Economist Intelligence Unit

High-net-worth investors and asset managers: Bridging the gap

A white paper by the Economist Intelligence Unit sponsored by Citi's Global Transaction Services

Preface

High-net-worth investors and asset managers: Bridging the gap is an Economist Intelligence Unit study sponsored by Citi's Global Transaction Services. The Economist Intelligence Unit bears sole responsibility for this report. Nigel Adam is the author. Dan Armstrong is the editor. Mike Kenny produced the report. The findings and views of this report do not necessarily reflect the views of the sponsor. Our sincere thanks are due to the survey respondents and interviewees for their time and insights.

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Executive summary

Asset managers have become more distant from the high-net-worth investors they serve. This trend can be reversed, but it is likely to require a change in the way managers approach this expanding market. To find out more about this problem and potential solutions, the Economist Intelligence Unit undertook a study, sponsored by Citi's Global Transaction Services, including a comprehensive global online survey and in-depth interviews with 15 senior executives at asset-management and advisory firms. The principal findings are as follows:

- **Asset managers are not closely connected** to high-net-worth investors. They have few opportunities to make direct contact with investors in order to learn about their needs and how to meet them. They are more inclined to focus on product development than on effective marketing and communication.

About the survey

In May 2008 the Economist Intelligence Unit polled 168 senior executives from the asset-management community on their views of the high-net-worth investor market. Sponsored by Citi's Global Transaction Services, the online survey focused on the gap between asset managers and the two client groups they serve: the distributors who market their products and the high-net-worth investors who buy them.

All of the respondents work for asset-management companies or distributors (and in some cases firms which fill both roles). All serve the high-net-worth market. The average asset size of the firms surveyed was $57bn. Prominent sub-sectors included diversified and retail banks (21%), mutual funds (20%) and hedge funds (13%). In terms of geography, about one-third of the respondents were located in Europe, 28% in Asia and 25% in North America.

The survey was supplemented with in-depth interviews with a range of managers and distributors in Europe and the United States.

- **High-net-worth investors need to be educated** in the concept of risk-adjusted returns, where risk tolerance is taken into account when targeting returns. Two-thirds of survey respondents agree that these investors think in terms of absolute rather than relative returns.

- **The demand for alternative investment vehicles is growing** as high-net-worth investors pursue higher returns, although the vast majority of high-net-worth assets still remain in the traditional asset classes of equities, bonds and cash. Traditional long-only managers will face a challenge in meeting this growing appetite for alternatives.

- **Wealthy investors appear willing to pay higher fees** for superior performance, especially in the alternative sector asset classes such as hedge funds, private equity and real estate. Performance fees, where the manager keeps part of any gain above an agreed target return, are becoming more widely accepted among high-net-worth individuals.

- **Capital markets volatility has magnified the mismatch in expectations** between investors and their asset managers. Investors believe managers should be more communicative and more transparent in their investment process so that they do not spring surprises on them. Managers believe that better long-term results are achieved when an investor maintains a consistent investment strategy through market cycles.

- **There are synergies between investing for institutions and wealthy individuals.** Products are increasingly similar, and the same systems to control risk and measure performance can be applied to both categories. But dealing with the needs and emotions of individuals requires a different set of skills than dealing with institutions, which can be approached in a more uniform way.

- **Managers need to develop a better support network for high-net-worth efforts**, as they already have in the form of investment consultants for their institutional clients. That will probably mean forming partnerships with intermediaries, even developing proprietary distribution teams to handle wealthy investors.

- **Advisers as well as managers should focus more tightly on investors' needs.** Advisers ought to talk with other advisers such as accountants, lawyers and estate planners. Advisers should have a comprehensive training agenda and access to more experienced advisers. They need to be sure they are obtaining a comprehensive rather than a partial picture of the client's needs.

Introduction

Wealthy individuals are potentially a lucrative revenue source for asset managers. Yet the evidence suggests that asset managers as a group have many hurdles to clear before they can reap these potential rewards. Above all, there remains a gap between the "manufacturer" of investment products or solutions and the expectations of increasingly sophisticated investors. Those expectations vary enormously, depending on the size of the individual's assets and his or her particular situation.

This paper, written by the Economist Intelligence Unit and sponsored by Citi's Global Transaction Services, starts by diagnosing the gap in attitudes between asset manager and client (largely a function of historical distribution patterns in the developed countries). It also examines deficiencies in the existing product line-up, where traditional asset classes need to be supported by alternative investments and a broader global view.

In addition, the research looks closely at one critical issue. Since asset managers typically deal with intermediaries—banks, insurance companies, family offices or independent financial advisers—how can they develop a closer partnership with the intermediary/distributor who "owns the client"? Unless they make a determined effort in that regard, enlarging the share of the overall client wallet will prove elusive.

The traditional business model

High-net-worth investors are a heterogeneous group. They differ from the so-called mass affluent by having at least $1m of free cash to invest, although many industry practitioners tend to substitute a floor of $5m. (In the survey 40% of respondents had between $5m and $30m of assets under management and a similar proportion indicated over $30m.) The greater the wealth, the more sophisticated and more demanding the investor is likely to be.

Institutional investors tend to have similar needs: meeting pension liabilities or increasing the value of an endowment. But individual requirements vary considerably. "Wealth management is a very complex business and confronts you with a number of issues aside from pure investing," says Pat Keating, vice-president at Dimensional Fund Advisors, an asset-management firm in Santa Monica, California. "Taxation is typically a major factor in decisions and often there is the question of inter-generational wealth transfer to consider."

In the traditional model, high-net-worth investors were served by a private bank or other financial adviser who offered overall planning as well as trade execution in stocks and bonds. Although these entities continue to enjoy a thriving existence, much of the asset-management function has been outsourced to specialist firms. Some asset-management firms are part of a larger entity that also has wealth-management capability; others manufacture purely for outside distributors.

In the US, individual investment products are typically distributed by major banks and brokerage houses, insurance companies and the army of 27,000 or so registered investment advisers. In the high-net-worth market, so-called family offices, typically managing wealth on behalf of several families, have become a major force due to their concentrated buying power vis-à-vis asset managers.

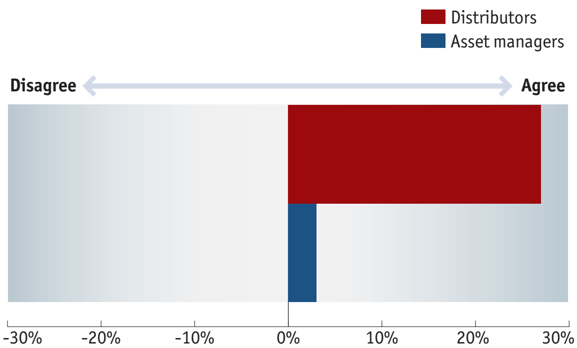
Intermediaries also hold sway in Europe, whether in the form of large private banks or investment firms, insurers or financial advisers. In both markets

few asset managers now deal directly with the high-net-worth investor. “The model of an asset manager dealing directly with the end-customer has been reduced dramatically in the last ten years since, for many, the cost of items such as branding, marketing and record-keeping are high and not aligned with the core investment management business”, says Robert Higginbotham, President, at Fidelity International in London. “We view this slightly differently and will seek to have a breadth of distribution strategies.”

Fidelity does maintain contact with investors alongside its intermediary distribution channels, using direct, mail- or web-based marketing tools. “We don’t want to be completely disintermediated,” says Mr Higginbotham. “There will always be a group of customers who want to manage their own financial affairs directly. In addition, by having contact with the end-investor, we can engage in more meaningful conversations with our intermediaries because we have direct knowledge of what that investor is looking for.”

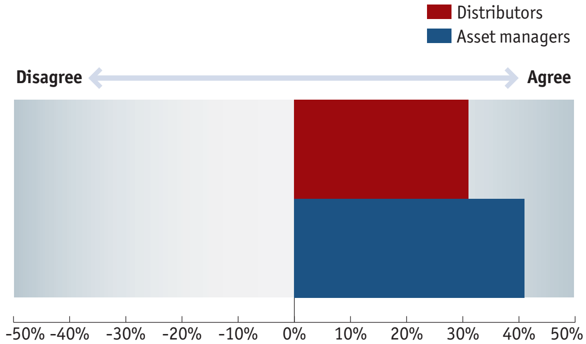
On this topic the survey asked: Do you agree or disagree that advisers do an excellent job in uncovering and understanding the product preferences of high-net-worth investors? The chart below subtracts the percentage of respondents who disagree from the percentage who agree,

Agree or disagree?
Advisors to high-net-worth investors do an excellent job in uncovering and understanding their clients’ product preferences



Source: Economist Intelligence Unit survey, May 2008.

