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Next-Generation Outsourcing for Wealth Managers: Riding the Wave of Converging Business Trends

A critical shift in thinking is under way among wealth managers, as several converging business trends encourage a comprehensive review of how their firms operate. First, a flood of game-changing technology innovation is enriching the role and value of data, just as wealth clients and regulators escalate their demands for greater access to information. At the same time, emerging business and organizational models emphasize the advantages of collaborative relationships with third-party providers over the traditional model that keeps functions linked together in-house. In addition, value-added service is making a comeback as a critical market differentiator to complement technology.

The result of these trends is the transformation of an old idea — outsourcing — into a fundamentally new way of delivering services, with advancing technology rapidly coming on-stream to weave together client and third-party provider relationships. While the option to outsource has long been on the table, opinions on its merits have differed. Now, outsourcing is rapidly gaining traction as wealth managers — pressed to squeeze more value than ever from their business operations — are taking a longer look at how leveraging external resources can help them do that.

As the evolving architecture of outsourcing redefines the landscape, it will offer wealth managers access to a dramatically expanded range of capabilities while helping them reinforce their own core role. Looking ahead, the emerging paradigm for outsourcing's next generation includes a far wider range of standardized service models, "private label" opportunities, cost structures geared to market conditions, and new approaches to delivering and supporting business processes.

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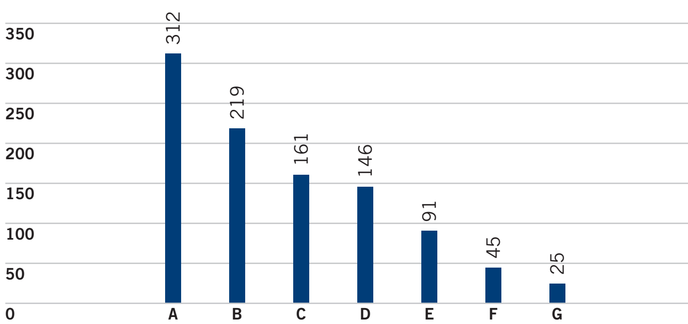
Feeling the heat today

For wealth managers of all types — from family offices to trust companies — today's volatile and complex environment is occupying their attention and leading to consideration of new options. Wealth managers confront a host of immediate challenges that make outsourcing a potentially attractive strategic option. Foremost is the struggle to improve profitability. At the same time as theyexperience downward pressure on revenues, amid uncertain markets and increasing competition, they must also battle to contain the upward creep of costs. A recent survey of chief operating officers at wealth management firms found that reducing costs through enhanced efficiency was the second most frequently cited business objective, after supporting and enabling business growth (see Figure 1).

Figure 1: Top business objectives for wealth management COOs



■ Sum of weighted ranked responses

A Supporting and enabling business growth
B Cost reduction through enhanced efficiency
C Risk management
D Becoming more customer-oriented
E Ensuring legal and regulatory compliance
F Increasing organizational change agility
G Setting up new operations/branches

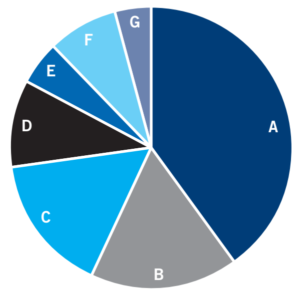
Source: PricewaterhouseCoopers Global Private Banking and Wealth Management Survey 2009.

Two cost drivers in particular — maintaining and upgrading technological infrastructure and ensuring a stable of talent to meet future needs — account for some of the most severe pressures on overhead, in addition to the expense of mitigating operational risk.

In the wake of the financial crisis, the compliance burden has grown more complex, as reporting and transparency requirements expand (and the rules charting the new territory are still far from being finalized). Similarly, private wealth clients are voicing new expectations. Their revised attitude toward risk management spurs them to seek greater transparency as well, not only about what is in their portfolios, but also about the health of their wealth managers' operations.

Driven in part by these transparency demands, wealth managers now spend 16 percent of their time on administration and error resolution — nearly as much time as they spend on marketing and prospecting, and double what they spend on investment research and analysis (see Figure 2). This new reality has led many firms to reexamine the outsourcing question.

Figure 2: How wealth managers spend their time



A. Contact with existing clients
40%
B. Marketing and prospecting
17%
C. Administration and error resolution
16%
D. Portfolio management
10%
E. Compliance
5%
F. Investment research and analysis
8%
G. Training
4%

Source: PricewaterhouseCoopers Global Private Banking and Wealth Management Survey 2009.

