Digital Wealth Management

From disruption to a sustainable business model

The basic conditions for the management of private assets have changed drastically in recent years. This is due to a number of factors, including:

- **Products:** The increasing importance of passively managed and therefore low-margin funds, which should reach a market share of around 30% by 2020 (EY Global ETF Research 2017)
- **Profitability:** The decrease in profitability since 2009, from 37 to 23 basis points of assets under management (BCG Global Wealth Report 2017)
- **Regulatory:** The increase in transparency requirements – e.g. regarding costs in the EU through Mifid II
- **Digitization:** The rapid growth of assets managed by FinTechs and robo-advisers – e.g. to over $150 billion in the US (TechFluence, 2017)

When these dimensions are compared internationally, there are significant differences. The US, for example, is much more advanced than Germany especially regarding the adoption of digital solutions However, in Germany, the importance of robo-advisers will also massively increase in the next few years and, according to Oliver Wyman, the assets managed by them will increase to $42 billion by 2021.

The following article outlines developments in Germany. However, the key messages regarding the disruption scenario and future business models can also be transferred to other countries.

What are the implications of the above developments on wealth management – especially if robo-advisers expand their focus from smaller assets to the larger asset volumes of private banking clients? In addition to the high level of convenience that robo-advisers offer, they can provide clients with significantly lower costs than traditional banks. In Germany, while the total cost of traditional private banking (including the costs of depots, trading, portfolio management and products) is around 2% of the value of assets under management per year, the cost of robo-advisers is 0.5–1%.

The significantly higher cost of private banking, which is having a massive impact on returns – especially in the current low-interest-rate environment in Europe – is justified by traditional private banking providers by two aspects:

1. The active management of clients' portfolios and the claimed generation of an excess return
2. The scope and quality of the personal advice they offer

On the one hand, one must question the value of active management in the context of private wealth management given the empiric evidence and lack of scale. On the other hand, personal and high-quality advice cannot justify the significant price differences seen between traditional private banking and robo-advisers. Rather, the significant cost differences result from the complexity of the products and, above all, a lack of standardization and digitization of support and back-office processes. The continuation of trends seen in recent years leads to a disruption scenario in private wealth management.

The resulting disruption scenario is not only promoted by technological change and market developments, but, above all, is accelerated by changes in customer requirements – in particular, by the "generation of heirs". This generation has a significantly higher online affinity with user behavior and price transparency. Due to the large volumes of money that are inherited across generations – according to estimates for Germany, €2.1 trillion will be inherited between 2015 and 2024 – this change will have a significant impact on the industry.

The resulting changes do not affect banks alone. These also affect all those involved in the value chain, especially asset managers and stock exchanges. We assume that the relevant investors in Germany have liquid assets of €1 trillion. As already described, the total costs of traditional asset management generally amount to at least 2% of the investment volume or, correspondingly, €20 billion per year. In the future, with the improvement of efficiencies, it will be possible to offer private wealth management with a differentiated level of personal advice- profitably for 1% – i.e. there is a potential for disruption of €10 billion per year. In the disruption scenario, two €10 billion-questions will have to be answered: 1) how fast will the efficiency potential of €10 billion per year be lifted; and 2) who earns the remaining €10 billion?

However, the future will not belong solely to robo-advisers. Rather, these developments pave the way for digital wealth management as a profitable business model for existing players. This means the rise of private wealth management for investors with liquid assets of €10 thousand to €1 million, which uses a rule-based investment approach relying on ETFs to increase efficiency potential and combines this in a hybrid model with comprehensive online and offline advice. The combination of scaled investment processes with personal advice, which efficiently combines online and offline formats, will be the decisive success factor here.

Despite these opportunities for banks and financial services providers, who are adapting quickly to the new conditions, the upcoming disruption will initially lead to massive changes in the market. Two aspects will have to be addressed for the successful rise of digital wealth management. On the one hand, the exploitation of the efficiency potential through the extensive standardization of portfolio management, the digitization of processes and the seamless integration of online and offline customer interaction is important. The second aspect, which is critical to customer loyalty and business model profitability, is a new form of customer focus that breaks away from liquid assets and focuses on the investor and their family's advisory needs.

Examples of concrete project approaches for banks with traditional retail businesses include:

- Cost-efficient mapping of smaller asset volumes, which are typically not profitable, by using robo-advisers, possibly as a white label solution
- Changing from an active to a standardized passive investment approach to increase efficiency
- Expanding customer advice on all asset components – i.e. liquid and illiquid assets – based on digitized support processes

The key to the success of a digital wealth management strategy and the implementation of these measures will be a comprehensive transformation process that accompanies the introduction and use of new technologies and prepares employees for new roles and tasks within customer interaction. The development and direction of this transformation will be the core task of senior management in preparation for the new world of digital wealth management.