Wealth Management – What makes it different?

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A well known encyclopaedia defines Wealth Management as “an advanced type of financial planning that provides individuals and even families with private banking, estate planning, asset management, legal service resources, trust management, investment management, taxation advice, and portfolio management. Thus, wealth management encompasses asset management, client advisory services, and the distribution of investment products.” The asset management universe has many different worlds within it, all of which touch on Wealth Management. For many people, the goal is to manage portfolios of securities on behalf of themselves or clients. But this is a simplistic view and conceals a wide divergence in the business models of the different types of asset manager. The managers of institutional funds have a different modus operandi from those who manage hedge funds and this differs from the work patterns of the manufacturers of retail funds. Wealth managers are different from all of these: this article describes some of those differences and outlines some of the implications to the industry.

Not just securities …

Wealth managers deal in a more complex mix of assets than any other asset manager. Their clients (most likely) have share holdings, but they may also have bank accounts with the firm and they may wish to borrow money for particular purposes. These three business lines are core to any large wealth manager – asset management, banking and credit. Institutional managers focus on the first without concern (as it were) for the other two.

But, importantly, wealth managers are offering increasingly sophisticated financial planning advice to their clients. This may be by means of online offerings of different products – with suitable commentary on why a particular product is best for a specific situation – or by means of one-on-one sessions with an adviser who has access to a wide range of financial products to meet the complex client needs.

We work for people!

The most obvious difference is that the clients of a wealth manager are individuals – they are not a pension fund or a distributor. They are people who have placed a chunk of their available wealth with a manager to advise them or to manage directly on their behalf. Hedge fund investors are also individuals – but with wealth management we are talking about the firm taking a much more holistic view of the needs of that person.

People are much more likely to have personal desires and foibles than are institutions – where the investment decisions are usually driven by performance requirements over a long investment horizon. Individuals may wish to raise money for their children’s education – and the investments will need to be matched to that requirement; they may have received a bonus from work and this can be invested as a single lump sum. They may wish a regular income stream from their investments – a fixed sum of money every month, regardless of the actual income that the investments generate. They may have particular attitudes to the riskiness or the ethical nature of certain investments and they may be off the age at which they should be planning for retirement.
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Pension funds have a single aim – they wish to generate enough cash to pay their liabilities to their current and future pensioners. (See our articles on Liability Driven Investments in the July 2005 and November 2005 issues of this Review). Private individuals have a huge range of objectives – they may wish to preserve their capital for future generations or they may wish to generate enough money to pay school fees for their children. They may suddenly wish to raise a large sum (that yacht, you know …) or have a pot of gold to invest (great bonus this year …). The key thing is that there are as many sets of needs as there are clients; and these needs may change with startling suddenness. The wealth management firm has to be able to react to these different demands and offer individual services to individuals.

That sounds like an expensive way of working, and if the client doesn’t bring much cash to the table in the first place then the firm has a difficult tightrope to walk in terms of appearing to give a full and/or personal service while at the same time keeping their operating costs within the parameters of what they can charge.

And so are our business lines …

Of course, wealth management can mean a lot of things. There are a few principal divisions in the area:

A) High Net Worth / Ultra High Net Worth – This is the arena of the Private Banks where personal services and the availability of tailored products and advice are key to a successful firm. Charges here are likely to be higher than elsewhere, but the cost of servicing these high net worth clients is also significantly higher than for the other types of client. These clients are able to demand a high degree of responsiveness and individuality in the service they receive.

B) Affluent – the arena of the classic English stockbroker and private client asset manager. The services here may seem personalised, but very often the relationship managers may have hundred’s of clients they look after – so providing a real level of personally tailored advice is very hard. In these firms, the use of technology to provide the appearance of individualised services but actually providing a bulked up approach is key to financial success.

C) Mass Affluent – this arena is typically served by the online brokerages (TDWaterhouse, Barclays Stockbrokers for example). These firms will offer access to multiple products (for example, ISAs and SIPPs) either online or through a standardised approach. Reporting back to the clients is unlikely to be tailored – although the quality is increasingly sophisticated.

And where are we going?

Wealth management is going through a huge growth spurt. In the UK, particularly, we have been educated on the need to save more and to depend on ourselves for our pensions and long term security. As a result, there is an increasing demand on the provision of financial planning and investment services to the mass affluent: and the online brokerages and IFAs are all working to meet this challenge.

At the same time, there continues to be growth in the high net worth segment – we are all (well, maybe not all…) getting more affluent. The amount of money available globally in this sector has grown by some 28.7% (Source: Merrill Lynch / Cap Gemini) over the last three years (to close 2006) and this growth is accelerating. We see an increasing segmentation in this market where a small number of very large firms (UBS, Barclays Wealth, and Merrill Lynch among them) are offering a global service to global clients. These are facing competition for clients and are differentiating themselves by brand and by a ever-growing level of service. At the same time, there are a large number of mid-level firms who offer services to their local (whether national or regional within that) communities. The rapid growth in wealth in the BRIC (Brazil, Russia, India and China) countries and in Asia more generally is providing opportunities for both sizes of company.
And in the UK, there still remain one or two of the old stockbroker – giving a service that meets a local need and focuses on a more unsophisticated level of investment. But this is a gradually dying breed – over the last few years, many have predicted the demise of this sector. It remains, but over time it will get harder for these firms to survive in the face of competition from IFAs moving up and the big firms moving down.

Summary
Wealth management, as a business sector, faces a wide range of challenges. In next month’s Bluerock Review we focus on the issue of client servicing – seen by many CEOs as the most significant challenge they are facing.