EQUINITI

The back office: not a differentiator, but a business enabler.

THE CHANGING FACE OF UK WEALTH MANAGEMENT

Why are things changing?

- Competition is growing
- Regulation is building
- Consumers are changing

Leading to

Greater pressure on wealth managers to:

- Understand and segment the customer database
- Develop appropriate customer solutions
- Build their brand to beat the competition

In order to do this what needs to happen?

Wealth managers and brokers need to make investments and find savings in their business

How can savings be made?

Outsource the back/middle office functions which are not unique

70% believe all firms will be looking to outsource over the next 5 years

Resulting in

ABILITY TO INVEST IN CUSTOMER RELATIONSHIPS AND BUSINESS GROWTH

Foreword

In the context of the significant changes impacting the wealth management industry, Equiniti has prepared this report in association with thought leaders to explore the challenges in more detail.

Whilst regulation is the most touted, rapidly changing customer expectations are also placing increased pressure on UK wealth managers.

This report aims to help senior level executives consider the need to focus on proposition and brand; the position of the middle and back office in the equation of business development; outsourcing as a potential solution and the internal and external influences impacting the market.

Report Highlights

70% of wealth managers believe all firms will be looking to outsource some or all of their processing requirements within 5 years

38% of wealth managers have changed their view on outsourcing as a result of regulation

Only 12% of wealth managers see outsourcing as a means of developing strategic advantage

A fifth of wealth managers blame a lack of outsourcing solutions as an argument for not outsourcing

Global economics, changing customer demographics, regulation and technology are the primary instigators of change

Wealth managers need to focus on customer proposition and their brand

The back office is not a differentiator or driver of business development whether outsourced or retained inhouse; but it is a business enabler

Is the future clear for the back office?

Mark Taylor
Managing Director
Equiniti Investment Services

Just as we are emerging from a very deep recession the Wealth Management industry is being hit with a wave of change which is coming in the form of:

Global economics	Low interest rates, global competition and new entrants.
Customer demographics	With an ageing population looking for additional sources of income, an increasing number of people inheriting wealth and younger investors joining the market in response to the pressure to do more for their retirement, investment objectives are changing and increasingly diverse.
Technology	There is the general expectation from investors for mobile, on demand services and increasing levels of support and information. There is a new generation who sees social media as a standard and trusted form of customer engagement and who use it to build communities and support networks, and technology is continually and rapidly changing.
Regulation	Driven by Europe and bridging towards global harmonisation the cost of compliance is predicted to rise by a further 16% by 2015*.

Customers are, knowingly or not, looking for brand value.

This in turn creates the need for business strategy and IT strategy to align in order to achieve true competitive advantage.

The back and middle office are business processes. They are not business drivers and they are not differentiators.

The need to evolve, or even overhaul, business models in response to these factors is inevitable.

Wealth managers will need to focus on and invest in their strategic positioning to meet the changing needs and increasing expectations of investors.

Customers are, knowingly or not, looking for brand value which can only be achieved by developing a customer proposition based on core competencies and extensive customer segmentation.

Meeting regulatory requirements is not optional and will not wait. Facing the economic challenges of recent years has been the principle focus for many wealth managers. It is unlikely there has been the opportunity and available cash to invest in scoping the true implications of the upcoming regulatory changes or planning for the implementation of necessary new business processes.

These two points both bring the middle and back office into focus for different reasons: as a potential area of cost saving and as an area for necessary change. This in turn creates the need for business strategy and IT strategy to align in order to achieve true competitive advantage.

When the times are good and share values and trading volumes high the need to fully understand and segment back office costs is not a priority; revenue is sufficient to carry the business forward. In the current market, however, despite a slight pick up in recent times, revenues are harder to come by and the pressures are greater. There is the need for investment in developing the customer proposition to stay ahead at the same time as implementing complex regulatory requirements.

The middle and back office are vital to business. The need for cyber security, safe-handling of data and accuracy are paramount. One slip and a reputation is tarnished and clients are lost. However, the middle and back office are business processes. They are not business drivers and they are not differentiators in a challenging market place; no investor will ask what systems are used to ensure the protection of their data or management of their funds, rightly or wrongly, these are taken as given.

