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MYTH BUSTERS

Understanding High-Net-Worth Individuals

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INVESTMENTS & WEALTH INSTITUTE®
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The global wealth management industry is growing and changing at a rapid pace. As wealth shifts to younger generations and different individuals, the core demographics of high-net-worth clients are morphing. For financial advisors, these changing demographics demand flexibility and the setting aside of misconceptions and preconceived notions.

First, it is important to understand the backdrop. Global wealth for high-net-worth individuals (HNWIs) grew by more than 10 percent in 2017, driven by Asia Pacific and North America in particular, as Capgemini wrote in its 2018 World Wealth Report.[1] In 2016, growth was spotted at just 8.2 percent. With that kind of annual growth, HNWI wealth is on track to exceed $100 trillion by 2025.

With the growth of wealth has come the growth and development of technology. Technology now permeates the personal and work lives of individuals, and it inevitably has impacted how wealth managers work with their clients. At the same time, client expectations have changed. HNWIs, as BNP Paribas Wealth Management pointed out in a recent report, expect digital tools at their disposal for every aspect of their lives.[2] About two-thirds of HNWIs expect their future wealth-management relationships to be digital, and many say they would replace a firm that isn't skilled at digital outreach through integrated channels. It is up to wealth managers to use these new tools in optimal ways to best serve their clients.

Despite these changes, old ideas about wealth management persist. Here are six of the myths we come across most regularly and what they really mean for the future of wealth management.

MYTH #1: RETURNS ARE KING

Myth: "Investors do not care who they're working with; they just want the best returns possible."

Strong portfolio performance and investment returns are undeniably important for investors, but they ultimately aren't what makes investors satisfied with their wealth managers—personal connections are. Capgemini found that investment performance and investor satisfaction levels were not fully correlated. Investors posting average performance reported a range of overall satisfaction. Investors in Spain, for instance, outperformed their Swiss peers, but reported much lower satisfaction. It may seem counterintuitive, but it shouldn't. Indeed, only 55.5 percent of HNWIs globally said that they connected strongly with their wealth managers, despite substantial investment returns in the previous two years.

Interestingly, Capgemini found a 10-percent difference in the satisfaction levels of younger HNWIs versus their older counterparts, with younger investors being less satisfied. Clients requiring more complex transactions and tailored advice also were reportedly less satisfied with their wealth managers. As Capgemini reported, the HNWI focus on customized services and a desire for a holistic approach, including factors such as investment advice, credit solutions, and business expertise, are keeping advisor satisfaction low.

It truly is this personal touch of wealth management that sets financial advisors apart. HNWIs are sensitive to the long-term success of their investments, and financial advisors need to work with them on a personal level to understand their needs to make sure their investments meet these goals. Investors want a relationship with the person managing their money. They often are considering their legacies, be it their family's younger generations or the social impact they may have on their communities. RBC Wealth Management, for instance, found that high-net-worth women in the United Kingdom are prioritizing legacy and social impact.[3] These women reported that they hoped to pass their businesses on to offspring, that they wanted to protect the livelihoods of their employees, and they wanted to have an economic and charitable impact in their communities. Likewise, an RBC survey of young American HNWIs found that global social impact is an important part of their intended legacies.

Wealth managers should be sensitive to the reasons HNWIs choose them. After all, 44.4 percent of HNWIs say they found their wealth managers through referrals, and those who were referred report stronger levels of connection with their advisors than those who actively sought out advisors themselves. It is also important to note that there is a trend toward consolidation in wealth management. On average, clients tapped the services of 2.2 firms in 2017, compared to 2.6 firms in 2014, according to Capgemini. Financial advisors must keep on their toes to retain business.

MYTH #2: TECHNOLOGY EVENTUALLY WILL REPLACE FINANCIAL ADVISORS

Myth: "Young people just want robo-advisors. There will be less and less demand for human advisors."

The growth of technology in wealth management, and across every aspect of finance, is undeniable. The millennial generation long ago exchanged waiting in a line for a bank teller for a 30-second transaction on a mobile app. Investors want cutting-edge technology to make investing easy and efficient, but they also want to speak to real human advisors on occasion. So, hybrid advice is increasingly important, with more than 50 percent of HNWIs globally ranking it as very important. This was especially pronounced in Latin America and Asia Pacific (ex-Japan), which had 76.1 percent and 68 percent, respectively, ranking hybrid advice "highly important," according to Capgemini.

There also needs to be a reality check about what "robo-advisory" really is. Our imaginations may jump to robots and rooms full of computers, but it's more than that. BNP Paribas Wealth Management pointed out in a recent report that robo-advisors are not human advisor replacements but a helpful automation tool. These platforms aren't meant to be the be-all and end-all for investors. They can help provide advice with the use of algorithms and they can conduct transactions 24 hours a day, seven days a week. They are expected to allow traditional advisors to focus on client relationships, because robo-advisors cut down on the time spent on data entry and investment management—a win-win for everyone.

