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DPM & the Advice-Led Revenue Generation Model

There is a ubiquitous push across Asia's wealth management community to derive more stable revenue by migrating clients more towards discretionary mandates and advice-led, fee-generating solutions. A panel of experts at the Hubbis Investment Solutions Forum gathered to assess the industry's progress, or, in some cases, lack of.

These were the topics discussed:

- *What doesAdvice vs discretionary - what's best?*
- *How are you working with third-party partners?*
- *How can you differentiate your DPM offering? To what extent can you be innovative?*
- *Given more challenging market conditions - is advice more important than ever?*
- *Do Asian clients still have a strong desire to retain control? How do you deal with that?*
- *Opportunities of key market mega-trends like millennials, baby boomers, women empowerment, ESG, SRI. How are you capitalising on these?*
- *When a client gives you an active advisory mandate - what are their expectations?*
- *Do Asian clients have unrealistic expectations for higher risk-adjusted returns? Or less so today?*
- *How do we provide any real intellectual insights?*

PANEL SPEAKERS

- **Jean-Louis Nakamura, Chief Investment Officer, Asia Pacific - Chief Executive Officer, Hong Kong, Lombard Odier**
- **Anthony J. Harper, Chief Executive Officer and Co-Founder, Axial Partners**
- **Vincent Ng, Joint Chief Investment Officer, Wealth Management, Asia ex-Japan, Nomura**
- **Grizelda Lee, Senior Director, Head of Discretionary Portfolio Management, Asia Indosuez Wealth Management**
- **Peter Dietrich, Head of Business Development, Greater China, Morningstar**

EXECUTIVE SUMMARY

There is plenty of navel-gazing these days in Asia's wealth management community. A decade after the global financial crisis and the private banks and other firms have not yet significantly evolved their businesses beyond the dominance of product-led revenue streams. But they want to and are re-focusing their internal and external initiatives and investments to achieve this outcome.

Can they fully differentiate their discretionary portfolio management (DPM) offerings? Can they convert Asia's high-net-worth individual (HNWI) clients to advice-led fees, rather than needing to constantly promote product ideas with their clients? Can Asia's HNWIs change their spots and relinquish more control over their portfolios and also pay more readily for professional advice? Can these HNWIs moderate their expectation of returns as the markets turn more volatile after many years of bullish sentiment? Is the active approach in fact actually better than passive strategies anyway, even in testing times?

A panel of experts assembled at the Hubbis Wealth Management Solutions Forum in Hong Kong to debate these matters, increasingly considered to be of existential importance for Asia's wealth management industry.

JEAN-LOUIS NAKAMURA
Lombard Odier

GRIZELDA LEE
Indosuez Wealth Management

WE APPLY AND TREASURE the tailored advisory approach," said one guest on opening the panel discussion, "and this is truly from the bottom up rather than imposing our house views. Obviously, when clients come to us they have particular investment perspectives in mind, so we enter a dialogue with them. We are very open-minded to share our resources, our institutional research platform, the mission being to create value for their portfolios."

Another expert noted that there are three elements to portfolio management - market return, asset allocation returns in excess of market return and lastly the active management return.

VINCENT NG
Nomura

Managed accounts – a discretionary, fully transparent choice

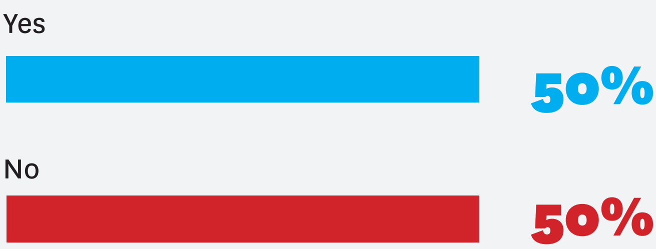
And one attendee highlighted their managed account platform, designed to help wealth managers who look after HNWIs access third-party money management via a managed account. "The solution," he explained, "shifts the relationship structure of the wealth manager with their clients from a sales structure, such as through a fund, to a discretionary structure via the managed account, which in turn results in a fee-based and potentially recurrent revenue stream from that relationship."

"We believe in taking the emotion out of investing," reported another banker. "Emotions in the field of family wealth management and planning and in the field of investments are negative, so we believe that the outsourcing to professional advisers and investment teams is advisable."

Exorcise the emotion

"To have a fruitful relationship long-term with our clients," he added, "those clients at some stage have to accept the idea that they have to start to buy DPM. This does not need to be the whole portfolio but some portion of that should be managed through a process which is systematic, agnostic, and longer-term allowing for the compounding of returns over time. We do not want to appear arrogant, but this is what we believe, and

DO YOU SEE ANY EVIDENCE FROM YOUR CLIENTS THAT THEY ARE MORE INTERESTED IN A DISCRETIONARY CONVERSATION?



Source: Investment Solutions Forum 2018 - Hong Kong

the clients are discussing this with us because they are open to the concept."

He noted that the bank already has two-thirds of its client assets under management (AUM) under DPM, although they reached that figure two years ago and it has since not budged. "The assets keep growing but the percentage penetration does not yet," he remarked. "We find that most clients are not able to sustain the perhaps somewhat boring, agnostic discipline with little space to play themselves."

Mind your (financial) behaviour

Another banker observed that advisory mandates still hinge on the client decisions. "Behavioural finance is involved in these situations," they explained. "For example, a client might have loss aversion, and be unable to cut an investment when clearly, logically they should. There have been studies conducted that show the psychological impact of a loss is double the impact of an equivalent gain. We have to also realise that clients have confirmation bias, which are preconceived conclusions on which they seek information that would support those views, so the client does not listen to the advice proffered. These are some of the challenges that I was facing when it came to advisory."

