Stick or twist?

Illustrating and assessing wealth managers’ strategic back-office technology options

Daniel Bruce
Today’s fast evolving technology landscape results in ever greater investments in technology capability, not only to help remain compliant, but to also develop innovative products and services to fulfil customer expectations and remain competitive.

For wealth management firms, this includes making long-term decisions on the future technology that will support their back-office. This has increasingly resulted in businesses outsourcing either their back-office technology or their entire back-office function to specialist providers.

Recent high profile complications with platform migrations may have tarnished the back-office technology outsourcing market and contributed to the feeling that deciding to use an outsourcer is akin to a game of Russian Roulette. However, as is often the case with the media, the stories that get most attention are those when things go wrong, not the numerous successes that go beneath the radar.

In spite of some recent poor publicity, we have found that conversations at Board and Executive level have been changing. In order to focus on their key revenue generating activities and control the risk capital they are holding, they are increasingly considering what could be outsourced and when it might make sense to do so. These decisions will impact the business for years to come so it’s not surprising that Boards proceed with caution.

Recognising that every firm is different, this article uses the example of back-office technology strategies to illustrate how using a logical assessment approach can help facilitate the discussions around the leadership table when setting your firm’s strategy.

Having helped businesses throughout the financial services sector make these types of strategic decisions, our starting point is to ensure the chosen option links back to the overarching business strategy and the internal capability and capacity, of both staff and systems, to make the necessary changes, are truly reflective of the business.

The article discusses some of the pros and cons of four common technology options in the wealth management sector and introduces a way to clearly illustrate their relative merits and some of the key considerations for effective third party engagement that are crucial to minimise and manage the risks of a poor transition and load the odds of success in your favour.
Technology outsourcing considerations

The back-office technology outsourcing market has a continuum of offerings to meet clients’ needs. To help assess if outsourcing some or all of the back-office would align with the strategic direction for your business, the four main scenarios we would expect to be part of the technology conversation, with increasing levels of outsourcing, are:

1. **Status quo** – Maintain the existing technology with minimal investment in IT development
2. **In-house technology development** – Invest in the current in-house technology enhancing the architecture, application and infrastructure to support your business strategy
3. **Technology outsourcing** – Implement an off-the-shelf third party technology solution tailored to your needs whilst retaining back office processing in-house
4. **Technology and back-office outsourcing** – Outsource technology and processing to an appropriate third party (or combination of third parties).

For all scenarios, we believe there are six key areas where the associated impacts of the selection should be considered:

- Customer
- Culture
- Cost
- Revenue
- Risk Capital Efficiency
- Regulators.
Flash summary

The possibility of outsourcing the firm’s back-office is emotive and each senior stakeholder will have different opinions and priorities. A structured approach to assessing and communicating the relative merits of not only the options, but also of any potential partners, is crucial to creating buy-in and support for the chosen direction.

In this article, we have illustrated the impact on customers, culture, cost, revenue, risk capital and the regulators, across each of the four scenarios for both the short term (0-3 years) and long term (3+ years). We have represented the impact as different size ‘wedges’: the larger the blue wedge the more optimal the outcome, (e.g. a technology migration has large implementation costs relative to maintaining the status quo so the short-term cost wedge is larger for the status quo) and produced a series of charts to enable a simple comparison between options.

Furthermore, and perhaps not surprisingly, the benefits of outsourcing the back-office can potentially provide an even greater opportunity to improve outcomes as:

- More attention can be focused on the customer (improving the Customer and Culture wedges),
- More time available to focus on growing the business (improving Revenue),
- A greater proportion of the cost base can be controlled (increasing the size of the Cost wedge),
- An element of back-office risk is transferred (improving Risk Capital Efficiency),
- Regulators are also increasingly supervising the back-office outsourcers (which doesn’t absolve your responsibility but can provide regulators comfort provided they are have a good working relationship with them).
Key business considerations

The strategic assessment needs to ensure the evaluation approach is clear, easy to follow and produces useful findings and/or recommendations. For each of the six key areas assessed, below is a short summary of how each of them could be impacted by the back-office technology strategy.

Customer

Customers are likely to have the best experiences and outcomes when their advisors can spend sufficient time focusing on their needs. Part of making that time, is ensuring the back-office effectively serves the advisor and the technology solution is key to enabling this. The two main characteristics of a fit-for-purpose technology solution are that it should be:

1. Accessible to users wherever and whenever they need it (advisors and customers if required); and
2. Usable, including integration with other technology that can enhance the offering.

