Whitepaper



Modular portfolio management – The new core product in retail banking

aixigo
Driving the New Wealth Experience.

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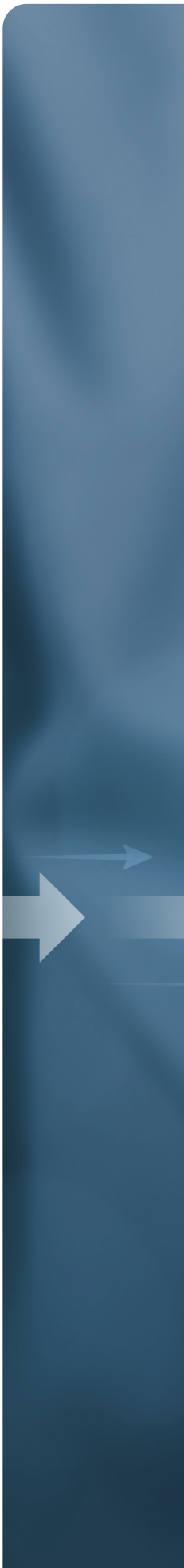
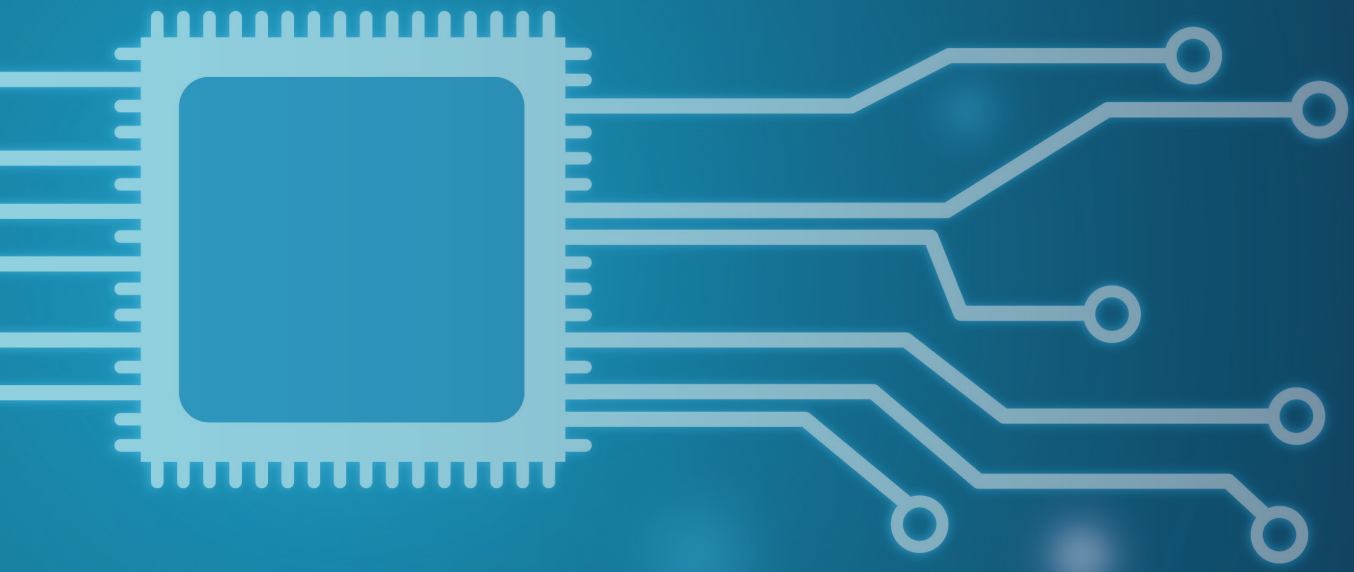






Digital, modular portfolio management has the potential to become the core product in the investment business!

Up to 80%

of all digital portfolio management clients opt for theme-based investments. Depending on the provider, this quota ranges between 65–80%.

100%

of portfolio management processes can be digitized, resulting in marginal costs per client of almost zero.

5 billion euros

of investment volume has been realized by Union Investment with its digital portfolio management offering. This service quickly established itself as an offering for all channels, but especially for the retail branch business.[1]

[1] Kirchner, C. (2022): Genos setzen 5-Mrd.-Duftmarke mit Robo-Advisor-Plattform, https://finanz-szene.de/digital-banking/genos-setzen-5-mrd-duftmarke-mit-robo-advisor-plattform/

Executive summary

Traditionally, "investments had to be sold". But then new players entered the market and began offering fully digitally managed investment services – Robo Advisors. This new investment concept started a hype and celebrated initial success on both the client and the provider side. Soon, however, criticism grew. The digital solutions enabled process efficiency, but left little room for individualization, which is a core element of client-oriented investment services.

This led to the idea of combining the best of both worlds. Hybrid portfolio management emerged as the perfect blend of digital solutions' maximum process efficiency and the adviser's human touch. Since up to 100% of the portfolio management process can be digitized, the marginal costs per client drop to almost zero. Digital portfolio management thus enables to tap into new customer segments and democratizes access to exclusive wealth management services even for retail clients. Incumbents quickly recognized the benefits and began launching their own personalized digital portfolio management offerings.

One example is Union Investment's digital portfolio management offering, which has been a tremendous success and has attracted an investment volume of €5 billion within a very short time frame.

Some providers have relied on a modular concept from the outset, permitting, for example, theme-based investments in addition to risk-adjusted investments. A concept that works.



