Technology and the future of wealth management
About this survey

This survey was commissioned by Taylor Wessing and conducted by Nisus Consulting to assess the UK wealth management industry’s view of how technological innovation will impact the industry over the next 5-10 years. The survey took place during early summer 2016 with respondents comprising senior individuals from across the UK wealth management sector.

With thanks, we also separately interviewed the following senior industry figures:
- Nick Hungerford: Co-Founder and Non-Executive Director – Nutmeg
- Nicholas Lambert: Partner – Sarasin & Partners
- Jason Hollands: Managing Director – Tilney Bestinvest

The results of the survey are grouped under the following themes:
- Drivers of change
- Impact of change
- Attitudes to ‘robo’ platforms and passive-strategies
- Regulation and risk
Foreword

“If you are not at this party [to enable digital delivery], then I don’t think you are seriously setting your business up for commercial success.” (Respondent comment)

This sentiment is not a surprise. Significant momentum is building towards disruption in the wealth management industry, driven both by changing client behaviour and the ‘FinTech’ advancement in technical capabilities. These trends in turn reinforce each other.

However at Taylor Wessing we find that the degree of adaptation and digitisation in the wealth management industry still runs behind other sectors we work with, which have already been transformed by technology, such as retail insurance, banking and payment services.

What comes through strongly in our survey is the expectation that other forces will also have a major impact on the shape of the industry in the years to come, such as increased sources of competition, the burden of regulation and the challenges posed by the ‘DIY’ investment market. While in some instances the use of technology is seen as a potential solution, in other cases it is seen as a catalyst for change.

85% of respondents agreed that “firms failing to innovate by enabling digital delivery of their services risked being left behind”.

So, is the way forward clear? In a word, ‘no’. Although it could be said that there is a consensus on change, there are a number of areas where expectations vary, for example as to the proper place for passive strategies within a portfolio or as to the advantages of automated advisory and management solutions. The variety of viewpoints that came out through the survey are perhaps indicative of an industry that is at a crossroads – but also that no one size will fit all and that some new business models are as yet unproven.

Looking at the future through a wider lens, HM Treasury and the Financial Conduct Authority (FCA) have, with their Financial Advice Market Review, firmly put in play the important social aspect of how the wealth industry bridges the ‘advice gap’. The challenge for both industry and regulator, however, is to solve this in a way that firstly enables firms to be sustainable and profitable and secondly guards against any new systemic issues that might arise.

So the question is – How do you think technology will change the wealth management marketplace over the course of the next decade?

“We are finding that the implementation of new technology is at the heart of most of the projects we are currently involved in within the wealth management space.”

Jonathan Rogers
(Head of Financial Services Regulatory, Taylor Wessing)
Key findings

Competition and disruption is on the rise and consolidation is likely to result. 73% of respondents felt there is potential for more automated service models to win business away from the traditional advisory/managed services.

A weighty 94% of respondents see potential for so-called ‘robo’ models to take business away from more traditional services. It isn’t all plain-sailing however, with 34% ranking failure to secure client investment portfolio suitability among the top risks arising from technological innovation.

In terms of the degree of opportunity for technological innovation to drive growth, execution-only services were ranked markedly higher (8.6/10) than discretionary or advisory services (both 6.7/10), perhaps a sign that technology could boost client confidence.

While it is tempting to link technology with greater commoditisation, the results suggest that increased personalisation is a stronger objective.

75% of respondents who anticipate greater market consolidation, ranked the cost of regulation as the key driver, ahead of more progressive objectives such as the need for scale and/or the creation of multi-channel models.

‘Ease of doing business’ and ‘reduced pricing’ were noted as the key needs of clients.

Technology will have greatest impact on how services are delivered to Savers, the Emerging Affluent and Affluent client segments (see page 9 for our definition).
Drivers of change

In terms of the client needs that will most drive change, ease of access was ranked highest, reduced pricing second, with improved asset management DIY tools ranking third – the first and last points illustrating a theme of technology delivering client empowerment.

Rank the following in terms of the investor requirements that will most drive technological change over the next 5-10 years? (1 = most, 5 = least)

- Ease of access: 2.37
- Reduced pricing: 2.58
- Improved DIY tools: 2.78
- Ease of product comparison/switching: 3.53
- Automated higher value services: 3.56

56% of respondents agreed that technologically savvy Millennials value digital access ahead of a relationship driven service.

Compared to their seniors, do you agree that the emerging wealth class (35 years or under) value digital access to their investment services before a relationship driven service?

