External Asset Managers in Singapore

Opportunities and challenges for the sector.

by T. Mandy Tham, Esther Kong and Juliana Koh

There has been a tremendous growth in individual wealth in the Asia-Pacific region over the past two to three decades. Singapore, with its strong standing as a financial hub, as well as its political stability and pro-business policies, has been a natural candidate to benefit from this growth. As the country pivots to the next phase of wealth management focusing on the ultra-rich, an ecosystem is fast evolving to support the growth of family offices on the island. In fact, Singapore has set its eyes on being a family office hub on the global stage and is rapidly gaining credibility as one. This trend has led to the symbiotic growth of the external asset manager (EAM) industry here.

Against this backdrop, Business Families Institute at Singapore Management University (BFI@SMU) conducted research that focuses uniquely on the perceived growth factors, challenges, and opportunities for the EAM sector in Singapore. It published the research report, which adopted a survey methodology, in January 2022. The questionnaire was launched online and collected a total of 41 responses between March and July 2021. Survey respondents ranged from senior executives to managers. They represented mainly the EAMs, fund management firms, and family offices. To add insights to and verify the survey findings, researchers followed up with exclusive one-on-one interviews with members of the Association of Independent Wealth Managers (AIWM), EAM representatives, and veterans managing the financial intermediaries at various custodian banks in Singapore. This article includes curated key insights from the research report,[1] as well as inputs from case studies written on the EAM business[2].

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THE EAM BUSINESS MODEL

The EAM business relies on a unique business model that is different from the traditional private wealth management model. Typically, when a high-net-worth client opens an investment account with a bank, the bank's in-house investment professionals would manage the account. However, with the EAM model, an external party manages the investments, while the bank services the account. The EAM offers investment advisory, discretionary portfolio management, tax, and succession planning services, as well as advice to the custodian bank where the client opens the account. The client then appoints the EAM to manage the assets with the custodian bank based on a Limited Power of Attorney (LPOA) over the account. The model thus creates a tripartite relationship among the client, the custodian bank, and the EAM (refer to Figure 1).

The EAM revenue model

EAMs generate revenue through retrocession, management, and performance fees. Retrocession fees are commissions the EAM receives from the bank as an incentive to choose that bank for its clients. They are the easiest to generate.

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Custodian banks also offer a rebate on a portion of their service fees to EAMs depending on the volume of trade executed for the clients. Some regulators require EAMs to disclose the retrocessions to their clients, while others may leave it to the EAM to volunteer the information.[3] EAMs may also decide to pass a portion of their retrocessions to their clients to reduce the net fees incurred by the client.

Some EAMs charge management fees for handling client portfolios. This is exacted annually, based on a discretionary mandate. The third revenue source is the performance fee, which is paid by the client based on the pre-agreed performance benchmark with the EAM. All three revenue models can be concurrently adopted by an EAM.