Modular digital portfolio management allows for the individual extension of the standard offer. This digital portfolio management approach permits, for example, theme-based investments or investments in alternative products such as hedge funds, real estate, precious metals or commodities. For further examples, please refer to the chapter “Modular digital portfolio management: Success stories”.



Vontobel and investify report that clients really appreciate theme-based investment opportunities, with between 65% and 80% of all clients utilizing this option as part of their investments.[2]

Altogether, the practical experience of Volksbank Rhein-Ruhr eG, Vontobel, investify and Commerzbank confirms the assumption that the FinTech-driven innovation "robo advisor" is proving its true potential, especially among established providers. The basic principles of digitalization that have been successfully developed by FinTech companies are THE catalyst for transformation among established providers.

Grand View Research, a market research and advisory firm based in India and the United States, also predicted that demand for hybrid robo advisors will continue to grow. Why? Because they combine the efficiency and robustness of robotic algorithms with the human element of a personal financial advisor. They also argue that US companies, such as Voya Financial, are using hybrid robo advisory platforms to help advisors become more effective and to enable better communication with the broker-dealer.[3]

[2] Vontobel reports that around 2/3 of all clients opt for theme-based investments. For investify and its partners, the quota ranges between 65% and 80%.

[3] Grand View Research (2021): Robo Advisory Market Size, Share & Trends Analysis Report By Type (Pure Robo Advisors, Hybrid Robo Advisors), By Provider, By Service Type, By End-use, By Region, And Segment Forecasts, 2022–2030, https://www.grandviewresearch.com/industry-analysis/robo-advisory-market-report

Chapter 1 – Investing in securities

About disruptors and new dynamics in the wealth management space

Traditionally, "investments had to be sold". For a long time, "investment advice" was the primary sales channel for "selling investments in securities". However, recent years clearly indicate that there are other promising sales opportunities for selling investments in securities apart from investment advice. For the sake of a common understanding, we will therefore first clarify three distinct possibilities to invest in securities.

There are three ways to invest in securities for private clients:

1. **Execution business:** The customer identifies and decides autonomously on his transactions.
2. **Investment advice:** The customer seeks advice and decides based on this advice which transactions to make.
3. **Financial portfolio management:** The customer defines his investment preferences and issues a mandate for the financial portfolio manager to make transactions on the customer's behalf.

The latter option, in particular, has recently gained more importance in distributing investments in securities. For this reason, this whitepaper takes a dedicated look at the latter: financial portfolio management. In practice, financial portfolio management is usually also referred to as "wealth management" (also, "WM") or "discretionary portfolio management" (also, "DPM"). This whitepaper will use the term portfolio management.

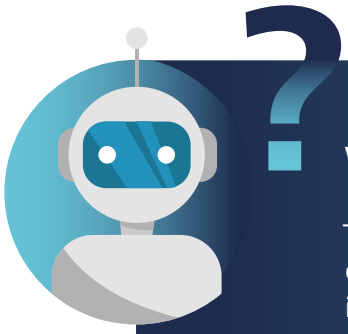
Why does portfolio management become increasingly relevant in the context of investing in securities?

In 2014, the first robo advisors entered the German market.[4] This entirely new product had already gained a foothold in the USA and caused a real boom here in Germany at times. For traditional portfolio management, the supreme discipline in the investment business, this new offering meant that it was beginning to falter.

[4] S., O. (2019): 6 Jahre Robo Advisor – wohin geht die Reise?, https://www.roboadvisor-portal.com/5-jahre-robo-advisor-wohin-geht-die-reise/

New market players – the FinTech scene – were responsible for this. This new trend was thrilling, because for decades, portfolio management was an exclusive offering from banks or wealth managers to investors willing to invest larger amounts of money. The new providers disrupted this course by offering their robo advisors.

In Germany, for example, Quirion was among the first robo advisor providers. In the following two years, providers such as Scalable Capital, LIQID and Whitebox expanded the offering. By 2021, there were already more than 45 digital investment providers.[5] Investify was also an early entrant. Some of their secrets to success will be discussed in chapter 3.4.



What is a robo advisor?

The term comprises two components: **"robo"** (for robotics) and **"advisor"**. Robo describes an automated process which uses mathematical algorithms to support investment decisions without the influence of a human. **"Advisor"** stands for wealth management services and, in this case, automated portfolio management using mobile or online channels. In summary, it refers to an online portfolio management service that automates client advice and the investment of client assets. Robo advisors pursue the purpose of promoting self-management of finances. In doing so, they provide necessary information in a way that does not require deep financial knowledge. Robo Advisors translate client inputs into investment logic, such as risk tolerance or liquidity factors. They then suggest suitable investment options that go far beyond highlighting a handful of exchange-traded funds from thousands of options. Most robo advisors aim to allocate managed ETF portfolios to their clients based on their individual preferences.[6]

One thing all robo advisors in the market had in common was a high level of automation and a customer experience that required little to no financial literacy. The human component was of secondary importance in these offerings, and often an advisor was not even part of the offering.

Nevertheless, interest in these offerings was initially high. What did robo advisors do differently, or perhaps better, than traditional portfolio management?

[5] S., O. (2019): 6 Jahre Robo Advisor – wohin geht die Reise?, https://www.roboadvisor-portal.com/5-jahre-robo-advisor-wohin-geht-die-reise/
[6] Moulliet, D. (2016): The expansion of Robo-Advisory in Wealth Management, https://www2.deloitte.com/de/de/pages/financial-services/articles/the-expansion-of-robo-advisory-in-wealth-management.html

Thanks to high margins, traditional portfolio management was so profitable for decades that there was little incentive for process optimization. Little competition existed around this exclusive service with the characteristics of a "manufactory". The "handcrafted" services were very exclusive and highly valued for precisely this reason.

