



OUTSOURCING: A MEANS TO A DIGITAL END

Wealth managers clearly have much to gain from outsourcing non-core functions; however, regulatory concerns suggest that – in some cases, at least – the process needs to be handled with greater care and attention. *Paul Golden* writes

Outsourcing trends have been analysed across a number of wealth management reports over the last 12 months or so.

For example, a study released by Fidelity Clearing & Custody Solutions in February 2019 reported that 43% of advisory firms were leveraging external consultants, third-party providers or individual specialists for select business functions.

The most commonly stated objective of these engagements was to create more value for clients, as advisors felt that successful outsourcing of functions such as investment management and legal and compliance allowed them to focus on deepening their client relationships.

The Fidelity study suggested that advisors that outsourced two or more of the top three outsourced functions were more likely to experience higher AuM and client growth, manage a greater volume of assets and pay their employees more.

The Compeer/Objectway report, *The Wealth Management Firm of 2025*, found that the majority of large firms would outsource their back office functions if they were starting again, but faced considerable challenges in replacing existing systems, including technology costs and HR issues arising from making large numbers of people redundant.

It noted that for smaller firms, the transition could be quicker and that outsourcing gave these firms access to much larger research and development teams, providing technologies they would be unable to develop and build in house.

Technology is a major factor in any outsourcing decision, according to Nucoro. The fintech published research last September suggesting that more one in five retail investors had stopped using a wealth management service because its digital offering was too weak.

The company said it expected more wealth managers to outsource this part of their proposition to specialist third parties to allow them to focus on their core proposition.

Gilly Green managing partner for wealth management and private banking at Sionic,

on the market have come under significant pressure,” she says. “The need to update legacy core systems to keep up with regulation, be scalable and provide a solid source of data for digital and advanced technology solutions has driven this trend.”

According to Green, many wealth management firms are blinded by the peripheral technology on offer rather than focusing on issues such as the supplier’s cultural match, strategic fit, depth of knowledge in the team, and ability to deliver in the timescales they need.

“There are many firms that dive into a supplier-selection process without setting out their own vision, the principles under which they want to operate, or what growth opportunities they may explore in the future,” she continues. “It is vitally important to consider these factors before contacting any supplier.”

EXPANDED OPPORTUNITIES

The significant growth of low-cost location resourcing options has expanded the opportunities for a wider range of functions and services, particularly in software engineering.

David Noyce, head of offshore software engineering at Opus Una Financial Services Consulting, adds that high-quality and broad service coverage are more readily available, and advances in communication tools allow seamless and transparent operations across borders and time zones.

However, he also acknowledges that wealth managers need to ensure there is no negative impact on processing error rates or customer



MANY FIRMS DIVE INTO A SELECTION PROCESS WITHOUT SETTING OUT THEIR OWN VISION

says there has been a growing trend towards outsourcing in UK over the last 10 years from a market largely limited to smaller firms and start-ups to an acceptance of outsourcing as a viable option for managers of all sizes.

One of the key drivers for this trend has been the need to upgrade legacy systems. “Firms with old systems that have become bespoke or out of sync with the latest version



Gilly Green, Sionic

experience through use of a third party.

“Other risk factors include increased difficulties for firms to keep the necessary level of oversight and ownership over their core data and customer interactions and the knock-on risk of potential compliance breaches,” adds Noyce.

Over-dependency on third parties is also a possibility. Without the right control framework and ongoing review and benchmarking, a firm can become unable to operate without a particular provider, exposing it to high levels of vendor risk.

In addition to cost considerations, another factor working in favour of outsourcing is that the labour market for wealth management has been tight in recent years, and it can be difficult for firms to find the talent they are looking for – especially if they are located in a place where the local talent pool is limited, says Stephen Van de Wetering, CEO at data management business Empaxis.

“In that scenario, outsourcing makes sense,” he continues. “Hiring a remote workforce has become much easier, and the reality is that work does not always come in neat, eight-hour increments. The other factor to consider is access to talent. Not everyone is an expert in portfolio accounting, for instance, so it might be better to hire a team of specialists in that area rather than waste time and resources struggling with this function.”

A September 2019 PwC report on internal audit planning for wealth management firms observes that firms are outsourcing critical functions to a concentrated set of vendors, which are often unregulated. This is one of the reasons why outsourcing is exercising the minds of regulators, particularly in relation to how it impacts the operational resilience of wealth management firms.

REGULATORY MOVES

The FCA is conducting a consultation on enhanced requirements for outsourcing and operational resilience, submissions for which close on 3 April.

In addition, the EBA’s guidelines on outsourcing for investment firms subject to the EU Capital Requirement Directive came into effect on 30 September 2019 for outsourcing arrangements started, reviewed or amended on or after that date.

The EBA has implemented transitional arrangements covering cooperation agreements extending up to 2021, a register of outsourcing and a review of existing “critical or important” outsourcing arrangements entered into before 30 September 2019.

The PwC report authors suggest that while board-level executives are increasingly focusing on outsourcing practices, in most cases this has not translated into clear accountability which often results in no one having a holistic overview of whom the firm is



David Noyce, Opus Una

“Outsourcing firms can provide specialist knowledge - whether that is in operations, execution, technology or compliance - and have the capacity and capability to deliver regulatory change that a wealth firm may be doing off the side of the desk,” he says.

