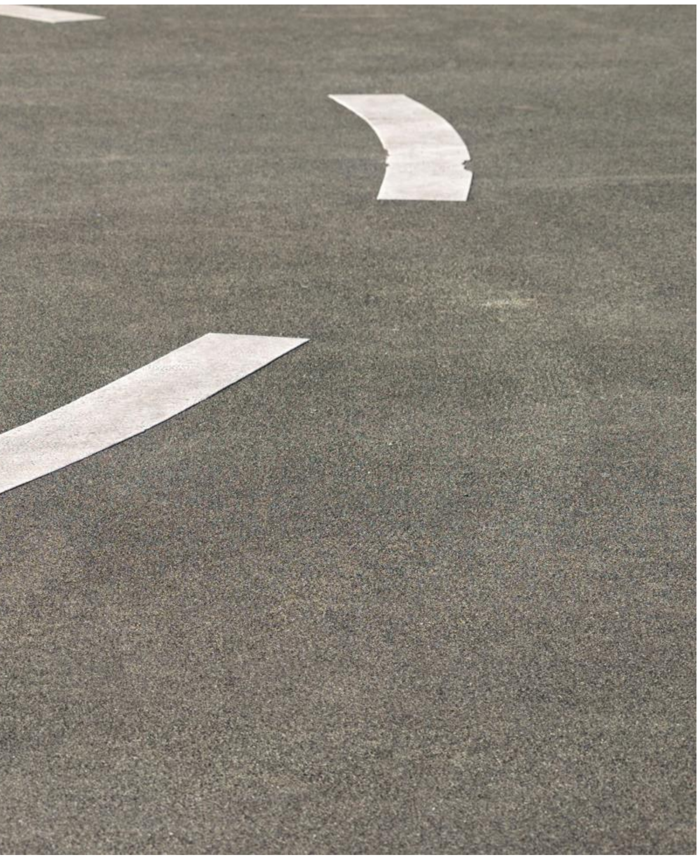
CAPCO

OPTIMIZING THE WEALTH OPERATING MODEL



OPTIMIZING THE WEALTH OPERATING MODEL

Overview

The wealth management industry is at a crossroads. Evolving client needs, disruptive technology and general cost, revenue and regulatory pressures are putting a strain on overall profitability. Firms continue to invest in obsolete, complex and rigid platforms that are decades old and cobbled together from mergers and acquisitions. Data has become siloed, making it more difficult to unwind manual processes and technology. The cost of investments to maintain the status quo continues to hamper the bottom line. As a result, wealth management firms continue to operate a suboptimal business model that prohibits growth. Firms must take steps now in order to transform the way they do business to manage a changing and challenging landscape.

Meeting and exceeding shareholder expectations on higher profit margins in the post-2008 financial crisis era has become increasingly challenging for wealth management firms. Improving business performance is paramount as firms continue to understand the myriad of changes affecting the industry. Total client assets reached an all-time high of $19.2 trillion at the end of 2015[1], a modest 4.1% CAGR since 2007. However, pricing pressures, increasing operating expenses and greater investment in capital expenditures (CAPEX) have narrowed overall profit margins, thus putting even more pressure on firms to continually reduce costs at a more dramatic rate.

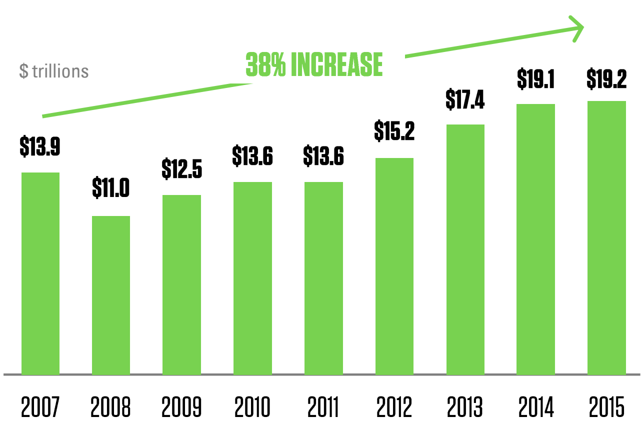


FIGURE 1. U.S. WEALTH MANAGEMENT INDUSTRY CLIENT ASSETS

Drivers for transformation

External pressures combined with enhanced client demands are driving transformation needs. Traditional operating models are not nimble enough to adapt to changing headwinds of the industry, which are occurring at rates unforeseen before.