FinTechs addressed the traditional offering's "pain point", the lacking scalability, and sought to automate the processes almost completely. Besides process automation, much emphasis was also placed on the customer experience.

With the message "We democratize investing by making banks/asset managers obsolete," these "disruptors" quickly won over investors. The high level of automation allowed FinTech companies to build a mass-market offering with small investment amounts. The marginal cost per customer, even with small investment volumes, was low.

A huge market potential became apparent.

However, criticism also intensified along the way. Insufficient individuality, insufficient quality, especially for high investment volumes or a growing number of securities accounts. One reason for this was that most offerings allocated exclusively ETF-based. This approach sidestepped the challenges of sophisticated investment strategies involving, for example, individual stocks.

Criticism of robo advisors grew. The lack of added value and quality could not match the claim of an exclusive offering. The human component, the influence of the advisor, was also missing.

This criticism led to a further refinement of the concept. The focus shifted towards value creation. **To combine the best of both worlds was stated as the new goal.**



Chapter 2 – Megatrend Hybrid Portfolio Management

The Best of Two Worlds

Something that websites, apps, social networks, and even the metaverse cannot nearly replicate is direct human-to-human contact. This interpersonal contact consists of numerous facets, such as empathy, sympathy, personal experience, etc., which "computers" alone cannot replicate. In a nutshell, interpersonal interaction creates trust, which has always been a major success factor in sales.

If you combine the advantages of digitization with the strengths of the personal component, the advisor, hybrid portfolio management is born. A concept that also appeals to customers. Evidence provides, for example, data from the U.S., where the hybrid advice concept is experiencing vigorous growth (see Figure 1).

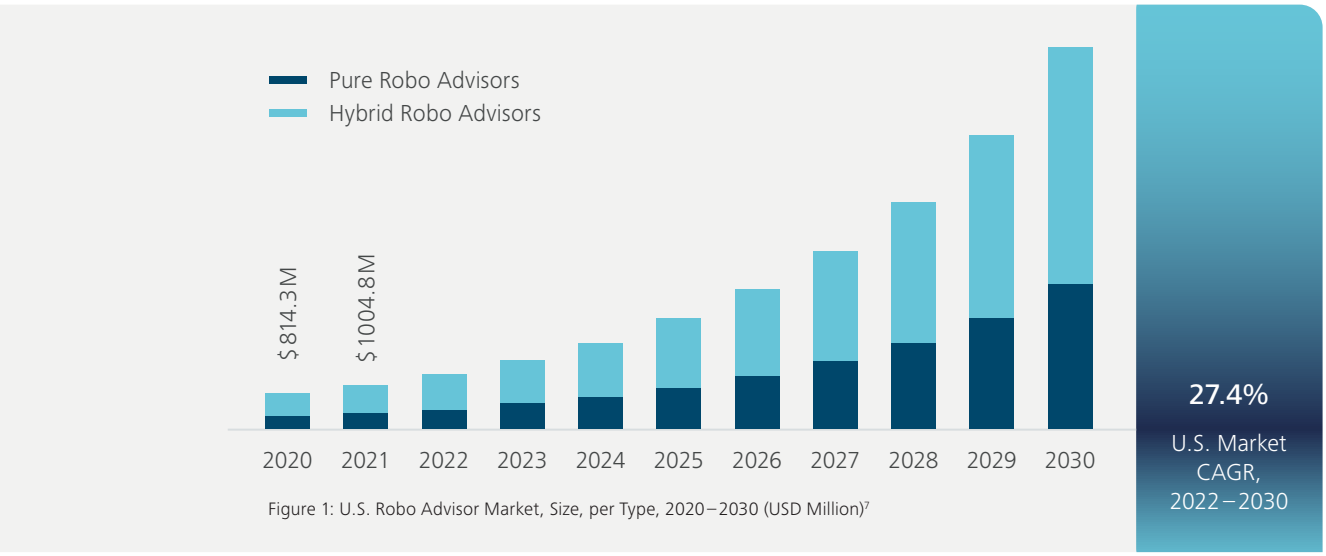


Figure 1: U.S. Robo Advisor Market, Size, per Type, 2020–2030 (USD Million)[7]

Grand View Research predicts that demand for hybrid robo advisors will continue to grow as they combine the efficiency and robustness of robotic algorithms with the human element of a personal financial advisor. Further, they note that U.S. companies, such as Voya Financial, are using hybrid robo advisory platforms to help advisors become more effective and enable better communication with the broker-dealer.[7]

[7] Grand View Research (2021): Robo Advisory Market Size, Share & Trends Analysis Report By Type (Pure Robo Advisors, Hybrid Robo Advisors), By Provider, By Service Type, By End-use, By Region, And Segment Forecasts, 2022 – 2030, https://www.grandviewresearch.com/industry-analysis/robo-advisory-market-report

Why do clients trust these concepts and sign portfolio management contracts? The answer is simple – because the offer fits.

Many clients want to invest and know their goals. What usually overburdens them is the "How?". How can I invest my money today and in the future? How do I identify investment products that suit me?

This is a tough question, especially since investing in securities is burdened with challenges and causes great uncertainty for many investors. Behavioral finance has been dealing with this topic of investor decision-making for many years.