“ RISK FACTORS INCLUDE INCREASED DIFFICULTIES FOR FIRMS TO KEEP THE NECESSARY LEVEL OF OVERSIGHT AND OWNERSHIP OVER CORE DATA

doing business with, and the associated risks.

Most of the experts *PBI* spoke to rejected the suggestion that regulation has made outsourcing more challenging though. Clive Stelfox, director at Multrees Investor Services, reckons it makes a compelling case for outsourcing non-core functions.

The need for greater compliance has been a catalyst for the growth in outsourced models, which can deliver far better compliance at much lower cost since in an outsourced model, firms are able to share some costs for all hosted clients.

That is the view of Paco Hauser, global head of markets at Avaloq, who suggests that the main risk factor is the transformation from an old target operating model to a new one.

“The new model needs to be defined in very close collaboration between the client and the service provider,” he adds. “Adhering to standards is very important, and sets the foundation for remaining cost efficient. A profound level of work, with experience built up over decades, goes into eliminating risks and making the transformation work seamlessly.”

Van de Wetering is a little more circumspect, suggesting that regulation has required more due diligence on the part of the wealth manager when it comes to the vendor-selection process.

“The SEC and other regulatory bodies expect firms to do more due diligence when ▶



Stephen Van de Wetering, Empaxis



Paco Hauser, Avaloq

choosing third-party vendors, so we see more firms asking about SSAE [an auditing standard for service organisations audit reports and disaster recovery],” he says.

AUDIT AND TRANSPARENCY

It is in the outsourcing provider’s best interests to be audited and fully transparent if they want to win business from wealth managers that have strict compliance requirements.

According to Luke McCabe, group executive and head of global wealth at FIS, the argument for wealth managers to outsource to a single provider that can provide both custody and full back office outsourcing has become increasingly compelling. Many wealth managers are therefore choosing to outsource not just operations, but the whole custody model.

“Wealth managers often fear that they will lose control and visibility and that mistakes made by their outsourcing partners will create customer service issues or worse still, regulatory fines or sanctions,” he says. “But the truth is that a good outsourcer will give a wealth manager more control than if all operations were managed in house.”

At a contractual level, a comprehensive set of key performance indicators backed up by an enforceable service level agreement will enable managers to impose penalties for missed standards. It is also advisable to establish a strong governance model at the outset of a partnership with an outsourcer to ensure that there are clear channels for communication and ways to address issues.

Most outsourcers will have proven operational capabilities and a competitive cost model otherwise they wouldn’t be in business. According to McCabe, a savvy wealth

manager will look beyond the functional dataset and consider three key factors: proven operational resilience, cultural fit and long-term planning.

It is the responsibility of the wealth manager to select the right combination of systems, services, people and processes in order to meet its regulatory obligations. It must, therefore, ensure that it has robust and reliable mechanisms to monitor ongoing service provision and make changes as and when necessary.

Using the service provider’s standard approach will reduce the risk of service failure and help to control costs suggests Peter Bambrough, management consultant at Citisoft.

“Don’t expect a customised, bespoke service at wholesale or ‘off the peg’ prices,” he cautions. “If the service provider is not making a profit, then it is not in their interests to continue to develop, deliver and market that service to increase their client base,” he says.

When selecting an outsourced service provider, Bambrough recommends asking the following questions:

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- **Does the service exist now?** Can you see it in action and get references from existing users, or are you being used to help develop a new service?
- **How will the service evolve?** Regulatory and business requirements are ever-changing, so service providers need to be constantly enhancing their systems and services, and
- **How does the wealth manager move onto the outsourced service?** The service provider should ideally have a well-documented, proven approach to this.

When businesses grow, the outsourcing of non-core functions can enable firms to attain greater scale, flexibility and speed to market. But Objectway CEO Alberto Cuccu acknowledges that outsourcing ecosystems may run the risk of creating “shadow operations” or resources dedicated to duplicating or checking the work of outsourced partners.



Peter Bambrough, Citisoft

“Wealth managers can mitigate this risk by avoiding vendor lock-in and anticipating whether they will build or buy technology at early points in their growth strategy,” he says.

They should also ensure that they retain sufficient oversight, and that their outsourcing partner gives them full transparency across all systems and controls. A sensible approach would be to work only with well-capitalised,

independent counterparties that have invested heavily in technology and security, and have specific experience in the wealth management business as well as in managing outsourcing partnerships.

TECH AND INNOVATION

Managers should also choose a provider that already has the technology and the ability to invest in technological innovation and can provide regular software updates.

It is vital for wealth managers to invest time in a good outsourcing relationship, owned by someone suitability senior within the firm who has the resources and capacity to make the relationship work.

“It comes back to avoiding a ‘one size fits all’ approach,” concludes Stelfox. “An outsource firm is there to look after a wealth management business, and shouldn’t disrupt it or expect it to compromise, for example, by curtailing its asset universe or enforcing unreasonable timescales.” ■