Agree or disagree?
Asset managers tend to work in isolation from the high-net-worth investors who use their products.



Source: Economist Intelligence Unit survey, May 2008.

resulting in a number which is positive when there is net agreement and negative when there is net disagreement. (Those who are neutral or said they didn’t know are not included.)

Clearly distributors think that they do an excellent job: about 30% more of them agree than disagree. Asset managers, in contrast, are evenly split: as many disagree as agree. This pattern is repeated again and again in the survey: each group is concerned about the performance of the other, while judging its own performance positively.

The divide between manager and investor is even more starkly illustrated in a question on whether asset managers tend to work in isolation from the high-net-worth investors who use their products. Both managers and distributors tend to agree that managers are somewhat isolated, though distributors feel that it is more pronounced.

Executives interviewed for this report generally agree that the wall between managers and investors exists, but they are divided as to who is responsible “There is no full transparency in terms of knowing what investor expectations are and then manufacturing the appropriate product,” asserts Alain Grisay, CEO of F&C Asset Management in London.

Some advisers maintain that the typical asset manager focuses on product rather than building

a very close relationship, even partnership, with advisers. "It requires a lot of work but unless the manager makes that effort and adds value to the overall offering, he can never expect to earn more than the basic fee for the investment product," says the head of one US wealth-management firm.

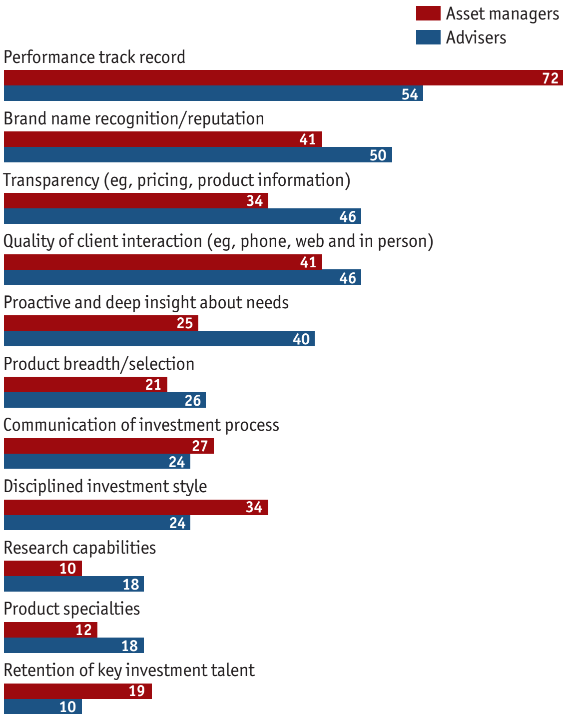
Joachim Faber, member of the board of management at Allianz Global Investors, one of the world's top five asset-management groups, offers this perspective: "It's true that the traditional high-net-worth model leaves a divide between manager and client. But trust is what really counts in this market. Clients are looking for more than smart solutions; they want the manager to have a track record of constantly delivering sound advice in bad times as well as good."

What does the investor want?

What does the investor want? In a word: performance. But performance is only one of several factors, and managers and advisers disagree on how important it is. When asked for the most important investor consideration when choosing an asset manager or adviser, 72% of managers cite performance, but among advisers the proportion is only 54%—only slightly more than brand recognition, service quality and product transparency.

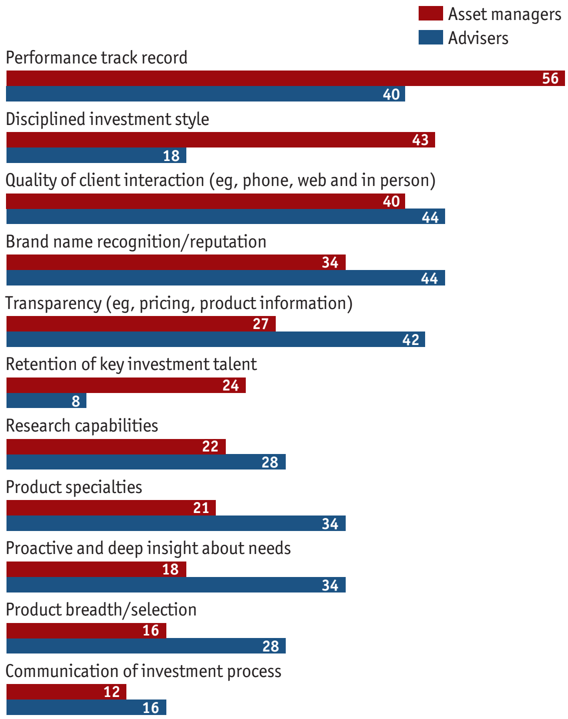
This pattern is also evident in the response to the question "Along what dimensions does your firm primarily compete?" Most asset managers compete on performance; it is the number one differentiator by a large margin. Advisers, in contrast, rank multiple factors roughly equally. And performance is not

How high-net-worth investors choose an asset manager/adviser
(%)



Source: Economist Intelligence Unit survey, May 2008.

How asset managers and advisers compete
(%)



Source: Economist Intelligence Unit survey, May 2008.

even the most important differentiator. Quality of service and brand name are tied for first, followed by transparency and then performance. An implication of this ranking is that managers may be underestimating the significance of client interaction. Supporting this conclusion is the fact that 40% of all respondents agree that high-net-worth investors will accept lower performance if it is accompanied by good client service. This attitude is especially common in EMEA.

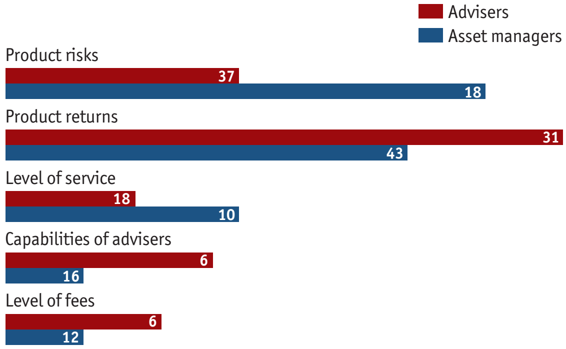
Recent volatility in securities markets has tested that view, however, especially since the research shows a lack of understanding among high-net-worth investors of the concept of risk-adjusted return. Whereas institutional investors typically assess returns measured against a specific benchmark, and quantify the risk taken to achieve those returns, individuals are more inclined to think in absolute terms.

“There is often an automatic assumption by private clients that the manager who is up 10% has done a better job than the one who has an 8% gain, regardless of the risk taken,” says John Maitland, head of private clients at Baring Asset Management. “Asset managers have a big opportunity here as sophisticated clients come to understand risk-adjusted returns and adjust their expectations accordingly.”

In the survey, both managers and distributors agree that high-net-worth investors think in terms of absolute rather than relative returns, with managers agreeing slightly more. Moreover, most executives—again, across both managers and advisers—believe that high-net-worth investors have a tendency to overstate their risk tolerance.

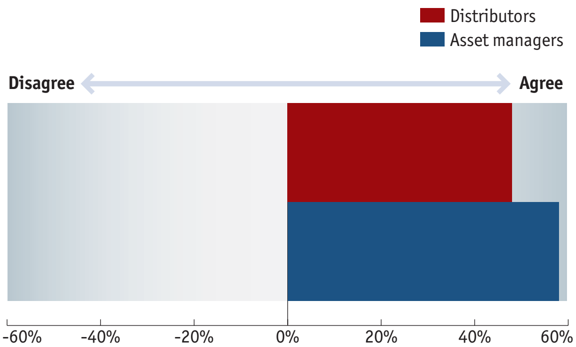
Answers to another question underscore the sharp divide in perceptions of returns versus risks. Advisers say that investors are most disappointed in the level of returns; managers, in the level of risk. To the degree that advisers are correct—because they are closer to the ultimate client—this gap suggests that asset managers could satisfy high-net-worth investors by taking on higher levels of risk.

