

Winning in Wealth Management

The recent changes and chaos in the financial services industry will likely have a significant impact on the wealth management business. Key drivers that will impact the wealth management business going forward include:

- The end of traditional investment banks
- Consolidation of commercial banks
- Changes in tax policy
- The demographics of the U.S. population

Each of these drivers, alone or in combination, will need to be successfully addressed for providers to be winners in the wealth management business.

The End of Traditional Investment Banks

Sub-prime lending problems which led to a credit freeze and liquidity crisis have effectively ended the investment banking business as we have known it in modern financial services industry history. Ironically, the elimination of the Glass Steagall Act (the 1933 Act that established the Federal Deposit Insurance Corporation (FDIC) in the United States and included a number of banking reforms) seemed to set the stage for many of the issues that ultimately led the demise of this business. It is now clear that how investment products are created will undergo a significant change and undoubtedly increased scrutiny. Much more diligence and oversight will be required to better understand and disclose the risks or potentials risks associated with investment products.

In addition, there is also likely to be an increased emphasis on the earnings fundamentals that support products by both regulators and investors. As result of increased transparency and regulation, the breadth of products offered and the returns they provide will almost certainly be more conservative. Clearly, this will influence providers of wealth and investment management services.

Commercial banks offering wealth management and private banking services will likely be the biggest beneficiaries of these changes—but well-capitalized private equity firms could also see an increase in business. With regards to private equity firms, there will probably be consolidation among private equity firms as the larger well-capitalized firms will have opportunities to acquire smaller firms or their investors. Some of the questions related to the impact to private equity firms include:

- Will there be a large enough population of investors who will be willing to invest in more risky ventures?
- How will independent money managers advise their clients with respect to private equity investments based on risk tolerance and transparency?
- How will commercial banks, private equity and money management firms position themselves relative to one and another as we transition to a new era in the financial services industry without investment banks?

Consolidation of Commercial Banks

As we have already witnessed, the commercial banking industry is going through significant consolidation. The recent activity—including JP Morgan Chase's acquisition of Washington Mutual and Wells Fargo's merger with Wachovia—has been driven largely by regulatory considerations. Given current pockets of weakness in the U.S. banking system, we will undoubtedly see more acquisitions over the next 12 to 18 months. There will also be some attractive strategic acquisition opportunities for well capitalized banks to include the ability to enter, enhance or grow wealth management. These acquisitions could include investment businesses (brokerages and money managers), products (mutual fund companies) or people (experienced private bankers and wealth managers). A good example of this type of acquisition is Bank of America's recent acquisition of Merrill Lynch, which also included First Republic Bank, a private bank. Depending on BofA's wealth management strategy and its ability to successfully integrate this acquisition, the bank could be well positioned to add significantly to its share of this business. Other commercial banks will be watching this situation closely. The question will be—can a large commercial bank truly successfully offer wealth management services?

The current environment and unproven track record of large commercial banks to successfully integrate wealth and investment management businesses may bode well for specialty banks and trust companies. Organizations like The Northern Trust and Bessemer Trust are well positioned to be beneficiaries of the demise of the investment banks and the uncertain ability of large commercial banks to offer quality wealth management services. These organizations have strong histories and reputations for offering excellent service and proven results. The interesting questions for firms of this ilk are:

- How will "specialty banks" and trust companies position themselves relative to commercial banks?
- Will these entities consider going "down market" to customers who have a net worth of \$1 million to \$2 million?
- If so, can they create a business model that makes sense both for themselves and for this segment of customers?

Changes in Tax Policy

While it would take a crystal ball to foresee the specific tax law changes that will be implemented in 2009 and beyond, there is no question that taxes will increase. Some of the questions for the wealth management business will be:

- What types of investments/products will benefit investors most as tax laws and policies change?
- How can commercial banks, private equity firms, and specialty banks and trust companies assist customers to better understand and benefit from tax law and policy changes?

- What new or additional skills and resources will be required by wealth management providers to address tax changes?

Tax policy will influence what providers offer both in terms of products and services. There will obviously be risk and reward considerations, but there may be an opportunity for individual investors to participate in some the areas of need related to the federal rescue plan.

Demographics of the U.S. Population

A big driver of the wealth management business will continue to be demographics. As the baby boom generation reaches or approaches retirement, its need for wealth management services continues to grow. While most of wealthiest of customers in this segment have already been identified (and already have long standing relationships with providers of wealth management and investment services), there is a large and potentially very attractive part of this segment that is unknown to providers. These are individuals who may own small businesses or who may have company-sponsored 401k plans or will receive significant retirement payouts or bonuses.

In many cases, these individuals are already customers of the large commercial banks that are getting larger through consolidation. However, the banks, even the large banks, continue to operate in silos and often are not even aware that they have a number of customers who should be courted and considered for wealth management and private banking services. As result, many of these customers do not even consider their banks for these services. Those banks that can “crack the code” by implementing enhanced data management capabilities that provide actionable business intelligence will be best positioned to tap into this lucrative segment. Adding these capabilities and insights will also facilitate a bank’s ability to identify “the next generation” of wealth management customers. The key will be the willingness and ability to make the required investments that can answer the following questions:

- Which of my banking customers are likely to be good wealth management customers?
- How can I identify these customers at the appropriate point in their need lifecycle?
- What value proposition can we offer to these customers that will be both attractive and differentiating?

The Winning Formula

Change oftentimes provides opportunity. In the financial services industry, we are seeing and experiencing an unprecedented level of change on multiple fronts. As many established providers of wealth and investment management services have disappeared or changed, commercial banks are attempting to add wealth management capabilities and specialty providers (private equity firms, trust companies and private banks) have an opportunity to expand their scope of

services and customer bases. Who will be the winners in the wealth management business as the new financial services industry evolves? The winners will be those providers that can best:

- Identify potential customers and determine their buyer values and anticipate their needs in advance of key life events (sale of a business or retirement);
- Translate those value and needs into tangible value propositions and competitive advantages that are clear to understand and meet specific objectives; and
- Instill confidence in these customers in terms of their ability to execute and to provide a high level of customer service with trustworthy advice

The formula for winning is not complicated, but the ability to execute is critical for an organization to benefit from the evolving financial services environment and turn it into a great opportunity in the wealth management business.

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