Private Banking

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Only the strongest will survive shake-out

Tougher rules, rising costs and cautious clients are countering a more positive outlook and making bank chiefs wary, writes *Daniel Schäfer*

On the face of it, private bankers and their clients are looking at a brighter world. This year has seen the comeback of market confidence, a reduction in volatility and healthy growth in many asset prices.

Yet there is still no escaping from the word "uncertainty". Six years after the start of the financial crisis, private banks and their clients continue to operate in an environment characterised by low interest rates, lacklustre economic growth and a wave of regulation that increases costs and complexity.

It is thus no wonder that private bankers continue to be wary.

"The market trends go against everyone," says Jacques de Saussure, senior managing partner of Pictet & Cie, the Swiss private bank and fund manager.

"We have had a low interest rate environment for four to five years, market activity is low, Switzerland is seeing the end of bank secrecy and the cost of regulation is impacting everybody," he adds.

Notoriously conservative private bankers are not yet convinced that abundant talk about a return to economic growth, rising equity prices and a renewed search for yield will be enough to change the fundamental issues facing their sector.

They say that positive factors such as a prospect of rising interest rates and a shift from bond markets into equities cannot counter severe headwinds from tightened regulation, a relentless pressure on costs and clients' cautious investment patterns.

These structural issues continue to weigh on profits and are set to trigger an extensive shake-out in the sector.

Tim Monger, financial institutions partner at Boston Consulting Group, says: "The profitability of the industry will not return to pre-crisis levels, at least for the medium term, as clients tend to invest in lower-margin products and costs are continuing to rise."

Consultants at rival Roland Berger estimate that margins have fallen 20 basis points in the past five years, thanks to lower client activity, less complex products and a focus on the super-rich – a clientele notorious for demanding low fees.

At the same time, tightened regulation affecting areas from money laundering to investment advice has sent private banks' costs spiralling upwards. In the past five years, private banks globally have gone from spending 61 cents for each dollar in revenue to 73 cents, says BCG.

The global crackdown on tax evasion is another costly issue, particularly in Switzerland, where US fines have already helped force two private banks – Wegelin & Co and Frey & Co – out of business, and where a recently struck agreement between the two countries is set to cause a wave of penalties.

One banker says: "The tax issue will have a massive impact on the Swiss private banking sector next year. For aggressive banks with a high number of US clients, the financial consequences will be substantial."

With banks forced to adapt rapidly to these structural changes, the business of investing rich clients' money is undergoing a Darwinian process that will leave only the strongest.

"The smaller banks in particular realise that they are going through a period where it isn't certain if they can remain profitable," Mr de Saussure says.

"We will see more banks that will either be acquired or decide to close or abandon their banking licence and

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Investment

Hefty fees for complex products are a thing of the past, says *Sam Jones*

When it has come to selling their investment credentials, many private banks have faced an uphill struggle in the years since 2008.

The crisis experience for most private banking clients was not a pleasant one: many found themselves stuck in complex products that their bankers had pitched to them as exclusive investments. At best, these proved highly illiquid, and at worst, blew up.

As the easy liquidity rolled out of markets, it became clear that many clients had been paying hefty fees for the privilege.

Private banks insist they have now turned a corner. In an environment in which markets are dominated by the unprecedented easing actions of major central banks and growing political uncertainty around the world, the value of good financial advice has perhaps never been higher.

Private banks have wised up to the need. Organisations such as UBS now have dedicated chief investment officers to provide broad, global advice on asset allocation and strategy.

"What we are trying to do is show that we're not just salespeople any more," says one Zurich-based banker. "What we want to push are products that make sense for our clients first and us second."

Part of that process is that private banks have focused less on high-margin, complex or structured products and more on simple, broad tactical asset allocation.

Alexander Friedman, chief investment officer at UBS Wealth Management (see profile below), has advised clients to put their money into straightforward equities this year.

He has been proved right. Developed market equities, in particular, have enjoyed big returns. The S&P 500 is up 26 per cent so far this year, while the FTSE 100 has risen 14 per cent.

Mr Friedman has also called for investors to slash their holdings of investment-grade bonds – corporate and sovereign – from an average of 16 per cent to just 2 per cent.

Private bank clients are, nevertheless, conservative by nature. Most still maintain a disproportionate share of their investments in cash. Private banks report that clients hold, on average, 20-30 per cent of their assets in cash or cash-like securities – and in some cases, much more.

All this exacerbates the conflict between a client's wishes and those of the bank to make a profit.

The key is for banks to find products that are both suitable for their clients' low or moderate risk appetites but also offer decent fee-earning potential.

As such, banks have begun to increase the number of alternative investment products they offer clients.

> 'What we are trying to do is show that we are not just salespeople any more'

Some, such as Deutsche Bank, have made big investments in hedge fund Ucits – tightly regulated, onshore versions of hedge fund products – which they believe are more palatable to risk-averse clients. Flows into these funds have surged in recent years. The sector manages around $250bn of assets, according to Eurekahedge.

But regular hedge fund and alternative investment products are coming back into vogue. With equity markets looking frothy and bonds plagued by the possibility of tapering, hedge funds have merit as a mid-way alternative, offering equity-like returns with bond-like volatility.

"We see opportunities in hedge funds, which have performed well in the year to date and benefit from falling correlations within many asset classes," HSBC's private bank told its clients: "We also believe that select real estate and private equity can add value to portfolios for investors who take a longer-term view, as we believe there is currently a high premium for somewhat less liquid assets."