THE EAM TRIANGLE BUSINESS MODEL

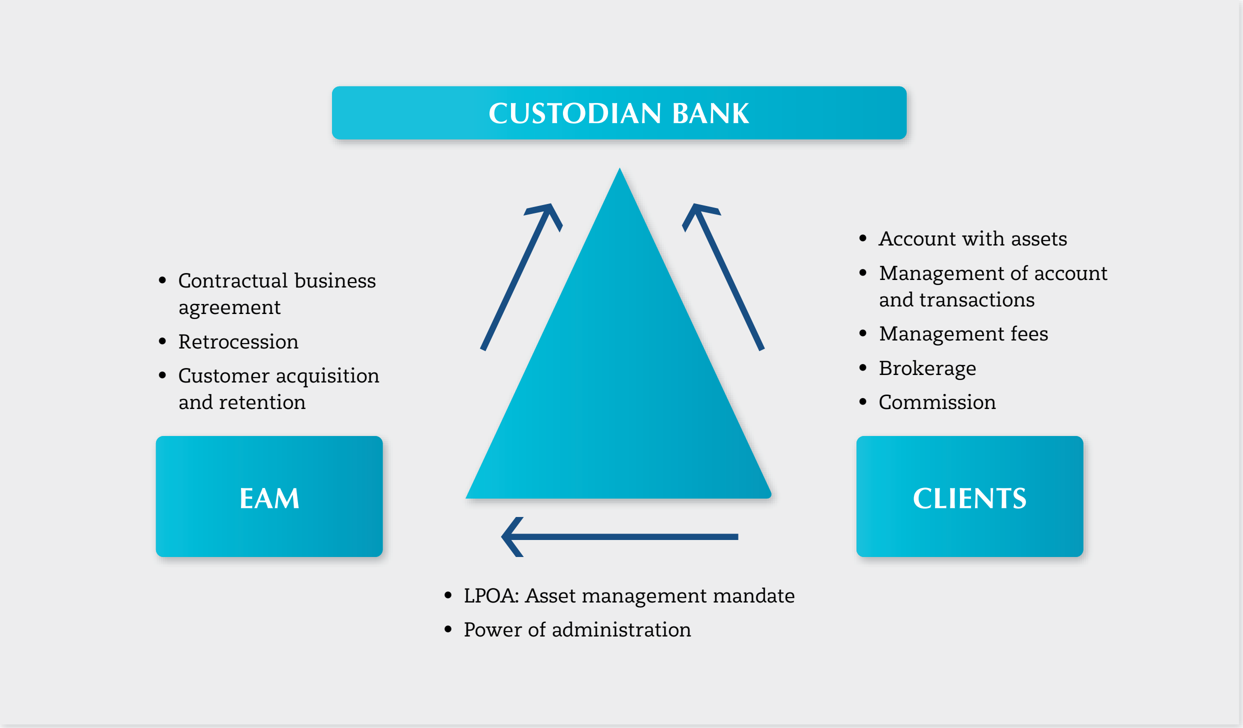

FIGURE 1

Source: Authors

GROWTH FACTORS FOR EAMS IN SINGAPORE

In our survey on EAMs in Singapore, we tried to assess the perceived growth drivers of the industry over the next five years and discovered that these come from mainly three sources: (1) the value proposition offered by the EAM, (2) the value proposition offered by Singapore for the business, and (3) support from regulatory and government authorities.

(1) Value proposition of the EAM

The primary value proposition that EAMs offer is a concentrated focus on building a long-term relationship with high-net-worth clients. EAMs do not face short-term revenue targets or the pressure of selling in-house products and are able to deliver long-term client-focused investment and wealth advisory solutions. They benefit from developing strong relationships with clients because of the independent and professional investment advice they offer.

The second value proposition stems from the gradual acceptance of the EAM model by clients. As the EAM sector matures, clients gain greater awareness and trust, and become more open to granting an LPOA to an EAM. Creating awareness continues to be an ongoing effort by the EAM industry.

The third value proposition is the EAM's ability to provide customised solutions to satisfy client needs. As independent advisors, EAMs can act as prime brokers and offer open architecture to clients. This means they can collaborate with many custodian banks, thereby gaining access to different capital markets, investment products, and solutions offered by their panel of partner banks. The wins come from the EAM's offering of bespoke investment management services for clients, owing to the open architecture nature of the EAM business.

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(2) Value proposition of Singapore

Singapore is well-recognised as a reputable financial and fintech hub. The island hosts top global banks and boasts of reputable local banks. Global asset managers such as BlackRock, Nomura, and Franklin Templeton have a physical presence in the city. Hence, investors are able to source for depth and breadth of investment, banking, and wealth management solutions in Singapore through the myriad of financial institutions present. As a fintech hub, Singapore further provides high-net-worth investors with private investment opportunities in the start-up space.

Another key value proposition is the growth of Singapore as a family office hub. A family office is a dedicated private company set up to manage the wealth of an ultra-high-net-worth family. Family offices generally desire a wide range of investment offerings, as well as value-add and flexibility in their selection of investment partners. The EAMs provide an alternative to the private banks, and more than 80 percent of our respondents believed they add value to family offices through high-quality client relationship management and engagement, while 56 percent also highlighted their expertise to advise on intergenerational succession planning.