There is much debate about the decision to outsource or retain middle and back office functions inhouse. As we talk to more and more wealth managers we find perceptions and opinions vary considerably.

Research recently commissioned by Equiniti among senior level executives of wealth management firms provides some insight into how the market is responding to the inhouse versus outsource debate.

* Source: Compeer cost of compliance survey 2013

WHY OUTSOURCE?

“Outsourcing begins with an understanding of your business’s core identity. If you understand your unique competitive advantage, you’re positioned to consider what work you’re doing that others could perform better”

Michael F Corbett, Chairman,
International Association of Outsourcing Professionals (AOP)

A wealth manager’s competitive advantage is derived from their proposition, their service, their brand

The middle and back office are the processes behind the transactions

Business Process Outsourcing (BPO) is not new, but is at a crossroads

Outsourcing is no longer just about cost saving: it is a strategic tool that may power the twenty first century economy

Companies are considering BPO alliances to gain strategic advantage

BPO enables companies to improve service and develop new propositions faster

BPO is essential for companies to remain competitive

Research findings

What wealth managers feel* outsourcing delivers:

- Improved customer service without the worry of operational detail
- Scalability
- Experience and infrastructure at start up, they have only kept inhouse those things where they can add value
- Efficiencies, the ability to integrate and realise economies of scale
- Expertise
- Operational risk management
- Allows focus to be given to investment performance and delivery to the client
- Access to CREST

* These responses were given during in depth interviews conducted as part of our wider research into wealth managers' perceptions of outsourcing the middle and back office.

Research findings

Research methodology

Research was commissioned by Equiniti to investigate the attitude of wealth managers towards outsourcing the middle and back office functions.

Survey responses were gathered from 60 senior levels executives within the wealth management sector and in depth, face-to-face interviews were conducted with senior executives from 10 firms of varying sizes including a cross-section of those who do and do not outsource and those who do in part.

Inhouse versus outsourcing

Our research confirms that the greatest attraction for outsourcing is deriving cost savings but it is also seen as an enabler for freeing up time to focus on customer relationships. As an outsourcing provider we can only concur with this through experience but would also emphasise the potential to reduce regulatory and security risks by utilising the industrial scale capabilities and systems that outsourcing firms such as Equiniti can provide. We also believe that outsourcing non-core functions such as the middle and back office processes will enable wealth managers to derive strategic advantage something only 12% of our survey respondents saw as an argument for outsourcing.

Understandably loss of control is of concern to wealth managers. However, the one size fits all approach of providers in the past, which limited the control and flexibility desired by wealth managers, is being overtaken by more modern solutions mitigating the cause for concern.

During face to face interviews, scalability and reducing/removing responsibility for complex tasks were also highlighted as primary reasons for outsourcing.

What are the two greatest arguments for and drawbacks of outsourcing your middle or back office?

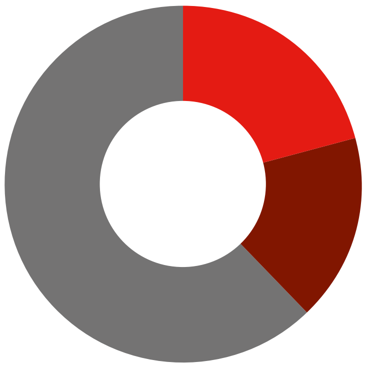
Arguments for outsourcing		Arguments against outsourcing	
Cost savings	66%	Loss of control	60%
Ability to focus on customer needs	43%	Security issues	38%
Headcount reduction	43%	Loss of service	37%
Reduction in regulatory risk	32%	Lack of flexibility	32%
Developing strategic advantage	12%	Cost of migration	20%
Focus on core business	2%	Limited choice of outsourcing solutions	20%
Reduction in market risk	2%	Hidden service costs	18%

Regulation as a driver for change

The inevitable pressure that regulation will have on middle and back office functions, most notably from the change to monthly client reporting, has lead to 38% of senior executives changing their view of outsourcing. In reality it is expected that due to past under-investment in legacy systems, many wealth managers have not been and will not be able to make the necessary investment, monetary and management time, in their inhouse systems to meet the regulatory requirements. The potential to reduce regulatory burden and risk through outsourcing should not be overlooked.