Don't forget, robo-advisors are easy to replicate. Advisors who don't use technology may lose clients, but robo-advisor capabilities aren't going to set wealth managers apart. Using robo-advisory in smart ways, as a supplement to human advisor skills and connections, will help retain clients. Technology is just one point of contact in the many potential facets of client interaction.

Considering the demand for hybrid advice and the role of tech companies in our daily lives, wealth managers need to take a "frenemy" approach to big tech. HNWIs increasingly are accepting the idea of big technology companies such as Apple, Alibaba, or Google moving into the wealth management space. Capgemini found that 37.5 percent of HNWIs would consider allocating between 11 percent and 50 percent of their wealth to such firms. At the same time, big tech companies face barriers such as regulations and their ability to execute investments. Only a few, including Alibaba, have been able to make the jump into wealth management. This young market will take time to develop before it can surpass traditional wealth managers. More realistically, the market will be characterized by collaboration and partnerships between big tech and the finance industry.

MYTH #3: BABY BOOMERS ARE LUDDITES

Myth: "Baby boomers barely know how to use their iPhones. Why would they want to use robo-advisors?"

The financial industry loves to talk about technology and how it is changing every aspect of the business, but the conversation often revolves around the younger generations. Millennials and Gen Z are known as the tech-savvy consumers. They are glued to their phones, communicating through social media, and more inclined to order take-out using an app than by making a phone call. But just as a hybrid approach is important for young HNWIs who are seeking personal interactions with advisors to complement technology, so too the hybrid approach is essential for busy boomers looking for an efficient way to manage their investments.

Even when it comes to the idea of big tech companies managing wealth, older HNWIs are not averse to trusting the likes of Google and Apple with their investments. About 60 percent of HNWIs older than age 60 said they would be willing to begin a wealth management relationship with a big tech company, Capgemini found. Globally, HNWIs are most interested in Google of all the big tech firms for wealth management, with 36.7 percent saying that they have "extreme interest" in the firm. There are some discrepancies geographically. In Latin America, a whopping 75.2 percent of HNWIs were interested in such a relationship with Google. In Asia Pacific (ex-Japan), that number was 60.8 percent.

The fact is, boomers are just as glued to their phones as millennials. Perhaps not everyone older than age 50 is active on social media, but many are. Working professionals use cell phones, tablets, and laptops on a daily basis. Financial advisors only need to look at their own cell phone use and technology habits to know what their clients want. If HNWIs are using technology at work, why wouldn't they use it in their personal lives as well? Age creates differences in how wealth managers interact and work with clients, but it is important to remember that every generation wants access to technology with an option for personal interaction on the side. Millennial is a mindset, not an age.

MYTH #4: HNWIs PREFER TRADITIONAL INVESTMENTS

Myth: "HNWIs are unlikely to consider risky investments or untested products such as cryptocurrencies."

Tried and tested investments have their place in portfolios, but savvy HNWIs are curious about new investment opportunities, too. The world's wealthiest investors were not exempt from the bitcoin craze, and they will continue to want to work with wealth managers who are knowledgeable and willing to explore new opportunities. For example, about

29 percent of global HNWIs have a strong interest in holding cryptocurrencies and 26.9 percent are somewhat interested, according to Capgemini. In Asia Pacific (ex-Japan), one of the burgeoning wealth markets, more than half of HNWIs expressed such interest. Interested investors believe that cryptocurrencies can offer investment returns and will serve as a store of value. But there is a difference in HNWI perceptions of cryptocurrency depending on age. About 70 percent of HNWIs younger than age 40 place great importance on receiving cryptocurrency information from their primary wealth management firms. In comparison, just 13 percent of HNWIs older than age 60 see such importance.

These numbers should be a wake-up call for wealth managers. Capgemini found that only 34.6 percent of HNWIs globally say they have received cryptocurrency information from their wealth managers. Fears about security and market volatility, and wealth managers' lack of focus on cryptocurrency assets, have held back the development of these investments. But as Goldman Sachs pointed out, whether or not you believe in the value of cryptocurrency investment, real money is being poured into the space, which at the very least should warrant attention.[4]

Wealth managers also should be ready to pay attention to the blockchain technology that cryptocurrencies use. This distributed ledger technology has the potential to revolutionize many industries, including wealth management. Although J.P. Morgan Chief Executive Officer Jamie Dimon has expressed skepticism about cryptocurrencies, he was quick to admit that blockchain technology is here to stay.[5]

Likewise, with the budding legalization of cannabis in some U.S. states and in Canada, marijuana-related investments have become another point of interest for investors, as Brendan Kennedy, executive chairman of Privateer Holdings, told the Yale School of Management recently.[6] A number of Canadian companies have visited Wall Street for initial public offerings. Investment in the industry started with HNWIs and family offices, Kennedy pointed out. Many investors have taken long-term views on the growth potential for the industry as global attitudes toward cannabis use continue to liberalize. If people are comfortable investing in alcohol, cannabis is an easy next step.

It should come as no surprise then that RBC found that HNWIs want more support from their wealth managers in achieving social impact investment goals.

