The Digital Transformation of Asset and Wealth Management
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PAUL TUDOR JONES CALLS ON QUANTS TO REVAMP FIRM HURT BY LOSSES
"Jones, suffering losses and about $700 million in investor withdrawals in the second quarter, has accelerated a high-tech revamp at Tudor Investment Corp"
Bloomberg – August 3, 2016

REGULATOR CALLS FOR GREATER ASSET MGMT OPS OVERSIGHT
"The Financial Stability Board (FSB), a global regulatory body, has proposed a set of policy guidelines including recommendations targeting firms based on size"
FundFire – July 12, 2016

HEDGE FUNDS’ TECH METAMORPHOSIS SEEN IN CITADEL’S MICROSOFT HIRE
"Silicon Valley watch out. The finance industry is coming after your top managers"
Bloomberg – July 7, 2016

ACTIVE MANAGERS FACE DIRE MULTI-ASSET, PASSIVE ONSLAUGHT
"Multi-asset and passive products will soon account for 93% of total net inflows"
FundFire – July 13, 2016

HEDGE FUND ROBOT OUTSMARTS HUMAN MASTER AS AI PASSES BREXIT TEST
"By luck or design, Nomura's Simplex Equity Futures Strategy Fund ended the [Brexit referendum] day with a 3.4 percent gain, one of its best results in three months of trading."
Bloomberg – August 21, 2016

ASSET MANAGEMENT: ACTIVELY FAILING
"As investors pour into index funds, asset managers are seeking new strategies to keep them on side"
Financial Times – July 17, 2016
The asset management industry is under siege. A near-perfect storm of poor investment performance, mutual fund outflows, investor preferences for passive, low-fee strategies, and an onerous regulatory environment have led to a fundamental shift in the asset management business model. From the largest traditional asset managers to the smallest alternative and wealth management firms, assets under management have been contracting and/or moving into lower-margin products, forcing these firms to reassess their revenue, growth and profit potential going forward. As recently reported by the Financial Times, “Profits for asset management companies are set to fall by a third over the next three years, with analysts highlighting the rise of passive investing and volatile markets as the biggest threats to active managers. Between 30-35% of the profits earned by investment managers globally could be ‘wiped out’ by 2018, unless more radical steps are taken to cut costs.”

The traditional asset management business model has withstood the test of time, persevering through multiple market cycles and across shifting geopolitical landscapes. Riding a 30-year wave of steadily rising equity prices and falling interest rates, this model delivered stable management and performance fees, healthy profits, and rising assets under management (AUM). As a result, asset management firms felt comfortable and confident investing in their businesses, expanding their infrastructure to meet the demands of a growing investor base. However, the new realities of the marketplace are presenting significant challenges to firms across the industry.

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**Expected organic growth 2016 – 2020**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Digital/robo advice</td>
<td>62%</td>
</tr>
<tr>
<td>ETFs</td>
<td>12%</td>
</tr>
<tr>
<td>Factors and smart beta</td>
<td>11%</td>
</tr>
<tr>
<td>Bundled multi-asset</td>
<td>4%</td>
</tr>
<tr>
<td>Alternatives</td>
<td>3%</td>
</tr>
<tr>
<td>Non-ETF index</td>
<td>2%</td>
</tr>
<tr>
<td>Asset management industry</td>
<td>2%</td>
</tr>
<tr>
<td>Active fixed income</td>
<td>1%</td>
</tr>
<tr>
<td>Active equity</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: BlackRock.

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**Public asset manager profitability**

<table>
<thead>
<tr>
<th>Year</th>
<th>Bps of EBITDA per $ AUM</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>18.4</td>
</tr>
<tr>
<td>2011</td>
<td>18.5</td>
</tr>
<tr>
<td>2012</td>
<td>18.7</td>
</tr>
<tr>
<td>2013</td>
<td>18.1</td>
</tr>
<tr>
<td>2014</td>
<td>18.3</td>
</tr>
<tr>
<td>2015</td>
<td>16.3</td>
</tr>
</tbody>
</table>

Source: CapitalIQ. Measures EBITDA per dollar of AUM for 33 global asset managers with an aggregate $13.4 trillion in assets under management in 2015.
Executive Summary—Five Key Challenges Facing Asset and Wealth Management Firms

**Investor preference for passive strategies and ETFs**
Senior executives of asset management firms need to look beyond their traditional products and strategically embrace passive strategies, such as smart-beta exchange traded funds (ETFs). To retain or grow assets in the current environment, they will also need to create products that offer a more customized, solutions oriented and multi-asset approach.

**Pressure on trading, technology and operations**
Today’s head of trading needs to be globally minded, technology-oriented and fully committed to breaking down the barriers between siloed trading teams. By embracing electronification, they will be able to streamline these teams onto one universal technology platform, greatly improving execution, communication and the value added to the investment process, all while reducing headcount and costs.