In which area do you think high net-worth investors are most likely to be disappointed by the products offered to them?
(%)



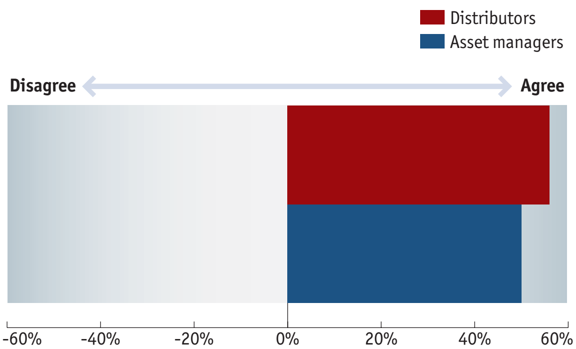
Source: Economist Intelligence Unit survey, May 2008.

Agree or disagree?
High-net-worth investors think in terms of absolute rather than relative returns



Source: Economist Intelligence Unit survey, May 2008.

Agree or disagree?
High-net-worth investors tend to overstate their risk tolerance



Source: Economist Intelligence Unit survey, May 2008.

What's the alternative?

Loosely defined, alternative investments are anything outside the traditional product range of equities, fixed-income securities and cash. More precisely, they include hedge funds, private equity, venture capital and real-estate vehicles. Timberland, commodities and natural resources also fall into this category, and funds that invest in infrastructure projects are becoming popular. Some would extend the definition even further to take in works of art, stamps and fine wine.

The attraction of alternatives is the potentially higher annual return, typically in the teens on a percentage basis but sometimes more in the case of successful funds, particularly hedge funds. The higher yield stems partly from the illiquidity of these vehicles; there is usually a lock-up period of several years before investors can recoup their investment. For institutional investors with a long time horizon, this has never been a real concern, but individuals new to alternatives need to be aware of it.

Although institutions are by far the major holders of alternatives, hedge funds at least were once the preserve of the wealthy, working with the big private banks. Only in recent years has the institutional share of the hedge market grown substantially. It is also worth pointing out that, according to US management consultants Casey Quirk, over 90% of institutional portfolios globally still consist of stocks and bonds alone. That proportion is almost certainly even larger among high-net-worth investors.

The research shows, however, considerable pent-up demand for alternatives. David Bauer, a partner with Casey Quirk, agrees with that finding. "Demand is certainly increasing among wealthy individuals. But at the high end these investors are in the business of staying rich, not getting rich. The traditional long-only investment managers have a different orientation; their goal is to help people get rich by beating a benchmark, not by running an absolute-return strategy. That presents a major challenge for those managers."

Not everyone agrees that the uptake of alternatives will continue in uninterrupted fashion. Pioneer's Dario Frigerio expects a partial shift back towards traditional investments, partly because of the freeze-up in the structured-product market and partly in terms of relative value. "The re-pricing of risk in the traditional sector is causing the pendulum to swing back in that direction," he says. "However, investors will still be willing to pay for excess return, over and above the market return."

The explosion of alternatives in the last three years has certainly helped to enhance returns for investors. But as Fidelity's Robert Higginbotham points out, the picture is not all rosy. "As with any rapid market development, there will be losers as well as winners. Will these products deliver what they promise? Do managers have confidence in their investment capabilities and control systems and is there transparency of information on risk to would-be investors?"

Once again, the issue for managers is advice and education first and product second. In the UK, at least, high-net-worth investors are typically uneducated with regard to alternatives, and hedge funds are still an emotive topic in view of their perceived (and real) risk. No doubt the demand is there but it needs to be properly channelled.

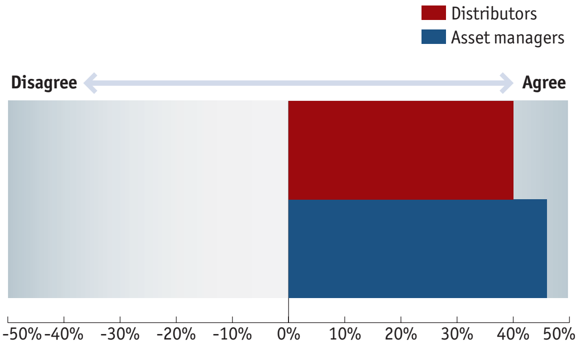
Change the product line-up

Managers and advisers alike appear to agree that they and their clients are faced with an excess of products from which to choose. Almost 60% of those questioned said high-net-worth investors are confused by too many products, a view shared about equally by the two groups. The research indicates that asset managers find it hard to break with the tradition of putting product development first, before canvassing clients (high-net-worth or institutional) as to what they really need.

Some managers dispute that, pointing to the need to cater for an increasingly knowledgeable high-net-worth community. "These investors are looking well beyond the traditional balance portfolio that consists of equities, bonds and cash," says Nicolas Faller, managing director, worldwide distribution partners, at Fortis Investments. "They are looking for alternative products such as unlisted real estate vehicles or private equity and infrastructure funds."

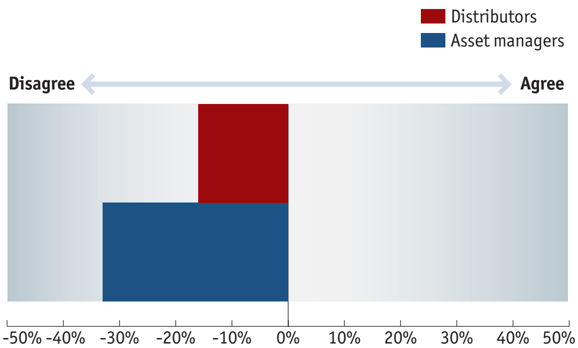
Mr Faller points out that product exclusivity also matters, regardless of the asset class in question. "Offering a global or European equity product is not enough, even if it does rank in the first quartile of performance, " he says. "The competition for shelf-space is just too great, and forces you to innovate. We were one of the first managers to launch an equity

Agree or disagree?
High-net-worth investors are confused by too many products



Source: Economist Intelligence Unit survey, May 2008.

Agree or disagree?
High-net-worth investors are unwilling to pay higher fees for superior performance



Source: Economist Intelligence Unit survey, May 2008.

focused solely on Turkey, for example, and it has grown substantially in size. That's basically a high-net-worth product."

The demand for alternative investment vehicles is certainly growing, a phenomenon confirmed by both the survey and individual interviews. Over 70% of respondents said that high-net-worth investors now have a strong appetite for alternatives, with advisers showing slightly less agreement (64%). As the search for higher (absolute) returns continues, few in the industry expect that appetite to wane. The question: to what extent will the traditional asset manager be able to feed the demand for alternatives (see "What's the alternative?" on page eight).

Although the returns offered by alternatives (including hedge funds) are typically higher, so too are the fees. The survey asked whether high-net-worth investors are unwilling to pay more for superior performance. Over half of respondents disagreed with that statement. (In other words, they agree that investors will pay fees for superior performance.)

Performance fees typically come into play if and when a manager exceeds an agreed return; above that return he will be paid a proportion of the gain. Such agreements are common in the institutional market, as a way of encouraging managers to do more than just meet the benchmark. Now they appear to be more widely accepted by individuals. "I wouldn't say high-net-worth investors are agnostic about fees, as they relate to hedge funds or private equity, but there is much greater tolerance for paying a higher fee if the benchmark is exceeded," said one asset manager. "That's a significant change."

Volatility hasn't helped

The mismatch in expectations between investors and their asset managers has been magnified by the market swings of the past year or so as the credit crisis took hold. A period of relatively low volatility ended abruptly last August when the sub-prime debacle occurred in the US. The subsequent market turmoil has heightened fears about the staying power of some high-net-worth investors.

Just over half of those questioned in the survey agreed that asset managers tend to rely on models that break down in times of high market volatility. Advisers had a slightly higher level of agreement, at 57%. Although institutional investors have long time horizons that enable them to steer through troubled times, some industry experts believe they have detected that high-net-worth investors tend to have less staying power.

