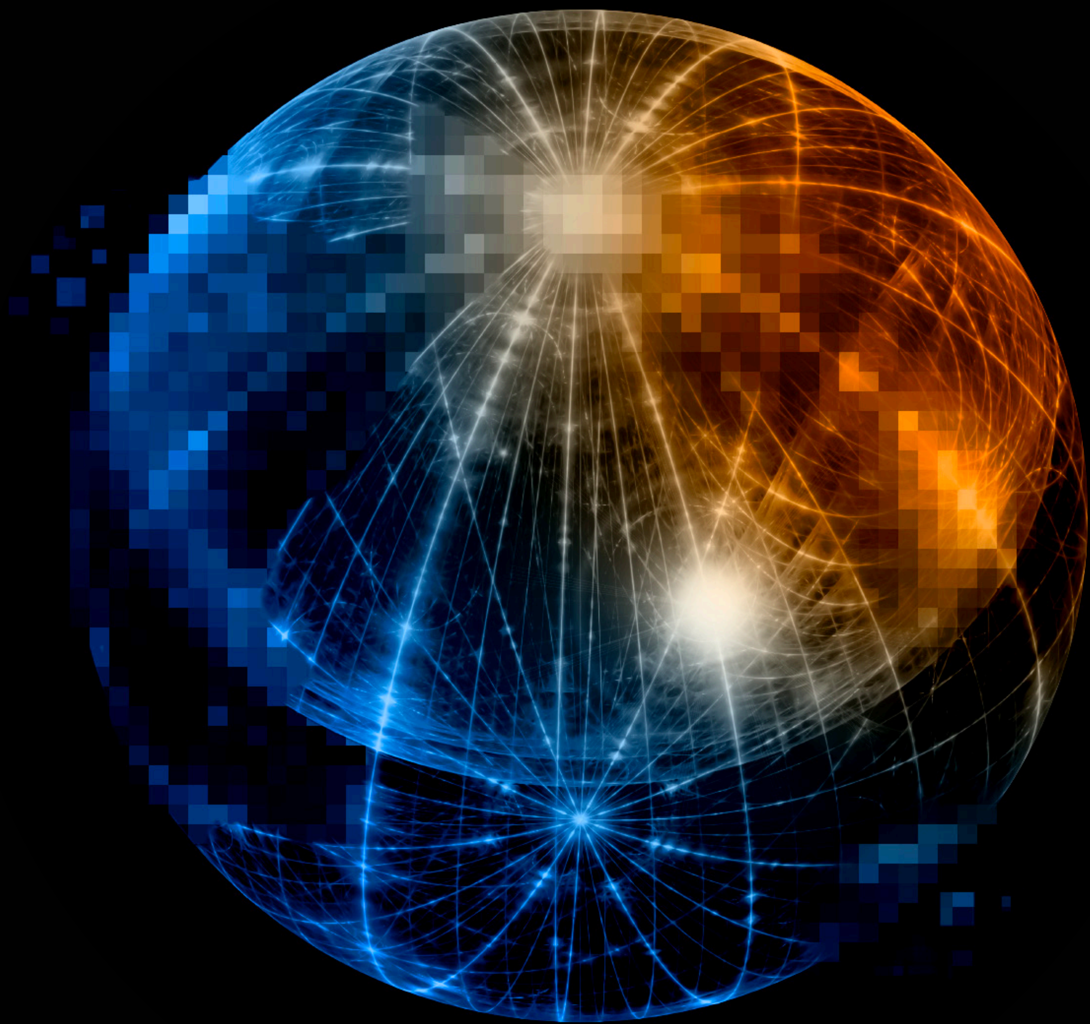

The COVID-19 pandemic: disruptor or accelerator?

How wealth managers can recover and thrive

Wealth management being remade

Quick highlights

- Industry trends that present both risks and opportunities for wealth managers
- Strategies to address investor apprehension and needs
- A new wealth management operating model for the next evolution of normal

As the world was confronted by the COVID-19 pandemic, economic, social, and political challenges quickly became apparent across the United States and globally. The abrupt spread of the virus shook the global economy as well, due to the closure of industries and businesses arising from social distancing measures.

Firms should position themselves to thrive in the "next normal," or risk losing market share

These abrupt circumstances affected both investors and wealth management firms. Investors saw direct impacts to their portfolios, given initial market drops and historic levels of volatility. Firms' top lines were affected as transactional revenues rose with trading volumes, while overall net interest income and fees tied to assets under management (AUM) declined consistent with market performance.