Technology is key to increasing efficiency and effectiveness and this will ultimately lead to more satisfied customers.

As well as the advisor influence, the leadership team is crucial in delivering the strategic offering for the customer and time spent resolving back-office risks and issues can be detrimental to the customer.

Culture

This article uses ‘culture’ to describe how employees feel when at work and how this feeds through to service quality and the retention of key staff, particularly advisors.

As discussed in the customer section above, the relationship between the advisor and the customer is key. The advisor needs to be supported, and the service quality they are getting from the back-office influences their motivation and propensity to stay with businesses. Having technology that is easy to use, intuitive, fit for purpose and innovates as needs change, has the potential to enhance the culture over the longer term. All employees benefit from the efficiencies and automation the next generation of back-office technology can offer.
Aside from maintaining the status quo, each scenario will involve a short-term cost increase as technology is upgraded or migrated.

The long-term cost control potential of outsourced back-office technology provision is through the ability of charging structures being aligned to the business models of the wealth manager. This can provide more predictability for both the fixed nature of some costs and the variable nature of others. Outsourcing back-office processing can further increase the predictability which can allow the business to scale quickly without the “fixed” overheads this can sometimes create.

However, the impact on third party relationship management costs should not be overlooked as they will likely increase in line with the increasing criticality of the outsourced service provision. We find that outsourcing initiatives often fail to deliver when:

1. The partner selected isn’t appropriately aligned to the needs of the business; or
2. The business isn’t sufficiently skilled and/or resourced to assess, implement and manage a strategic change of this magnitude.

Whilst not as significant as the potential benefits, this does mean that costs related to third party management should be expected to increase over both the short and long term as skills and capability are needed to help in vendor selection, implementation and ongoing management.

The success of wealth management firms is highly dependent on customer acquisition, including fulfilling a greater share of an existing customer’s needs, and customer retention. Management need to maximise the short time they spend together focusing on ensuring there is a compelling customer offering to maximise revenue generating opportunities. Unfortunately, we often see this doesn’t always happen as a considerable proportion of their time is spent discussing risks and issues coming out of the back-office.

A successful outsourcing relationship can enable the business’s leadership to spend less time discussing back-office technology, and the entire back office if it is outsourced, and more time enhancing the customer offering; attracting and retaining more clients and growing business revenues.
All financial services firms need to set aside capital to withstand unexpected losses, and it is essential to make sure risk capital is used efficiently so as not to unduly constrain the business.

As part of a wealth management firm’s Individual Capital Adequacy Assessment Process (ICAAP), operational risk is usually the greatest single risk category it is exposed to, with IT and business processing risks being significant contributors to the risk capital set aside.

As the financial services industry is highly interconnected, we often see risk capital being set aside by both parties for the same risks. By working with outsourcers to discuss possible risk scenarios, there’s an opportunity to reduce the capital requirement if:

1. The outsourcer has included the identified risks within their own ICAAP and has sufficient capital to absorb losses; and
2. The contractual provisions are sufficient to ensure the supplier is liable for rectification expenses.

However, a pure technology provider might not be a regulated entity and doesn’t necessarily have the capital strength to compensate customers, so third party selection and due diligence is crucial to protect customers in the event of things going wrong and ensure the business’ capital requirements are appropriate.

The ‘Regulators’ wedge considers the perceptions and interactions of your firm’s regulators. Following recent high profile incidences (e.g. VISA), a growing area of interest for the FCA is operational resilience; with the technology sitting behind businesses being fundamental to it.

In addition, the new data protection regulations, and the increasing incidence of cyber attacks, adds to the risk of loss from a data breach.

Whilst outsourcing will not absolve responsibility for complying with SYSC, engaging a specialist provider can improve the control environment and provide expertise that wouldn’t be economically viable in-house. Established providers should have mechanisms for providing the necessary oversight and assurance as an integral part of the outsourced service offering.

Furthermore, when it comes to implementing new regulation, an outsourcing specialist will more likely be interpreting and applying it in a homogenous manner, enabling the regulator to review a single outsourcer, knowing it will be applied in a similar (if not identical) manner for all of their clients.
Assessment of options

Having defined the key business considerations the assessment will incorporate, below we discuss the four main scenarios you could include as part of the back-office technology conversation.