"The persistency of assets, or lack of it, has become an issue in recent years," says Fidelity's Mr

Higginbotham. "If you look at gross fund flows they have gone up but on a net basis they are pretty much unchanged." This shows that client portfolio turnover has increased, possibly due to adviser asset-allocation models with a fairly mechanistic buy/sell discipline that prompts a sale when the market drops by a certain amount. Or advisers may simply be making aggressive short-term allocation changes. Whatever the reason, there are additional costs arising from portfolio turnover.

Signs of convergence

Most asset managers see a convergence between the institutional and high-net-worth segments, at least in terms of product range and investment process. The higher the individual stands on the wealth ladder, the more demanding he/she is likely to be when it comes to non-traditional products and a high service level. "The more wealth you have, the more you want investment banking–type solutions," says John Fraser, chairman and CEO of UBS Global Asset Management. "That means more alternative products and a provider with an excellent reputation."

Bringing existing institutional expertise to bear on the high-net-worth segment can help provide those solutions and also achieve economies of scale. At Baring Asset Management, the firm's private-client division has long been under the same roof as its institutional business. "We have achieved substantial synergies internally while our private clients are benefiting from an institutional level of expertise," says John Maitland.

Navigating the extremes

Effectively managing extreme risk is the goal of any adviser or investor. Both depend on asset managers to stress test their portfolios to see how they might perform in very adverse market conditions. However, most models used for this purpose do not predict extreme events because they assume that return distributions over time are normal. In fact, asset returns often possess distributions with tails that are heavier or "fatter" than those of a normal distribution. In other words, extreme outcomes occur more frequently than we think.

Although the shock to the capital markets last year created by the sub-prime debacle was not the largest in market history, it certainly falls into the extreme category. Advisers and managers alike were largely caught unawares and although volatility has eased somewhat in recent months, both parties are aware that investors are still demanding answers as to how to protect their investments against the extreme.

Baring's John Maitland thinks a large part of the solution should be determined at the very start of the client relationship. "There needs to be more precise profiling of the investor before investments are selected," he says. "If the investor has a low risk tolerance for equities then he/she should not have a large equity position. If the profile is done thoroughly, the investor should be happy whatever the market outcome."

Perhaps not surprisingly the research pointed to the need for communication and transparency on the part of asset managers in times like these, the more so since these attributes have generally been lacking even in normal times. This does present managers with a challenge as time is precious when they are trying to deal with swings in the market. But meeting the challenge is easier than facing a client taken by surprise with the unexpected.

"We stay in touch, either in person or by phone, with our intermediaries and consumers and we maintain a dialogue by mail or the web with our direct investors," says Fidelity's Mr Higginbotham. "We explain the impact of volatility, give our views on current conditions and caution against attempting to time markets. We provide ideas on where we think good sources of return are still possible. Importantly, we focus on generic education, not on selling product."

One clear result of the turmoil is that high-net-worth investors are seeking "guaranteed" products that carry a target return with limited upside but with little or no downside. At Fortis Investments, for example, Nicolas Faller points to "safety bond portfolios" the firm is offering to its distributors, made up of good underlying credits, a two-year maturity and a target return in euros of around 7%. "We try to convince our sales force to offer these rather than the best performing equity fund over the past five years. Why buy a product that's probably at the top of its cycle? But it's not easy to persuade them to offer the bonds as a solution."

The right dimension

Those seeking to counter the charge that asset managers are increasingly detached from wealthy investors might turn to Dimensional Fund Advisors (DFA), a manager based in Santa Monica, California, with $154bn of assets under management. DFA works both with institutional investors and with registered financial advisers on behalf of their clients. In the high-net-worth market it has developed a model that is unusual in the industry but one that appears to serve all parties well.

"I believe we are different from other asset managers who tend to tackle this market from a product perspective," says vice-president Pat Keating. "We work with advisers who are quite sophisticated and take a holistic, long-term view of the client's portfolio. From an investment standpoint this is more along the lines of an institutional approach."

Such is the strength of DFA's reputation and brand that advisers seek out the firm rather than vice versa. The advisers go through a comprehensive programme so they fully understand DFA's investment philosophy and process. Mr Keating describes the philosophy as believing that markets work, broad diversification within the portfolio, a long-term perspective and, last but not least, aggressive management of all transaction and other costs. "We will only work with those who fully share that thinking," he says, noting that this line of thought helps to steer all parties through periods of market volatility.

In the DFA model its advisers will bring the firm's portfolio managers into discussions with the client only at the request of their adviser. "They will reach inside the firm and bring asset management or tax resources to the table when they feel it to be necessary," says Mr Keating. "Typically that happens when the client has an expectation of meeting the manager regarding a specific portfolio issue; it is not common."

The institutional approach to investing manifests itself in the firm's high-net-worth business in a number of ways. "The products can be very similar, whether equities or fixed income, and portfolio construction tools are generally much the same," says Mr Keating. "But the rest is quite different. Tax, wealth management and risk analysis are very different to an individual."

Mr Keating believes the principal obstacle to achieving success in the wealth sector is knowledge of wealth-management issues. "Again, this is where our advisers diverge from institutional behaviour," he says. "You need to understand the different needs of different individuals. And although trust, confidence and relationship with their adviser certainly matter in the institutional market, when you deal with individuals they are absolutely indispensable."

DFA has managed to surmount that obstacle and make its asset-management skills part of the solution. It is a model others might seek to emulate.

Those synergies involve not only investment products—the firm adopts a multi-asset-class approach to reach a targeted return for both investor types—but also risk-control and performance-measurement systems that have been the norm for institutions but are new to private clients. But the synergies only go so far. "Individual clients have different needs and require a different approach," adds Mr Maitland.

Dario Frigerio, CEO of Pioneer Investments, agrees that convergence is happening, especially among the "gatekeepers" to institutional and high-net-worth investors: investment consultants acting for the former and, typically, large private banks and investment firms for the latter. "These are different types of intermediaries but if you structure product delivery—of alternative investments, for example—in a consistent way, you can serve both channels effectively."

On the other hand, he believes high-net-worth investors have a shorter time horizon than their institutional counterparts and are more risk averse. "We deal with the bigger private banks that have global distribution and we build portfolios for their individual clients just as we do for institutions. The difference lies in the emotions of individuals, especially in the volatile climate of late."

Although synergies help, asset managers have to recognise they must work harder with high-net-worth intermediaries to pin down the needs (and feelings) of the end-investor. The third-party distribution model is firmly entrenched in the wealth-management sector; with a few exceptions the concept of marketing directly to wealthy clients quickly runs up against the twin barriers of cost and regulation. (Compliance laws

now typically require exhaustive background checks on individuals to prevent money-laundering.)

Managers clearly recognise the power of intermediaries in key markets such as the US and the UK, where financial advisers play a major role in distribution. At Fortis Investments, Nicholas Faller recognizes that the company needs to bulk up its profile among financial advisers since neither Fortis nor the asset management arm of ABN AMRO (with whom it recently merged) had a major historical presence in the UK. "We are working on a feasibility study right now, "he says, "knowing we have to tackle this market."

Such power runs counter to the instinctive desire of many managers to have a direct relationship with the end-client. "If you are dealing with a third party there is always the potential for misunderstanding," says Baring's Mr Maitland. "It's much easier from our perspective to deal one on one for the purposes of educating the client and offering reassurance when necessary."

Mr Maitland adds that although some intermediaries encourage contact, others are very protective of their clients. "They don't want you to meet the client. They make it clear they are simply buying an investment product from you, effectively outsourcing the investment function."

Building a partnership

How, then, can asset managers establish a closer relationship—a partnership even—with their intermediaries? Paul Griffiths, global head of fixed income at Credit Suisse Asset Management, says that for many managers the high-net-worth client tends to fall between the institutional and purely retail groupings. The only way to avoid this happening is to build strong ties with the relationship manager working on the client's behalf.

"On the whole, asset managers are not structured to build this type of partnership and make them work. But managers need a support network, just as they do for institutional distribution, in the shape of consultants. That takes a lot of time. The quicker way is to tie up with a private bank or wealth-management operation. I think that increasingly asset managers are developing their own distribution teams to deal solely with high-net-worth investors."