However, this banker has now moved to the DPM side of the business. "We are using models and tools and are very much hands-on for the clients. Both advisory and DPM have their merits and suit some clients, or not. Our penetration rate is now over double-digit percentages for both disciplines."

Open minds for best-of-breed solutions

Another banker concurred, adding that overcoming the confirmation bias is difficult as is differentiating their offering. "Can we really generate alpha for our clients, or is it just beta return versus an alpha and beta framework? We emphasise a truly bottom-up process which is transparent and allows for a wide variety of views. This allows us to offer best-of-breed solutions, so, for example, we can advise clients to implement particular strategies by using actively managed funds, by using passive ETFs, by using some index product or other structured products. We also have an eye on the regulatory demands, which require us to be able to justify our recommendations."

He also noted that as different clients have divergent requirements and expectations, the firm overlays the bottom-up approach with a top-down process. "And our advisers act as the trusted partner for clients, to initiate and engage in their conversations with them in order to help differentiate us. Overall, the key message is the non-biased, objective approach to achieve the best solution for clients, so we partner with any kind of managers to deliver that true value to our clients."

Another expert highlighted the findings from studies it had conducted some years ago. One study was trying to quantify the value of advice, another was designed to address the difference between asset-weighted return and time-weighted returns.

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Bad timing is far from unusual

"These highlighted that investors are similar globally, they are bad market timers," he reported. "And the conclusion is that outsourcing to professionals is preferable from a variety of aspects, including the time involved. I think as people realise where we are educated on the value of the advice and the reality that we are typically not good market timers, that they are more likely to succeed in whatever their financial objectives. My conclusion here in Asia is it will only be a matter of time before people do start to go to a fee-based advice model and that to value that the industry needs to educate them more."

ANTHONY J. HARPER
Axial Partners

Trends – women's wealth and ESG

The discussion turned to women in the investment world, noting that trillions of investable dollars are now controlled by females as the globe's wealth and cultural norms shift to a modern paradigm.

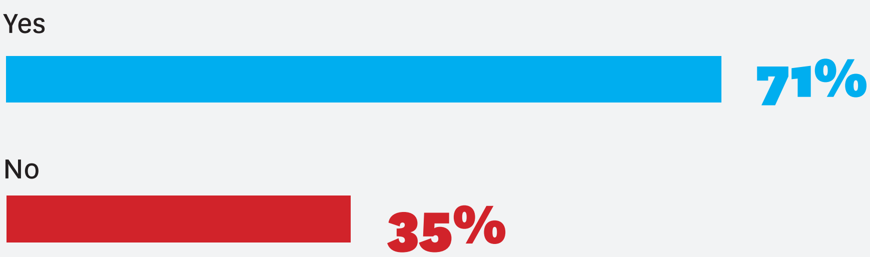
"Women live longer than men and have also been inheriting at a dramatic pace," noted one guest, "so when a male client passes away the client relationship has tended to move on to another firm, but far greater efforts are being made to maintain a broader client relationship, with the spouse and wider family."

Additionally, he remarked that as women and offspring in the younger generations control more wealth, certain investment preferences for example impact investing and ESG (environment, social and governance) investing become more prevalent.

A female guest commented that hiring practices have been improving towards women in the wealth management workplace. And another expert noted that in certain markets - for example, Malaysia - women are in the majority in senior levels of the banking and wealth industry and different countries are moving at varied paces, but all tending towards the same direction.

"ESG," said another participant, "is indeed rising fast, especially in Europe. It is not a new theme but what has helped accelerate its penetration is that the industry has largely

DO YOU THINK THE CONVERSATIONS WE HAVE WITH CLIENTS AROUND INVESTMENTS ARE TOO COMPLICATED?



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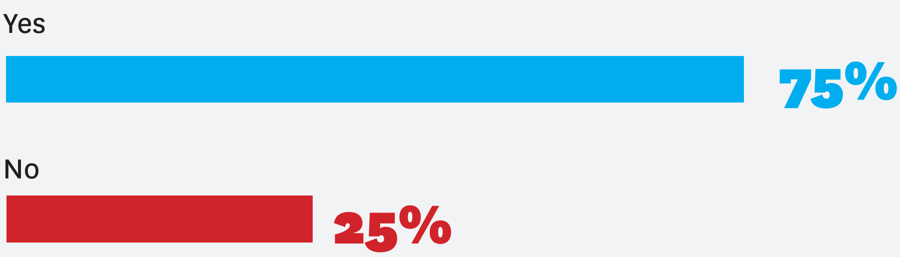
PETER DIETRICH
Morningstar

stopped trying to promote ESG or SRI [socially responsible investment] with the end goal that it might outperform, an approach which I believe was a mistake. As a firm for example, we have moved to more focus on how ESG could help managing risk and typically the way we manage DPM portfolios is try to diversify it as much as possible our exposure to various risk factors and what we have done over the last two to three years is to include ESG risk into the risk factors to which we want to be diversified. Today to be precise, some 80% of our portfolios are invested to include this factor."

Aggregation to obtain a holistic view

The discussion neared its conclusion with what one expert called a 'megatrend' in the form of aggregation. "Here in Asia we are multi-banked, he noted. "This impedes a more holistic view, whereas aggregation helps in the reporting of the client's total return. We see some fintech firms enabling aggregation software so that someone can actually get a common statement, with some banks enhancing and supporting that. This will all affect the conversion to DPM or advisory or managed account solutions." ■

DO CLIENTS STILL HAVE UNREALISTIC EXPECTATIONS ON INVESTMENT RETURNS?



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