Behavioral finance is a subtopic of capital market analyzes and evaluates the interplay between economics and psychology.[8] Behavioral finance dates back to 1742, when Georg Chr. Lichtenberg characterized the classic situation of decision-making under uncertainty – also known as ambiguity.

Most decisions in life have uncertain consequences. Decisions such as investing in a mutual fund or signing an insurance policy must be made without actually knowing whether the fund will outperform the market or whether the insurance policy will have to be claimed. Sometimes, the decision maker can estimate the probabilities of the potential outcomes, but in many cases, he or she cannot.[9] In this setting, ambiguity aversion describes the tendency to prefer the known over the unknown, including known over unknown risks.[10] Ambiguity aversion causes people to avoid situations with uncertainty because they perceive them as unpleasant. When in doubt, this causes passivity and sticking to the status quo.[11]

Before digitization and the first robo advisors, there has been no efficient and scalable offering that eased uncertainty for clients and supported them in their decision-making. Thanks to hybrid portfolio management, providers can now offer a service which solves this problem. Section 3 will outline some successful real-world examples.

[8] Goldberg, J. & von Nitzsch, R. (2004): Behavioral Finance, FinanzBuch Verlag
[9] Fox, C.R. & Weber, M. (2002): Ambiguity Aversion, Comparative Ignorance, and Decision Context, in: Organizational Behavior and Human Decision Processes, Vol. 88, No. 1, pp. 476–498
[10] Ellsberg, D. (1961): Risk, Ambiguity, and the Savage Axioms, in: The Quarterly Journal of Economics, Vol. 75, No. 4, pp. 643–669
[11] Easley, D. & O'Hara, M. (2009): Ambiguity and Nonparticipation: The Role of Regulation, in: Review of Financial Studies, Vol. 22, No. 5, pp. 1817-1843

Chapter 3 – Modular digital portfolio management: Success stories

Practical insights from Volksbank Rhein-Ruhr eG

The following section describes the experience of Union Investment, investment company of DZ Bank and part of the Genossenschaftliche FinanzGruppe, from the perspective of Volksbank Rhein-Ruhr eG.

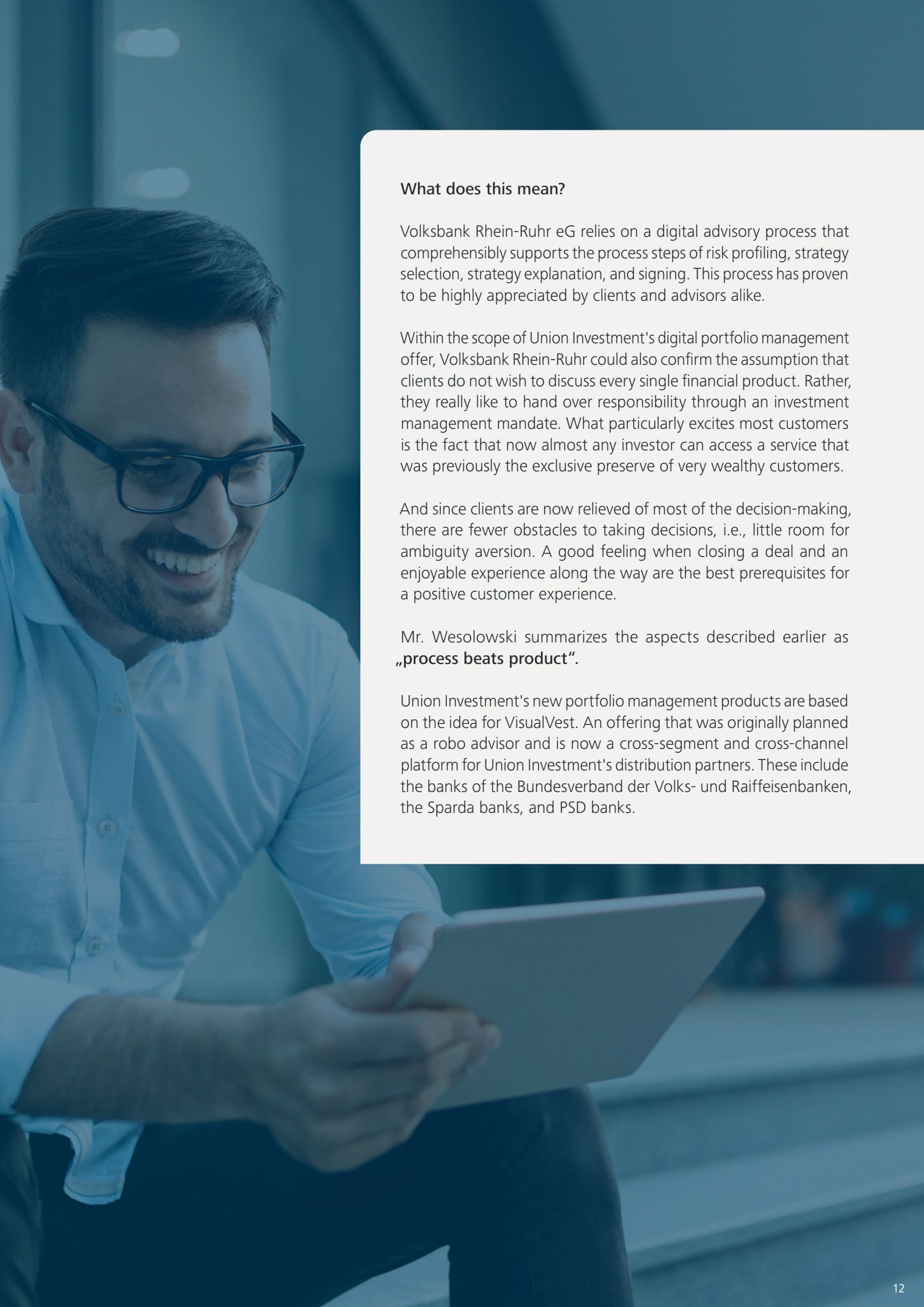
Union Investment enjoys tremendous success with its digital portfolio management service and has successfully positioned itself in the market with more than 5 billion AuM in private client business.

