver. When companies decide to launch a share scheme, a corporate ISA or even salary advances, employers will often draft in an independent financial expert to explain the pros and cons to employees.

"There are a lot of providers who sell all kinds of products in the workplace but employees need to understand the details. There is definitely a growing market for wealth managers and money coaches to go into firms to do that," says Watts-Lay.

Where businesses choose to work with a wealth manager as an ongoing employee benefit – as opposed to simply consulting them for a specific event such as a share scheme maturing – service levels may look quite different to what is offered to a wealth manager's private clients.

First, it's unusual to offer regulated financial advice to the whole workplace. The focus is typically on financial wellbeing.

"We have a financial wellbeing programme that can be delivered to businesses through workplace sessions and workshops," Loydon explains. "We help people to define their short, medium and long-term goals and understand their options. They're educational and not about financial advice."

Technology has a role to play: online platforms allow employees to access and engage as they wish, and video-conferencing materials can reach a wide audience. Financial coaching can be done via a Teams meeting or on the phone.

At Evelyn Partners, for instance, digital support includes goal tracking, budgeting tools and financial health checks. Open banking tools are used to create an app where employees can see all their finances – such as their bank account and pension – in one place.

There is a significant need for such guidance. According to Boring Money, the advice gap in the UK stands at 13.2 million adults. That is, people with investments or large amounts of savings but with low confidence in managing their money.

That need could translate into a big opportunity for wealth managers to educate these people in the workplace. "Working with employers will undoubtedly put advisers in touch with new networks of people who may then go on to become clients. There's no consistent figure for this, though, and it will depend on factors such as how much time an adviser is dedicating to these programmes and the size of the organisations they're working with," says Loydon.

Wealth at Work has seen a big jump in employees wanting to pay for advice; it is currently averaging 2,000 advice meetings a month.

But Watts-Lay cautions against seeing the workplace as a quick place to generate leads. "It can be a slow process. Sometimes an employee may instantly realise they need paid-for advice – or it may be five or 10 years later that they decide they want it.

"Working with employers will introduce advisers to people who may go on to become clients

68%

Take-up rate of financial coaching among US workers whose employers currently offer it

PwC, 2023