A private banking view – Episode 1 - Jean-Charles Neau - March 2015

It is no news that major trends are affecting wealth management industry. We have been talking about this for more than a decade in Switzerland. But now it is happening, stronger and faster. The financial crisis has been the trigger and everything which could have been prepared gently over 15 years is striking at the same time and within a few years, if not months. Not just in Switzerland.

Environment. Tax dispute puts pressure on asset retention in offshore centers, pricing execution and costs to develop new services and/or to restructure. Adapting to regulation (developed to compensate for previous excesses) is costly, time consuming and it prevents from thinking about anything else. If it was not enough, Swiss players are threatened by strong Swiss franc coupled with negative interests which all together hurt their profitability and limit their maneuvering space.

Financials. Capital requirement to cope with risk is sky rocketing while cost/income ratio of some players approaches not-for-profit NGOs (average has increased to 80 basis points). As a consequence, return on equity is expected to drop. Financial markets helped to generate revenues from AuM growth and transactions. But just a slight slow-down could really endanger many players because of costs incurred to quickly adapt.

Clients. Client trust is lowered, either because of declining players' reputation, conflicts of interests with product business, or volatile markets. Consequently, clients double think before investing into financial markets.

Global wealth is still in expansion and this growth tends to accelerate (+14.6% in 2013 reported BCG – banks who grew less than that were actually losing ground). But how much wealth is not in the hand of private bankers anymore but in real estate, art, etc.? Additionally, as a consequence of changes in origin of wealth, entrepreneurial mindset and social giving spirit, we see more and more assets flying away to direct investments and philanthropy. In its last research, Credit Suisse calculated that in Switzerland non-financial assets accounted for 44% in 2014 (growing from 38% in 2006). Should private bankers build revenue streams from these trends too? Or should it just be a free add-on to their standard services?

Technology. Banks and wealth managers are struck by disruptive technology at a time where their cost/income ratio is not at best to invest. Initiatives such as Watson project from IBM may well bring a revolution to Asset management and Advisory. Fintech may change the way clients interact with their banker and the price they are willing to pay for value, especially in the commoditized transactional and custody fields.

Last but not least, digital age transforms clients DNA forever, simply because, in their day-to-day life, they can get everything, everywhere, anytime; furthermore, most innovative players make it easy and sometimes even free. How long will it take before the new global, mobile, knowledgeable, time sensitive client says to his banker « why don't you do that as well? ». Service design and design thinking put clients at the very beginning of new developments and private bankers should embrace this approach.

Fortunately, technology also brings opportunities such as better understanding of clients, multiple contacts points, data driven lead generation thanks to Big Data, as well as process streamlining and mass personalization.

In the world of trust and personal interactions by essence, some private banks already developed such a technology infrastructure that it is even part of their commercial pitch! In addition, they understand that technology should be customized to markets' and clients' needs: infrastructure is built globally, application is developed locally; wise. Technology is a major chance to cope with changes as long as you make it totally agile and transparent for clients and internal users.

> *"if you truly serve clients needs well, you can get compliance for free"*

Regulation. Adapting is costly and time consuming. But this is not the worst effect. The worst is what happens for clients, complexity which is created for them and for the bankers, both being transformed into administrative agents. Unfortunately, current regulation trend works against what should be private bankers' DNA : trustful advice... Because regulators do not trust banks and want to avoid product mis-selling, they want to make sure Advisory will not be used against clients' interests. By enforcing the suitability concept, regulators transformed what used to be, and should become again, the unique selling proposition (USP) of a private bank, trustful advice, into a standardized offering. How to differentiate and compete if your USP is a standard imposed to all payers? In addition, implementing

the Advisory model raises risks ; because of consequent risk of non-compliance, one of the leading private banks is wondering whether they should really implement Advisory model in Europe and Switzerland, although this model was successful in Asia!

Compliance is an entry barrier but not a differentiator as such, except in the way you do it; do you create more complexity for your clients and people, or do you take this opportunity to adapt? The only way to do it with differentiation in mind is to make sure risk people think in terms of clients' satisfaction and not just regulators'. If you truly serve clients needs well, you can get compliance for free. Is there another route for private banking than total commitment to clients' needs? An interesting approach is observable in the US to create an Advisory code of conduct.

Efficiency. Well balanced cost cutting (meaning that it should start by understanding costs at client, product and service level, and finish by protecting future growth), streamlining to reduce complexity, outsourcing, winding down, consolidation and exchange of markets, post-merger integration, revenue assurance and enhancement, pricing model definition and execution, raising the bar in sales culture and effectiveness, bridging the gap between technology trends, clients expectations, existing infrastructure and end-users knowledge, agile capabilities, talent attraction and training, compensation, are certainly the most important initiatives private banks could take to re-focus and develop their business.

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Mindset. Change is good, especially when you have no choice. But it is so costly, risky and time consuming that you would rather have a vision and integrate more changes for the benefit of your clients and your business than just short term compliance. Instead of making it a pain, you can make it a step forward, see major opportunities where others see threats and let paralyzed competitors floundering in your wake. In addition, you mobilize your people better than with rules and sticks. A positive purpose that makes sense and shows the benefits is far much powerful and effective than a regulation which tells you what you can't do. This is another mindset which works absolutely well as long as ethics and integrity rank first in your applied values.

Business model. Finally, these trends force to recall the real question. What is the mission as a bank in general and as a private banker in particular, where to compete, for which clients, against which competitors, is it affordable to be truly integrated and global or is it more profitable to focus on niches (markets, services, clients segments), is there a viable in-between position, do we have the volume for that, how to price, can we afford the cost, how to differentiate?

Because anyone can now access financial markets at the click of a button for 15 cents as opposed to 1.5%, because financial technology can be better at portfolio management and monitoring than human beings, because trustful advice becomes again the one and only unique selling proposition, because product push and client centricity are not compatible, because regulators will not allow this combination anyway, we may well see disintermediation as we have witnessed in travel industry. Regulators in US and Europe already paved the way with clearly segregated license models.

Where do we go from there? There is no single answer, as one should customize to banks situations and histories. However, a change in mindset is critical. It would certainly help to think about what a banker is supposed to do and what private bankers were doing one or two hundred years ago (before enjoyable returns granted by banking secrecy and gate keeper position towards financial markets – all of them being no longer valuable). It would help to review what is happening in different parts of the world and in different industries. « Strange » innovators and new markets entrants should not be ignored or, worse, looked at in a complacent and condescending way, as they could become substitutes.

Most important of all, asking clients will bring the answer. Ask what they have to say about them, you, your competitors. Put their interests first. Really.

Traditional differentiators are product and service innovation, operational excellence or client relationships. In services industries, they are nearly mutually exclusive or at least strictly prioritized. In wealth management, one cannot be average on these three dimensions anymore. Investments to raise the bar everywhere would be huge. Is it time to set priorities and align?

What would be your choice? Take the survey and give your feed-back on alavise.com/blog.