How have they achieved this? **Roman Wesolowski**, Sales Director at Volksbank Rhein-Ruhr eG, provides a simple and multifaceted answer.

> We believed that portfolio management was right for many of our clients and our bank. And then have helped our advisors embrace the product and provide the best possible advice.



Roman Wesolowski
Sales Director Volksbank Rhein-Ruhr eG



What does this mean?

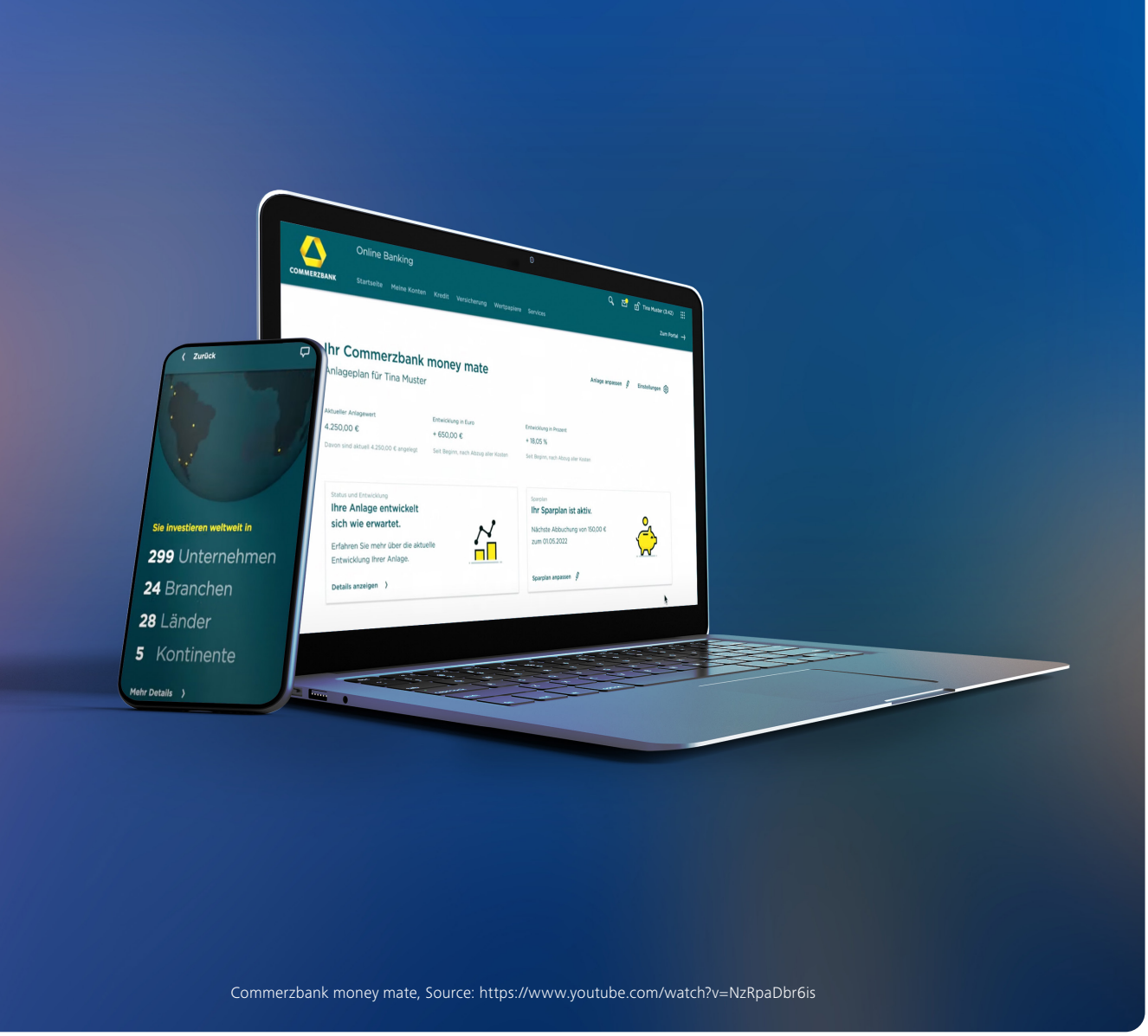
Volksbank Rhein-Ruhr eG relies on a digital advisory process that comprehensibly supports the process steps of risk profiling, strategy selection, strategy explanation, and signing. This process has proven to be highly appreciated by clients and advisors alike.

Within the scope of Union Investment's digital portfolio management offer, Volksbank Rhein-Ruhr could also confirm the assumption that clients do not wish to discuss every single financial product. Rather, they really like to hand over responsibility through an investment management mandate. What particularly excites most customers is the fact that now almost any investor can access a service that was previously the exclusive preserve of very wealthy customers.

And since clients are now relieved of most of the decision-making, there are fewer obstacles to taking decisions, i.e., little room for ambiguity aversion. A good feeling when closing a deal and an enjoyable experience along the way are the best prerequisites for a positive customer experience.