EVOLVING CLIENT BEHAVIOR

- Changing demographics brings new perceptions, attitudes and expectations.
- Investors value holistic, goals-focused advice.
- There is a call for democratizing asset classes and investment strategies.
- Clients are showing increased interest in retirement planning.

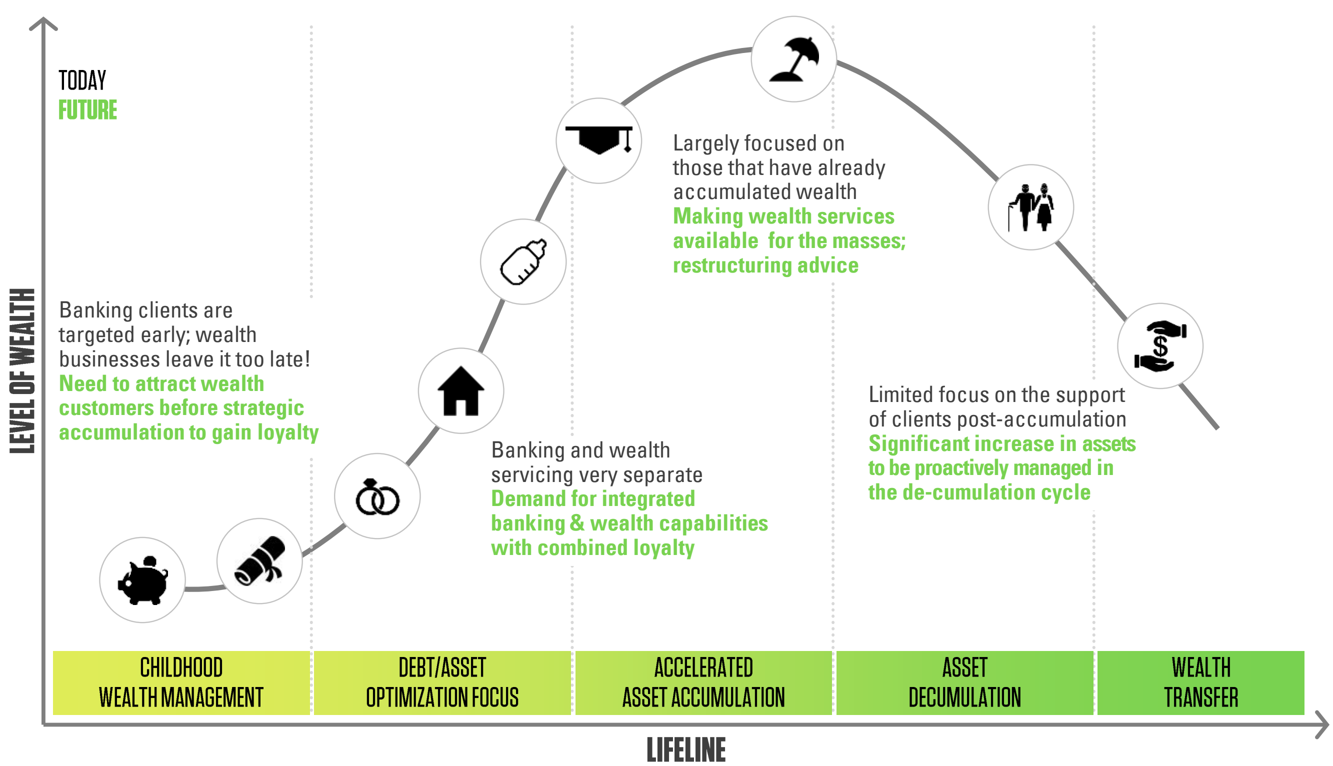


FIGURE 2. THE WEALTH MANAGEMENT LIFE CYCLE

There is a changing paradigm within the wealth management industry. Wealth management is evolving to support the masses (not just the already wealthy). Clients are becoming increasingly focused on managing wealth to meet life milestones and want holistic, value-focused advice, as opposed to the performance return-based model of the past.

REGULATORY PRESSURES

We expect to see an uptick in regulatory changes to major financial institutions over the coming years. The Department of Labor has rolled out their much awaited Fiduciary Standard for Retirement advice, and we continue to see regulatory authorities focus on transparency over advisor and firm compensation, transaction monitoring and controls, client protection, etc.