To outsource or not?

Across the wealth management community, a lively debate is under way over the comparative merits of outsourcing. The opposing sides represent two visions of the private banking sector, both of which evoke overlapping views about the principles that best define these banks' core services.

Historically, the major concerns about outsourcing have been that it could result in:

- Diminished control over a firm's essential functions, including protecting confidentiality and managing client relationships
- A risk for the wealth manager to become locked into suboptimal technology
- A decreased ability to customize services

Partly as a result of their efforts to address precisely these concerns, leading providers have raised outsourcing to an entirely new level. This transformation is thanks not just to state-of-the-art technology advances alone, but also to fresh approaches to service that put the client at the heart of the relationship.

Those who today favor outsourcing as a smart solution argue that it will enable wealth managers to:

- Rein in back- and middle-office costs, particularly for technology infrastructure, easing pressure on operating margins
- Align costs and revenue streams, mitigating the challenge of fixed costs that are uncorrelated with market conditions
- More effectively manage and distribute operational risk
- Access the most current technology through a provider, avoiding the expense of potentially wrong-footed technology decisions, as well as maintenance headaches
- Concentrate limited resources on upgrading their firms' high-level core business activities, such as client contact, portfolio management and investment research
- Enjoy comprehensive service backed by dedicated service teams, as opposed to the purchase of stand-alone software
- Leverage a provider's scalability and flexibility on behalf of clients, resulting in capabilities far beyond a firm's actual in-house resources, such as new markets and asset classes

In general, advocates view outsourcing as a timely strategy that addresses the critical challenges in today's wealth servicing market. While relieving private bankers of distracting administrative burdens and their associated costs, outsourcing frees them to focus on their traditional core client-facing strengths. Outsourcing's next generation surpasses this conventional formula by seamlessly leveraging a provider's capabilities, enabling wealth managers to enhance their own service offerings and affording them the latitude to broaden their operational perspective.

Deepening the marketplace through innovation

In today's outsourcing marketplace, providers come in many shapes, including tech-centric firms that focus on technology solutions. It is among financial services providers that some of the most striking innovation is emerging. In particular, leading custodians and administrators with wide-ranging global presence are both influencing and building upon the outsource-favorable trends now redefining the industry.

Anchored in the financial services industry, these third-party providers bring an affinity for the issues and concerns already familiar to wealth managers, based on their complementary expertise and experience. The best of their service offerings give clients a wide range of choices that include custody and the full portfolio of middle- and back-office functions. What places them at outsourcing's frontier is the key role that innovation is coming to play in their organizations, and technology represents only the most visible aspect.

Whether consistently building new solutions based on specific client feedback or embedding strategies for innovation across all client-facing functions, leading outsource providers now regard innovation not as a product, but as a continuous process and long-term investment in responding to pressing business challenges today, as well as anticipating future scenarios. The results of this approach: dynamic technology solutions and services that are rich in expertise.

Expanding Options

As next-generation outsourcing gains momentum, its range of responsive, flexible solutions continues to evolve, on both the technology and service fronts. Three pivotal models of technology outsourcing have emerged:

- **Outsourcing can easily accommodate the varied needs of clients that want to migrate, wholly or in part, to providers' best-in-class technology platforms. The result of deep and ongoing investment, these systems offer scale, speed and modular flexibility that even the largest wealth management firms could until recently only aspire to.**
- **As providers continuously improve their technology offerings by integrating the latest in third-party vendor systems, wealth clients enjoy the benefits, in cost and scalability, far beyond their size.**
- **Alternatively, some firms opt to develop their own proprietary systems for purposes of competitive advantage. Leading outsourcing providers can support this client-specific infrastructure, enabling firms to deploy their own technology while relying on external leading-edge expertise.**

As financial services outsourcing grows in scope and capability, this degree of flexibility will become a critical and distinguishing best practice.

Technology, a conundrum with a solution

As the outsourcing market expands, its dynamics are shifting, and the universe of experienced outsourcing specialists capable of delivering within the terms of the new paradigm remains limited. The prime reason for this is simple. As outsourcing's value proposition continues to evolve, the resources — in technology, talent and service — necessary to put it into practice are substantial. The critical role of technology, in particular, is the greatest differentiator.