**Poor investment performance**
As active portfolio management and mutual fund products continue to underperform, both traditional and alternative asset managers need to expand their suite of products to include more quantitative investment strategies, which have outperformed and are attracting material inflows.

**Rise of robo-advisory**
Today’s younger and more digitally oriented investing demographic is focused as much on fees as they are on performance. As a result, they will increasingly turn to robo-advisory platforms. Wealth management firms will need to embrace this technology if they want to court this emerging investor base.

**Regulatory and compliance requirements**
The new breed of successful compliance officer will aggressively leverage cutting-edge technology and data applications. The only way to ensure confident delivery of the required level of information will be to have highly accurate, enterprise-wide internal reporting systems that can capably assess the firm’s compliance with regulatory requirements.
While institutional investors have generally been fleeing hedge funds, they are increasing their allocations to systematic/quantitative strategies. Simultaneously, after seeing large outflows from 2008 – 2013, quant funds have become more transparent and have added more low-fee and mutual fund products to attract AUM. Institutional inflows to quant funds reached over $7 billion in the first quarter of 2016, and these funds were among the best performers during the recent Brexit-driven market gyrations. Bloomberg reported that Brevan Howard Asset Management used artificial intelligence (AI) to mine social media in advance of the vote.

Traditional analytics are being transformed by advanced digital technologies such as machine learning, artificial intelligence and predictive reasoning. These technologies, along with new quantitative techniques, are able to provide a competitive portfolio management advantage for those who are able to implement them. This evolution will continue and intensify going forward, as will investor demand for quantitative products.

### Recent market events

**August 9, 2016** – Wells Fargo acquired Analytic Investors, an institutional quant firm with $15 bn in AUM.

**June 29, 2016** – GAM acquired Cantab Capital Partners in order to build out a new quantitative investing unit, GAM Systematic.

**April 19, 2016** – Fundamental asset manager T. Rowe Price launched three new quantitative equity funds.

**Feb 27, 2015** – Bloomberg reported that Bridgewater is building an AI unit reporting to IBM alumnus David Ferrucci.

### Institutional flows into active quant strategies USD (billions)

<table>
<thead>
<tr>
<th>Year</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016 Q1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Flow</td>
<td>-$43</td>
<td>-$17</td>
<td>-$24</td>
<td>$23</td>
<td>$5</td>
<td>$7</td>
</tr>
</tbody>
</table>

Source: eVestment.

### New roles

<table>
<thead>
<tr>
<th>Role</th>
<th>What competencies are needed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quant/systematic portfolio managers/analysts</td>
<td>Strong engineering/technical skills adapted to a market context</td>
</tr>
<tr>
<td>Artificial intelligence developers</td>
<td>Coding/programming ability with AI and machine-learning expertise</td>
</tr>
<tr>
<td>Distribution professionals able to represent quant products</td>
<td>The ability to credibly articulate increasingly sophisticated quant and systematic strategies to investors</td>
</tr>
</tbody>
</table>
Investor Preference for Passive Strategies and ETFs

There has been a massive shift of assets away from traditional, actively managed funds into passive strategies and ETFs. In the first quarter of 2016, worldwide institutional asset managers saw net outflows of $95.4 billion, according to eVestment. These outflows came on the back of a further $137 billion in outflows during Q4 2015. Equity strategies alone reported $58.6 billion of net outflows in the first quarter, their 12th consecutive quarter of redemptions. The bulk of these equity outflows came in actively managed portfolios, which lost $70.5 billion, while passive equity strategies, in contrast, attracted net inflows of $11.9 billion. This trend is reflected in investor opinion as well as fund flows: a BlackRock survey found that 60% of Millennial and 40% of Gen X investors believe the market will outperform active fund managers, compared to 30% of Baby Boomers. Traditional asset management firms who have shunned ETFs for a variety of reasons, including the desire to safeguard their proprietary active-management investment processes, are at risk of being left behind. The new realities of the marketplace demand lower fees and greater liquidity, and asset managers will have to adapt by adding passive strategies into their suite of products.

<table>
<thead>
<tr>
<th>Year</th>
<th>Active</th>
<th>Passive</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>-$140</td>
<td>$184</td>
</tr>
<tr>
<td>2011</td>
<td>-$69</td>
<td>$166</td>
</tr>
<tr>
<td>2012</td>
<td>-$67</td>
<td>$132</td>
</tr>
<tr>
<td>2013</td>
<td>-$244</td>
<td>$87</td>
</tr>
<tr>
<td>2014</td>
<td>-$500</td>
<td>$108</td>
</tr>
<tr>
<td>2015</td>
<td>-$120</td>
<td>$82</td>
</tr>
<tr>
<td>2016 Q1</td>
<td>$83</td>
<td>$25</td>
</tr>
</tbody>
</table>

Source: eVestment.