Whichever route they choose, managers need to start communicating better with advisers. Says Chris Keogh, who heads up the SEI Wealth Network, a private client service that works with high-net-worth families: "Managers typically spend too much time selling products they have already developed and not enough time determining the real needs of the market they are seeking to serve."

Pennsylvania-based SEI has developed an interesting business model that juxtaposes its private client operation with an existing unit offering wealth solutions to financial intermediaries. As Mr Keogh explains, SEI wanted to understand better the emerging needs of the end-investor so that it could also get a closer focus on the challenges faced by intermediaries and in turn offer them better solutions. Its Wealth Network caters mainly to individuals and families with total assets under management ranging from around $20 million to $200 million.

Mr Keogh suggests that asset managers begin by making every effort to meet the requirements of intermediaries first. "If they just put out products without first understanding the intermediaries' needs and then ultimately the underlying needs of the end-user, then asset managers cannot add value. Through the intermediary they should be looking for a line of sight to the client," he says.

Or as another wealth manager put it: "Jointly talk about opportunity and brainstorm how to get there. Most intermediaries want more feedback from asset managers but don't get it."

Know your client

Of course, understanding what the client really wants or needs is the crux of the issue for both adviser and manager. Specific issues such as taxation and inter-

How the regions differ

Regional differences are alive and well in the world of high-net-worth investors. So say the survey respondents, comprised of asset managers and advisers, who often offered sharply different views on the preferences of investors in their own markets.

Certain things everyone can agree on. Performance is the most important metric. The array of products is confusing. There is high demand for alternative investments. Yet even among these universals there is regional variation. Performance is most important to investors in the Asia-Pacific region. The array of products is most confusing to investors in EMEA. And demand for alternative investments is highest in North America.

Elsewhere the opinions of investors vary. The survey presented respondents with statements like "High-net-worth investors will accept lower performance if accompanied by good service" and asked respondents to agree or disagree. Statements were scored by subtracting the percentage who disagreed from the percentage who agreed, yielding a positive percentage (net agreement) or a negative percentage (net disagreement).

Nowhere was there as much regional variation as in fee and service expectations. All regions feel that performance is important. But not all feel that service is important. Respondents in Asia-Pacific—and to a lesser extent those in the Americas—say that their high-net-worth clients don't care much about service. In EMEA, however, service is quite important—to the extent that it can compensate for lower returns.

Meanwhile, Asia-Pacific investors also appear to have a unique view of performance. They are unusually fixated on "home runs"—high-risk investments with the potential to pay off many times the initial outlay. At the same time, a bare majority of Asia-Pacific respondents say that investors in their region will not pay fees for superior performance.

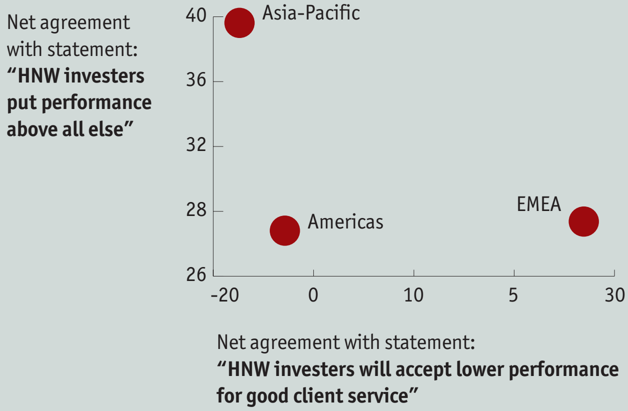
Although all three regions concur that investors have a strong appetite for alternative investments, American respondents are especially clear on that point. This may reflect the poor returns available in their domestic equity and fixed-income markets, but also a longer tradition of alternative use, especially in the hedge-fund and private-equity sectors.

Global trends, regional variations

Investors everywhere want:	But especially in:
Performance	Asia-Pacific
A less confusing array of investments	EMEA
More alternative investments	North America

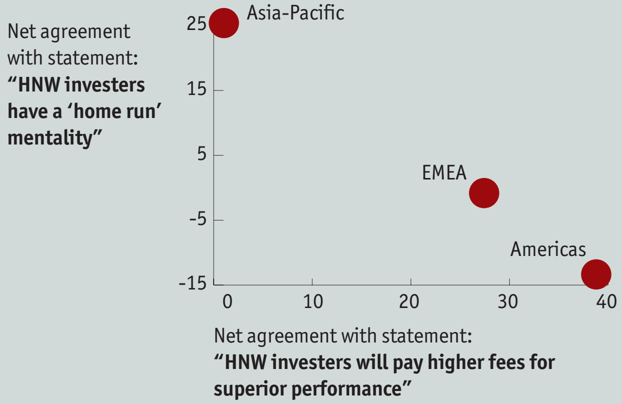
High-net-worth investers in:	Are *most* likely to:	Are *least* likely to:
Asia-Pacific	Put performance above all else Have a "home run" mentality Be sensitive to potential conflicts of interest in product recommendations	Accept lower returns in exchange for good customer service Be confused by myriad products Pay higher fees for superior performance
EMEA	Be willing to accept lower returns in exchange for good customer service Be "confused" by myriad products Overstate their risk tolerance	Think in absolute rather than relative returns
Americas	Have a high appetite for alternative investments Pay higher fees for superior performance Think in absolute rather than relative returns	Overstate their risk tolerance Be sensitive to potential conflicts of interest in product recommendations Have a "home run" mentality

Performance versus service preferences
(%)



Source: Economist Intelligence Unit survey, May 2008.

"Home run" mentality versus willingness to pay performance fees
(%)



Source: Economist Intelligence Unit survey, May 2008.

generational wealth transfer aside, the client may have multiple goals that have to be met. "It sounds simple but it requires a fundamental shift in thinking by wealth managers," says Mr Keogh. "You have to be clear about those goals and then dedicate yourself to achieving them."

Earlier in this report, it was mentioned that 43% of survey respondents agreed that advisers did an excellent job in uncovering and understanding the product preferences of high-net-worth investors. What might be done to push that figure even higher? Spending more time with clients to understand desires, concerns and risk tolerance is certainly necessary. But speaking with other key financial advisers such as accountants, lawyers and estate planners, is critical to obtaining the full picture.

Turning to the asset manager, recall that over half of survey respondents believed those managers tend to work in isolation from the high-net-worth investors who use their products. How can that be remedied? John Brennan, head of private wealth management at William Blair & Co., a Chicago-based investment firm, pointed to the importance of adviser training in helping investment managers. More robust client information would be another improvement.

"I think most asset managers are providing products and services which meet the needs of the high-net-worth client but there can be a shortfall with regard to adviser training and experience, "says Mr Brennan.

"I also think clients can short-change the process if they don't share full information, such as the actual allocation of total assets and the full view of all holdings across multiple providers," he continues. "With that additional information the manager can think holistically, explain the benefit of a particular action, and then demonstrate through follow-up how that has added value."

Two other survey questions are relevant to this particular issue of client needs. When asked which development is likely to grow the most in terms of influence over high-net-worth investor decisions over the next three to five years, just under half (47%) mentioned the use of advice enablers such as scenario planning, research and comparison tools. The need for more formal financial education was in second place at 36%, followed by the desire for more control over execution of transactions with 32%.

Advice also wins out in the second question: in which of the following areas do you think the asset-management industry should concentrate in order to grow over the same time period? Over half (52%) selected deep and proactive advice. An adviser who is free of conflicts of interest (typically a major concern for investors) was a second with 41%.

Profitability: Art or science?

Even with the best ideals, asset managers have to mind their bottom line. The high-net-worth investor pays his adviser a fee, of which only part goes to the asset manager. "You might keep a little more of the overall fee if you are working through a family office that asks more in the way of service," says a senior executive at a major European asset management firm. "But if you are on the big private-banking platforms, fees are more related to performance and consistency."

Some managers find it hard to balance the customised approach that is often demanded with maintaining a viable profit margin. "The solution required is typically more of a bespoke solution than it would be in the retail sector. But even a high-net-worth account of, say $30m, remains quite small relative to an institutional account," says another senior executive. "Finding the right balance is truly an art."

