WEALTHARC

WEALTH MANAGEMENT FEES UNDER PRESSURE

Data-driven insights into Swiss Wealth Managers' fee models

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INTRODUCTION

Switzerland is the world leader in management of private wealth. In recent years, consistently high-performing markets and positive net flows have driven the increase in Assets under Management (AuM), which has helped fuel revenue growth for External Asset Managers (EAM). AuM is set to grow until 2025, but pressure on profitability will intensify, too. Investors and regulators are increasingly demanding value for money and transparency from the EAM industry. In other words, EAMs need to deliver more for less. PwC estimates that EAM revenues from fees will decline by **22.4% until 2025** (PwC).

In this report, we set out to uncover the different fee models applied by Swiss EAMs, a topic that has received little attention in the past.

- **How can EAMs know whether their fee model is in line with the market?**
- **What is a standard fee rate charged by Swiss EAMs?**
- **How can EAMs ensure profitability in the coming years?**

EAM MARGINS UNDER PRESSURE

While the growth of AuM is expected to continue until 2025, the ratio of revenue by AuM will decline in the same period. Hence, the real challenge will be to protect and improve profitability in the future. We see the following trends as the root cause for the squeezing of margins:

- **Interest rates:** In the past, interest rates allowed EAMs to expect an annual risk-free return of up to 5%, meaning fees tended to be easily absorbed in the process. In contrast, the current zero and negative interest rate environment is breaking cross-funding options for EAMs.

- **Transparency:** Since the 2008 crisis, investment professionals have been forced to disclose fees and other related revenues in detail. "Hidden fees" are much more difficult to apply than previously. Already today, and increasingly by 2025, investors will want to know where every Swiss Franc of management fees has been spent and what value it is providing to them.

- **Passive & robo investments:** The continued rise of passive and new low-fee products challenges the plain-vanilla strategies of EAMs.

- **New generation of investors:** A new generation of tech-savvy investors has emerged, which will increasingly demand transparency and accountability from their advisors.

- **Regulation:** Complex regulatory requirements are driving investment professionals' costs up, whilst fees are stagnating. This combination is depressing the margin of EAMs.

- **Consolidation:** Competition between EAMs is fierce, leading to increasing consolidation in the market. Larger EAMs are able to spread risk and regulatory cost across many investors compared to smaller EAMs. Our report "Technology as Vaccine – How COVID-19 impacts Wealth Management" revealed that industry consolidation is a major concern for 26% of the Swiss EAM industry.

FEE MODELS OF SWISS EAMS

The University of Applied Sciences Lucerne (Institute of Financial Services Zug IFZ) has recently surveyed Swiss Asset Managers regarding their fee structure.

Accordingly, the biggest revenue source is management fees, making up **82%**, compared with **18%** generated from performance fees. Whilst the survey of the IFZ looked at the Asset Management industry more broadly (i.e. Institutional and Independent Asset Managers), our report puts its focus solely on the fee model of Swiss EAMs.

We have conducted research amongst our clients and prospects to understand their fee levels. The following report uncovers the average management and performance fees for different mandates, strategies and portfolio sizes. The sample consists of 27 Swiss EAMs from different regions.

Our research has revealed that the majority of Swiss EAMs, namely **85%**, apply management fees only. **15%** combine management and performance fees. Roughly **10%** of surveyed EAMs are using retrocessions.

Below shows the average management and performance fee for advisory and discretionary mandates.

Mandate	Average Management Fee	Average Performance Fee
Advisory	0.46%	9.84%
Discretionary	0.72%	10.13%

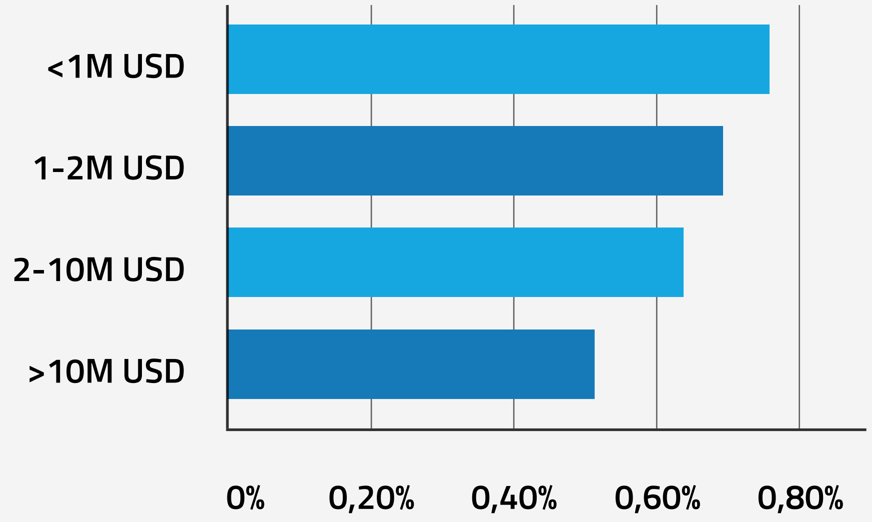
MANAGEMENT FEE ONLY

Our research uncovered that **85%** of portfolios carry management fees only. This corresponds with the trend that EAMs are shifting away from performance fees towards management fees. Accordingly, performance fees are applied by a minority of EAMs.