(3) Support from Singapore authorities

The Singapore government has made concerted efforts to develop the country into a credible family office hub. The majority of our survey respondents were aware of support such as grants and regulatory compliance, as well as support for digital platform know-how and grants from the Singapore government for EAMs to develop their digital wealth management capabilities. AIWM, a self-regulatory body which represents about 70 members from the EAM ecosystem, actively engages in dialogue with the Monetary Authority of Singapore (MAS) based on the needs of the EAM sector.

In addition, Singapore has also passed legislation on the Variable Capital Company (VCC) framework to spur the growth of family offices, which would drive the symbiotic growth of the EAM sector. Launched on January 15, 2020, the VCC is a new corporate entity structure under which several collective investment schemes can be gathered under the umbrella of a single corporate entity. The VCC framework offers operational flexibility, tax exemption, and cost savings to family offices for their fund management. For instance, the VCC structure can be adopted for open-ended or close-ended funds,[4] as well as various investment strategies that range from traditional to alternative asset classes[5] such as private equity. It also allows for distributions to be paid from profits and capital[6] to the investors. However, a VCC must be managed by a Singapore-based fund manager regulated or licensed by the MAS, as per the VCC legislation. These fund managers are also obligated to use a licensed custodian for the safekeeping of assets.

When an individual manages a fund on a discretionary basis in Singapore, it creates a taxable presence for the fund. However, under sections 13R and 13X of the Singapore Income Tax Act, funds managed by Singapore-based licensed fund managers will enjoy income tax exemption that also extends to VCC funds. As the VCC requires a Singapore-based licensed fund manager such as an EAM to manage its investments, the legislation helps spur the demand for EAMs. Since the launch of the VCC legislation, more than 260 VCC funds have been set up.[7]

CHALLENGES FOR EAMS IN SINGAPORE

There are some known challenges within the EAM industry which, based on our survey response, have been categorised under three areas: (1) operational and productivity challenges, (2) business challenges, and (3) relational challenges.

(1) Operational and productivity challenges

More than 60 percent of our respondents viewed the client onboarding time at custodian banks as time-consuming, and the compliance, legal and operational requirements as costly and difficult for EAMs to satisfy. The issue of the Know Your Client (KYC) requirement illustrates such challenges.[8] Citing verbatim from a respondent, "There should be uniformity in requirements for all financial institutions and EAMs. Delegation of power on KYC matters should be increased to avoid the EAM and the bank doing the same tasks twice using different criteria."

Currently, both the EAMs and custodian banks are required to conduct client KYC as per regulation, but often, there is duplication in the workflow. In addition, custodian banks generally uphold KYC standards above those required by the MAS, and EAMs must work with varying levels of stringency in KYC standards across their panel of custodian banks. One solution is for custodian banks to share their KYC standards with the EAMs and work collaboratively with the latter to reduce duplication of work. Based on our interviews with selected custodian banks, we found that many banks have already done so and intend to strengthen their engagement with the EAMs in the future.

More than 70 percent of respondents expected regulations such as technology risk management, KYC, and licensing to be tightened over the next five years. The heartening news is that, similarly, more than 70 percent believed that there would be greater support from the MAS to help the EAMs navigate the changing regulatory landscape.

Another challenge shared by almost half of our respondents was the lack of a robust end-to-end digitalised client data management system from custodian banks to handle client accounts. Digitalisation would also be a powerful enabler for an effective and efficient regulatory compliance process for the EAMs. As one respondent pointed out, "There should be some consolidation of portfolios and establishment of minimum digital standards that private banks need to meet, or for banks to set up standardised APIs (Application Programming Interfaces) for data sharing with the EAMs."

On an encouraging note, custodian banks are increasingly setting up dedicated EAM desks to provide specialised services and investing in human capital and digital systems to support the EAMs. For example, the dedicated EAM desks would be staffed by a skilled team that understands the workflow of the EAM business, and are supported by a digital platform that provides the EAMs with pricing, execution, and monitoring in real-time. The EAM business is scalable and hence profitable for custodian banks. Both parties would benefit from working collaboratively in addressing these operational and productivity challenges.