Though backstop and contingency efforts have been implemented to assuage uncertainty, there remain questions about the short- and long-term impacts on wealth management. Many existing industry trends have been accelerated, while others have reversed, and firm strategies have quickly pivoted to respond to client needs in a new environment. While there are several future scenarios to consider as the pandemic plays out,[1] wealth management firms should consider several actions as they begin their recovery in order to position themselves to thrive in the "next normal." Otherwise, they may risk losing market share and relevance during an already trying time.

Two steps forward, one step back

The trajectory and direction of industry trends observed in wealth management up to the COVID-19 pandemic have been altered by the current global health and economic conditions—some trends have accelerated. Of particular note are these three:[2]

- Investor preferences for **lower-cost, passive strategies**
- The adoption of **digital channels** across generational divides
- Advisers' shifts toward **holistic financial planning** to enhance client outcomes and customize experiences

This is active management's time to shine. While passive investing has dominated during the recent record-length bull market, active management poses advantages during volatile and turbulent times, and firms that transform people, process, and technology within their equity platforms could be better positioned to grow assets and win back investors into active strategies.[3] While outflows have been pronounced, particularly from equity strategies, the crisis provides an opportunity for active managers to demonstrate value against other strategies, showing their abilities to pick individual winners and generate alpha compared to typical index approaches. Additionally, during times of volatility, investors' definition of success often changes from growth or outsized returns to downside protection and preservation of capital. This presents another opportunity for active managers and certain product types such as structured notes or increased use of options and other hedging strategies.

Proactive advisers and firms are driving client discussions about actively managed products, as a renewed interest in such strategies has arrived.[4] Product manufacturers may also seek to enable this spike in interest through performance-based features that have yet to achieve mass appeal.

During unpredictable times, there is a premium on customized, human, and timely communications with investors. With the shifts to virtual business practices, many wealth managers have aggressively reached out to their clients by phone to make it a "moment that matters" and build further goodwill through a human touch. Firms with larger customer bases have relied on electronic means, emails customized through artificial intelligence (AI), or social media to connect. This is certainly the case of robo-advisers and other business models that cater to self-directed investors. Still, some other firms have not accepted the trade-off between human and digital engagement models and have sought a third way, for instance, by adding a human touch to electronic communications with advisers signing or adding a hand-written line to a generic email, while also leveraging AI to further tailor electronic communications to individual customers, mixing analog and digital communications.

In times of uncertainty, market corrections, and high volatility, the value of financial planning and professional advice becomes clearer to many retail investors. The COVID-19 crisis should, therefore, accelerate the trend toward more comprehensive financial planning and advice at the heart of the relationship between retail investors and their wealth managers. This kind of service level is difficult to maintain within a traditional commission-based brokerage account. So, firms should consider continuing to focus their asset gathering efforts on fee-based services. Fee-based assets have often been "stickier" for firms and advisers, while such arrangements also offer investors access to more holistic advice. Deep relationships with clients are profitable relationships, and firms and advisers should continue to strive to deepen that relationship in troubled times.

In the near term, the extension of the federal tax filing deadline has required clients and advisers to reevaluate both the 2019 and 2020 tax years. Clients want to understand their options for accepting portfolio losses to offset gains or suspend or roll back their required minimum distribution (RMD) given their associated impacts on tax liabilities. Adjustments and detailed client modeling are components of advising on individual tax circumstances, including for contributions to individual retirement accounts and health savings accounts, Roth account rollovers, tax payments for 2019 returns, and estimated tax payments for 2020. Likewise, the increase in gift exemptions to $10 million until 2025 under the Tax Cuts and Jobs Act (2017) may be opportune for clients in a position to facilitate intergenerational wealth transfer. These considerations will necessitate firms to provide additional fiduciary and tax planning services and will likely be incorporated by firms that are responsive to such shifting needs.

Investors may be more willing to pay for financial planning if it incorporates varied scenarios and delivers a path to achieving life goals (or make effective trade-offs between them) through uncertain times. Also, given that the pandemic quickly turned into a liquidity crisis for some retail investors, the scope of the financial advice they sought from wealth managers was broader than simply investment products, but also included banking and lending products. Indeed, financial advice in a crisis is about an investor's or a household's total wealth, which concerns both sides of their balance sheet, as well as current and future cash flows. In that sense, the crisis is only accelerating the convergence of banking and wealth management.

When wealth managers pivot from responding to the immediate challenges posed by the crisis toward recovery, technology investments in several key areas should be prioritized to support success in what is likely to be a rapidly transforming market. At the same time, the pandemic has created an imperative and an opportunity for organizations to reengage with the workforce and reinvent their workplaces. The biggest challenge organizations may likely face in recovery is the tension between preparing for a return to previous activities and routines, such as getting back to work, while also embracing a new reality, rethinking work.[5]

Not a return to the old way of doing business

The acceleration in market and competitive trends, along with the confidence many wealth management firms have gained in their remote delivery capability, have set the stage for a strategic reset of firm operating models. Building on the success of operating remotely and faced with the challenges of getting back into the office, many firms have decided to remain remote with a portion of their workforce. Those functions that will be coming back into offices will need to migrate back slowly, according to detailed plans currently under development. Servicing the industry remotely provides its own challenges and opportunities to drive success in active strategies, serve clients through digital platforms, and provide holistic advice. While most firms will take on many of the strategies below, those firms that deliver on the potential of these opportunities will likely establish or extend market leadership.