- Strongly agree: 21.5%
- Agree: 34.2%
- Neither agree or disagree: 17.7%
- Disagree: 22.8%
- Strongly disagree: 3.8%

“They [Millennials] prefer digital access, it’s their natural way of communicating. The idea of speaking face-to-face with someone isn’t a normal interaction.”

Survey respondent
We anticipate that the real challenge for firms will be to deliver both digital environments and client relationships that stand out from the crowd.

Which of the following factors do you think will most drive competition in the wealth sector? (1 = Least, 10 = Most)

<table>
<thead>
<tr>
<th>Factor</th>
<th>Score</th>
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</thead>
<tbody>
<tr>
<td>Digital platforms resulting in increased portability of client choice</td>
<td>6.76</td>
</tr>
<tr>
<td>Better data analytics enabling more specialist managers/strategies</td>
<td>6.45</td>
</tr>
<tr>
<td>Established technology brands entering the market</td>
<td>6.44</td>
</tr>
<tr>
<td>Smaller managers leveraging their businesses through online platforms</td>
<td>5.94</td>
</tr>
<tr>
<td>Speed to market of new online brands/platforms</td>
<td>5.77</td>
</tr>
</tbody>
</table>

The only clear conclusion that can be drawn here into the ways in which technology could drive competition, is that there is an expectation of more competition! Of the stimulants to competition listed, participants pointed first to platform development in that it will be easier for clients to switch accounts – and this answer is in and of itself rooted in an anticipation of a more competitive environment. The threat of disruption from new market entrants, whether established technology brands or start-ups, also featured prominently.

75% felt that over the next 5-10 years technology will drive greater consolidation.

But a number of respondents observed that consolidation is already happening due to subscale businesses suffering lower returns in a low interest world and from the burden of regulation – regulation being cited as the top driver for consolidation.

Numerous respondents pointed to whether a firm had legacy or new IT as itself being a factor in determining on which side of the M&A table it would sit.

"Firms with legacy IT with no capacity to modernise or scale are likely to be absorbed ... firms may acquire more agile and technologically savvy firms to accelerate their transformation programmes."

Survey respondent
Impact of change

There was a clear consensus that technology will have the greatest impact across smaller accounts. However, interestingly there were strongly opposing views held on the Ultra High Net Worth and Institutional categories, with a roughly 50/50 split between those expecting change and those not.

Our own experience at least is that the greater volume of business model innovation is currently occurring in the Affluent, Emerging Affluent and Saver segments.

“I think that the impact [of technology] will be pretty significant across all [client] segments. I think you have to be pretty naïve to think that wasn’t going to be the case. I also think there is a bit of perception that Ultra High Net Worth Individuals aren’t interested in digital technology. Actually, anything that makes people’s lives genuinely easier I think is agnostic of clients.”

Survey respondent

What do you think the impact of technology will be on the following investor categories, in terms of driving change?
“The main thing is making the back office delivery of your business really efficient.”

Nicholas Lambert (Partner, Sarasin & Partners)
It was felt that the greatest opportunity for growth driven by technological innovation is in the execution-only sector, as distinct from discretionary or advisory. This perhaps illustrates an expectation that technology can serve to enhance investor knowledge and automate tasks, so encouraging greater direct involvement by investors. HM Treasury’s September 2016 consultation on narrowing the regulated definition of ‘investment advice’ is intended to clear the way for the industry to present non-advisory tools to clients with greater confidence.

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To what extent is there an opportunity for technological innovation to drive growth in UK users for the sectors below? (1 = lowest opportunity, 10 = highest opportunity)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Execution only</td>
<td>8.60</td>
</tr>
<tr>
<td>Discretionary</td>
<td>6.75</td>
</tr>
<tr>
<td>Advisory</td>
<td>6.75</td>
</tr>
</tbody>
</table>
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Rank the following in terms of the most important factors where you see technology having the greatest potential to deliver a competitive advantage to your firm’s business. (1 = most, 5 = least)

<table>
<thead>
<tr>
<th>Factor</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enhanced customer engagement &amp; service functionality</td>
<td>2.07</td>
</tr>
<tr>
<td>Efficiency &amp; effectiveness of back office</td>
<td>2.70</td>
</tr>
<tr>
<td>Investment performance</td>
<td>3.21</td>
</tr>
<tr>
<td>Targeting wider customer base</td>
<td>3.40</td>
</tr>
<tr>
<td>Better data interrogation capability</td>
<td>3.60</td>
</tr>
</tbody>
</table>
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Technology is seen as a way to enhance customer engagement and service functionality, more so than just to improve efficiency. However, the wealth sector is clearly not a complete convert with respondents indicating some circumspection as to the advantages of targeting clients through new media channels or the advantages to be gained by improvements in data analysis. We believe new technologies will play a significant role in driving down costs of supplying investment advice and management services – enabling firms to recognise efficiencies for their client base, and at the same time enhance the overall client experience.