For wealth managers, technology represents both a barrier and a gateway. Indispensable to their operations, it is also a huge and problematic cost center. Asset managers cite disaster recovery systems requirements as the top factor causing their IT costs to rise.[1] Technology costs associated with data warehousing and compliance management also loom large in budgets today. As technology and the needs it addresses grow more complex, maintenance and upgrades consume ever more resources. This is a particular challenge as legacy infrastructures fall behind the innovation curve and systems integration presents difficulties that can result in costly errors. Yet increasingly, participating in the technology race requires running faster to stay in place.

Leading outsource providers have learned that committing to deep investment in technology can yield breakthrough results. Their integrated best-in-class platforms enable high-speed automated processing capable of seamlessly integrating information in a way that is scalable for clients of all sizes. Flexible open architecture can accommodate both regulatory and financial product shifts, along with seamless software upgrades.

With the door now open to the commodification of data, real-time Web-based dashboard access to information can become standard practice. Providers also keenly recognize, in their systems architecture, the importance of achieving trusted solutions to address data security and other operational risk issues. This leading-edge approach to outsourcing technology makes it possible to deliver and support information-rich business processes with remarkable flexibility.

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[1] Investment Adviser Association, 2010 Survey of Asset Management Industry Operations and Compensation Practices, p. 4.

Next-generation service

While technology provides the essential infrastructure for outsourcing, it is only part of the story. Equally vital are robust and affordable service models that help wealth managers achieve new levels of operating efficiency.

Outsourcing was once perceived as an inflexible, one-size-fits-all solution that seldom took into account a client's unique needs and business characteristics. Yet, given their core business, wealth managers value customization and control. To address this need, leading outsource providers have sought ways to allow for degrees of customization while building efficiencies of scale into their operations.

Striking this balance relies in large part on modularity — free-standing functional "lift-outs." Clients may prefer a tailored à la carte menu of services over a full suite. Modularity takes the standardized processes that characterize most back- and middle-office functions to a new level, allowing clients the choice of functions to outsource, as well as flexible tools that affect work flow, for example, and such wealth client-facing functions as portfolio management and reporting.

In addition, service level agreements (SLAs) oriented to the needs of wealth managers offer scope to enhance control and customize service. Ideally a reflection of a collaborative approach to outsourcing between client and provider, SLAs should specify not only service expectations but also how a provider's performance will be tracked, including all metrics, key performance indicators and qualitative assessments.

Thus, as outsourcing moves into its latest phase, it opens the door to intriguing opportunities for "private label" branding of the tools that wealth managers adopt. In today's data-intense environment, wealth managers will be able to influence how data get enriched, produced, accessed and leveraged. For example, Web-based dashboards could be configured to reflect a client's operating business principles and priorities.

Gaining ground on costs

Besides technology and technology-enabled service, outsourcing must also deliver cost benefits. Recent volatility has shown the risks wealth managers incur when overhead is fixed despite market conditions. Outsourcing offers a means to better align costs with revenues. Leveraging a provider's resources can also help shrink operating costs, such as those associated with processing. It also enables even small firms to realize scale far beyond their size (an important competitive consideration) as they draw upon a provider's multi-tiered technology investments and relationships.

Choosing your partner

Depth in technology coupled with expertise introduces today's wealth manager to a spectrum of business continuity solutions and capabilities through outsourcing that are, in practice, otherwise beyond the reach of most. That said, not all providers are equal. Choosing a provider is a critical task that should be approached in the spirit of strict due diligence. Adhering to a few key selection criteria can make all the difference.

An ideal provider will:

- View outsourcing as a partnership, versus a vendor relationship
- Demonstrate longevity and financial stability
- Offer a robust service platform
- Show deep expertise and investment in technology and compliance
- Operate globally and in multiple regional markets
- Offer á la carte capabilities and flexible SLAs

Riding the wave

In its current stage, outsourcing through world-class financial service providers is poised to give wealth managers and their end-clients access to remarkable service capabilities. The headway created by today's innovation is likely to extend the arc of development even further as providers ensure their own readiness to meet future regulatory and investment needs. As innovative, partnership-based business models and the technology to support them expand the options available to wealth managers, outsourcing will continue to gain momentum as a compelling business strategy.

For wealth managers, client service sits at the apex of their business pyramid. In the emerging outsourcing paradigm, it will continue to occupy that position. As a result, wealth firms will be able to redeploy their resources toward concentrating on the core competencies that distinguish them, even as they leverage the resources of their provider partners to offer breakthrough services.

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