Client interactions are quickly becoming fully digitally enabled. Critical business workflows are being digitized to enable changes in both client behavior and accommodate field personnel working remotely. For example, it has become increasingly important for advisers to be able to onboard new clients and open new accounts via virtual channels, appropriately managing risks such as know your customer (KYC) and Regulation BI disclosure requirements[6] without the need for "wet" signatures or an exchange of mailed documents.

Onboarding clients isn't where the story ends. The next challenge will likely be in providing differentiated experiences through the integration of interactive planning and performance reporting tools, in either a virtual or in-person setting. Incorporating visual representations of real-time scenario planning can provide for a richer experience and greater memory retention. We anticipate that firms who are investing heavily in designing and implementing these interactive experiences may be able to deepen their relationships with their clients.

Lines of defense will need to transform. While much has been written about system resiliency and trading controls, there are thousands of processes and hundreds of procedures and controls in nonglamorous supervision, risk, compliance, and operations functions within wealth management. These processes and controls have historically been underinvested in from a technology perspective, as either new regulatory compliance or client-facing initiatives held a greater priority. As a result, many of the supervisory responsibilities of these functions are still dependent on physical proximity, including those performed within branch offices. With that being said, key controls for many firms were already being digitized, and we expect this trend to be accelerated as firms reflect on their challenges of processing record volumes and managing extreme volatility. The maturation of the combined capabilities of advanced analytics, machine learning, and visualization software have made these capabilities more affordable. Margin and collateral controls are one example where digitization is being driven as a result of the high volumes of margin calls, counterparty collateral disputes, and liquidations or sell-outs experienced in the immediate market response to the crisis. It is prudent for each firm to revisit its controls inventory and ensure that each control is fit for operating in a remote environment. We also recommend mapping specific regulatory requirements, including the handling of personally identifiable information, by function and documenting how those are managed in a remote working environment.

Collaboration software has changed the way people work together. Colocating has been an important objective for many business functions to date because it has substantial collaboration benefits. Before the crisis, many wealth managers were already thinking through opportunities to further centralize and share some services (for instance, with pools of client service assistants assisting several geographically dispersed adviser teams through a centralized location). With the crisis, the idea of virtual rather than physical centralization has come to the forefront, with more flexible models emerging for sharing resources across teams and markets. Indeed, the premium is on access to expertise through any means rather than geographic proximity and physical interactions.

As a result, firms will likely continue to turn to secure team collaboration software. Whether applied to a team of traders, advisers, client service assistants, product specialists, or operations professionals, this software can enable teams to stay connected and communicate almost as effectively as being physically together. For instance, a leading private bank had just completed an installation of a new CRM system when the crisis hit. This new system enabled the firm to coordinate an immediate campaign to reach out to all existing and prospective clients and provided client teams the ability to continue to operate as one, even from multiple locations.

One of the bottlenecks that the industry faces currently is the ability to train staff remotely. Most firms operate training programs under an apprentice model, where a senior employee trains a junior employee through side-by-side training. The limitations of this approach created challenges in late March, as firms couldn't effectively transition workers to remotely functioning processing areas inundated with volume. This outdated model can be refined through remote learning and collaboration platforms.

Looking ahead

As the industry slowly emerges from the crisis and the "next normal" takes hold, the success of wealth management firms will likely depend on their ability to use the crisis to accelerate their digital transformation and embrace a more flexible operating model. Client interactions will change, whether by choice or necessity. Digital enablement will likely continue to be leveraged to meet business and customer needs, while how and where employees work and are supervised has already changed. **The timing of this transformation may have been accelerated by as much as two years in just the previous two months.**

Digital enablement
Many clients are embracing new digital tools to interact, while advisers adopt digital tools to enable them and their teams at an equally breakneck pace.

Decentralized operations
Workforce and control framework flexibility is paramount; compliance and regulatory hands were forced, and remote working and supervision arrangements, which were long thought not feasible prior to COVID-19, were executed in only a few weeks' time.

Value of advice
The long bull market preceding the current environment challenged the value of professional investment management and advice. Those firms that weather the storm of COVID-19 are likely to have clarified the value that their services deliver.

Start the conversation

For more information about how wealth management firms are responding to the COVID-19 pandemic, please contact a member of our team:

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