- Increasing regulatory burdens and reporting
  - Consumer protection
  - Financial products
  - Conflict of interest
  - Outsourcing
  - Cybersecurity
- Rising costs of risk
  - Trading practices, middle and back office
  - Compliance
  - Information management
  - Client onboarding
  - Portfolio management

DIGITAL

As technology advances, this will reshape the way that the industry conducts business and services its clients. We will continue to see a shift to automation in standard wealth management services affecting all levels of affluence.

- New models are emerging from innovations such as digital advice, crowdfunding and Blockchain
  - Over the next five years, the global assets under management of robo-advisors is forecast to grow to an estimated $255 billion, taking increasing market share away from traditional wirehouses and retail broker-dealers.
- Robotics and Machine Learning will change the way we execute our business models, providing more automated processing and predictive analytics that will provide greater business intelligence from front to back office.

FIRMS AND RELATIONSHIPS

- New firms and business models are driving competition for clients and assets.
- Established client-advisor relationships are at risk with impending wealth transfer.
- Advisors are retiring faster than the industry can find substitutes.
- Macro-environment challenges clients and advisors to identify best return/risk scenarios.

DOWNWARD PRESSURE ON FEES

We continue to see pricing pressures placed on the wealth industry, which is impairing top-line revenue. The industry as a whole is in a “race to zero” as it relates to fees and commissions.

- Clients are questioning the value of their wealth manager as service differentiation has become commoditized, and they are migrating toward lower-priced firms.
- The emergence of digital wealth management firms is providing alternatives for clients. As digital capabilities mature beyond just advice, this will enable lower price points (fees and commissions) and provide more competition.
- Technology and innovation will enable the proliferation of products and asset class access to all levels of affluence, such as Exchange Traded Mutual Funds (ETMF) that provide lower costs and greater liquidity. Investors can now build a very sophisticated, globally diverse portfolio at a much lower cost and with far better liquidity than five years ago.
- The enactment of the new Department of Labor Fiduciary Standard will be the first of a wave of regulatory changes over the next five to 10 years that will scrutinize advisor compensation and drive change to provide more transparency.
- Wealth managers will migrate toward a fee-based model of management, providing more enhanced wealth management services rather than the conventional “order taking.” As of 2015, 37% of accounts are fee-based, and this trend will continue to increase to 50% by 2025 as regulatory bodies and client demand continue to scrutinize the legacy commission-based model.

INCREASING COST PRESSURES

Based on our research, we have seen that, on average, wealth managers continue to struggle to control costs. Today's shifting landscape includes ever-changing regulatory mandates, legacy depreciating platforms that require significant investment for maintenance, and general deficiencies in the operating model that require greater headcount to execute Run the Bank (RTB) and Change the Bank (CTB) agendas. In the face of these changes, increasing operating expenses put an overall strain on historically tight profit margins.

- On average, operating cost-to-income ratios, a measure of operational efficiency, have been steadily increasing, from 79% in 2012 to over 85% in 2015, which continues to put pressure on overall profitability.
- CAPEX continues to rise as well, increasing from 13.5% of total costs in 2009 to over 16% in 2015.
- CTB spend has increased to comprise of over 40% of total IT costs, up from 33% in 2009. We anticipate total CTB spend to increase as regulatory bodies push down costly mandates and investment in digital technology increases.

Impact to wealth managers

As these macro and micro level forces continue to manifest across the industry, wealth managers are highly susceptible to the challenges facing them.

- Rapidly increasing cost and regulatory pressures are affecting bottom-line profit margins.
- Top-talent human capital is deployed across non-core business functions.
- Firms are highly invested in a commoditized middle- and back-office function, which detracts focus from core capabilities and service differentiation.
- There is a limited availability of talent to continually invest in platform enhancements.
- Legacy platforms lack modernization to attract financial advisors and clients.
- Processes, technology and data are siloed, which makes RTB functions cumbersome to execute and manually intensive.
- Antiquated clearing and settlement platforms and operational functions have a complex infrastructure and are costly to innovate.

Platform upgrades are critical to success.

"Wealth management firms continue to operate a suboptimal business model that prohibits growth."

Future of wealth: optimizing the operating model

Wealth managers that do not transform their operating model risk losing substantial wallet share to competitors that are investing in core business functions that provide competitive advantages, attract financial advisors, reduce operating costs and improve overall profitability.