Has legislation/regulation changed your view on the value of outsourcing your middle or back office?

Somewhat	21%
Yes	17%
No	62%

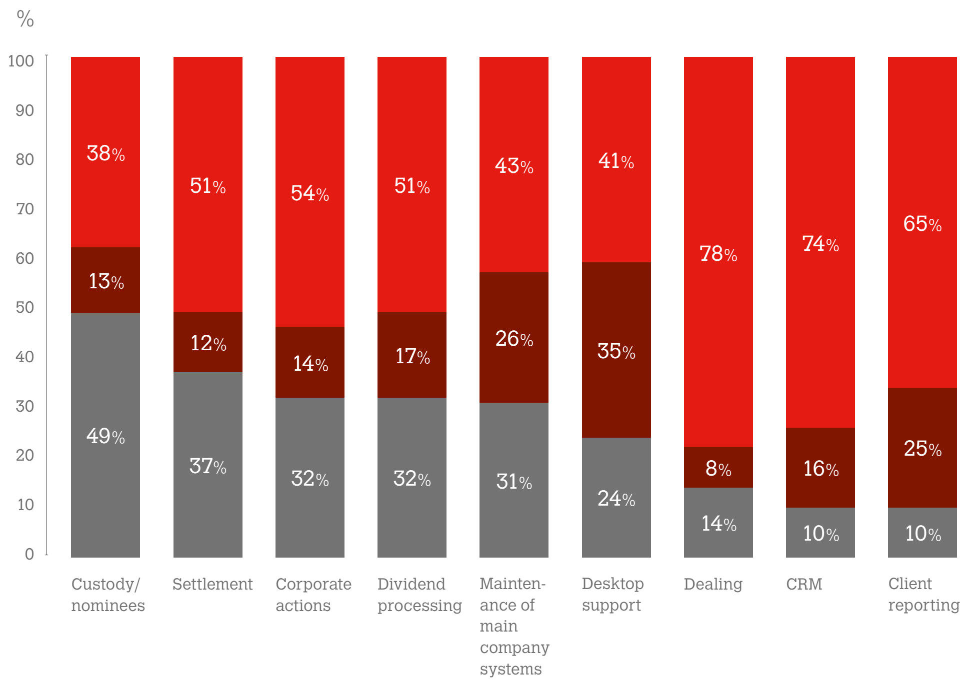


The current landscape and sentiment

Custody/Nominee (49%) and Settlement (37%) are the most commonly outsourced processes with CRM (10%) and Dealing (14%) at the other end of the spectrum, which is perhaps to be expected as front of house services. While around half of respondents are already entrusting crucial back office functions to an external third party, there are still around 64% who would never consider outsourcing Client Reporting. This is despite the fact that the requirement for reporting will increase from annually to monthly. This is perhaps linked to the concerns over security and control as raised in a previous question.

Does your company currently outsource any of the following, or is it thinking about doing so in future?

- Would never in future
- Would outsource in future
- Currently outsourced



Research findings

Although some interviewees were polarised in terms of their opinion of outsourcing, some being highly in favour or highly against outsourcing, the aggregate view suggests that wealth managers are open to outsourcing but perhaps cautiously so, wanting to weigh up the influencing factors before making a decision.

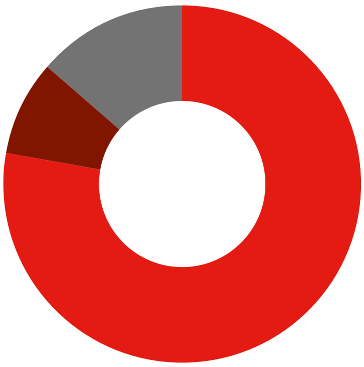
Generally speaking, what is your attitude towards outsourcing?

Positive	31%
Negative	13%
Dependant on circumstances	56%

Of the firms interviewed all utilised some form of outsourcing and having made the decision to outsource 78% are entirely satisfied with their current systems/service provider. That leaves almost a quarter who are not satisfied or are looking to move provider. During interviews the most successful outsourcing relationships appeared to be those which adopted a partnership or 'co-sourcing approach'.

Generally speaking how happy is your company with your current system/service provider(s)?

