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Firing On All Cylinders: Where Human Meets Capital

McLagan's Wealth Management practice is excited to announce the start of a thought leadership series, Firing On All Cylinders, designed to explore some of the key challenges and opportunities in the wealth industry today. We will consider how wealth managers can address these challenges holistically by improving client engagement, employee engagement, and financial results.

Our first topic, Where Human Meets Capital, explores the evolution of human capital in wealth management. In this week's article Peter Keuls, McLagan's Global Head of Wealth Management, explores how technology continues to change the wealth management workforce, and considers how firms can best position themselves for tech-enabled success.

As long as there is wealth, there will be a need from the wealthy to plan it, protect it, grow it, apply it, and transition it. Historically, this has been a very high-touch undertaking. Now, however, wealth management is one of the sectors that will be most impacted by technology which will replace what were once considered to be core functions such as relationship management, investment management, and trust administration with machines.

Transitioning a wealth manager from a very traditional business to a nimble, technology-enabled enterprise will require thorough workforce planning and deliberate shifts in the employment lifecycle – recruitment practices, location strategy, pay and benefits programs, performance management systems, and culture. The challenge is that these types of changes can be both risky and time-consuming while more nimble and less encumbered competitors threaten to outflank established firms. The implication is clear – firms need to carefully plan the workforce shifts that will be required over the next decade and get started now on creating the environment for future success as a WealthTech enterprise.

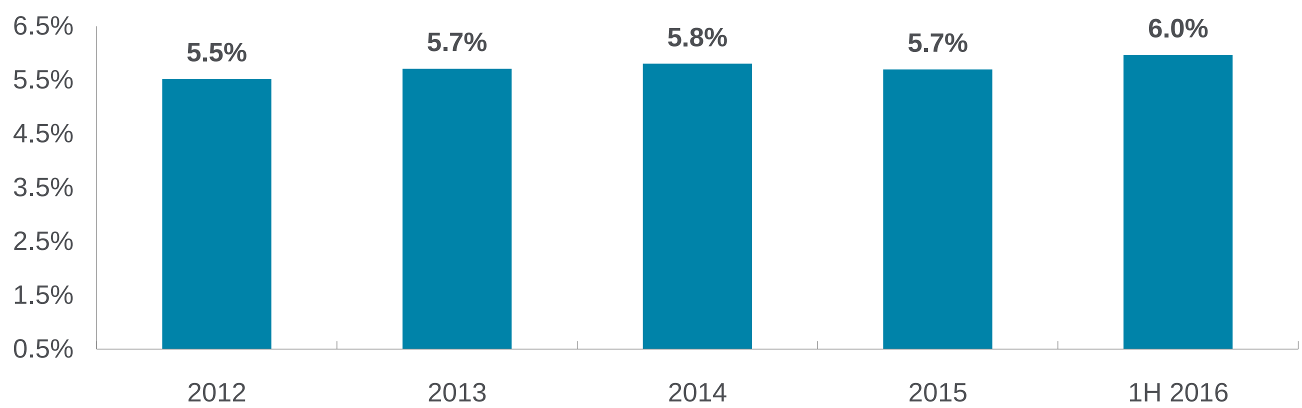
How the Wealth Management Workforce Will Change

Continued decline in the cost of computing power coupled with emerging artificial intelligence capabilities will move automation in wealth management into a new era. We have already seen digital and mobile technology empower both client advisors and clients to access information, analyze their accounts and execute transactions more efficiently. Many basic administrative processes have already been streamlined and automated.

Trust administration and portfolio management are ripe for transformation, especially as artificial intelligence becomes widespread. Automation in investment management in the form of index investing has already effectively replaced at least 20% of the equities investment industry, but machine learning tools will threaten what is left of active management. Computers are increasingly able to spot patterns from masses of data, learn without human intervention and make trade-off decisions enabling them to identify, test and refine active management strategies. They will be able to do that more objectively, more quickly and more thoroughly than human portfolio managers. In time, trust administration and portfolio management will largely be automated. While wealth management firms are now completely occupied by introducing automated investment offerings leveraging ETFs and index funds, the next wave of innovation will focus on the core discretionary portfolio management products in order to deliver active management at fee levels closer to index funds – a much more competitive value proposition than the current high fee / low alpha proposition provided by most active management.

We are already seeing the shift to a WealthTech workforce with technology headcount and functional expenses growing at the expense of other functions.

Figure 1: U.S. Brokerage Firm Technology Costs as a % of Total Expenses
2012 – First Half 2016



Wealth Managers of the future will need to be technology companies as much as financial firms. As such, they will be competing with a much broader set of firms for talent than they are used to doing. Top technologists expect a very different work environment than is typically found in banks (see table below) and, as a result, banks have had difficulty attracting teams to staff design and development of new robo offerings. Many firms are finding they need to pay a premium to find the critical talent they need or make an acquisition which comes with its own challenges.