The operating model is an absolutely critical framework that sets the tone for how businesses adapt and run, and it will ultimately determine their success and profitability. Hence, firms must transform the operating model, particularly in the face of a volatile and changing landscape. The target operating model for wealth management firms will have the following characteristics:

- Lower operating costs maximize near-term and long-term profitability.
- Variable cost base aligns to business volume and revenues.
- Financial and human capital is focused on core business differentiators to provide clear added value to clients.
- Regulatory and operational risk is reduced through improved controls.
- Business model and technology platform provide stability and scalability to adapt to changing environments.
- Technology platform is a source of competitive advantage and a tool that attracts advisors and clients.
- Functional processes are automated, improving operating efficiency as well as reducing manual intervention and error rates.
- Commoditized aspects of the operating model are outsourced to leverage community-based investing.

Desired target state operating models

Capco focuses on optimizing the wealth operating model to improve the overall cost base, operating efficiency and value proposition. We work with our clients to determine the optimal approach based on numerous quantitative and qualitative factors. We are well versed and have experience with each of the following models:

VENDOR TECHNOLOGY MODEL

Wealth manager outsources technology platform to enable core back-office functions, such as clearing and settlement, asset servicing, margin, etc. Firm resources are utilized for RTB functions, thus keeping institutional knowledge in-house. This model allows firms to remain self-clearing whilst maintaining some level of platform control.

Key benefits

- Cost base will be variable based on transaction volumes (trades, journals, wires) with a minimum threshold.
- Platform enhancements, maintenance and regulatory costs are absorbed by service provider and distributed across clients.
- Platform scalability is improved, allowing for greater business scale and improved service.
- Firm maintains flexibility and control over the platform and operational processes and procedures.
- Total cost savings is attained from reduction in IT and operations headcount.
- Error rates are reduced and process efficiency is increased due to more automation and less reliance on manual processes.