Mr. Wesolowski summarizes the aspects described earlier as **„process beats product“.**

Union Investment's new portfolio management products are based on the idea for VisualVest. An offering that was originally planned as a robo advisor and is now a cross-segment and cross-channel platform for Union Investment's distribution partners. These include the banks of the Bundesverband der Volks- und Raiffeisenbanken, the Sparda banks, and PSD banks.



Commerzbank money mate, Source: https://www.youtube.com/watch?v=NzRpaDbr6is

Practical insights from Commerzbank

Commerzbank launched its "money mate" offering only recently in 2022.

money mate offers clients a digital investment service that does not require any prior knowledge. Customers can invest from 1 euro and track the development of their assets through an online banking dashboard. There, experts summarize all relevant information for the client in a compact form. money mate enables transparent insights into the development of the portfolio and provides background knowledge on investments made. Advisors are on hand to answer open questions.

This offering by Commerzbank is designed to provide efficient advice and combines it with an impressive customer experience. The video demonstrates the added value that money mate generates for customers.

Very special about money mate is the solution's foundation: The service is based on the knowledge and research of the world's largest active wealth manager – Allianz Global Investors. Thus, this digital offering is based on the best possible expertise.

Practical insights from Vontobel

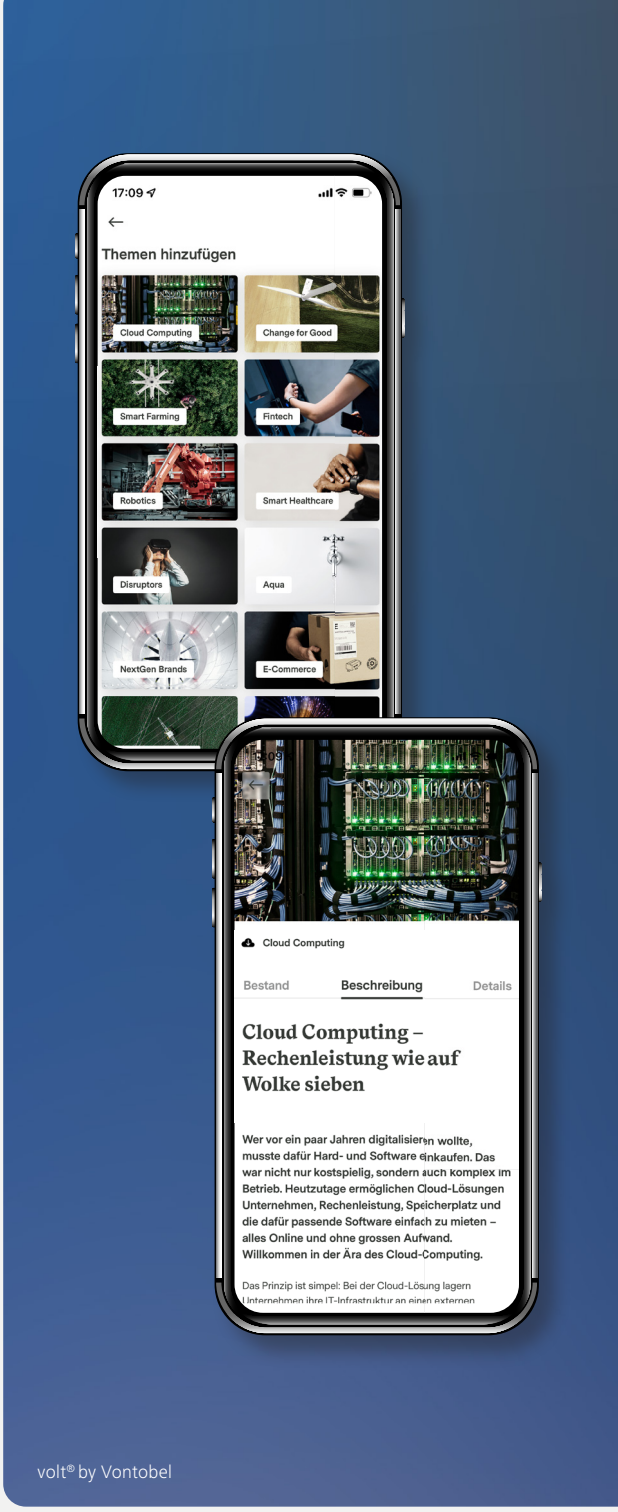
Vontobel is another pioneer. With volt® by Vontobel, they offer the first active, digital wealth management service in Switzerland. With volt®, clients can shape their portfolio to suit their preferences and benefit from the expertise of more than 300 investment experts and over 90 years of investment experience.

A special feature of Vontobel's first active digital portfolio management service is its modular approach. In addition to their individual risk-based investment strategy, clients can, for example, also choose themes in which they would like to invest. Based on their selection, clients then regularly receive theme-based, curated content.

Why is this so valuable? In chapter 2 of this whitepaper, we highlighted the hurdles that can arise when clients feel uncertain about their choices. Vontobel solves this problem by proactively sharing the portfolio's performance and providing explanations for the portfolio manager's decisions. The theme-based investments further give clients a personal connection to their portfolio.

The assumption that these individualization options are important to clients is also confirmed by the actual user behavior within volt®. Two-thirds of clients decide for theme-based investments. On average, they select 3 themes.

What used to be a simple investment process now becomes something personal. Something that the customer can track, shape, experience, and understand.



volt® by Vontobel

What insights can we already derive from user behavior?