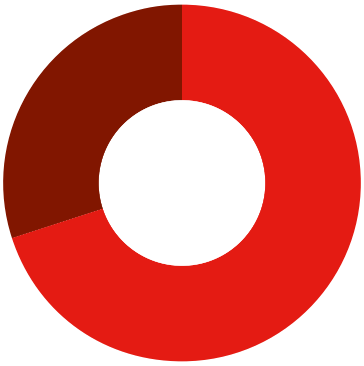
Entirely satisfied	78%
Not satisfied	8%
Looking to change suppliers	14%



Looking to the future

Whatever the current sentiment is, the direction that senior executives believe outsourcing will take is clear.

Looking at investment business generally, what do you think will happen for the majority of post trade processing in the next 5 years?



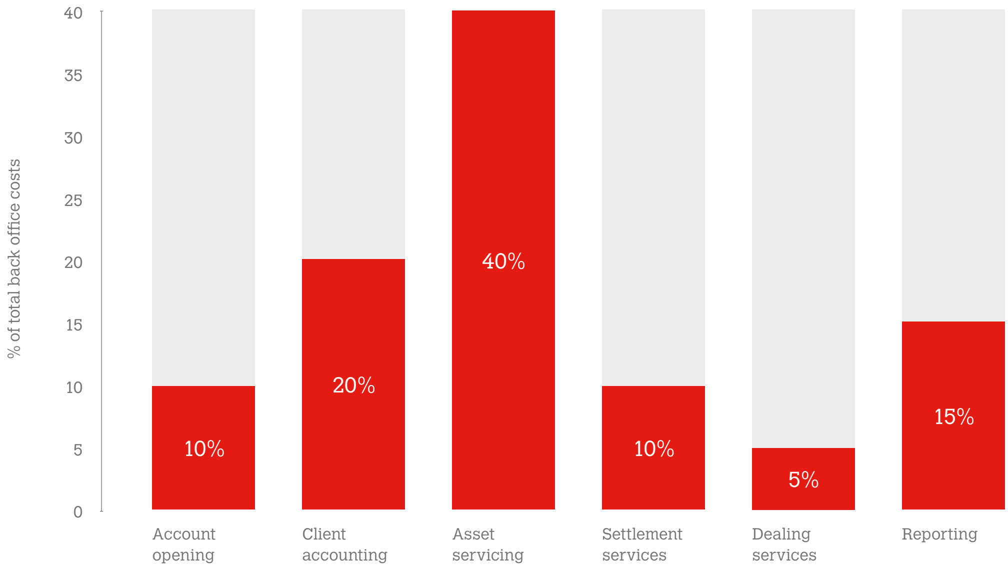
■	All firms will be looking to outsource some or all of their processing requirements	70%
■	Large firms will keep their own operations departments and never outsource any aspects to third parties	30%

Outsourcing is tried and tested

For many years, outsourcing the back and middle-office has been commonplace for large parts of the institutional investment management community. It has allowed fund managers to focus on the day-to-day attention of the fund's strategy and client servicing. Outsourcing to an independent administrator has become essential to attract capital and has also enabled funds to reduce their internal costs, while at the same time increasing due diligence by benefiting from the expertise of specialised administrators through services such as valuations and financial reporting and research support.