(2) Business challenges

More than one-third of our survey participants ranked the following business challenges as their top three concerns: competition for talent from banks, fulfilling risk controls required as part of the overall technology risk management, and unwillingness of banks and brokers to consider the EAMs as wholesale clients deserving of institutional pricing.

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Indeed, the issue of talent attraction and retention is a challenge for the EAM sector, as it must compete with banks that have deep pockets for senior wealth professionals, and within the sector. The private banking industry in Singapore is maturing, and there is a greater supply of senior private bankers and investment professionals for the EAM sector to recruit from. However, being a salaried employee in a well-structured bank and enjoying the support from teams of specialists (e.g., product specialists, risk specialists, compliance and legal team, portfolio management, and research team) is very different from fulfilling almost all aspects of the job by oneself in a much smaller scale EAM set-up. The right candidate must have an entrepreneurial mindset and the skill set to be successful in the EAM business. Hence, the EAMs compete for talents with established banks, not just based on compensation and seniority, but also the right fit for the business.

This segment of talent is in demand both locally and globally. Organic talent development within the EAM sector could be a solution to this talent crunch. Universities, through degree and diploma-granting programmes, can also work collaboratively with the industry to build a pipeline of talent for the wealth management industry, including the EAM sector.

As for the second challenge, the AIWM regularly conducts educational programmes, and provides support for its members on regulatory and risk control matters. It also engages the MAS in dialogue on such challenges facing the EAM sector.

For the last challenge, some EAMs are considering forming an alliance to increase their collective bargaining power in negotiating for institutional pricing with banks. In this business, pricing is a function of the quantity of trades, not unlike other non-financial wholesale businesses. As the quantity of trades increases, the buyer gains bargaining power to negotiate for greater discounts from the seller. Hence, an EAM with assets under management (AUM) in excess of $1 billion would execute more trades with the custodian banks than an EAM with an AUM of $200 million. The former would be able to enjoy more preferential pricing than the latter. As the average EAM outfit gains in size and hence, bargaining power over time, it will be a natural progression for the EAM sector to enjoy wholesale pricing from private and investment banks.

(3) Relational challenges

Relational challenges are defined as concerns impacting the EAMs' relationship with the end-clients. Top on the list are two challenges related to the support from custodian banks: client satisfaction is influenced to some degree by the custodian bank's service level, and the custodian banks' effectiveness in serving the EAM community can be improved.

To understand the first challenge, let us recall that the custodian bank hosts and services the client account. Hence, the quality of account servicing by the custodian bank directly affects the client's overall experience. For instance, if the bank is slow during the client's onboarding and account opening process, the client could have missed the best timing for his/her investments. This would adversely affect the client's overall investment experience with the EAM, although the onboarding and account opening process is out of the EAM's control. As for the second challenge, custodian banks generally do not have a uniform fee structure for end-clients, which includes the EAMs, as fees levied are tied to the strength of the relationship between the clients and the bank. Retrocessions, that is the rebate of fees from the custodian bank to an EAM, are privately negotiated between the EAM and the bank, and differ across EAMs. Hence, there is a clear lack of transparency in the pricing of fees by custodian banks.

To address such challenges that are out of the control of the EAMs, better engagement and collaboration between the EAM and the custodian banks must be established.

OPPORTUNITIES FOR SINGAPORE'S EAM SECTOR

Despite the challenges, there are plenty of opportunities for the EAMs. The majority of our respondents are enhancing their competitive advantage by transitioning to an open architecture. Forty-one percent believed that there would be a roll-out of minimum competency standards for EAM professionals in the next five years, and there would be a formation of an EAM alliance network and ecosystem to deliver value-added services to clients.