New roles

<table>
<thead>
<tr>
<th>Role</th>
<th>What competencies are needed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Head of ETFs</td>
<td>The ability to design, implement and manage more solutions oriented products and strategies</td>
</tr>
<tr>
<td>Head of passive strategies</td>
<td></td>
</tr>
<tr>
<td>Head of multi-asset</td>
<td></td>
</tr>
<tr>
<td>Head of ETF distribution</td>
<td>Deep relationships with sophisticated institutional investors, combined with strong technology and/or product expertise</td>
</tr>
<tr>
<td>Head of digital product development</td>
<td>A combination of strong technical and product design skills with investor connectivity</td>
</tr>
</tbody>
</table>
The most significant technological trend in global markets of late has been the increasing electronification of trading across multiple asset classes. Most asset and wealth management firms have multiple trading platforms for different products, channels and currencies – an expensive, inefficient and outdated execution model these firms can no longer afford. With electronification having already conquered the equity, commodities and foreign exchange markets, the next trading domino to fall will be fixed income, which has stubbornly clung to its outdated voice-execution model. JP Morgan Chase's recently announced partnership with Virtu Financial to use their technology in the dealer-to-dealer US treasury market is indicative of the future of trading. Within the next decade, it seems inevitable that electronic execution will be the standard across all major global asset classes.

Gary Cohn, the President and COO of Goldman Sachs, was recently quoted at the Deutsche Bank Global Financial Services Investor Conference as saying, "In addition to capitalizing on disruption in the competitive landscape, we continue to embrace technologically-driven market disruption … there has been a tremendous rise in electronification in the financial markets over the last two decades … We invested in technology in response to feedback from our clients and adapted early to the electronic market in Equities … We aim to provide these clients better execution and lower transaction costs."

The challenges facing trading, technology and operations demand a new breed of technology savvy trading leadership for asset management firms.

### Notable Moves

Citadel has been at the forefront of recruiting new talent to build its IT capabilities. In Q2 2016, they made a number of substantial executive hires, bringing in Microsoft’s COO, Kevin Turner, as the Chief Executive Officer of its Citadel Securities unit, and Morgan Stanley’s CIO Steven Lieblich as the Chief Technology Officer of its hedge fund business.

Other notable moves include Bank of America’s hiring of Pankil Patel from Credit Suisse to lead electronic trading services in the Americas, Bridgewater Associates’ hiring of Jon Rubinstein from Hewlett Packard to serve as its co-CEO and Point72’s hiring of Timothy Shaughnessy from IBM to be its Chief Operating Officer.

### New roles

<table>
<thead>
<tr>
<th>New roles</th>
<th>What competencies are needed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Head of trading/electronic trading</td>
<td>The ability to lead large global teams; strong risk-management and execution background; technology orientation</td>
</tr>
<tr>
<td>Head of trading technology integration</td>
<td>The capacity to transform outdated and siloed infrastructure, embracing electronification and deciding whether to &quot;build or buy&quot;</td>
</tr>
<tr>
<td>Head of derivative trading/clearing/operations</td>
<td>Product fluency in derivatives across asset classes and geographies, combined with a strong operations background</td>
</tr>
</tbody>
</table>
The robo-advisory industry continues to see rapid growth, focused primarily on the mass-affluent market segment. Robo-advisors have built up over $200 billion in AUM over a relatively short period of time and are projected to increase to $2.2 trillion over the next five years.

As PwC wrote in its January 2016 “US Asset and Wealth Management M&A Insights,” “Due to their robust technology platforms and low human involvement, the robo-advisors are able to provide high end wealth management advice at a low fee to their price-sensitive customer base.” PwC also stated that, “Morgan Stanley, Bank of America Merrill Lynch, Wells Fargo and Deutsche Bank have all recently publicly stated an intention to significantly invest in developing or acquiring digital advisory capabilities” and noted, “While it is unlikely that robo-advisors will completely replace their human counterparts, the optimal model will combine a robust digital experience with the ability to interact with a human advisor.”

Robo-advisors are here to stay, and wealth management platforms will need to adapt to this new reality to remain relevant. A BlackRock survey revealed that 58% of Millennials are interested in using a robo-advisor platform. If wealth managers can establish digital relationships with this emerging demographic of potential clients, they can then introduce more traditional products to achieve a greater share of wallet. Despite being digitally disruptive, robo-advisors will enhance, not replace, the wealth advisor.