1. Status Quo

It might not be a realistic long term option given continually changing consumer and regulatory expectations, however maintaining the status quo can be a useful baseline for the analysis.

**Pros**

1. No significant capital expenditure in the short term.
2. No disruptive change.
3. Concentrate on other parts of the business.

**Cons**

1. Risk of future regulatory changes and non-compliance.
2. No innovation, eventually leading to a loss of customers.
3. Declining efficiencies.
4. Technology upgrade deferred, not avoided.

<table>
<thead>
<tr>
<th>Rationale</th>
<th>Short Term</th>
<th>Long Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer</td>
<td>• Consistent, stable customer experience.</td>
<td>• Customer experience becomes dated and time with advisor reduces as they cope with outdated technology.</td>
</tr>
<tr>
<td>Culture</td>
<td>• People know who to talk to when things go wrong and issues can be rectified quickly.</td>
<td>• De-motivated team as proposition falls behind the competition and more manual workarounds required.</td>
</tr>
<tr>
<td>Cost</td>
<td>• Little impact to the cost base.</td>
<td>• Regulatory changes implemented via manual processes.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Lack of straight-through-processing and automation means business doesn’t benefit from economies of scale.</td>
</tr>
<tr>
<td>Revenue</td>
<td>• Continue on the same trajectory over the short term.</td>
<td>• Competition innovates and changes as customer expectations change leading to a reduction in new business and an increase in redemptions.</td>
</tr>
<tr>
<td>Risk Capital Efficiency</td>
<td>• No change to the capital requirements as no major changes to risk profile.</td>
<td>• Manual processes lead to increased risk exposures and consequently increased risk capital.</td>
</tr>
<tr>
<td>Regulators</td>
<td>• No significant change from the current level of regulatory supervision.</td>
<td>• IT system integrity deteriorates leading to increased risk capital.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Manual processes reduce the control environment and increase risk of harm to customers, increasing supervision.</td>
</tr>
</tbody>
</table>
2. In-house technology development

Maintaining and developing the current in-house system gives maximum control over the direction of future technology.

**Pros**

1. Maintain control of infrastructure and processing.
2. Aligned to existing culture.
3. Control over direction and speed of enhancements.

**Cons**

1. Continual investment to keep up with the industry standard.
2. May still require a technology upgrade at some point.
3. Risk of unsatisfactory delivery.
4. Subject Matter Experts needed throughout development, taking them away from their day jobs.
5. Key man dependency increases as few understand the technology.
6. Regulatory developments prioritised over efficiency upgrades.

---

### In-house Development

<table>
<thead>
<tr>
<th>Rationale</th>
<th>Short Term</th>
<th>Long Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer</td>
<td>Consistent, stable customer experience.</td>
<td>Innovation and digital enhancements incorporated into the technology to remain competitive.</td>
</tr>
<tr>
<td>Culture</td>
<td>People know who to talk to when things go wrong and issues can be rectified quickly.</td>
<td>High levels of staff engagement and a stable workforce.</td>
</tr>
<tr>
<td>Cost</td>
<td>At best, costs continue on the current trajectory.</td>
<td>Any benefits from economies of scale outweighed by continued development costs from regulatory change and investment in the customer offering.</td>
</tr>
<tr>
<td>Revenue</td>
<td>No significant change from the current business model and revenue growth continues on the same path.</td>
<td>Technology and back office processing continue to be discussion points at Executive meetings, detracting from growing the business.</td>
</tr>
<tr>
<td>Risk Capital</td>
<td>No significant change to the risk capital requirements.</td>
<td>IT related risks (cyber and operational) remain with the business.</td>
</tr>
<tr>
<td>Efficiency</td>
<td>No significant change in regulatory oversight.</td>
<td>Back office process failure risk remains with the business.</td>
</tr>
<tr>
<td>Regulators</td>
<td></td>
<td>The implementation of new regulatory rules on an in-house system could be considered ‘riskier’ than on a system used by several market participants.</td>
</tr>
</tbody>
</table>
3. Technology outsourcing

Retaining the back-office processing whilst outsourcing the technology is an approach used by many.

**Pros**
1. Cost of upgrades shared amongst wealth managers using the technology.
2. IT system risk transferred to supplier leading to potential risk capital reduction.
3. Increased process efficiencies.