Fabian Freitag, Head of Product, Digital Investing at Vontobel, shares his thoughts and insights. He describes volt® by Vontobel as "digital wealth management made by Swiss Private Banking".

Freitag emphasizes that the concept was special from the very beginning as it relies on a core-satellite approach and, unlike other offerings, also depicts the detailed allocation within theme-based investments. This enables a customer experience that exactly matches the aspirations of the successful and active wealth manager.



He tells that this unique customer experience is highly appreciated by clients. Fabian Freitag explains that the offering's primary target group is both delegators and validators. Clients can therefore decide for themselves within the volt® offering how much influence they want to have. The modular approach of the solution, which enables customers to make theme-based investments, known internally as "convictions," goes still one step further. Clients can also invest in alternative products, such as hedge funds, real estate, precious metals or commodities.

Although this offering is still young, it has already elicited very enthusiastic feedback from customers in the first few months.

Along with its offering for end customers (B2C), Vontobel has also established an offering for third parties such as other banks, financial services providers or asset managers (B2B2C). This offering is also highly popular, as it permits these parties to benefit from the success of this concept as well.

Practical insights from investify

The following section is based on a conversation with investify CEO Harald Brock. He explains the reasons for the introduction of theme-based investments in digital portfolio management, the implementation as well as insights gained from the user behavior of investify clients and clients of investify partners.

Today, investify provides its solution for digital portfolio management in excess of 20 companies. These act either as intermediaries or partners of the investify white label solution. About 50% of the partners rely on core-satellite strategies. This means a portfolio management approach in which a broadly diversified core portfolio is enriched by more specific individual investments (satellites).[12] Within investify's solution, the "core" investment is risk-adjusted. The "satellite" investments are composed of curated themes.

Risk management starts with 5 or 7 risk classes, which the customer can easily define in the app via a guided process. Clients particularly value the simplicity of this process. Following the definition of the risk-adjusted portfolio, the client can additionally select from more than 20 themes. This allows individuals to customize easily their mandates with additional preferences.

Harald Brock further points out that investify as well as most of the partners develop the offered themes themselves.

[12] bevestor (2021): Core-Satellite-Strategie, https://blog.bevestor.de/core-satellite-strategie/

What insights can be gained from user behavior?

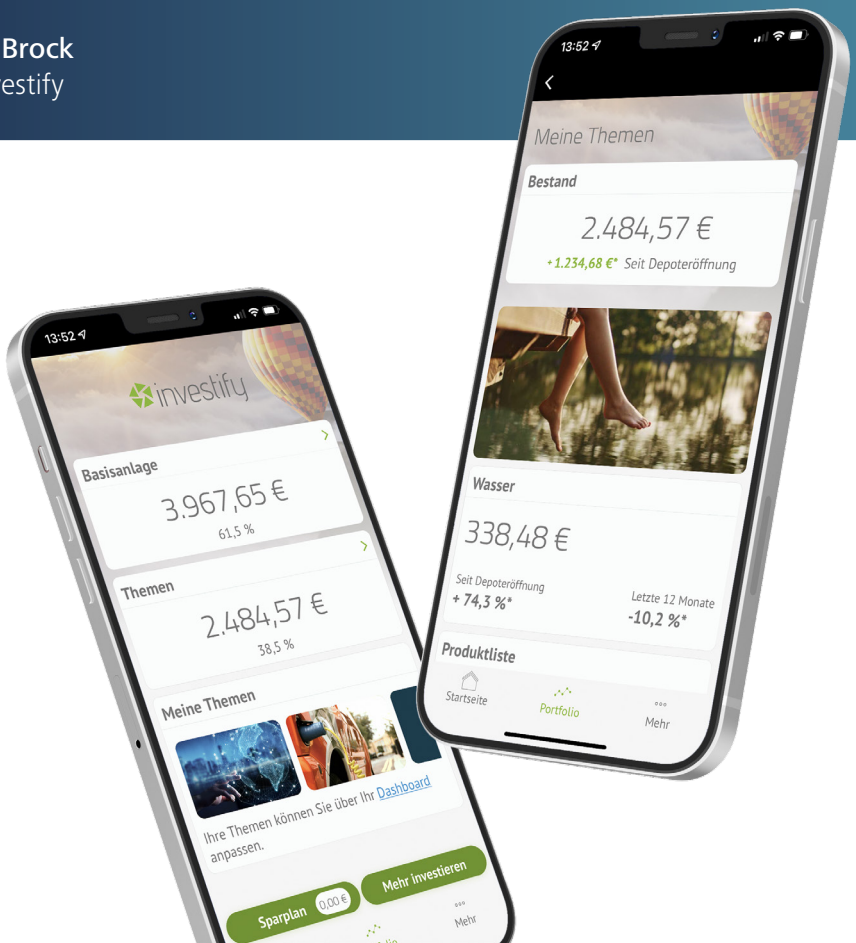
Mr. Brock reports that about 65 to 80% of portfolios include a thematic choice. Both in investify's offering and that of its partners. This means that more than two-thirds of customers add thematic investments to their portfolio. The number of themes ranges from 4 to 7, dependent on the partner. Harald Brock therefore highlights that the interest in theme-based investments is strongly reflected in general user behavior. Although no favorite topics can be identified across the board, special interest in certain themes can be observed, depending on the provider. In the case of investify's direct end customers, for example, these are technology and growth themes.

Overall, it becomes apparent that investify's sophisticated concept allows for high-quality personalized investments.