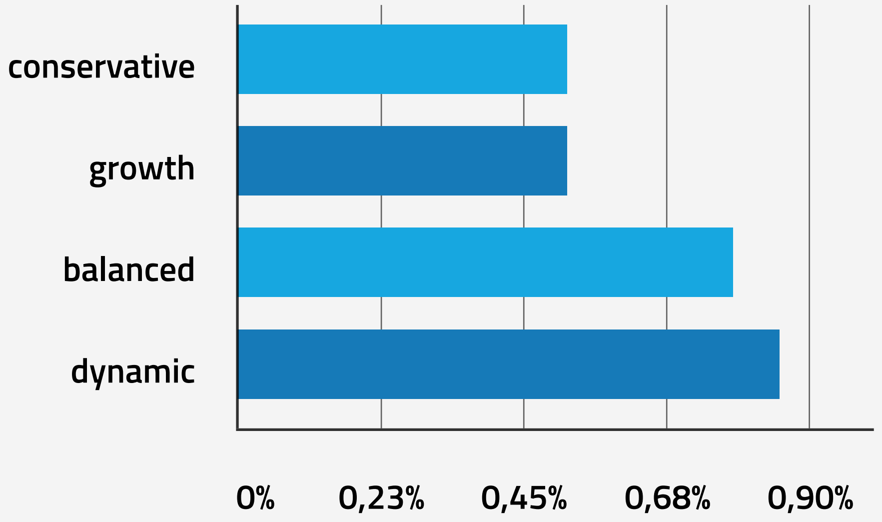
These EAMs justify their performance fees through more active investment strategies including product-specific and thematic investments. On the other hand, EAMs with no performance fee tend to focus on long-only strategies.

As the majority of Swiss EAMs apply management fee only, we will provide more granular insights into the fee structure of these mandates. The average management fee for advisory mandates is **0.52%**, whilst the average management fee for discretionary mandates is **0.74%.**

AVERAGE MANAGEMENT FEE PER ASSET BUCKET



AVERAGE MANAGEMENT FEE BY STRATEGY



Clearly, lower fees are attributed to lower risk strategies.

MANAGEMENT FEE AND PERFORMANCE FEES

Let's now have a look at EAMs that combine management and performance fees.

Asset Bucket	Average Management Fee	Average Performance Fee
< 1M USD	0.75%	11.28%
1-2M USD	0.66%	9.34%
2-10 M USD	0.75%	11.28%
> 10 M USD	0.66%	9.34%

It appears that asset buckets with less than 1m USD justify the highest management and performance fees. Evidently, with increasing asset size, the average fees drop.
The ongoing growth in assets will push more and more affluent people to seek financial advice. This segment is expected to be an important revenue driver in the coming years.
The higher volume of mass affluent investors combined with the new regulation for investor protection will continue to challenge the operational setup of EAMs. To sustain and increase the servicing of this segment, it is undeniable that EAMs need to digitalize their operations through platforms such as WealthArc.

PORTFOLIO COMPARISON: MANAGEMENT FEE ONLY VS COMBINATION OF MANAGEMENT & PERFORMANCE FEES

	Portfolios with Management Fee only	Portfolios that combine Management & Performance Fees
Average Management Fee	0.74%	0.66%

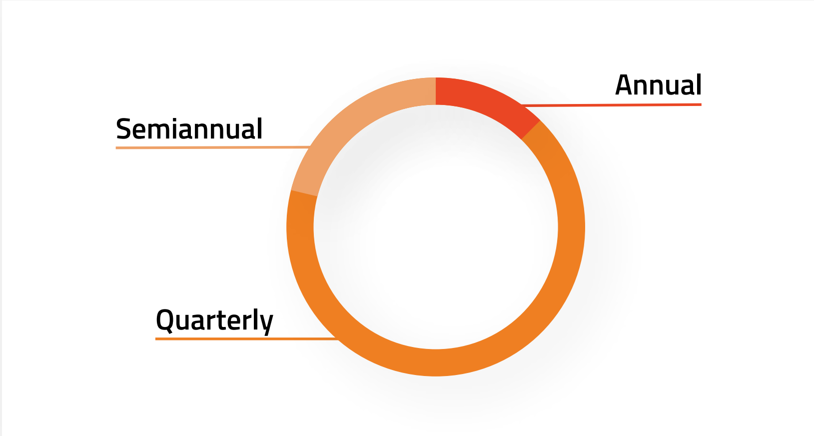
Clearly, the average management fee decreases for portfolios that combine both types of fees.