**Cons**
1. Loss of control over the technology.
2. Dependence on supplier.
3. New systems and ways of working.

---

<table>
<thead>
<tr>
<th>Rationale</th>
<th>Short Term</th>
<th>Long Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer</td>
<td>Limited customer impact with consistent back-office relationship.</td>
<td>Innovation and digital enhancements incorporated into the technology to remain competitive.</td>
</tr>
<tr>
<td>Culture</td>
<td>Significant change causes disruption and increased stress.</td>
<td>“Connectedness” reduces as back office have limited ability to investigate and rectify issues.</td>
</tr>
<tr>
<td>Cost</td>
<td>Implementation cost substantial.</td>
<td>Cost control achieved through outsourced IT development function and shared technology upgrades.</td>
</tr>
<tr>
<td>Revenue</td>
<td>Leadership focus on technology outsourcing and back office integration impacting new business flows.</td>
<td>Back office processing and interactions with technology continue to be discussion points at leadership meetings.</td>
</tr>
<tr>
<td>Risk Capital</td>
<td>Level of change activity could increase the risk capital.</td>
<td>IT related risks (cyber and operational) passed to outsourcer if sufficiently capitalised and contractually liable.</td>
</tr>
<tr>
<td>Efficiency</td>
<td>Potential to use surplus capital in development activity.</td>
<td>Back office process failure risk remains with the business.</td>
</tr>
<tr>
<td>Regulators</td>
<td>Change increases risk of harm to customers during the transition.</td>
<td>Regulatory interpretation more homogenous</td>
</tr>
</tbody>
</table>

---
4. Technology and back-office outsourcing

Another option is to fully outsource your back office operations, either with a single outsourcer providing both the technology and the processing, or a partnership between technology and back-office outsourcing specialists:

**Pros**

1. Cost of upgrades shared amongst wealth managers using the technology.
2. Focus on core differentiators to increase revenue growth.
3. IT and back-office processing risk transferred to supplier leading to operational risk capital reduction.

**Cons**

1. Loss of control over the technology and back-office processing.
2. Dependence on supplier.
3. New ways of working and interacting with the back-office.

<table>
<thead>
<tr>
<th>Rationale</th>
<th>Short Term</th>
<th>Long Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer</td>
<td>• Limited customer impact with consistent back-office relationship.</td>
<td>• Innovation and digital enhancements incorporated into the technology to remain competitive.</td>
</tr>
<tr>
<td>Culture</td>
<td>• Significant change causes disruption and increased stress.</td>
<td>• “Connectedness” reduces as back office have limited ability to investigate and rectify issues.</td>
</tr>
<tr>
<td>Cost</td>
<td>• Implementation cost substantial.</td>
<td>• Cost control achieved through outsourced IT development function and shared technology upgrades.</td>
</tr>
<tr>
<td>Revenue</td>
<td>• Leadership focus on technology outsourcing and back office integration impacting new business flows.</td>
<td>• Back office processing and interactions with technology continue to be discussion points at leadership meetings.</td>
</tr>
<tr>
<td>Risk Capital Efficiency</td>
<td>• Level of change activity could increase the risk capital.</td>
<td>• IT related risks (cyber and operational) passed to outsourcer if sufficiently capitalised and contractually liable.</td>
</tr>
<tr>
<td>Regulators</td>
<td>• Change increases risk of harm to customers during the transition.</td>
<td>• Regulatory interpretation more homogenous</td>
</tr>
</tbody>
</table>

Smart decisions. Lasting value.™
Stick or twist?

Outsourcing in all its variations has many proponents and detractors and despite becoming common practice for some services (e.g. payroll), it can be an emotive decision not easily made.

In the case of back-office technology, our analysis suggests that, usually, the strategic timeframe being considered is fundamental to the eventual decision and that, over the longer term (3+ years), having a modern platform provides the potential to deliver, at least a proportion of, the benefits the outsourcers claim.

The diagrams below are a summary of the prior four scenarios and show the general development of increasing benefit as firms increase outsourcing.
Whether technology outsourcing at this time is right for your business will depend on the unique characteristics of your firm. When done ‘right’, it can transform a business and allow it more time to concentrate on growing the business.

Having well defined plans and strategy at outset will increase the probability of selecting the appropriate partner and reduce the risk of a poor implementation.

The Crowe Outsourcing Assessment Tool has been developed to weigh up the pros and cons across various impacted areas of your business and over time.