“IT IS IMPORTANT TO ENSURE THAT ANY NEW TECHNOLOGY SOLVES MORE PROBLEMS THAN IT CREATES AND THAT IT IS NEVER REGARDED AS A SUBSTITUTE FOR REAL PROFESSIONAL KNOWLEDGE.”

Survey respondent
Attitudes to ‘robo’ platforms and passive strategies

In the UK market there is an increasing need for individuals to take more responsibility for their own financial future and some legislative developments such as the introduction of additional pension flexibility have already shone a spotlight on this. In March 2016, HM Treasury and the FCA published their final report following the Financial Advice Market Review (FAMR). One of the outcomes of FAMR is the UK Government’s support for the development and delivery of mass market automated advice models that have the potential to bridge the ‘advice gap’, whether they are fully automated, hybrid (i.e. with human interaction in the process) or use tools to bring efficiencies to the face-to-face advice process.

In a speech in April 2016, Tracy McDermott former acting FCA CEO addressed the role of technology in bridging the ‘advice gap’ stating that “automated advice offers the chance of ensuring consistent outcomes, thanks to automation and the ability to minimise the risk of human error. Take, for example, ‘robo-advice’ ... while it won’t be for everyone, it has the potential to be an extremely effective way of providing more affordable and engaging advice for many consumers.”

“Digital will enhance the client relationship in whatever format. Today’s client service represents nothing like the service that will exist in five years’ time.”

Nick Hungerford (Co-Founder and Non-Executive Director, Nutmeg)
Do you think so called ‘robo-advisors’ that provide direct-to-client automated advisory services and/or asset selection services will grow in terms of market share over the next 5-10 years?

- Yes, exponential growth: 21.8%
- Yes, steady growth: 34%
- Yes, some growth: 33.3%
- No growth: 0%
- Don’t know: 3.8%

To what extent is there potential for ‘robo-advisor’ models to attract clients that are currently paying for a traditional advised/managed service?

- Significant potential: 3.8%
- Some potential: 73.1%
- No potential: 20.5%
- Don’t know: 2.6%
On balance the majority agree that the adoption of passive management strategies will increase over the next 5-10 years, compared to active management strategies. Although a significant 25% were undecided, the bulk agreed that passive strategies could become on a par with active strategies. This question, however, stimulated a lot of comments from respondents, not least flagging the need to take cautionary account of the whereabouts of the economic cycle and the need to properly consider actual client needs.

“Passive management tends to focus on market index returns – the attraction to passive comes at the top of the market cycle. But for UHNWIs this is rarely an appropriate benchmark. Risk management and overall wealth protection are more relevant.”

Survey respondent
Regulation and risk

There were strong divergent views as to the impact technology will have in terms of regulatory compliance:

35% felt greater adaptation of technology would increase the risk of breach/enforcement, but

46% felt it would decrease this risk.

Perhaps the contrasting responses indicate that: on the one hand there are those who envisage technology being used to deliver compliance and risk management tasks more efficiently and with reduced human error (RegTech); and on the other hand there may be those who envisage technology being used to create new ways of investing and doing business, so raising the prospect of as yet unknown systemic/business model risks.

What impact do you think increased adaptation of technology in service delivery will have in terms of regulatory compliance risk (i.e. increasing/decreasing the prospect of regulatory breaches)?

<table>
<thead>
<tr>
<th>Impact</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decrease</td>
<td>46.2%</td>
</tr>
<tr>
<td>Increase</td>
<td>34.6%</td>
</tr>
<tr>
<td>Stays the same</td>
<td>17.9%</td>
</tr>
<tr>
<td>Don’t know</td>
<td>1.3%</td>
</tr>
</tbody>
</table>

“On the one hand if you use technology it means you have a process, so it should decrease compliance risk. Equally you have got the prospect of systemically poor advice. In the main, compliance risk is going to stay the same.”

Jason Hollands
(Managing Director, Tilney Bestinvest)
Not surprisingly, cybercrime was seen as the stand out business risk deriving from technological innovation, followed by IT failure. Respondents were more confident when it came to investment performance, with only modest concern that use of platforms could lead to over-concentration, or reduced ability to respond to volatility. The concern that technological innovation could lead to a lack of suitability ranked highly – perhaps the FCA’s 2015 Thematic Review on Suitability of Investment Portfolios (TR15/12) is still ringing in the ears.