SEI's Keogh may have the last word. In helping the intermediary understand and meet its own business needs and the needs of the end-consumer, he suggests, the asset manager can provide added value through their relationship as well as through the development of products and services designed to meet those needs. "Without that added value the asset manager can hope for no more than the basic investment product fee," he concludes."

Conclusion

This report set out to see how asset managers as a group could serve the high-net-worth investor better, in terms of both providing solutions and offering good client service. It also noted that some managers have not ventured into the high-net-worth sector at all, either for reasons of cost and profitability or simply fear of venturing into the unknown. Institutional clients have traditionally provided the asset-management industry with returns good enough to stick with that line of business.

Yet the research shows that the wealthy investor is now too significant to overlook. Not only are these individuals growing in numbers and becoming more geographically diverse but the average amount of wealth is heading upwards. Whereas a $30m portfolio might have placed an investor in the ultra-high-net-worth category three years ago, the entry level is now at least $50m. When individuals are grouped within a private bank or family office, the amounts at stake will be several times that.

From a business standpoint, the high-net-worth market offers a different source of revenue for the asset manager who may be over-reliant on institutions in an increasingly competitive and possibly shrinking market as defined-benefit pension plans fade from the retirement stage. Moreover, managers should be able to exploit potential synergies between the two segments, bringing institutional-style products and service to a high-net-worth audience that is becoming increasingly demanding.

However, to realise this potential, and to bridge a gap between the asset manager and the wealthy individual, some major steps need to be taken:

- Since dealing with third-party intermediaries is the only viable business model in the high-net-worth market, asset managers need to do much more to form partnerships with those entities. Instead of focusing on product first, they must step into the intermediary's world to find out what the investor, and by implication the intermediary, is looking for.

- By adding value in this way the manager may come closer to resolving the profitability issue. In a closer relationship the adviser may be willing to outsource certain functions to the manager, whether those relate to asset allocation, risk management or performance measurement. Investors are prepared to pay for successful management of their assets and managers should be able to gain a slice of that growing pie.

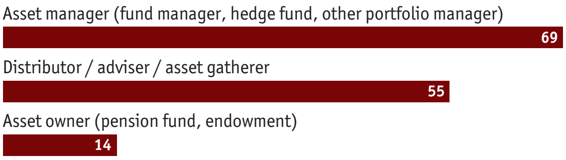
- Managers must not allow themselves to be totally divorced from the end-investor, regardless of whether the intermediary is prepared to allow direct contact. They must work with the adviser to raise their profile with the investor, such as by supplying educational materials and market commentary and/or by conducting informal surveys. Managers need to keep abreast of general trends: the growing appetite for Sharia-approved investments on the part of wealthy Middle Eastern individuals is just one example.

- Especially in this volatile climate, asset managers need to communicate more clearly than ever their investment process. So-called manager risk, where funds may be invested in areas the individual thought were off-limits—such as sub-prime mortgages—needs to be countered by full transparency. If trust is absent from the manager/adviser/investor relationship, the other steps will be taken in vain.

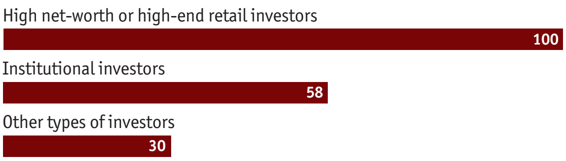
Appendix: Full survey results

"High-net-worth investors and asset managers" is a survey conducted by the Economist Intelligence Unit on behalf of Citi's Global Transaction Services from April 24th to May 12th 2008. There were 168 respondents.

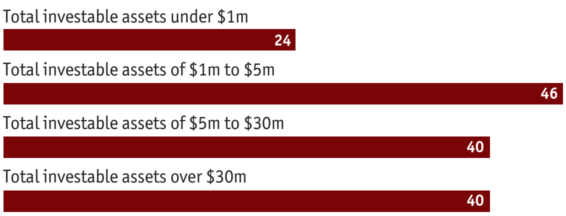
What role—if any—does your firm play in the asset management industry?
(% respondents)



Who are your firm's ultimate clients?
(% respondents)

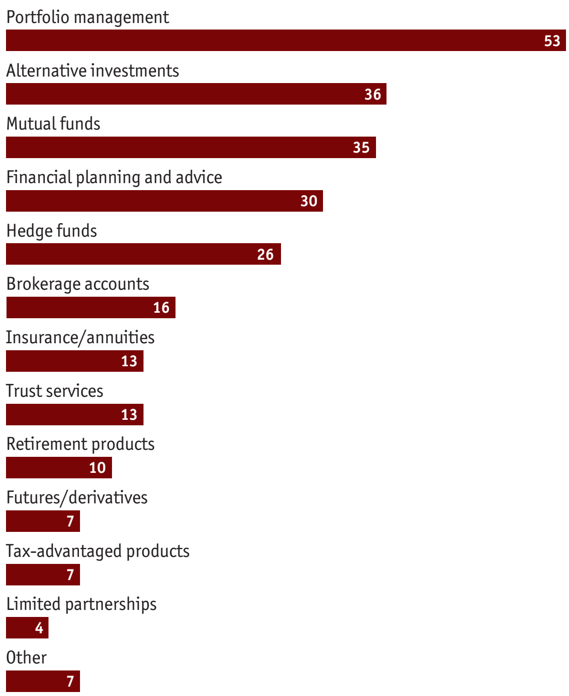


How would you characterise your firm's high net-worth or high-end retail investors in US dollars?
(% respondents)

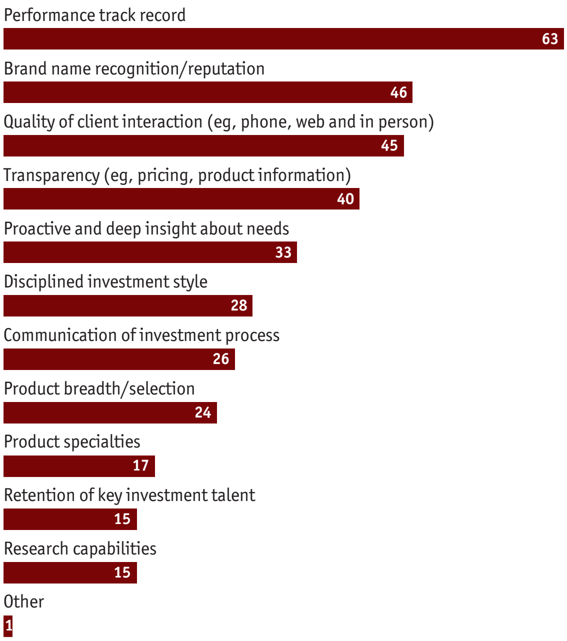


Which of the following best describes your firm's business model?
(% respondents)

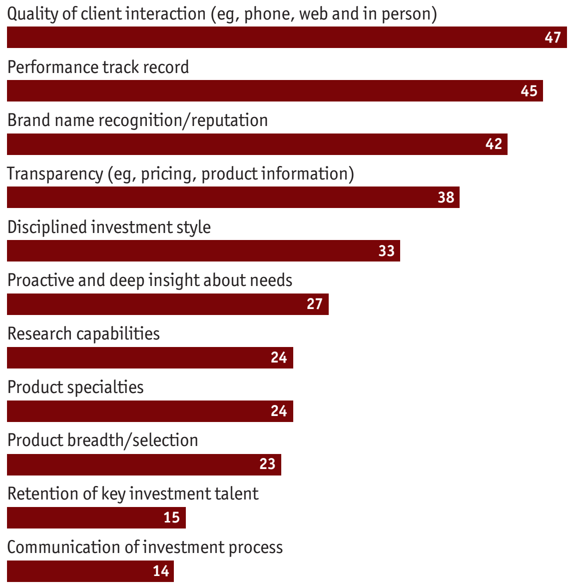
What products does your firm offer?
(% respondents)