> A financial investment has to be personal, and if I assemble my kitchen according to my needs, then I want the same for my money. This thesis is supported by numerous studies, e.g. the Digital Pulse Check of zeb.

Harald Brock
CEO investify



Findings and perspectives for financial service providers, banks and wealth managers

The afore mentioned examples confirm the assumption that the innovation of "robo advisors" triggered by the FinTech scene is proving its true potential, especially among the established providers. The basic principles of digitalization successfully developed by FinTech companies are THE catalyst for transformation among the incumbents.

In summary, the following conclusion can be drawn – the concept of digital portfolio management, in particular modular portfolio management, is promising. What are the deciding factors here?



1. Wealth management services have been relied on by clients for decades. Until now, however, the "user audience" has been limited. Digital portfolio management eliminates this barrier and, for the first time, allows a large customer segment to access the most exclusive financial service. Portfolio management becomes scalable.



2. Clients who are aware of their goals will be thrilled if they "only" have to worry about defining their personal goals and the advisor takes care of the "how". Moreover, the "how" is realized in the highest quality based on the best expertise of renowned financial institutions.



3. Financial institutions can design the offering in line with their own strategy, values, and vision.



4. Modular approaches to digital portfolio management continuously create new opportunities for interaction or contact with the client. A personalized offer with the best process efficiency becomes reality.



5. Dynamic investment parameters (such as individual risks per theme) are automatically taken into account and do not produce additional work.



6. Modular portfolio management is a service offering rather than a securities advisory offering. This means that, overall, it offers the opportunity to reduce complexity and optimize revenue structures.



In conclusion, the findings can be summed up as follows: **Digital, modular portfolio management has the potential to become the core product in the investment business!**

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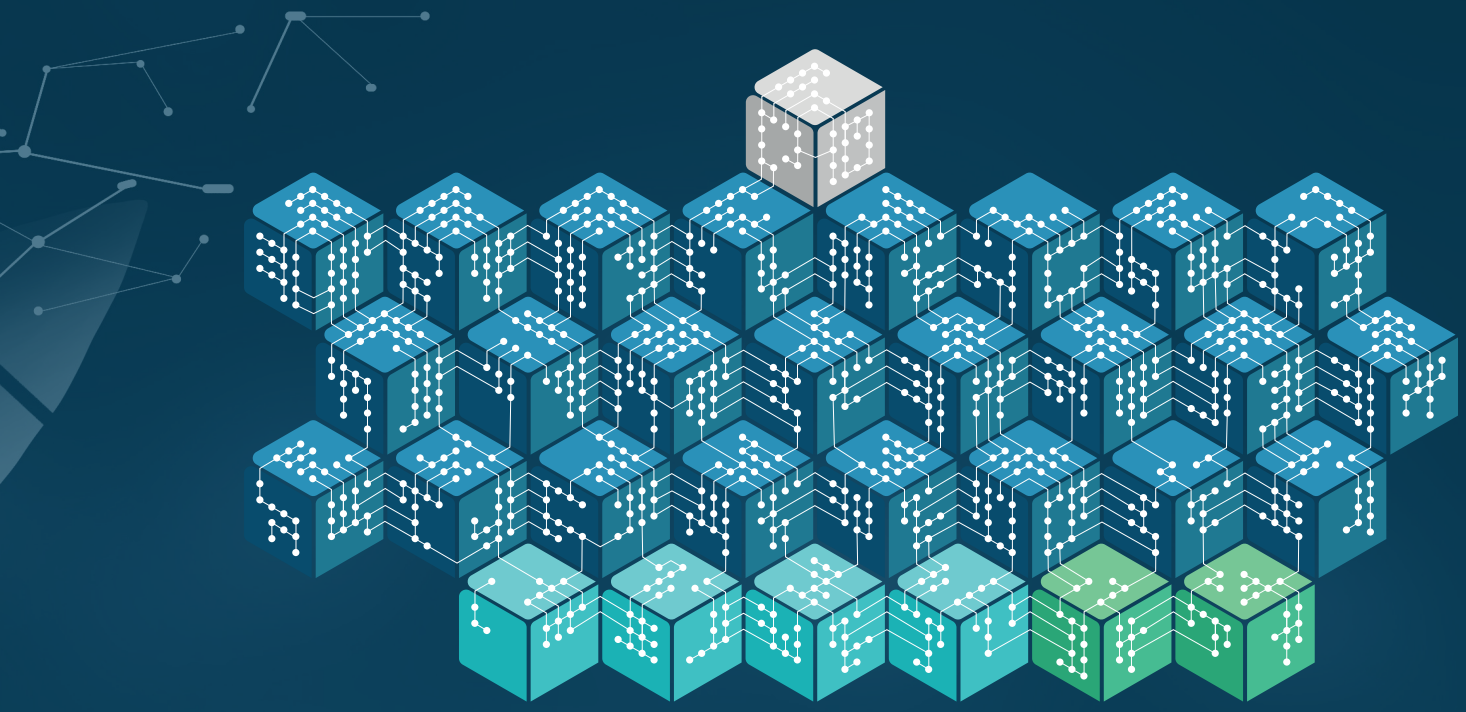

Vontobel and investify's offering are built on the aixigo:BLOXX Wealth Management Platform. This world's fastest API-based platform enables financial service providers and wealth managers to create own individual, innovative and profitable services. Internationally, numerous customers, including Bank Vontobel, BNP Paribas, Commerzbank, Targo Bank and Hargreaves Lansdown, are already benefiting from aixigo AG's platform.

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