	Tech Company	Financial Firm
Pay	Lower bonus Pre-IPO options with huge upside potential	Lower base, higher bonus Regulated Less attractive equity with onerous vesting and clawback provisions
Work location	San Francisco, Virginia, Dallas Remote working common	New York, St. Louis, Charlotte Remote working growing
Work environment	Casual, unstructured, creative	Formal, structured, bureaucratic
Career path	Flexible, can be highly accelerated	Hierarchical
Mission	Disruptive	Conservative

Planning the Workforce of the Future

Wealth management firms need to begin creating the workforce of the future and a critical task will be to determine how to blend the very different talent profiles, cultures and talent practices of technology and financial firms. This planning must include:

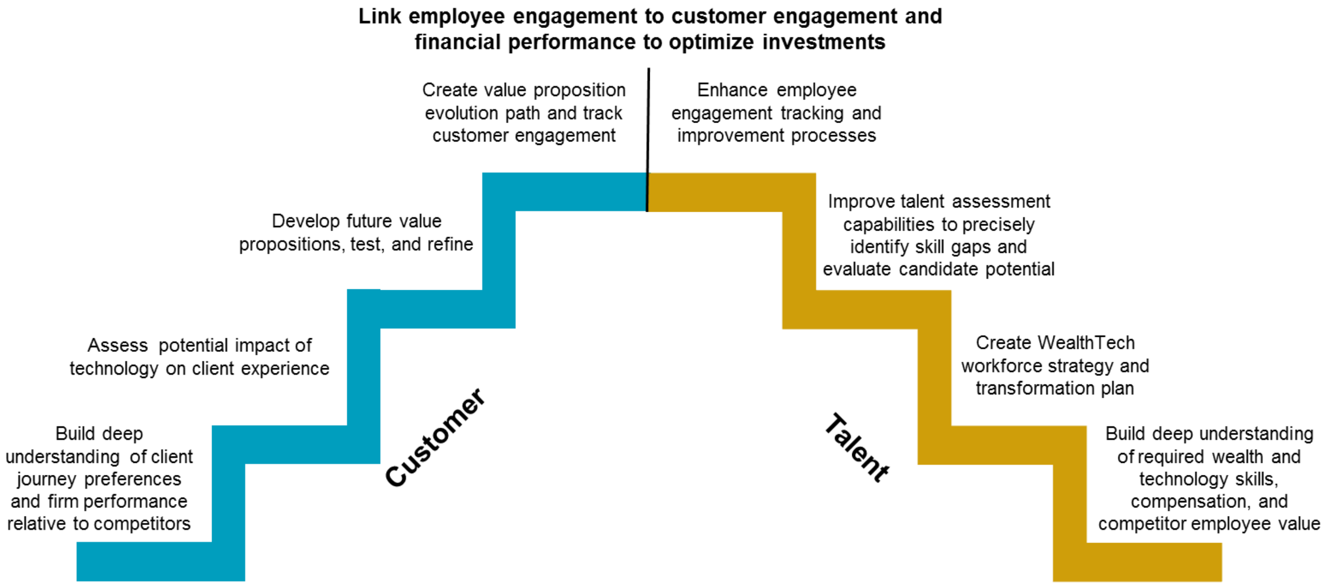
1. Mapping the value proposition, service, and supporting capability development path

2. Anticipating the skills that need to be acquired and, equally importantly, the skills that need be exited – getting this timing right will be critical

3. Creating an employee value proposition that is as attractive as Google or a tech start-up, while maintaining the core wealth management values that are critical to the unique fiduciary requirements in this sector. The mission, work content, and office environment is more important than pay for many technology recruits. FinTech start-up Monzo found, “people want to work on really hard problems from scratch with other talented people, rather than be small fish in a big pond, maintaining software that’s been there for 30 years.” Because banks find these engagement factors more difficult to change, they often rely on pay to attract talent – an expensive proposition.

4. Developing a talent sourcing strategy that includes both internal talent development and external talent recruitment to meet the workforce plan goals. Talent assessment tools for both existing staff that can be developed into new roles and new recruits will be critical for identifying the best candidates for the roles that need to be filled. Most firms have under-invested in these tools and use outdated technology resulting in greater recruitment risk.

Figure 2: Workforce Transformation Path



As much as wealth management firms need to reinvent their value proposition and business model, they need to transform their workforce strategies to support these changes. The pace at which the business can make these organizational shifts will be the bigger constraint on change than the sheer technical development time. Planning the workforce of the future must begin now.

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