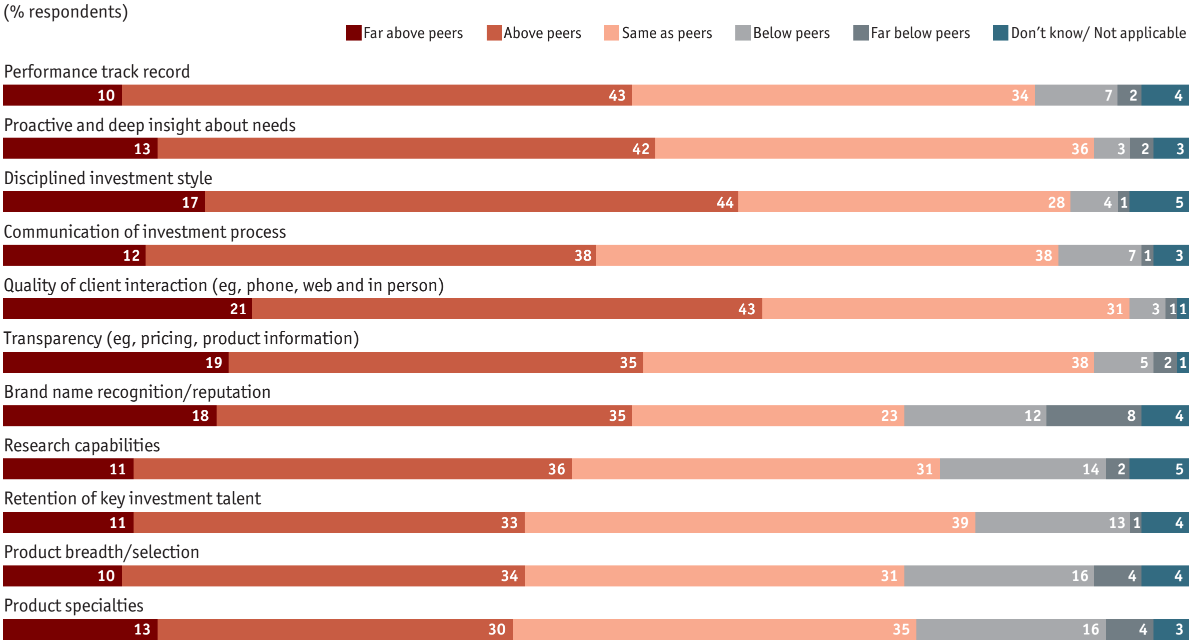
When choosing an asset manager or adviser, what do you believe are high-net-worth clients' most important considerations?
(% respondents)



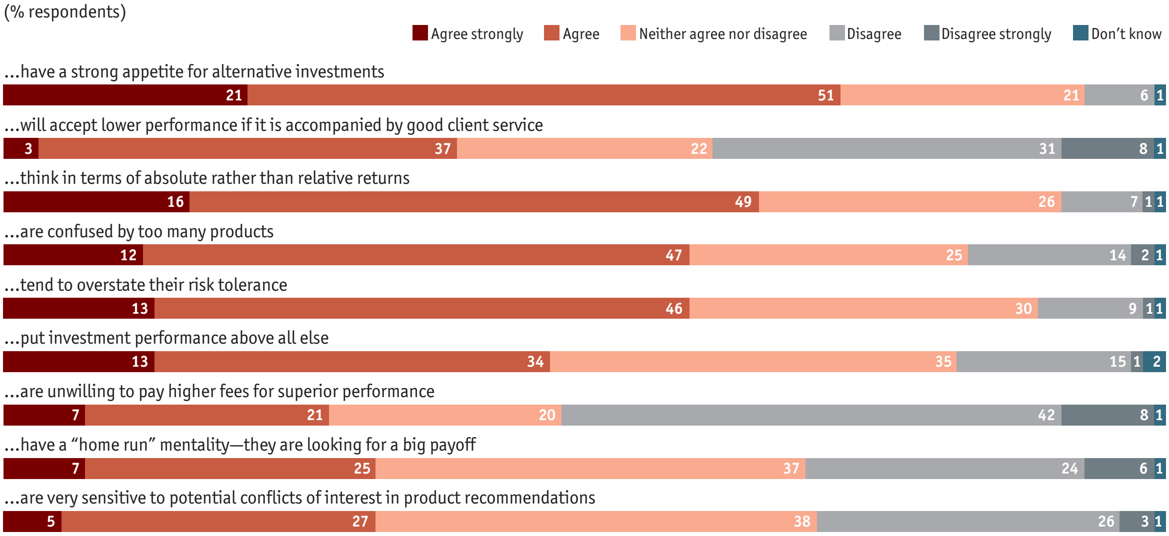
Along what dimensions does your firm primarily compete?
(% respondents)



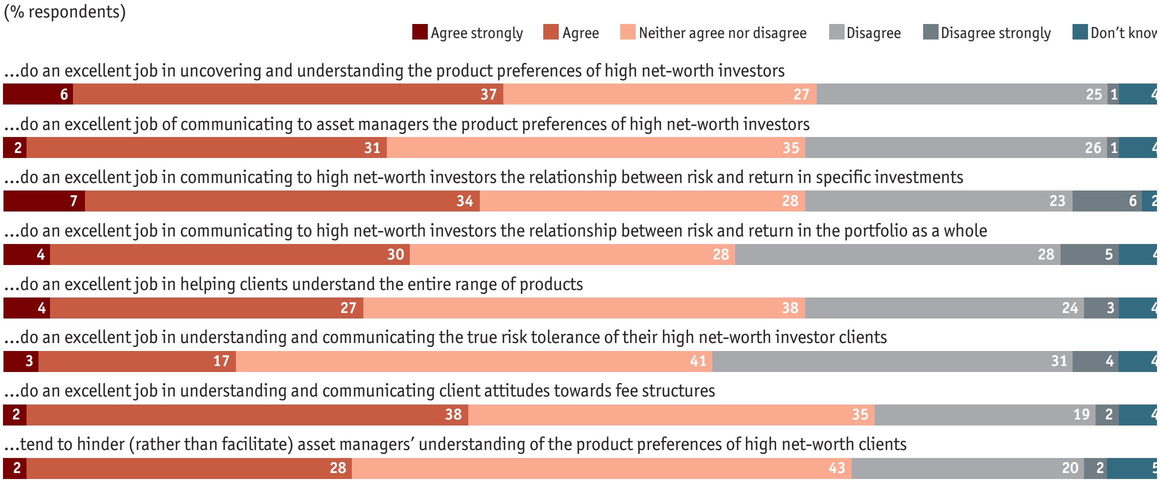
How does your firm compare to its peers along each dimension?
(% respondents)



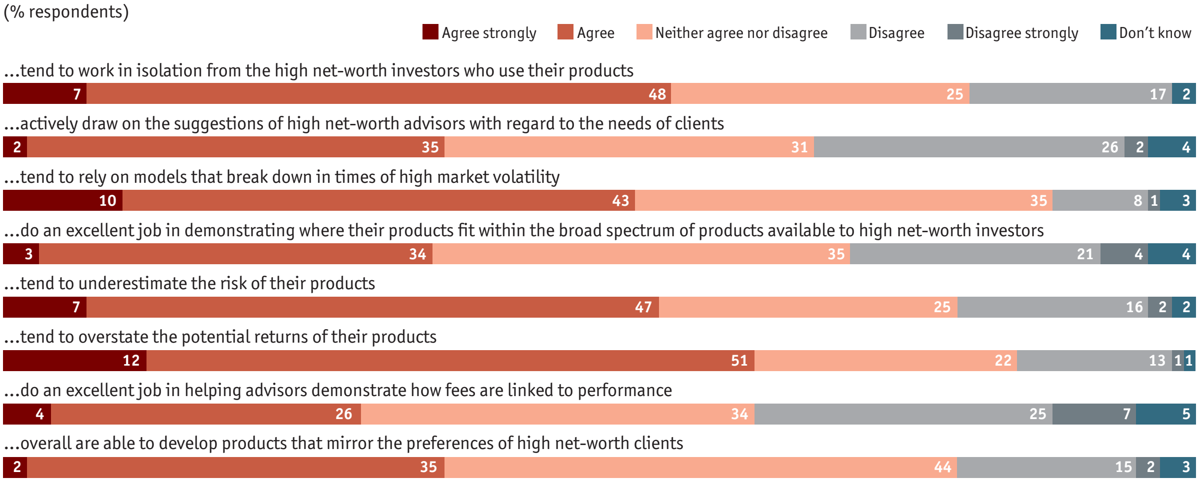
Do you agree or disagree with the following statements about high net-worth investors? High net-worth investors...
(% respondents)