Rank the following in terms of the greatest business risks deriving from technological innovation? (1 = greatest, 5 = least)

<table>
<thead>
<tr>
<th>Risk</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cybercrime</td>
<td>1.91</td>
</tr>
<tr>
<td>IT failure</td>
<td>2.98</td>
</tr>
<tr>
<td>Failure to deliver suitability/appropriateness over time</td>
<td>3.08</td>
</tr>
<tr>
<td>Over-simplification leading to over concentration of asset selection</td>
<td>3.43</td>
</tr>
<tr>
<td>Platforms less able to react to extreme market events</td>
<td>3.51</td>
</tr>
</tbody>
</table>

To what extent could the following drive consolidation in the wealth industry? (1 = least consolidation, 10 = most consolidation)

<table>
<thead>
<tr>
<th>Factor</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Burden of regulation</td>
<td>7.75</td>
</tr>
<tr>
<td>Scale required to do business</td>
<td>7.73</td>
</tr>
<tr>
<td>The need for efficiency in developing technology</td>
<td>7.06</td>
</tr>
<tr>
<td>Move towards more multi-channel businesses</td>
<td>6.09</td>
</tr>
<tr>
<td>Move towards more international businesses</td>
<td>5.65</td>
</tr>
</tbody>
</table>

There was far greater uniformity of view as to the burden of regulation. As mentioned previously, this was seen as the most likely driver of consolidation (ranking ahead of other imperatives such as developing multi-channel businesses, internationalism and efficiency of technology adaptation).
Final words ... Brexit

It is interesting to read Andrew Bailey’s (CEO of the FCA) letter (August 2016) to the Chairman of the Treasury Committee in response to a request for information on EU single market passporting numbers. There is significantly greater UK inbound traffic in the banking and insurance sectors (1,278 passport into the UK, only 322 passport out). This perhaps illustrates the overall numbers of UK/EU firms in these sectors and the desirability for mainland EU banks and insurers to have a foothold in London. However, 2,250 investment firms passport out of the UK, compared to just 988 passporting in from the rest of the EU, indicating the strength of London as an international base for investment firms, with the ability to passport into the EU clearly playing some part in this.

What these figures strongly underline is the need for Brexit negotiations to deliver a framework in which these thousands of cross border relationships are protected as far as possible, with properly considered transitional and grandfathering arrangements designed to minimise disruption and uncertainty to both businesses and clients.

These figures demonstrate a high relative value of the single market passport to the wealth management sector although the actual value is harder to discern and is disguised by a very wide range of factors. Even before counting the prospect of any ongoing rights secured under Brexit negotiations, our clients are already looking at the status quo, in particular:

1. The existing EU framework most relevant to wealth management, MIFID (to be updated by MiFID II/MiFIR – effective 3 January 2018), contains rights for ‘third country firms’, with the UK highly likely to be assessed as ‘equivalent’ for these purposes. These rights could, with some adjustment, provide valid operating environments for some businesses.

2. If a business found it necessary to obtain a licence in the EU, in contrast to capital heavy operations such as banking and insurance, there is more scope to find efficient ways of doing this.
Our Financial Services Regulatory practice

Taylor Wessing is a global leader in the technology sector and has worked with companies across the financial services industry for many years, advising in respect of current and emerging technologies. Technology is increasingly being used to support the delivery of financial services, generating growth in the FinTech market. This evolution brings numerous legal challenges, which Taylor Wessing is ideally placed to solve wherever a client is at in their corporate lifecycle.

Our dedicated financial services regulatory team has deep expertise guiding wealth management businesses through the regulatory issues and hurdles that apply to the development of innovative services and products.

As a full service law firm, our financial services regulatory team works seamlessly with experts from other Taylor Wessing teams to support the financial services community on issues including:

- New business establishment, including FCA/PRA licensing
- M&A and capital market deals involving regulated businesses, including regulatory due diligence
- Corporate restructuring and insolvency
- IP, commercial and consumer law
- Data protection, privacy and cyber security
- Corporate tax and employee incentives
- Senior manager and employee misconduct
- Reputation management
- Regulatory disputes and investigations, including financial crime.

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“Jonathan Rogers provides counsel for clients including insurance companies, fund managers and banks on the total landscape of regulatory change and development. He is praised for his ability to offer counsel which is ‘succinct, pragmatic and easy to convey to non-lawyers at a senior level.’”

Chambers 2016
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- Life Sciences
- Energy
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