There is a trend toward risker and relatively illiquid investments as well, as investors search for yield, as UBS and Campden Wealth state in their Global Family Office Report for 2018.[7] Almost half (46 percent) of the average family-office portfolio is allocated to alternative investments. Allocations have increased in private equity and real estate. One-half of family offices said that they plan to invest more in direct investments, especially private equity, ensuring that the trend will continue.

MYTH #5: SOCIALLY RESPONSIBLE INVESTMENTS ARE NOT A PRIORITY FOR HNWIs

Myth: "Socially responsible investments are a drain on returns, leaving little appeal to savvy investors."

Socially responsible investments (SRI), green bonds, impact investing, and similarly socially conscious investment techniques are not just a philanthropy equivalent for do-good investors. Smart investors are just as sensitive to the social and environmental impacts of their investments as they are to returns. In fact, studies have shown that the two often go hand in hand. In Asia, where wealth is booming, those numbers were particularly outstanding. RBC Wealth Management found that more than 90 percent of HNWIs in India said that social impact was a key concern.[8] About 89 percent of Chinese and Indonesian HNWIs reported the same.

It should come as no surprise then that RBC found that HNWIs want more support from their wealth managers in achieving social impact investment goals. This again factors into the importance of personal client-advisor relationships. Successful wealth advisors are able to tap into client preferences, pursue their SRI ambitions, and still bring home returns.

This will only be more important in the coming years. Three-fourths of HNWIs younger than age 40 consider social impact important, compared to just 45 percent of those older than 60.

As a subset of SRI, impact investing allows HNWIs to generate a specific social or environmental effect in addition to financial gain. This type of investing is on the rise, with one-third of family offices reporting involvement in 2017, up from one-quarter in 2016, according to UBS-Campden Wealth's Global Family Office Report for 2018. The most popular areas of investment are education, housing and community development, and agriculture and food. SRI will continue to be a priority for these HNWIs: About 45 percent of family offices say that they will increase their sustainable investments in the next 12 months, and 39 percent say they believe that the next generation will increase allocations to sustainable investment.

Similarly, environmental, social, and governance (ESG) principles are influencing how investors think about their portfolios. ESG metrics allow investors to mitigate risks by examining a company's ESG practices. For instance, examining a company's governance can expose issues with transparency, the approach to management, problematic hiring practices, or other issues that can cost investors in the long run. The difference is clear for investors. The performance of ESG-related investments, such as the FTSE4Good U.K. index and the KLD400 benchmark in the United States, have fared better than their non-ESG counterparts in recent years.

MYTH #6: ADVISOR RELATIONSHIPS WITH HNWI FAMILIES ARE FOR THE LONG RUN

Myth: "An investor prefers to maintain the relationship with a parent's or spouse's advisor after the parent or spouse passes away."

Sadly, wealth managers can't bank on keeping their HNWI families as clients in perpetuity. Three out of four surviving spouses fire their financial advisors within a year of a spouse's death because they have had little to no relationship with the advisor and want a fresh start with an advisor of their own choosing. Children, grandchildren, and divorced spouses of HNWIs are likely to feel the same. Each generation and wealth holder will have different priorities and want a wealth manager who knows and responds appropriately to these priorities.

That is not to say that financial advisors should prepare to be dumped as soon as a primary client passes away. Smart financial advisors will realize that client relationships are almost never with just one person. Relationships always should be with entire HNW families if the advisor intends to keep clients for the long run. Keeping client relationships means more personal awareness of families' changing needs and catering to the concerns of women or younger clients. For instance, jargon is a major concern to women investors. About 41 percent say that when choosing an investment, information in plain English is more important than returns and fees. Similarly, about one in three women say they have stopped using a financial advisor because they were dissatisfied. Clearly, advisors need to adapt to answer these concerns.

Technology is helpful in this situation, but it is not a panacea. Advisors should use technology to streamline mundane tasks in order to free up time so they can focus on client relationships. Only with a genuine commitment to communication and response to HNWI families will wealth managers be able to maintain client relationships for the long run.

Fortunately, wealth managers do seem to realize the importance of technology and artificial intelligence (AI) in particular. A report from Forbes Insights and banking software company Temenos found that 93 percent of wealth managers believe AI will play a role in the future of their practices.[9] Acceptance of digitalization by wealth managers has increased from 25 percent in 2016 to 52 percent. Likewise, HNWI acceptance has increased from 14 percent in 2016 to 41 percent. About two-thirds of HNWIs say their wealth managers should adopt some level of AI immediately, and more than half of responding advisors say that AI will be essential for them to successfully offer personalized services to their clients.

CONCLUSION: MYTHS BUSTED

Too often, reliance on misconceptions loses financial advisors their clients. In my experience, open-mindedness and flexibility are the best approaches to meeting HNWI needs. Financial advisors shouldn't approach millennials with the idea that they only want to interact with technology any more than they should expect an older investor to avoid technology. HNWIs are a diverse and complex bunch. The best client service results from open communication and personalization of the advisory experience, with a little help from technology along the way.

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ENDNOTES

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