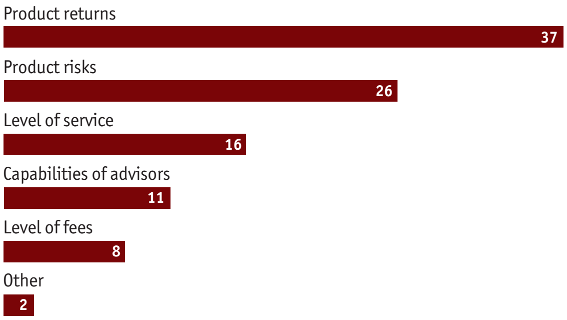
Do you agree or disagree with the following statements about advisors to high net-worth investors? Advisors to high net-worth investors...
(% respondents)



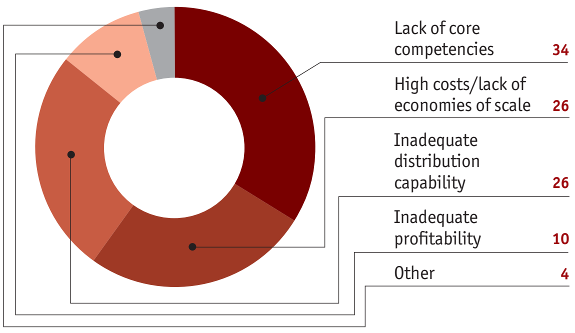
Do you agree or disagree with the following statements about asset managers whose products are used by high net-worth investors? Asset managers...
(% respondents)



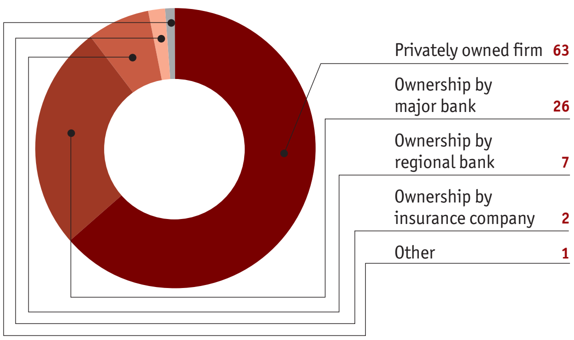
In which area do you think high net-worth investors are most likely to be disappointed by the products offered to them?
(% respondents)



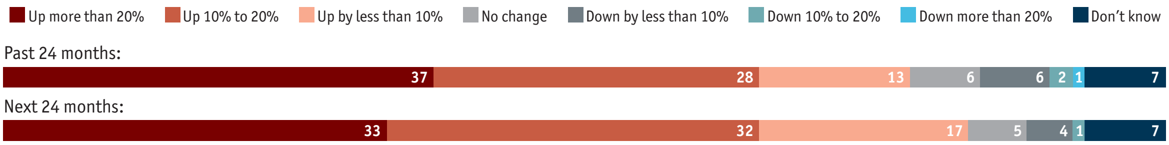
What do you think is the most significant obstacle deterring asset managers from entering the high net-worth space?
(% respondents)



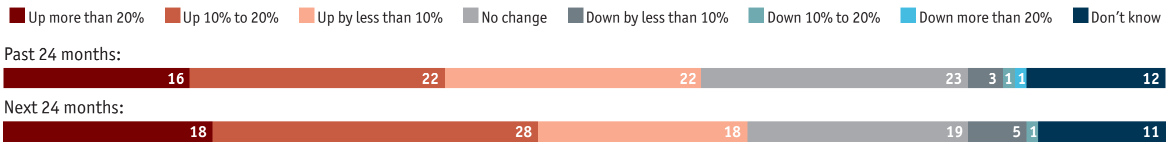
Which types of asset managers do you believe serve the high net-worth investor best?
(% respondents)



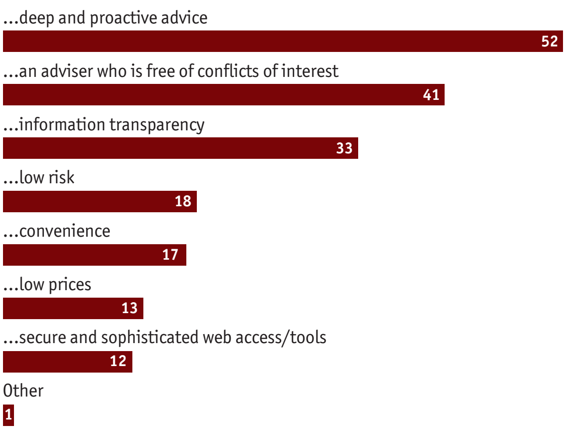
How has your firm fared over the past 24 months in terms of asset growth? And how do you expect it to fare over the next 24 months?
(% respondents)



How has your firm fared over the past 24 months in terms of margin growth? And how do you expect it to fare over the next 24 months?
(% respondents)



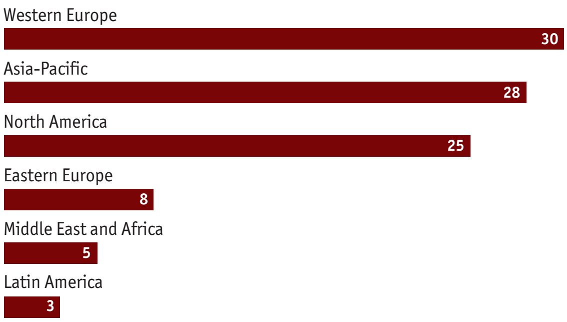
In which of the following areas do you think the asset management industry should concentrate in order to grow over the next 3 to 5 years? Firms should address client desire for...
(% respondents)



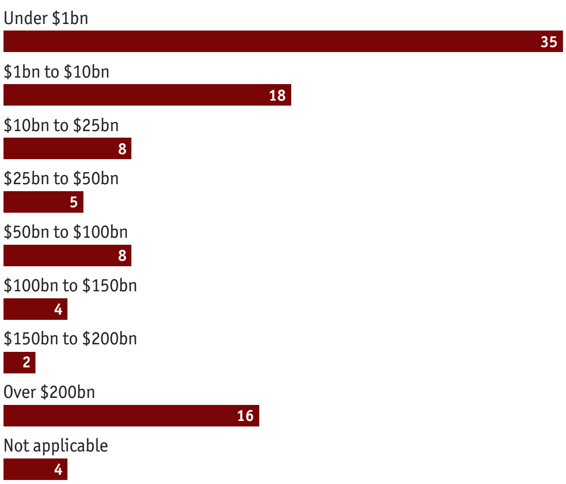
Which of the following developments are likely to grow the most in terms of influence over the high net-worth investor decisions over the next 3 to 5 years?
(% respondents)

About the respondents

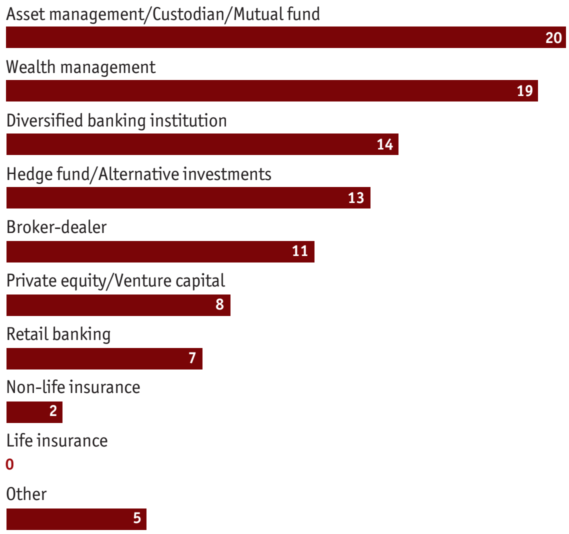
In which region are you located?
(% respondents)



What are your firm's global assets in US dollars?
(% respondents)



In which subsector of financial services does your firm operate?
(% respondents)



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