### New roles

<table>
<thead>
<tr>
<th>Role</th>
<th>What competencies are needed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Head of robo-advisory platform architecture and integration</td>
<td>Strategically minded digital leader to build/buy/integrate the robo platform</td>
</tr>
<tr>
<td>Head of client experience</td>
<td>Digital CMO experience</td>
</tr>
<tr>
<td>Digitally savvy wealth advisors</td>
<td>Connectivity with the next generation of investors</td>
</tr>
</tbody>
</table>

### Rise of Robo-Advisory

**Forecast—Robo-advisor AUM USD (trillions)**

<table>
<thead>
<tr>
<th>Year</th>
<th>AUM (trillions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016E</td>
<td>$0.3</td>
</tr>
<tr>
<td>2017E</td>
<td>$0.5</td>
</tr>
<tr>
<td>2018E</td>
<td>$0.9</td>
</tr>
<tr>
<td>2019E</td>
<td>$1.5</td>
</tr>
<tr>
<td>2020E</td>
<td>$2.2</td>
</tr>
</tbody>
</table>

Source: KPMG.
The current regulatory environment, which has consumed the attention of the banks for the past several years, is now asserting itself on the buy-side. To meet the new wave of regulatory requirements, asset and wealth management firms will have to invest significantly in their legal and compliance capabilities, which will be a further drain on profitability.

There is little room for error, as the ability to deliver a credible risk-governance model to the regulators has never been more important. Accurately measuring, monitoring and managing credit, counterparty and liquidity risks have become enterprise-wide imperatives, not only because of greater regulatory scrutiny, but also because of the overwhelming financial implications of non-compliance, which can threaten the very survival of an asset management firm.

The traditional path for compliance officers within asset management firms has been almost exclusively through the legal and compliance silo. In our analysis of the background of incumbent CCOs at global asset managers, we found that 68% have risen to their current roles from a purely asset management compliance background. For firms to build systems and processes in a way that is mindful of new market realities and regulatory demands, they will need to employ compliance officers who are digitally savvy and technology-oriented.

### Backgrounds of current CCOs at global asset managers reflect a lack of career diversity

<table>
<thead>
<tr>
<th>Background</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compliance (asset management)</td>
<td>68%</td>
</tr>
<tr>
<td>Legal (asset management)</td>
<td>41%</td>
</tr>
<tr>
<td>Regulator</td>
<td>38%</td>
</tr>
<tr>
<td>Legal (law firm)</td>
<td>24%</td>
</tr>
<tr>
<td>Consulting/big 4 accounting</td>
<td>9%</td>
</tr>
<tr>
<td>Audit</td>
<td>6%</td>
</tr>
<tr>
<td>Compliance (commercial banking)</td>
<td>6%</td>
</tr>
<tr>
<td>Compliance (investment banking)</td>
<td>6%</td>
</tr>
<tr>
<td>Risk</td>
<td>6%</td>
</tr>
</tbody>
</table>

Source: Russell Reynolds Associates.

### New roles

<table>
<thead>
<tr>
<th>Role</th>
<th>What competencies are needed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technology-oriented compliance officer</td>
<td>Legal/compliance experience combined with a business-oriented and tech-savvy approach</td>
</tr>
<tr>
<td>Head of compliance/platform design/integration</td>
<td>Technology leadership with a background in enterprise risk management</td>
</tr>
</tbody>
</table>
# What’s Next for Asset and Wealth Managers

The asset and wealth manager of 2020 will be vastly different from those of today.

## 2016 challenges

<table>
<thead>
<tr>
<th>Poor investment performance</th>
<th>Delivering smart beta and low-fee alpha to investors via algorithmic, quantitative and artificial-intelligence based strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Passive strategies and ETFs</td>
<td>Providing multi-asset solutions and incorporating a mix of active, factor-based and passive strategies in bespoke portfolios</td>
</tr>
<tr>
<td>Trading, technology and operations</td>
<td>Offering integrated and technologically advanced trading platforms across multiple products and currencies, seamlessly linked with clearing and operations. Able to transform a highly-efficient trading tech &amp; ops platform into a profit center</td>
</tr>
<tr>
<td>Robo-advisory</td>
<td>Offering mobile-enabled products that gather substantial assets from Millennial investors. Robo-advisory integrated with financial advisors to deliver a seamless coverage model. Providing a best-in-class user experience and the ability to scale without large sales networks</td>
</tr>
<tr>
<td>Regulatory and compliance</td>
<td>Possessing enterprise-wide reporting driven by a seamless technology infrastructure encompassing all dimensions of risk and governance. Product teams working in partnership with compliance to develop new products and distribution strategies</td>
</tr>
</tbody>
</table>
Russell Reynolds Associates is a global leader in assessment, recruitment and succession planning for boards of directors, chief executive officers and key roles within the C-suite. With more than 370 consultants in 46 offices around the world, we work closely with public, private and nonprofit organizations across all industries and regions. We help our clients build teams of transformational leaders who can meet today’s challenges and anticipate the digital, economic, environmental and political trends that are reshaping the global business environment. Find out more at www.russellreynolds.com. Follow us on Twitter: @RRAonLeadership.

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