Berkshire Capital

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Changes occurring in wealth management as sector evolves

In 2006, New York University economics professor Nouriel Roubini warned a group of economists at an International Monetary Fund meeting that the U.S. was staring in the face of a massive housing collapse that would reverberate worldwide. Initially dismissive of his comments, economists did an about-face following the housing and financial crashes. The colorful Roubini, dubbed "Dr. Doom" in a 2008 *New York Times* profile, has been a fixture among the pundit class ever since.

This year, the economist's Roubini ThoughtLab consulting arm turned its attention to the wealth management industry, warning "that a convergence of technological, economic, demographic and consumer trends will turn the wealth profession on its head by 2021, reshaping customer expectations, disrupting business models, and altering advisor roles." In this instance, Roubini will find a receptive audience: wealth managers have been living, breathing and reacting to disruption since the financial crisis he predicted.

Predictably, one of the disruptive elements is technology. Roubini ThoughtLab, in its "Wealth and Asset Management 2021" white paper, quotes **UBS** Wealth Management Chief Operating Officer Dirk Klee as saying customers' "desire for a digitally enabled experience" is proving more significant than regulation or low interest rates. Adds Rodolfo Castilla, global head of wealth management products and platforms at **Citigroup**'s Consumer Bank: "Across all generations, all demographics, all segments, digital and omnichannel interaction will be mandatory for our clients in the very, very short term." Roubini states the case more starkly, saying managers must "drive wide-ranging digital transformation or face extinction at the hands of competitors both old and new."

The technology imperative was on full display in October when UBS joined the growing roster of robo advisors by introducing the UBS SmartWealth platform. In a clear bid for millennials, the venerable Swiss wealth manager said it will accept clients in its launch market of the UK with a minimum investment of only £15,000 ($18,300), underscoring the financial viability of smaller accounts in the robo age. The company said the new business "shows that digital innovation is not the sole reserve of startups. Large market-leading institutions have the resources to research, test and build transformative new products and services." UBS plans to expand the service into other parts of Europe, as well as Asia.

Attracting millennials and Gen Xers looms large on the to-do lists of wealth managers, as those generations save and inherit money from their baby boomer parents. With these two groups, technology will be critical, as both are more likely to be impressed with the quality of a firm's app and information, as well as cybersecurity, than they are with the wood-paneled offices that wooed their parents. In a "2016 Wealth Management Trends" report, PwC adds another key element to that list: trust, or what it calls the "quiet revolution" beyond technology. "No longer is it acceptable for financial professionals

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to hold clients at arm's length and to build trust solely on the notion that the wealth manager is the expert," writes the consultant. "Today, clients want more personal, more real-time, more effortless interactions." Younger clients "will not necessarily choose to keep their parents' financial advisors," PwC warns, citing its own research showing asset attrition rates of more than 50% in intergenerational wealth transfers. A 2015 report on the U.S. wealth industry by Capgemini underlines the "much lower trust and confidence" high net worth individuals under 40 years of age have in their wealth managers, with only 64% expressing positive sentiment compared with 76% for older HNWIs.

The other challenges facing wealth managers mirror broader trends in the asset management industry, with regulatory costs taking their place alongside the expense of technology. Additionally, many older investors — chastened by two market crashes since 2000 and focused on wealth preservation — have taken larger and less profitable positions in cash and bonds while adding plain-vanilla index funds or ETFs in equities. That has combined with technology and regulatory costs to pressure profitability, with smaller, independent firms facing particular difficulties. On top of that, firms with more than $1 billion in AUM already generate 40% more revenue per professional than those below that threshold, according to **Charles Schwab**.

For all the challenges and uncertainty, the opportunity set in U.S. wealth management remains enormous. While the Roubini ThoughtLab report notes that the largest proportional increases in wealth between now and 2021 will occur in emerging markets, the U.S. is expected to record the largest absolute increase in assets of $44 trillion. To gain a slice of the pie, independent managers have some tough decisions to make about how best to compete — and for many that includes selling to a larger or similar-sized competitor.

Between 2009 and 2013, there were 335 deals for registered investment advisors in the U.S. representing an aggregate $406 billion in AUM. In the broadest terms, that adds up to sellers with an average of $1.2 billion in AUM, but a closer look at the data shows 58% of the sellers had less than $500 million in AUM. RIAs represented the largest share of buyers (44%), but private equity firms have also been important players.

Among buyers, a significant group are the aggregators, including **Affiliated Managers Group**, **Focus Financial Partners** and **United Capital**. These firms are proficient and sophisticated in their ability to source, review, structure, price, close and integrate acquisitions. At the same time these buyers do face risks. One involves overseeing firms with disparate cultures. The other is pricing discipline: The competition among buyers of all stripes for leading independent firms could press aggressive consolidators to loosen their standards and overpay — a precursor to future operating difficulties. Of late, valuations have climbed for wealth managers with industry-leading key performance indicators and financial performance metrics.

