

# How Swiss wealth managers can keep flying

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**T**he thought-provoking cocktail of digital (technology) disruption, low yield environment and the rise of passive investment products is severely impacting the traditional Swiss wealth management and many players are not prepared for it.

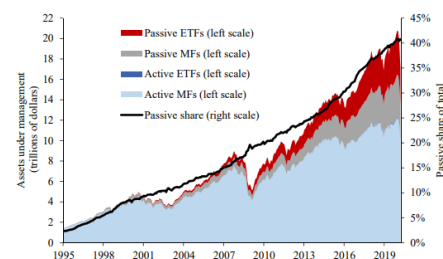
## 1 A perfect storm

During the past decade, the wealth management industry has been subject to an increasing pressure to innovate its core activities. This affects both, the investment department as well as customer relationship management. In single-stock and bond picking, traditional wealth managers are facing increasingly fierce competition from low fee passive products and systematic approaches such as factor-based processes. The integration of these third party products in client portfolios often raises questions about the added value of traditional wealth managers.

At the same time, the new crowd of “robo-advisors” attempts to commoditize the asset allocation while offering a seamless digital onboarding and portfolio implementation process. Fortunately, despite huge support from venture capital, the success of fully digital wealth management offerings has so far been limited. We suspect that they do not yet cater to the typical Swiss wealth management clientèle that appreciates the personalized and trust relationship offered by established firms.

However, this can change swiftly as changing consumption patterns in other industries have shown, exacerbated by the inevitable generational shifts among relationship managers as well as on the client side. We expect the new generation of customers to judge wealth management services differently and compare them directly with the more efficient standards enabled by technological progress. This process will be exacerbated by the following developments:

Figure 1: Total assets in active and passive MFs and ETFs and passive share of total



Source: Morningstar, Inc.

Figure 1: Money is flowing into passive - Kenechukwu Anadu and Osambela, 2018

- The low or negative yield environment reduces expected future returns on investments and thereby unfavorably impacts the ratio between total expenses (wealth management fees, custody fees, transactions fees, . . .) and the expected gross return. Over the past years, strong performance of Equity and Fixed Income on the back of falling yields could somewhat disguise the deterioration in expected returns. However with risk free rates at or below zero in all major developed markets the potential for further price gains is rather limited today.
- The rise of low-cost investment solutions provides clients with a perfect yardstick to judge the performance of pricier active portfolios, be it investment funds or wealth management accounts. Furthermore, the wide range of ETFs enables the robo-advisors to easily replicate a standard asset allocation, which as studies have shown tends to be the main return driver (see for instance Brinson and Beebower, 1986). With a growing landscape of more sophisticated systematic thematic, factor-based and multi-asset products, this is not only affecting benchmark huggers but also previously more differentiated offerings.

- Regulatory and jurisprudential pressure alongside the new digital offerings results in increased transparency, which allows clients to better assess the costs/benefit ratio of wealth management services and results in declining revenues from retrocessions.
- At the same time, the regulatory and legal environment results in a significantly higher cost base, not only in wealth management but in the financial industry in general.

Combined, these points provide a perfect storm, putting severe pressure on revenues and margins. While strong market performance has counterbalanced these factors over the past decade with extremely low expected returns, the outlook is now increasingly gloomy.

## 2 We have seen this before

This explosive cocktail reminds us of the massive changes the airline industry had to undergo, especially in Europe, following a series of deregulation measures in the 90' followed by the proliferation of the internet. The new regulatory environment significantly reduced market entry barriers and allowed innovative businesses to lower fares while capturing higher margins.

This was achieved by rigorously cutting non-essential costs. On the one hand, the new competitors introduced a no-frills product, relying on streamlined online booking, cutting out costly travel agencies and abandoning fidelity programs and IATA membership. On the other hand, starting from scratch provided them with the possibility to bet on a highly standardized, modern fleet of aircrafts, reducing maintenance cost while increasing negotiation power with aircraft manufacturers, flexibility in crew management.

Today, there is no doubt that the rise of these new offerings has had a permanent impact on the industry, forcing existing businesses to adapt with often limited success. The once so mighty national carriers are fighting for survival rescued again and again by governments for dubious nationalistic reasons (subsidy, airport slot protection, lax anti-trust law enforcement).

### 2.1 Why wealth managers should study Ryanair and Easyjet

Just like the low-cost carriers in the airline industry, the new players in wealth management offer a no-frill core product in a streamlined manner and for a disruptive price. While in the case of an airline the core product consists of safely bringing the customer from point A to B, for the “robo-advisor” it means building a standard portfolio that is more or less in-line with the client’s ability and willingness to take risk. In both

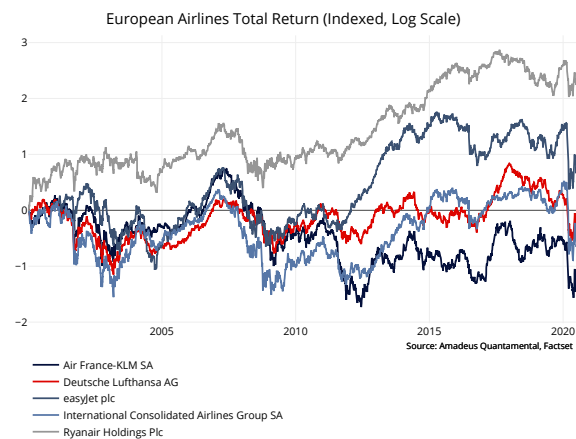


Figure 2: It seems clear who added more value

cases, there is no fancy personalized service and core product can be benchmarked against that of the incumbents. Most importantly, both business models rely on the internet as the primary medium of communication and exchange of information, allowing a 24/7/365 point of access. In order to deliver these core services at a disruptive price the new business models had to invent new ways of operating which incumbents are noting and trying to replicate. This has not occurred yet in the traditional wealth management industry as they felt immune to this threat, believing that their clients would never want the “Easy Jet” solution. However, our view is that they are missing a key point and the airline industry can again serve us with a good example. The low-cost carriers initially targeted the mass market segment as they heavily relied on volume to achieve maximum occupancy rates but they eventually impacted all segments, including the business and first class.