INVOICING FREQUENCY

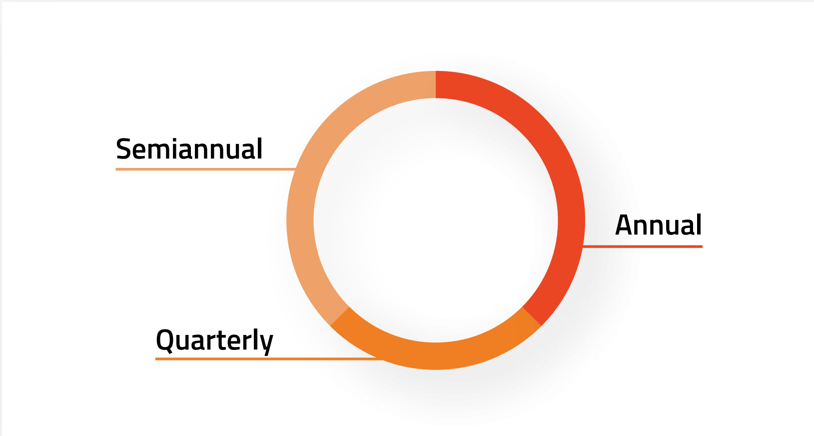
Most EAMs charge their management fees quarterly. Performance fees are more distributed over the course of the year. WealthArc automates invoicing for wealth managers by replacing other accounting tools as well as manual tasks in the process.

In WealthArc, invoices are fully customizable such as fee levels, frequency, calculation methodology, exclusion of assets, retrocessions and available languages. In addition, enhanced reporting functionalities by client, mandate, custodian and other criteria enable EAMs to run detailed analytics on profitability.

MANAGEMENT FEE FREQUENCY



PERFORMANCE FEE FREQUENCY



INNOVATION IN FEE MODELS

One might object that the question is not about increasing or decreasing fees, but rather what kind of services are offered to justify them. In other words, the answer is not to simply lower the fees, but rather a combination of increasing transparency, as well as improving how the value of the offerings and services is communicated to clients. According to EY, nearly half of discretionary wealth management clients are dissatisfied with the fees they pay and do not trust that they are being charged fairly. Fee awareness is lowest for older investors and for investors with low levels of investment knowledge. Several advisors we spoke to openly communicate with their investors about their fee structure, operating cost and advisor compensation.

EAMs should not ignore this and develop a transparent pricing model that is understandable. This transparency is a prerequisite for trust, the most important currency in the advisor-investor relationship.

As we have seen, all EAMs in our survey apply management fees or a combination with performance fees. If we look to other regions in the world, EAMs are adapting their fee models and also offer fixed fees, per hour rates and subscription packages. These models target especially an emerging cohort of investors who demand tailored and flexible advisory models. In addition, the pandemic pushed many investors to invest during the bullish recovery, mostly via trading platforms and brokers. Studies indicate that this trend is here to stay. Eventually, these investors will seek professional advice, financial advisors will need to think about how they can best monetize this emerging clientele.

ENSURING PROFITABILITY

Swiss EAMs build on expertise and trust in the advisory process. But with increasing investor and regulatory scrutiny, advisors are forced to find ways to innovate their operating model. Hence, how can EAMs justify and maintain their fee level?

- **Transform through technology:** Platforms such as WealthArc automate many time-consuming and cumbersome daily tasks of EAMs. The streamlining of workflows from front-to-back office increases the efficiency and satisfaction of all team members. It allows advisors to fully dedicate their time to what matters most, namely their investors and the markets. In addition, the customer relationship management system not only ensures KYC and document management but also improves prospecting and acquisition.

- **Investor Experience:** Those offering a streamlined and technologically-enabled client experience will be on the track to success because they'll provide new value to their clients. Thereby, advisors can differentiate themselves from the competition and justify premium fees. Due to the ongoing pandemic, investors have adapted to digital communication channels and will demand the same going forward.

- **Fee Transparency:** According to a study by PwC, only 56% of investors say they fully understand the fees they pay. 45% of investors do not trust their advisors to charge them fairly. Hence, investors do not fully appreciate the value of their advisor relationship, which lies in low awareness and understanding of the wealth management fees they are being charged. EAMs should therefore develop a transparent pricing model that is understandable and fair.

- **Return:** Obviously, advisors that are able to provide consistently above-average returns can defend their fee levels.

TRANSFORM THROUGH TECHNOLOGY

EAMs who haven't yet prioritized the implementation of advanced technology will need to do so in order to win, or even to survive. Those who have initiated the transformation of their operating model have focused on integrating a single technology platform such as WealthArc. These EAMs are optimising their business from front to back and are ready to face the new reality of sustained fee pressure and regulatory scrutiny, which will, as outlined, intensify until 2025. The front-to-back automations include, but are not limited to:

- Automatic Consolidation and Reconciliation
- Enhanced Portfolio Analytics
- Automated & Customizable Invoicing
- Accounting and Profitability
- Trading & Rebalancing
- Investor Reporting
- Compliance: AML, FIDLEG/FINIG, MIFID, MIFIR
- Back-office management
- Digital client portal accessible via app
- Digital onboarding (automatic, guided KYC)
- Access to all statements and documents, including eDocuments
- Lead generation and conversion tracking

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METHODOLOGY

WealthArc combined interviews with data-driven insights from 27 Wealth Managers in Switzerland between January and March 2021. All participants are directly involved in wealth management in various positions ranging from Managing Director to Portfolio Manager.

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