Currently, there's little sign any of these firms are backing off from deal-making. New York-based Focus has again cut multiple deals this year directly and through its partner firms. In one, Seattle-based **Merriman Wealth Management** acquired **Summit Capital Management** to create one of the larger wealth firms in the Northwest, with more than $2 billion in assets. Merriman became part of Focus in 2012. Focus also cut deals with firms in Chicago, Denver and Memphis while expanding into Australia with the purchase of Melbourne-based **MW Lomax Group**. Additionally, the *Wall Street Journal* reported in August that Focus has "confidentially" filed for an initial public offering, a long-anticipated move that could bolster the firm's war chest. AMG has made five acquisitions of firms on both coasts since creating its **AMG Wealth Partners** unit in 2011. This included two deals last year for managers with a total of $13 billion in assets. At the time, AMG Chief Operating Officer Nate Dalton noted that, with $30 billion in AUM among its affiliates, AMG Wealth had reached a scale where "you can start to leverage to improve and provide additional opportunities to the businesses."

United Capital has made a dozen acquisitions since 2015, the most recent involving an established Connecticut firm with $370 million in AUM, **Westport Resources Management**. In an interview with *Financial Planning*, Westport founder and CEO John Vaccaro cited the importance of compatible cultures as his reason for teaming up with United Capital. "A good cultural fit means a much higher likelihood of success," he said. Technology was another compelling reason. "Advisers are facing a digital revolution that is not going away and is only getting stronger," said Vaccaro, a former theatrical producer who founded his firm 30 years ago. "The key is to integrate the best of digital and human advice, and I think United is years ahead of the rest of the industry in this process."

A few recent transactions highlight the various paths independent firms are taking.

Going Corporate: Selling to a large publicly traded firm, as California's **Atherton Lane Advisers** did last January when it cut a deal with **BNY Mellon**. Founded in 2005, Atherton has $2.7 billion in AUM with an average client portfolio north of $3 million and a prized location in Silicon Valley, which has been generating double-digit annual growth in both the number of HNWIs and their investible wealth. For Atherton and firms that make similar decisions to engage with major players, the lure of resources is a driving force. "This combination will enable us to greatly strengthen and diversify the solutions and capabilities we deliver to our clients," said Atherton Principal Perry Olson. The two companies cited expanded private banking, credit and lending services; global asset management opportunities via BNY's various boutiques; increased access to alternative investments; and enhanced technology and reporting capabilities. For BNY, which targets the most elite firms, Atherton bolsters an existing presence in Silicon Valley.

Indie Marriages: An August deal in which New York's **Tiedemann Wealth Management** acquired San Francisco's **Presidio Capital Advisors** represents a merger between two mid-size independent firms to form a significant entity with $13 billion in assets (two-thirds from Tiedemann) and complementary locations. These types of deals allow firms to remain independent while building additional scale, sturdier capital bases, and synergies in areas such as technology, marketing and administration. "This partnership enables us to provide our clients with deeper and expanded investment, estate planning and trust resources and services," said Brodie Cobb, founder and CEO of Presidio Capital parent **Presidio Group**.

Success in these deals is highly dependent on the merger of similar cultures and businesses, including agreement on responsibilities and leadership roles. In this instance, the top two executives at Tiedemann, including CEO Michael Tiedemann, maintain those roles at the combined firm, which retains the Tiedemann name. While many deals such as Tiedemann-Presidio involve geographic expansion, intrastate deals can be equally compelling if there are complementary factors at work. For example, one firm may serve ultra high net worth investors while the other focuses on the HNWI market, or in large states such as California and Texas may serve clients in different cities.

Raising Capital: Savant Capital Management took a different and intriguing approach by tapping a range of investors for a recapitalization as a means to remain independent. Savant's action also laid the foundation for a generational ownership transition. A 30-year-old Illinois firm with $4.7 billion in AUM —$2 billion more than in 2013 — Savant raised over $50 million in debt and equity from some 20 investors, among them an asset manager, family offices, a merchant bank, wealth management firms, and more than a dozen other private investors. Following the transaction, a significantly expanded internal shareholder base left employees with 75% of the firm while outside ownership was dispersed. Savant stressed that the outside investors "cannot require Savant to sell the firm."

In the current low-yield environment — as investors ranging from family offices to ultra high net worth individuals to pension funds seek out direct investments — Savant's strategy could prove attractive for other wealth managers who wish to maintain their independence. In particular, many such investors have long-term horizons and fewer structural constraints than private equity firms, for example. As Savant put it: "Importantly, all of the capital is from patient investors not bound by time constraints often found with institutional investors." ▲