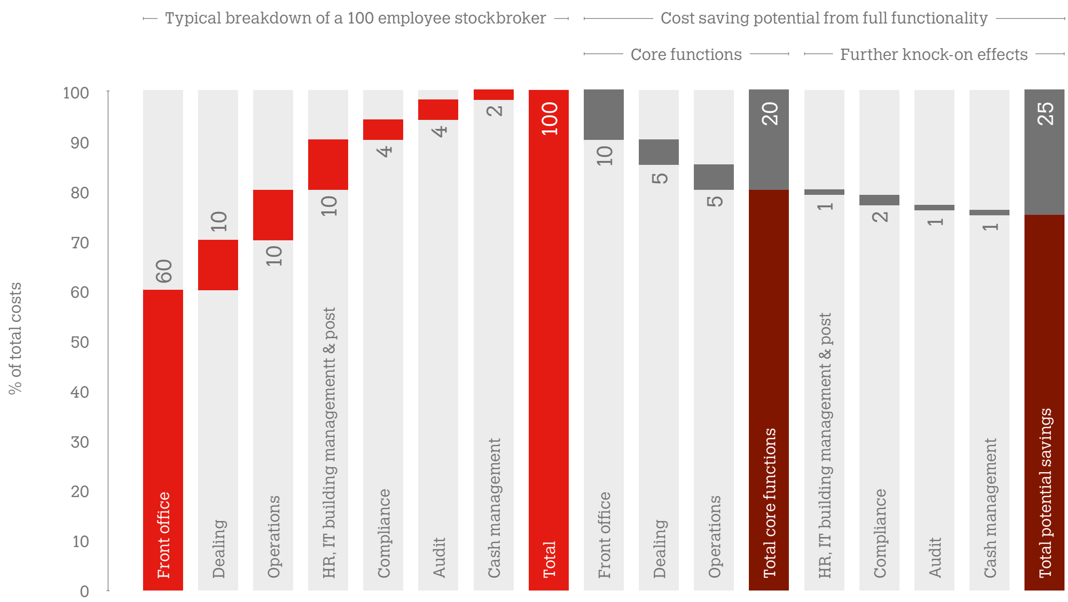
The model has been proven at an institutional level but it has been some time before a cost effective equivalent has been available for wealth managers.

Our research has shown that many wealth managers are unclear of the breakdown of middle and back office costs, but we are able to estimate through research, feedback and general cost modelling that back offices costs equate to around 40% of total costs and are likely to be split as follows:



Research findings

The chart below demonstrates how the same type of outsourced service, previously available exclusively to the institutional market due to cost, could reduce the headcount of a 100 employee stockbroker by 20, before the possible savings that result across HR, IT, Compliance, and Finance.



Source: Equiniti, Ares & Co analysis

Conclusion

Brokers and wealth managers are clearly having to face up to new challenges on a number of fronts. Change, therefore, is essential. As with all change, there lies uncertainty, but also potential.

Firms that will come through this period in the best shape will be those who use it as a catalyst to achieve cost savings and derive strategic advantage through greater efficiency of middle and back office management, and a clear customer proposition underpinned by a strong brand.

Whether the middle or back office, or parts thereof, are outsourced will be each wealth management firm's decision to make, however, better results will be achieved when business strategy and IT strategy are inextricably linked. Importantly, the need to recognise the back office as the commoditised process it has become will ensure focus stays on those areas that will deliver true proposition and brand differentiation.

Outsourcing: how to get it right

Lexa Hunt
Senior Partner
McLean Consulting

Lexa has over 17 years' experience as a Chief Operating Officer and is founder of McLean Consulting.

McLean Consulting has a breadth of practical experience working with both established and start-up broker dealers, asset managers and businesses supporting the Financial Services sector.

Cost savings is by no means the only benefit firms should look to gain. Others are less quantifiable and won't feature in the P&L but that doesn't mean their impact is not significant.

Cost savings is a driver but it is a separate debate. The key to making a decision to outsource is about attaining a better solution.

Key Requirements

- Reputation and track record
- Scale
- Innovative technology solutions
- Cultural fit
- Data security and data management expertise
- Service guarantees
- Flexibility and modularity

If you are a COO the topic of choice is currently outsourcing.

Will you really find a better solution for the business, derive economies of scale, benefit from others' innovations? Will you get a good service if you are one of the smaller clients? Can you reduce the inhouse team and save on headcount? Even if you tick all or most of these boxes, there are still many other considerations.

Understandably, cost reduction is often the initial trigger for any businesses to consider an outsourcing strategy. However, it is by no means the only benefit firms should look to gain. Others are less quantifiable and won't feature in the P&L but that doesn't mean their impact is not significant.

CEOs and the Boards of Directors, especially Non-Executive Directors, have become increasingly focused on managing risks as well as financials and a well thought out outsourced proposition can assist in mitigating operational risk. Reputable third party providers bring with them industrial strength capabilities which can apply to security, data management and systems, as well as investment in innovation and dedicated expertise in the areas of technology, investment processes and regulation.

