



# SHAPING the New Order of WEALTH MANAGEMENT

Here's an overview of four strategic developments that will shape the direction of the U.S. wealth management industry.

**BY** J. GIBSON WATSON

**D**uring the autumn of 2008, in what seemed to be a blink of the eye, enduring investment banks had disappeared, credit markets had ceased functioning normally, and the government had begun nationalizing financial systems. Suddenly, politicians of all stripes, many with virtually no real-world experience, were pulling the levers on the great free market train.

Calculations of how and why the capital markets lurched so completely off the rails will occupy academics for a very, very long time. They should. The speed of the train wreck was astonishing. While the wheels actually started slipping in 2005 when an unthinkable large and slippery pool of subprime loans began oozing into the marketplace, the big machine's ultimate derailment in the autumn of 2008 was sensational.

Make no mistake. This was no simple course correction for the market. This was a fundamental business rearrangement of the market. And out of this disorder will emerge, dare I say, a new financial world order.

## **A Different Landscape**

As the global economy reorders, leaders of the money management industry confront a more profoundly uncertain business environment than they've ever faced. Uncertainty surrounds not only the depth and extent of the disorder but also the very future of global economic order. Uncertainty of this magnitude is bound to leave some industry executives lost in the fog. The task of industry's real leaders, then, is to overcome the abstractions and begin shaping the future.

The profile of the entire wealth management industry is about to be transformed. This disorder, unpleasantly enough, has temporarily leveled the playing field by flattening the features of the players. In the short run, this collapse of distinction opens the competition for affluent investors in a meaningful way to a

whole bunch of non-Wall Street sorts such as financial planners, CPAs, lawyers, insurance agents and bankers. We have to think that given the mind-numbing number of managed products and securities in the marketplace today, the competition will be won not by reputation, size or brand, but by the quality of product, advice and service offered.

## **Emerging Realities**

While the rebuild is in its early stages, the firms and managers that are to bring order out of this confusion will have to move quickly if they're to rebuild and regain consumer confidence. Near-term decisions will influence not only how well organizations manage the current chaos, but more important, how they'll compete over the long haul. The survivors will be companies that, despite the complexity, confusion and

uncertainty of this marketplace, carefully assess the landscape and move forward. From our perspective, there are a number of distinct strategic developments emerging out of the clutter that will shape the direction of the new order of the wealth management industry.

## **1. Size no longer equals trust.**

The days of investors looking no further than the big Wall Street houses for investment advice are very likely over. The idea that size and history alone are enough to win the hearts, minds and wallets of folks with money disappeared with Lehman. Don't count on it re-emerging, especially now that all the former investment banks are commercial banks. The new reality is that multilayered wealth managers are simply more complex,

not more inspiring.

Already there is money in motion. Investors, many of whom are looking at a near halving of their net worth, are looking for a better form of investment advice and a better class of investment product. In an environment where prudence, risk management and excellence are more important than ever, it's reasonable to expect the emergence of high-touch, high-quality, advisory firms to come to the fore.

## **2. Financial advisers are free agents.**

Not surprisingly, there's a palpable and growing dissatisfaction among advisers who know the old brokerage world is hurting. While broker satisfaction is strained up and down the industry, a recent survey (2009 National Financial Broker and Advisor Sentiment Index) reported that two-thirds of brokers who say they're likely to switch firms this year would prefer to move to another type of firm. Since a huge majority of brokers who switched firms in 2008 chose a nonwirehouse setting, we're willing to infer that many, particularly the most productive, have been noiselessly looking for a similar kind of soft landing for their respective books of business in 2009.

The demand for top-producing advisers will be strong across all levels of the continuum. To their collective credit, the wirehouse firms have responded with aggressive retention package offers and improved payout ratios. But the trend toward independence is already in motion, and we see nothing on the horizon that will do anything but accelerate that kind of activity. Reports indicate that Schwab and Fidelity alone attracted some 140 wirehouse teams representing upward of \$20 billion in client assets during the third quarter of 2008. We'd have to think the events of the fourth quarter, not the least of which dramatically reduced equity positions, will only accelerate that kind of activity.

The result will likely be a dramatic dislocation of good advisory talent away from what's left of the big brands. The environment is ripe for recruiting everywhere else. The bank model, certain regionals, independents, and

boutiques are likely to benefit. Look for acquisitions and consolidations to accelerate.

## **3. An environment of intense regulation and over-legislation is here to stay.**

The federal government has already assumed a dramatically expanded, and likely permanent, role in the business of financial markets. Policy-makers have gone to great lengths to stabilize the monetary systems, to support individual companies whose failure might pose systemic risks and to prevent a deep economic downturn. But we've no idea how well the Feds will work with the Street to develop effective regulatory and monetary policies or what those responses may mean for the long-term health of the global capital market.

We'd have to expect, though, legislators will overshoot the mark in the form of major structural reforms of finance and many other sectors. Though little has occurred through this crisis to discredit the system of free-market capitalism, it's very likely the Securities and Exchange Commission and Financial Industry Regulatory Authority will have their figurative hands in the industry to an extent few imagined possible. We've already seen caps on executive pay. Look for similar intrusions into bank oversight and the risk management process. For firms operating under this scrutiny, the value of self policing and a well-designed best practices procedure cannot be overstated.

## **4. Investment quality and open architecture will be absolutely essential to success.**

In my opinion, the speed of the gradual migration from proprietary products to open architecture investment platforms will increase algorithmically. In-house offerings and programs—already less viable—will wither as investors seek objectivity, quality and broad diversification. True open architecture, especially the kind that looks beyond simple performance and emphasizes qualitative due diligence and process, will align with both

client goals and regulatory scrutiny. Banks structured with these ideals as key ingredients, and the firms that emulate them, will have a distinct advantage in the new world.

## **Surviving and Thriving**

All of the rebuilding will take place in the midst of an economy that is, to say the least, not so robust. Recession is upon us and, it's impossible to gauge the effects of proposed Federal spending. But no matter what happens on the economic front—and any number of things could—what is certain is the crisis on Wall Street has turned a nation of spenders into a nation of savers.

For the wealth management business, the implications of all this are profound. As assets under management, already down by nearly a third in 2008, continue to shrink, further cost cuts and product mergers and closings will likely follow. Against that backdrop of what's essentially forced consolidation, banks may be in the best position to capture the bulk of the resulting money in motion. Indeed, banks, among all their competition, have the best opportunity to secure client trust. In addition to a mostly untarnished brand, banks are uniquely positioned to satisfy fiduciary responsibilities by serving investors' best interests.

In the long term, we could well end up with a new, fair, transparent and judiciously regulated environment where capital formation has found traction and the economy is motor-ing full-speed ahead. In the short term—say the next year or two—we will certainly end up with new wealth management leaders as re-ordering dynamics take shape. Those financial services companies that demonstrate the most flexibility and awareness will likely survive the crisis. Those whose leaders seize the extraordinary opportunities that arise during periods of uncertainty could very well prosper. **■**

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*J. Gibson Watson is president of Denver-based Prima Capital. Watson was a presenter at ABA's Wealth Management Conference in March.*

*All views expressed in this article are solely those of the author.*