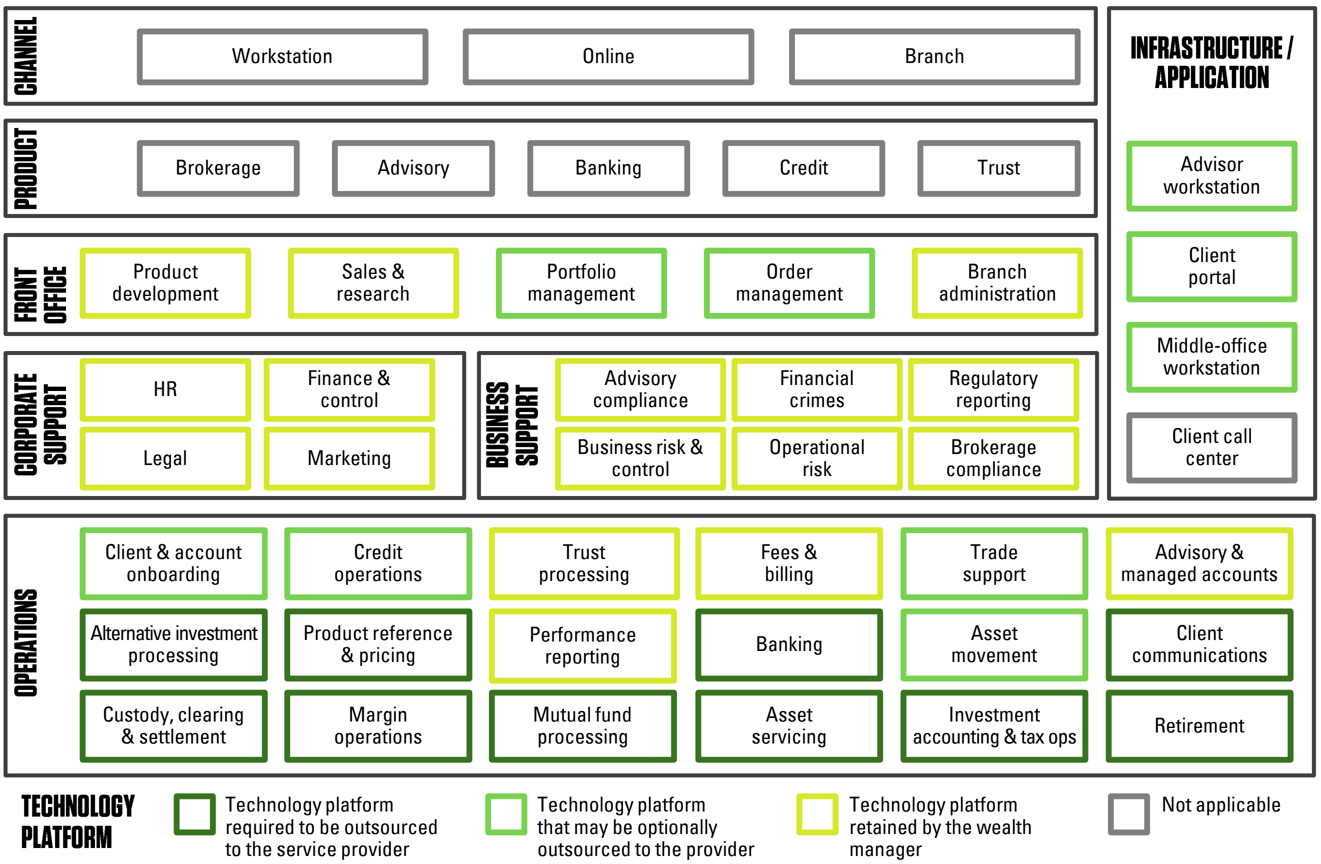


FIGURE 3. WEALTH TECHNOLOGY OPERATING MODEL IN A VENDOR TECHNOLOGY ARRANGEMENT

In the Vendor Technology model, core processing and back-office technologies are outsourced to the service provider. Depending on the vendor, they may provide additional capabilities, such as the advisor workstation, client portal and middle- and back-office tools, which provide for a more integrated experience.

HYBRID OPERATING MODEL

This is a combination of IT Outsourcing (ITO) and Business Process Outsourcing (BPO) on surgically selected functions that require cost optimization to develop a "best-of-breed" platform. The core processing technology platform is outsourced to a vendor, as well as additional non-core processing functional capabilities that exhibit higher-than-benchmark run rates and cost of ownership. In addition, operational (RTB) resources are outsourced in a BPO arrangement in order to maximize cost savings. In this model, firms retrain self-clearing status whilst optimizing their operating model.

Key benefits

- Cost base will be a hybrid with a variable base for the ITO component and typically a fixed fee for the BPO component.
- Self-clearing status is maintained.
- Best-of-breed operating model and core differentiating technology are based on business priorities.
- Platform functionality can be enhanced fairly rapidly.
- Greater cost savings are realized as a result of technology platform and resource outsourcing.

FULLY DISCLOSED MODEL

Wealth manager outsources all middle- and back-office technology, operations, and balance sheet to fully disclosed service provider (correspondent clearing firm). Firm relinquishes self-clearing status and platform control. Service provider assumes balance sheet and is responsible for day-to-day funding, in addition to settlements and working capital requirements.

Key benefits

- Balance sheet relief – All customer debits and free credits are converted to service provider, therefore minimizing capital requirements for FOCUS reporting.
- Reduction in working capital – Service provider is responsible for working capital and funding settlements.
- Total cost savings – Approximately 20% cost savings are typically achieved from technology and operations displacement for core functions.
- Reduces platform reinvestment – Platform upkeep and enhancements are based on community investment and absorbed by service provider and amortized across all clients.
- Increased focus on core differentiators – Service provider is responsible for core processing technology and operations, allowing the correspondent to focus on value-adding functions/technology core to the business.
- Shared regulatory obligations – Service provider takes responsibility for some regulatory obligations (e.g. SSAE 16 audit). Service provider will fulfill some regulatory obligations on behalf of the correspondent: OATS reporting, TRACE reporting, MSRB reporting, Mutual Fund 22c-2 Market Timing Surveillance, etc.).