The emerging EAM ecosystem

What does an ecosystem that bolsters trust in the EAM sector look like? From our survey findings, we believe that the EAM sector would evolve to become a three-pillar ecosystem. The first pillar comprises stakeholders who complement revenue-generating products and services for the EAMs, such as working groups with the MAS, family office networks, private banks, and tax experts. The stakeholders under this pillar work collaboratively to improve the bottom line of the EAMs. For example, working groups representing the EAMs will engage the MAS on regulatory compliance requirements and seek its support to manage such costs. The family office networks will engage the EAMs as investment partners, bringing revenue growth to the EAMs. Private banks will support the EAMs as custodian banks, providing them with capital market products and services. This way, the EAMs can grow their revenues when more clients are onboarded, and better bespoke investment solutions can be tailored for the latter through offerings from various custodian banks.

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The second pillar is a general network comprising experts and universities to support research, training, and thought leadership. For example, the AIWM provides general information to the EAMs, self-regulates the conduct of its members and through this, upholds a minimum reputational standard for the EAM sector. It also generates awareness of the EAM business model among prospectives clients, providing them a forum for networking. Universities as experts in training and talent development can support the EAMs in their learning and development needs. The second pillar, while not directly adding to the financial revenues of the EAMs, is instrumental in charting the longer-term non-financial aspects of the sector, such as establishing the reputation of the EAM sector and ensuring a pipeline of talents for the sector.

The third pillar will be formed by the existing network such as investment banks, fintech associations, and corporate banks that remain vital to the growth of the EAM sector. For example, fintech associations will continue to support the EAMs in their digital transformation journey and adoption of technology. The EAMs will continue to tap into the investment banks for corporate finance solutions sought by clients, such as the issuance of bonds or equities for the clients' operating businesses. Similarly, corporate banks will continue to support the EAMs by providing corporate banking solutions for their end-clients, such as cash management and trade financing solutions for the clients' operating businesses.

We anticipate that the individual players in each pillar will change over time as the EAM sector evolves, but the main contribution of each pillar to the EAM ecosystem would remain.

CONCLUSION

To summarise, we presented the EAM business and revenue model in this article, and explored growth factors and challenges for the EAM sector in Singapore. If we are to conclude the outlook of the EAM sector in one word from our findings, the word would be 'optimism'. Our survey participants ultimately expect the EAM sector in Singapore to grow vibrantly. AMI

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Endnotes

[1] The research report can be downloaded at https://bfi.smu.edu.sg/knowledge-research/insights/growing-ecosystem-wealth-management-singapore-lenses-external-asset

[2] The case studies are as follows:

a) "Creating a Representative Voice: The Association of Independent Wealth Managers (AIWM) in Singapore"

b) "HP Wealth Management: Pioneering External Asset Management in Singapore"

c) "Turning the Tide: The Journey of Rebuilding for Success"

d) "Bank of Singapore's EAM Business: Standing Tall Against Competition".

[3] Sandrine Giroud, Nicolas Ollivier, and Simine Sheybani, "Update on Retrocessions Under Swiss Law: Risk of Criminal Liability for Asset Managers Failing to Report Retrocessions to Clients", LALIVE Blog, December 4, 2018.

[4] Open-ended funds allow subscription and redemption into and out of the funds any time. Closed-end funds have an initial subscription period, after which the funds will be closed to new subscriptions. Redemptions for closed-end funds can only happen at the end of the funds' investment horizon.

[5] An asset class is a group of similar investment instruments. Generally, equities, bonds and cash/money market investments are regarded as traditional asset classes, and these can be accessed by most investors and are easily converted into cash. Alternative asset classes are those investment vehicles that fall outside of traditional asset classes. Alternative asset classes are generally illiquid (i.e., harder to convert into cash) and might not be made accessible to retail investors. Examples include hedge funds, private equity, venture capital, and private debt.

[6] Capital is the initial investment amount put up by investors to start the fund. We can think of capital as the principal amount.

[7] David Ramli and Lulu Chen, "The Super Rich are Choosing Singapore as the World's Safest Haven", Bloomberg, May 26, 2021.

[8] Know Your Client (KYC) is a due diligence process to understand, collect and verify material information on the client as part of the account opening requirements mandated by rules and regulations in Singapore and other jurisdictions.