Achieving and maintaining this kind of robust infrastructure inhouse is simply unattainable for many wealth managers. For some it may be affordable but is not cost-effective and for the entrepreneur, who is starting a business and wanting to focus on core competencies, they will not be interested in building a cost laden 'back office' of people and systems to carry out processes that they fundamentally don't understand and possibly can't afford.

While cost saving is a driver, it is a separate debate. A comparable price for the service versus the inhouse solution is often agreed so if you can pay the same for better technology, flexibility and innovation without loss of control, and you are mitigating some operational risks, then you have achieved a reasoned and effective argument for outsourcing. The key to making the decision then becomes about attaining a better service.

When is a good time to outsource?

At start up exploring the options should be an essential part of the business plan taking into account general costs, regulatory burdens (ongoing cost, time, knowledge) and resourcing requirements (staff and expertise). Is it realistic to do it yourself or is there a more simple 'plug and play' solution that fulfils the requirement and may provide a better alternative.

For established firms business continuity is paramount. It may be that the robustness of legacy systems with too many work-arounds and the need for essential investment reaches a critical point. The ideal time to move systems is when business requirements change such as at the time an upgrade is due or when launching a new product or business area.

What should you look for from your outsourcing partner?

This is not a complicated equation in the first instance and should not be compromised: reputation, scale, technological capability and, something that is often overlooked, cultural fit – do you like the way they do business because you are making an involved, long term commitment.

Data security is a risk that is increasingly on the radar and firms worthy of consideration will be able to demonstrate expertise and experience of managing sensitive data and of mass migration of data.

The customer experience is at the heart of every wealth manager's business so SLAs that can be enforced and ensure reliability and service continuity, even in a worst case scenario, should be clear and readily available.

One of the big concerns for wealth managers is the degree of influence they will have and the loss of control. Make sure the solution and service offering is transparent. Wealth managers should feel they and their customers will ultimately be better off. If that is not the case, question the solution and see where there is scope for change.

It may sound obvious but make sure it is the right solution. Don't buy something because it has part of what you want, or because it has the main element you need but comes with a few unnecessary add-ons. Find a modular solution that enables you to only buy, and pay for, what you need.

Getting the most out of your relationship

Outsourcing is not a handover of all responsibility.

Being clear about the on-boarding process and timeline will avoid ambiguity and getting off on the wrong foot. Timescales may move but outlining clear milestones and target dates will provide direction.

Outsourcing is not a handover of all responsibility. Firms have an obligation to demonstrate oversight and in some cases regulatory obligations to maintain. From a day-to-day management perspective it is critical that all outsourced business is proactively managed. This is a point that has often been neglected and can be a significant factor if the relationship deteriorates. Clear responsibilities, deliverables and liabilities detailed in an SLA which is used to manage and monitor the relationship is essential. And both parties have a responsibility to meet their commitments.

And of course there is the other side of the coin, when shouldn't you outsource?

If you have made significant investment to develop robust inhouse systems, the time may not be right to outsource.

Many arguments can be made in favour of outsourcing but it isn't always the right decision, or the right timing.

If a wealth manager has already made significant investment in inhouse systems and processes and they are robust, they will want to derive a return on the investment. Outsourcing in that case may not be the right choice, at least for now.

In closing

The decision to outsource is an important one and based on many factors. Factors which will be different for different wealth managers, but the market is rapidly looking for innovative, practical outsourced solutions to cover all the operational aspects of business.

In life today we increasingly say 'there is an App for that' and we are happy to tap into those solutions. For the middle and back office you can also buy and plug in expertise as and when you need it. Why not go to the experts and leave yourself free to focus on what you are good at?

Regulation: driving change, challenging resources

Richard Warrington ACIB MBA
Head of Operational Risk
Equiniti Investment Services

Richard has worked in the wealth industry for over 25 years and is Head of Operational Risk at Equiniti Investment Services. He has also served on industry bodies for over 10 years and regularly supports working parties which shape industry change.

Fully comprehending the myriad of regulation that currently governs the wealth management industry is a huge and ongoing challenge.

When evaluating the regulatory challenges that we are faced with, we need to look not only at where we are today but to what is coming along tomorrow; keeping in view the consequences of not getting it right.