- In the short haul segment, where comfort matters less to clients, many routes are now exclusively served by low-cost carriers as incumbents can not operate them cost efficiently enough. Here a parallel can be seen with the rise of ETFs versus active management.
- The distribution side of the airline business has been impacted across all price segments. Efficient online booking portals make traditional travel agencies redundant even for less price sensitive customers.
- As the traditional carriers had to adopt their business models, copycatting most of the new processes, the new entrants started to propose limited key aspects of the premium services reducing the disparity of the offerings.
- Beyond that, the low-cost carriers put a precise price tag on every single service they offer, from the option to choose certain seats choice to on-board catering and entertainment. To the customer it comes down to the simple question: If I can fly a route for 100 Euros, what extra service

do I get for 500. Maybe not the same experience but the same journey.

We think that the wealth management industry will have to rapidly confront these structural challenges and only players who are able to adapt and offer a more differentiated and streamlined service/experience will be able to prosper and survive in the medium-term.

## 2.2 A modern fleet is half the battle but don't forget the tomato juice

**Digital as a communication tool:** The way we consume services has been profoundly changed with the internet. We can access information, buy almost any type of good, order our preferred restaurant dish, manage our bank-accounts, communicate with friends and family whenever we want to without being subject to the constraints of regular business hours. We strongly believe that this is of great value (or a given?) for a new generation of clients and key in their assessment of a service's quality. While the personal interaction with their wealth manager will remain important, as the basis of mutual understanding and trust, the ability to obtain relevant information at any desired time will be key as well. For the wealth manager, this can provide a great opportunity to enhance customer experience while streamlining interaction and thereby reducing costs if the right digital tools complement the existing offering.

- Amadeus has developed an online tool allowing the client to monitor their accounts and is developing an App allowing them to play with their asset allocation in order to better understand the risk/return consequences of allocation decisions. The App also deliver several easy to understand tutorials on various financial instruments that the clients can review at their own pace. This leads to more effective meetings as all parties start better prepared and informed.

**Technology as a counterforce to the incremental cost increases** stemming from increasing administrative burden related to client-onboarding, KYC procedures, risk profiling. The time and effort it required to on-board a client has drastically increased in recent years as AML procedures have been extended and wealth managers are obliged to assess the risk profile of every single clients. In most wealth management companies this process is still paper based not allowing any efficiency gains and making the on-going monitoring cumbersome. As these checks have to be duplicated for the banks the process becomes even more fastidious.

- Amadeus is developing a mobile onboarding App allowing a more efficient process, while enhancing the client's experience. The App permits to determine the client's risk/return profile and defines goals for the mandate. Automated background

checks allow us to immediately address potential issues with the client. A digital protocol enables to monitor the client relationship more efficiently and seamlessly share all relevant information with the PMS.

### **Once clients have been onboarded and their risk profile and returns expectation agreed on, the wealth manager implements the selected strategy.**

This is the start of a marvelous journey as nothing stays static with the passage of time, be it due to changing market environments or new developments in the client's personal situation. To fully satisfy the client as well as the regulator, managers need to constantly review if the portfolio is in line with the stated objectives. This is often done through manual checks.

- At Amadeus we believe that this is prone to errors, does not allow a streamlined, cost efficient solution. Again, the client does not want to know how a service is executed but is only interested in the results being delivered. In this situation, technology actually enables a more personal experience as the digitalization and automation of replicable procedures gives the relationship manager more time for truly personal interaction with the client.

### **Finally, a wealth management client willing to pay premium fees expects a premium service in return.**

Quite often we hear that apart from trust and competency, the key differentiator in wealth management is to actually listen to the client and offer customized solutions instead of a standard product. We all want to feel special. In wealth management, many market participants try to give clients this feeling with nice entertainment and a lot of talking but at the end, especially in a more controlled and regulated environment, customers will only be impressed by actual results.

- Through our sister company, Amadeus Quantamental, we have developed strong capabilities in factor investing, allowing us to offer differentiated single-stock portfolios without feeding an army of buy side analysts. The output of our highly informative quantitative models and analysis can be visualized seamlessly through tailor-made reports readily available to the client. As we believe that experience is as important as getting the numbers right, our toolbox allows managers to directly integrate their judgement calls in the investment process and track the performance of these decisions.

In this case technology is actually not standardizing an offering but tailoring it to the specific needs of the client in a controlled manner.

### 3 Economy seats keep first class beds in the air

These limited examples, far from replacing the key USP of Swiss wealth managers will, we hope, strengthen the core offering in a way that allows us to effectively cash in on this USP. If you want your clients to continue flying first class, counterintuitively you need to integrate, what those serving the mass market are already offering. Just like in the airline industry there is demand for premium services but wealth managers need to be highly cost efficient in their standard processes to extract a sufficient margin from offering this premium experience. For Swiss, the nice flat beds, better entertainment services and better ground experience sold to business and first-class clients are the backbone of profitability but the airline as a whole can only function with tightly controlled costs and high occupancy in the economy class. Realizing efficiency gains not at the cost of the customer experience is the key challenge for every wealth manager who intends to stay in business for the next decades.

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