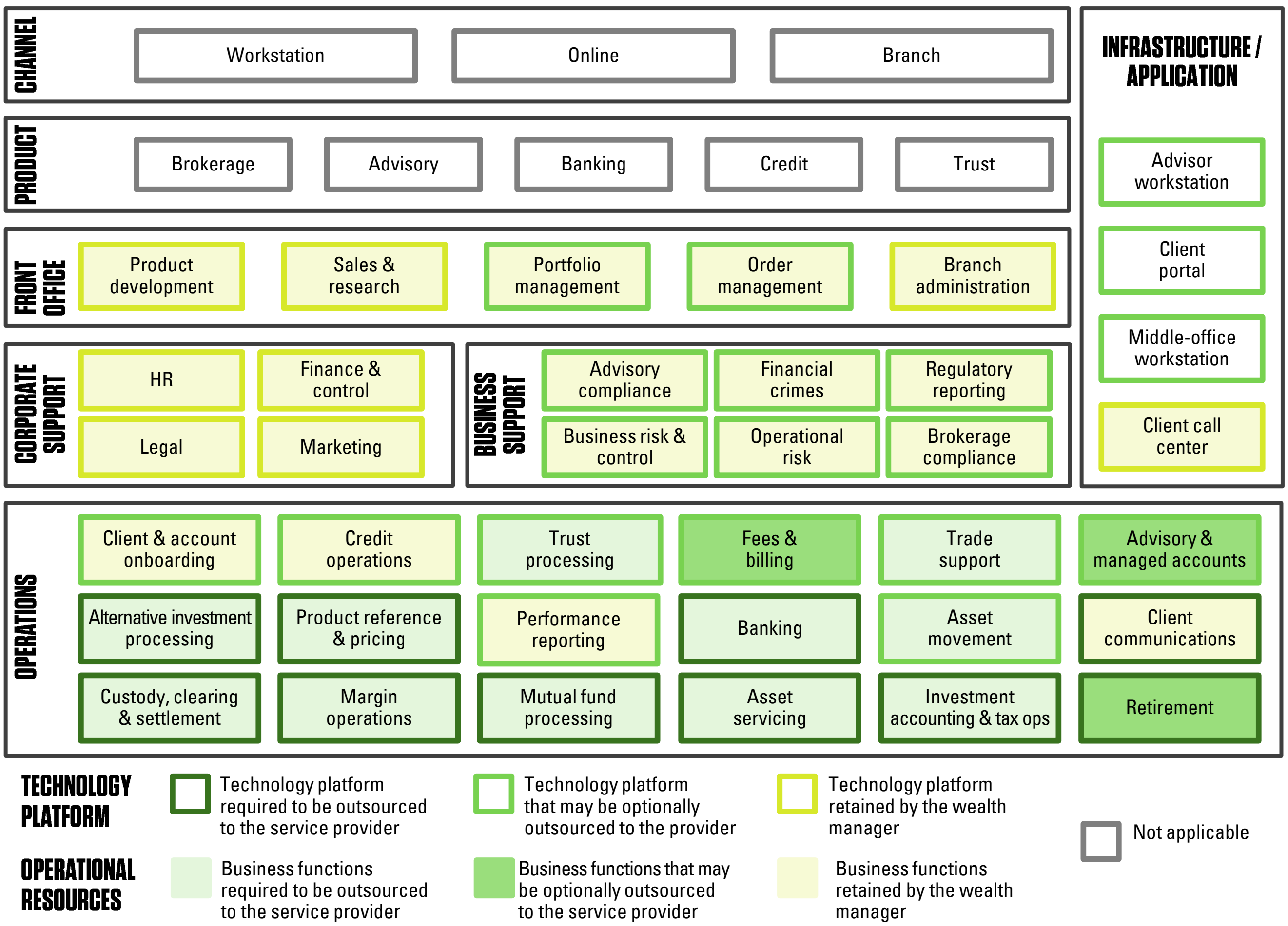


FIGURE 4. THE WEALTH FUNCTIONAL AND TECHNOLOGY OPERATING MODEL IN A FULLY DISCLOSED ARRANGEMENT

As part of the fully disclosed clearing model, wealth managers outsource core processing technology. The resources of the correspondent clearing firm will execute the functions on the wealth manager's behalf. In addition, service providers have matured their platforms and provide the optionality to displace several core client technology capabilities, above and beyond standard back-office functions.

PROCESS OPTIMIZATION

Functional process automation leverages advanced technology (machine learning and robotics) coupled with business process management (BPM) and traditional re-engineering approaches (e.g. Lean and Six Sigma) to improve process efficiency, reduce costs and error rates, minimize risk and improve control. The adoption of Machine Learning provides for greater business intelligence and predictive analytics for various front-, middle- and back-office functions.