A number of high profile FCA cases reported in the media have evidenced how too many organisations rely on processes and controls put in place in the past as being fit for purpose when in fact they were not or had become outdated. Failure around AML controls, transaction reporting, system and control failings and client money have each resulted in multi-million pound fines for regulated firms in 2013; not to mention widespread negative publicity in the press.

It is natural for firms to review their own positions in light of the problems others have encountered, but as can be seen from the range of areas where fines have been imposed above, it is important to have a structured programme to review the effectiveness of compliance across all regulated areas; not just the latest hot topic.

There is a continuous flow of industry changes coming from an array of bodies; FCA, HMRC, IRS, HM Treasury and European Parliament; to name but some. However, one of the most pressing priorities for wealth managers is, or should be, the implementation of the HMRC UK-US FATCA Agreement. In reality, this means distilling, from literally hundreds of pages of guidance notes and legislative documentation, the impacts to product offerings, operating models, control systems, IT platforms and staff. Each of these needs to be meticulously analysed and actions defined and delivered in challenging timeframes.

It is important to have a structured programme to review the effectiveness of compliance across all regulated areas, not just the latest hot topic.

Following hard on the heels of this inter-governmental agreement are plans to develop similar reporting requirements for Crown Dependencies and there is talk of this potentially being rolled out across other countries. While dealing with today's concerns it is equally important to keep on top of industry consultations and play an active role in shaping how regulation looks in the future; we as an industry ignore this at our peril.

One of the most pressing priorities is the implementation of the HMRC UK-US FATCA Agreement.

Much legislation emanating from the EU is focussed on industry models from mainland Europe which isn't necessarily consistent with the UK and Irish models. Legislative wording, if not drafted carefully, can have far reaching unintended consequences. For example, the current scope of the proposed Packaged Retail Investment Products (PRIPs) regulations goes beyond packaged products to include direct investments such as equities and bonds; which would have fundamental impacts on the UK market.

The FCA review of client assets runs to 240 pages and covers the full CASS Handbook. Potential impacts vary from usage of term deposits for client money, application and use of uncleared monies and enhanced client reporting obligations to the possible need to repaper terms and conditions with clients following clarification of the client impacts of the 'DvP window'.

It is equally important to keep on top of industry consultations and play an active role in shaping how regulation looks in the future.

It should not be underestimated how much time is required just to understand 'draft' regulations to ensure that budget and resource are committed for what may occur in the future and need to be implemented in given time frames.

It should not be underestimated how much time is required just to understand 'draft' regulations.

Regulation is dynamic and becoming more complex to manage as the EU moves away from issuing directives to be implemented under a local regulator and towards issuing direct regulation, creating a two-tiered regulatory system.

In conclusion, the regulatory obligation for firms participating in the wealth industry is significant and with that comes cost. The challenge is to manage this cost whilst not compromising compliance and falling foul of a regulator who has already set out their stall to be tougher than previous manifestations.

Regulation is being driven by Europe and is bridging towards global harmonisation with 17 major consultations undertaken by the FSA and 11 already implemented.

Equiniti Wealth Solutions

Equiniti Wealth Solutions is a new service being developed by Equiniti which will provide centralised pooling of custody and business processes, as well as a customer interface, for wealth managers and stockbrokers.

It is being designed to reduce the cost of processing at the same time as reducing regulatory risk; enabling wealth managers and stockbrokers to focus on customer service and business growth.

Equiniti Wealth Solutions will:

- Recognise the cost imperatives for wealth managers and retail brokers
- Allow retention of inhouse systems for portfolio management and executing orders with the market
- Include a CREST interface
- Provide enquiry facilities for brokers and their clients
- Process corporate actions
- Provide a high level of MI and reporting.

About Equiniti

Equiniti is a market leading business process services provider. We support 1,600 of the UK's leading businesses and public sector institutions, including around half of the FTSE 100. Our core capabilities are centred around complex administration and payment solutions including money transmission, administration and customer interactions delivered by 2,700 employees in 23 UK office locations.

We are leaders in share registration and the provision of investment administration, systems and custody services, branded investment solutions and share trading facilities for corporate clients. Equiniti administers over £11 billion in assets in custody, across around 8,000 lines of stock, and settles approximately 1.5 million trades per annum. The business, which is part of the Equiniti Group, also offers complementary investment products to retail investors from within the Group's customer base.

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