As with any large implementation, a few key activities required to ensure success are:

- Having a long-term strategic vision and plan for your project or relationship.
- Clearly forming and communicating the goals and objectives of your project or business relationship to create staff buy-in and progressing to a better relationship with the selected vendor.
- Selecting the right vendor – this is essential for a healthy relationship – can the vendor deliver on their promises and is their long-term ambition aligned with yours? Can they demonstrate their capabilities on a live example?
- Insisting on a contract or plan that includes all aspects of the relationship, especially the financial considerations.
- Providing sufficient resources to enable effective change management.
- Keeping open communication with all affected individuals/groups.
- Rallying support and involvement from decision makers involved – the impact through the transition period can be significant and it is vital everyone works effectively throughout.
How Crowe can help articulate and manage the risks of back-office outsourcing

Crowe understands the challenges faced by organisations looking at outsourcing. The Crowe Outsourcing Assessment Tool can be used to assess and communicate the implications across the various areas requiring consideration.

**Customers**
Customers are the life-blood of businesses. Meeting their needs, both now and in the future is fundamental to continued success. Crowe provides independent assessments on the potential impacts to customers free of the potential biases an internal assessment can deliver.

**Regulators**
Crowe understands regulators’ concerns and priorities, and we can provide insight and proportionate recommendations to help ensure your wider strategy is aligned with their expectations.

**Risk Capital**
Having been through several Supervisory Review and Evaluation Processes as practitioners, as well as consultants, Crowe has deep expertise in financial, capital, liquidity and balance sheet risk management and advises on pragmatic approaches to modelling, stress testing and analysis.
k-office outsourcing

to assess and communicate the implications across the various areas requiring consideration.

Culture
Understanding “the way we do things around here” and the likely implications of proposed changes to the culture is crucial for the successful management of any change programme. At Crowe, we are experts at change management and regularly work with organisations to assess and change the business culture to effectively deliver their strategic goals.

Cost
Technology and outsourcing providers have the potential to sugar-coat the likely costs (both of implementation and on-going) and internal staff may be influenced and motivated by their own biases. Crowe is independent of your business and your potential third parties, allowing an unbiased assessment of the potential cost implications.

Revenue
Accurately predicting revenue implications of strategic initiatives is rare. The potential to over-estimate the revenue impact is common and often driven as a result of optimistic assumptions set by influential proponents of the initiatives. Crowe provides a critical, unbiased assessment of the assumptions to inform decision makers of the benefits, risks and implications of initiatives.

It is important to consider a holistic view across all the areas impacted. Crowe’s Outsourcing Assessment Tool and methodologies help businesses make informed decisions.

Smart decisions. Lasting value™
Our Approach

Crowe is a consulting firm based in London, with deep experience and expertise across the financial services sector. We characterise our approach as “managing risk from the inside out”.

Pragmatic
Applied: We take time to understand your culture, systems and processes, to tailor solutions that fit to your business.
Proportionate: Our hands-on industry and regulatory experience enables us to work with you to make judgements on requirements and prioritisation.
Practical: We only recommend solutions that meet your needs and can be implemented effectively and cost-efficiently within your business.

Empowering
Collaborative: What we do is ‘with clients’ not “to them”, working shoulder to shoulder with your teams to ensure buy-in and shared ownership.
Embedded: We align solutions with your strategic objectives and promote the consideration of risk in everyday decision-making across the business.
Sustainable: We transfer our knowledge, leaving your teams well-equipped to manage risk as part of business operations.

Progressive
Strategic: Our approach will be tailored to your business and its strategic objectives.
Positive: We believe embedding the consideration of risk can unlock potential in people and businesses to create lasting value.
Forward-thinking: We leverage our industry knowledge to develop innovative, forward-thinking solutions to help your business implement your strategy efficiently and effectively.

About Us
Crowe is a consulting, audit and technology firm with offices across the globe and over 33,000 professionals. Connecting deep industry and specialised knowledge with innovative technology, our dedicated professionals create value for our clients with integrity and objectivity.

Our UK office helps financial services clients to make pragmatic, practical, proportionate improvements to how their businesses work.

We use our practical experience of leading and developing strategic initiatives to focus on helping firms make informed decisions and implementing approaches in a way that adds demonstrable value to their businesses.

Contact Us
Daniel Bruce, Principal
+44 (0) 203 4576 656
daniel.bruce@crowe.com