Key benefits

- Fairly quicker implementation times and less invasive change across the organization
- Reduced operating costs and lower FTE headcount
- Shorter process lead times and increased utilization rates
- Lower error rates and reduced operational risk
- Increased process efficiency through the use of workflow and automation
- Predictive analytics enables firms to quickly identify trends and actionable intelligence on a variety of functions, such as predicting asset churn, identifying fraudulent transactions, spotting trading opportunities, etc.

Transform or lose wallet share!

Why Capco?

Capco partners with wealth managers and broker-dealers to reduce operating costs by up to 30%, improve profitability and allocate resources to focus on their core business.

Our offerings

Operating model benchmark and recommendation

- Benchmark current state operating efficiency and cost base against industry and peer averages by utilizing a proprietary tool to identify opportunities for automation, outsourcing or process improvement
- Evaluate the firm's organizational and operational readiness for future disruption
- Provide a recommended operating model approach based on quantitative and qualitative factors

Business case and vendor analysis

- Draft business case with clear articulation of quantitative and qualitative benefits, transition costs, associated risks, etc.
- Leverage existing RFP accelerators to initiate vendor proposition and selection.
- Engage with potential vendors to conduct due diligence and perform high level platform gap analysis

Target operating model design and transformation

- Construct detailed target operating, organizational and architectural models using Capco accelerators
- Mobilize program resources and infrastructure and initiate conversion implementation
- Execute key organizational change management functions to manage internal and external communications, advisor and staff training, and preparation of clients for the transformation

Change management expertise

- Our proven methods mitigate common delivery risks to schedules, quality and cost.
- Our experienced consultants deliver complex global business transformation and change initiatives.
- We have worked with leading wealth management firms on improving end-to-end global processes.

Our differentiators

Wealth transformation expertise
Capco has extensive experience designing and implementing business models and executing large-scale transformations resulting in reduced cost base and improved operating efficiency for wealth managers and broker-dealers.

- Capco has worked extensively with clients to develop and refine their business and technology strategies in support of client experience programs and changing landscapes.
- We have delivered numerous conversions to outsourcing providers.
- Capco has deep experience in driving change management functions with our clients, which will help to minimize the overall impact to your business.
- Team of 100+ resources has extensive wealth management experience.
- Most of our employees have worked in the wealth management industry and have expansive knowledge of front-, middle- and back-office wealth functions.

Wealth clearing model expertise
- Capco understands the wealth clearing business and has conducted vendor analysis to contrast the leading clearing firms.
- Capco has worked intimately with all leading clearing providers, such as Pershing, Fidelity (NFS), First Clearing, SunGard, Thomson and Broadridge, and we have detailed knowledge of their respective platforms and functional capabilities.
- We continuously monitor the wealth management clearing landscape and keep abreast of the trends.

Accelerators
We have a diverse set of accelerators and tools that are devised to quickly assess your operating model and platform capabilities in relation to competitors and aide in mobilizing and executing the change initiative.

- Capco has a host of artifacts such as conversion playbooks, operating models, reference architecture, detailed wealth process flows, training plans and communication collateral used to successfully transform the way wealth managers operate.

- Our methodologies leverage existing analysis frameworks developed through our transformation experience, marketplace interaction and thought leadership.
- We continue to refresh our methodologies and frameworks to conduct similar engagements where rapid vendor analysis is necessary.

Engagement style

- Collaboration: Our approach engages all relevant stakeholders. Adopting this approach supports ownership of the recommendations, maximizing the ability to implement successfully.
- Knowledge transfer: Capco understands that business requirements must be completely understood and interpreted. We will deliver effective reference architectures and flows and transition them so that sustainability is assured.
- Focus on quality: We place intense focus on detail and delivery of high-quality artifacts.
- Flexibility: Capco understands the uncertainty and complexity of strategic initiatives. The senior talent on the Capco team is experienced in making adjustments during the engagement, if necessary.

1. Aite Group, April 2016

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ABOUT CAPCO

Capco, an FIS™ company, is a global business and technology consultancy dedicated solely to the financial services industry. Our professionals combine innovative thinking with our unrivalled first-hand industry knowledge to offer our clients consulting expertise, complex technology and package integration, and managed services to move their organizations forward. Through our collaborative and efficient approach, we help our clients successfully, innovate, increase revenue, manage risk and regulatory change, reduce costs and enhance control. We specialize in Banking & Payments, Capital Markets, Wealth & Asset Management and Technology Services. We serve our clients from offices in leading financial centers across North America, Europe, Asia Pacific and Africa.

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