lakyara vol.333

Chief investment office's role in setting investment strategy in wealth management space

Aki Ono

28.January.2021

Nomura Research Institute, Ltd.

Aki Ono

Senior Consultant

Financial IT Retail Business Planning Department

Executive Summary

Some major Japanese financial institutions have recently established chief investment offices to formulate investment strategy in their wealth management businesses. In managing customer assets, a chief investment office cannot truly excel without first building trust both internally and externally.

Chief investment office sets investment strategy for wealth management units

At least two major Japanese financial institutions[1] have recently set up chief investment offices[2] to set investment strategy/policies for their wealth management units. They are following the lead of Western counterparts like UBS and Credit Suisse, which established their chief investment offices a decade ago to offer institutional-level service to high-net-worth individuals (HNWIs).

A chief investment office's mission is to formulate a house view[3] and maximize risk-adjusted returns on customers' assets. Chief investment offices are headed by a CIO whose role is to externally communicate the firm's house view in addition to bearing ultimate responsibility for managing customers' assets. Chief investment offices are typically staffed with 100-200 economists, analysts, strategists et al. Their staff's roles include setting strategic and tactical asset allocations and identifying investment themes.

Chief investment offices are similar in many respects to the front offices of asset management companies and other buy-side firms. In this sense, chief investment offices are not an organizational innovation. Their significance lies in their application of institutional investment practices to the retail arena in pursuit of better portfolio performance. In other words, chief investment offices in the wealth management space can be said to transplant business models from the institutional market segment to the retail market segment.

Why establish a retail-facing chief investment office

To establishing a chief investment office, a financial institution has to reconfigure

NOTE

1) The Nikkei reported that Nomura Securities and SMBC Nikko Securities established chief investment offices in July and September 2020, respectively.

2) These organizational units' names differ among companies. We uniformly use "chief investment office" for convenience.

3) A house view is typically the firm's region-by-region economic outlook and market calls on individual asset classes. It forms the basis of the firm's investment strategy.

its organization and reassign personnel. The process consequently often takes a year or two to complete. European and US early adopters of chief investment offices generally decided to undertake the time-consuming and costly process for two reasons.

The first was a loss of trust from customers. Regaining trust by pursuing customers' interests became an urgent priority for wealth managers experiencing asset outflows in response to post-GFC investment underperformance. Other shortcomings they sought to address included poorly reasoned investment theses and wide variations in the quality of financial advisors' services. Although customers derive added value from the analysis underlying wealth managers' investment ideas, such analytical underpinnings were often flimsy. The second reason was to rein in burgeoning costs. Cost-cutting had become an urgent priority in the wake of pre-GFC business expansion that led to organizational sprawl, bloated headcounts and dispersion and duplication of functions. In sum, Western financial institutions established chief investment offices in the aim of winning customers' trust and improving efficiency.

4) Per a July 2020 interview survey.

Although chief investment offices are still in their infancy in the wealth management space, they are already steadily paying off[4] (see table). For instance, wealth managers that have established a standard process whereby their financial advisors formulate financial plans based on customers' needs and risk tolerance and then recommend an asset allocation sanctioned by the chief investment office have realized uniform service quality and freed themselves from dependence on financial advisors' personal skills.

Another point that cannot be overlooked is that having a house view facilitates expansion of services for HNWIs, including SMA (separate managed account) and investment advisory services. For example, some wealth managers add value by assembling a lineup of investment advisory services that includes the chief investment office's investment ideas and portfolio optimization recommendations

Payoffs from having a chief investment office

Service standardization	Consistency in investment recommendations Freedom from dependence on financial advisors' personal skills
Closer client relationships	Augmentation of SMA/investment advisory services More opportunities for conversations with clients based on house view
Improved efficiency	Easier access to research reports Improved operating efficiency by virtue of tool synergies

and access to reports. Meanwhile, the house view and related reports play a key role as grist for conversations with clients. Some financial advisors have reported a twofold increase in opportunities to touch base with clients since their firms established a chief investment office.

Additionally, wealth managers with chief investment offices are steadily making their business processes more efficient through such means as cross-organizationally consolidating research functions and reallocating human resources. Other efficiency improvements include making research more accessible through centralization of resources in the chief investment office and timelier dissemination of investment recommendations and market alerts through reprogramming of systems and tools to reflect the house view.

Chief investment office's organizational role

However, establishing a chief investment office entails challenges also. One challenge is internal resistance to a uniform investment approach, particularly from financial advisors who have built a clientele by exercising their own discretion. That such financial advisors would resist following a uniform investment process is understandable. Wealth managers with chief investment offices have in fact experienced loss of morale and defections among their financial advisors when they first established their chief investment office. If the chief investment office's investment strategies and recommendations underperform, doubts about the chief investment office's investment acumen would of course arise and staff's confidence in the chief investment office could very well waver.

From such a perspective, it is important for financial institutions to internally and externally express confidence from the outset in their chief investment office's ability to manage customer assets. To prevent conflicts of interest, the chief investment office should maintain some degree of organizational independence. In addition to being functionally and hierarchically independent of retail and institutional sales forces, a chief investment office should also be segregated by a Chinese wall.

To staff up a chief investment office, one option is to externally recruit experienced buy-siders to cross over to the retail market segment. In fact, wealth managers often hire CIOs previously employed by a hedge fund or family office. The CIO is responsible for managing customer assets based on an investment horizon of at least five years. In this respect, the chief investment office's orientation differs from that of business units that pursue short-term returns. This difference helps to boost confidence in medium/long-term investment performance.

Lastly, it is crucial for the chief investment office to internally gain recognition and understanding by proactively sharing resources with other organizational units. Actual examples of such initiatives include supporting financial advisors by giving internal presentations on the house view or participation in client meetings. Such efforts contribute to fostering internal trust in the chief investment office.

The chief investment office thus plays a key role in extending buy-side business models across the retail market segment, but merely establishing a chief investment office is not enough. A chief investment office cannot truly fulfill its role without first gaining trust both internally and externally.

about NRI

Founded in 1965, Nomura Research Institute (NRI) is a leading global provider of system solutions and consulting services with annual sales above $4.8 billion. NRI offers clients holistic support of all aspects of operations from back- to front-office, with NRI's research expertise and innovative solutions as well as understanding of operational challenges faced by financial services firms. The clients include broker-dealers, asset managers, banks and insurance providers. NRI has its offices globally including New York, London, Tokyo, Hong Kong and Singapore, and over 13,000 employees.

For more information, visit https://www.nri.com/en

Inquiries to : Financial Market & Innovation Research Department
Nomura Research Institute, Ltd.
Otemachi Financial City Grand Cube,
1-9-2 Otemachi, Chiyoda-ku, Tokyo 100-0004, Japan
E-mail : kyara@nri.co.jp

https://www.nri.com/en/knowledge/publication/fis/lakyara/