It is not just in asset classes that banks are giving advice. Credit Suisse, Julius Baer and UBS have outlined ambitious targets to expand their private banking business in part by lending more to wealthy clients. Loans to bolster investment returns or to allow clients greater flexibility in their finances are seen as profitable areas aligned with client needs.

Private banking may have undergone a period of tranquillity and reinvention in the wake of 2008, but practitioners say now is the time for it to make its mark again as a positive and profitable line of business.

Profile Alexander Friedman, UBS

Alexander Friedman's appointment two years ago to the new role of chief investment officer at UBS Wealth Management was intended to telegraph a clear signal: the Swiss institution was putting its investing missteps and scandals behind it, **writes Sam Jones**.

Mr Friedman has an impressive record when it comes to managing the finances of the wealthy. Until March 2010 he was the chief financial officer of the $36bn Bill and Melinda Gates Foundation and served on its management committee – a role he still performs. Mr Friedman oversaw the foundation's finances during a period when it more than doubled in size.

The foundation hired him after a five-year stint at Lazard as a mergers and acquisitions specialist. He has also held a supervisory seat on the board of Actis, an emerging-markets focused private equity firm, and set up his own investment vehicle, Asymmetry.

Mr Friedman has amassed an impressive set of business connections. He is chairman of the Seattle Art Museum investment committee, a member of the Council on Foreign Relations and a former judge for the Financial Times-Goldman Sachs Business Book of the Year awards.

Alexander Friedman: impressive connections

Mr Friedman has made political connections, too: after gaining a BA from Princeton and a law degree from Columbia Law School, he became an adviser to the secretary of defence in the Clinton Administration.

At UBS, the establishment of the chief investment officer's office has been central to the bank's effort to compete with the likes of BlackRock and Pimco. Mr Friedman's links in the investing world have been valuable, as has his investing nous.

A dependable, institutional opinion on global financial matters – from Federal Reserve tapering to Abenomics – is something clients at UBS have until now lacked.

Praise from the best is praise indeed

We don't see awards as a goal in themselves, not even when presented by the prestigious Financial Times Group. Instead they inspire us to continue to pursue excellence for our clients. By reaffirming the value those clients place in our unique service model: a network of renowned domestic private banks with deep roots in their communities going back centuries. All backed by the global capabilities and strength of ABN AMRO Bank. As a result, we are today one of the leading private banks in Europe*. So if you're looking to develop a sustainable long-term wealth strategy, please find out more at abnamroprivatebanking.com/ft

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*Top 3 in the Eurozone and number 7 in Europe, Scorpio Private Banking benchmark 2013.

Only the strongest are likely to survive

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keep their client relationships as independent asset managers.

"There will be a wave of smaller banks consolidating next year and in 2015. There is always a market for domestic niche players, but it will be difficult for highly regulated cross-border groups to stay independent," Mr de Saussure adds.

Bankers are also not very hopeful of any respite as a result of an uptick in client activity.

Jürg Zeltner, chief executive of UBS's wealth management arm, says there will not be a sudden return to a "risk-on" environment. "I think we are settling into a new norm. We will see for a long time relatively high liquidity reserves for clients," the head of the largest private banking business in the world by assets says. Clients have for several years been sitting on cash levels of about 30 per cent, curbing their own and banks' ability to make higher returns.

30%

Typical cash levels for private banking clients

This is one of the reasons banks are set to be forced into a wave of joint ventures, partnerships and outsourcing projects in middle and back office areas.

Examples of this trend abound. A number of large banks are in talks with various providers about outsourcing background checks on clients, while UBS has recently outsourced a large part of its procurement, and Deutsche Bank has outsourced its wealth management back office operations in Switzerland to Avaloq Group.

But beyond those support functions, even highly rewarded relationship managers are no longer sacrosanct as the efficiency of banks' client-facing parts is coming into focus.

Banks have inflated their cost structure throughout their activities and functions, says Mr Zeltner.

Many banks are moving to a system where fewer relationship managers are covering more assets.

BCG's Mr Monger says this does not necessarily work to the detriment of the client. "In the past, banks have often overserviced their clients," he says.

"They are now starting to become more sophisticated about the amount of service they provide for different clients. They are moving from a one-size-fits-all to a tailored approach."

A rapid move to mobile and online technology plays a crucial role. "Some clients might get much less face-time but a much better iPad app," he adds.

With clients continuing to be risk averse and developed countries mired in slow growth, private banks are also forced to look towards Asia.

Mr Monger estimates that 70-75 per cent of growth in the next five years will come from emerging markets and mostly the Asia-Pacific region, despite the jitters in those markets this year. In five years, the region is set to overtake the US as a centre for wealth.

"Everyone is trying to figure out how to get into this market," he says, adding that this trend plays into the hands of the larger banks that can afford to invest in those regions.

"We will see a substantial transformation of our industry and the survivors will come out of this stronger," Mr de Saussure says. "There is still money to invest; this is certainly not the end of our business."

We are the champions: the giants of private banking are becoming ever more dominant
Getty

'Champions' league' rules the roost

Global groups Big banks have raised market share but even the giants are refocusing, says *Daniel Schäfer*

In wealth management, big is once again beautiful. Regulators around the globe might be debating if banks are too big to fail but in private banking, the giants are becoming ever more dominant.

Last year, the top 20 wealth managers gained market share from smaller operators with an average increase in assets under management of 10.9 per cent, according to Scorpio Partnership, a consultancy and research group.

"In spite of a number of challenges – both economic and regulatory – we have seen the confirmation of a new champions' league of global wealth managers," says Sebastian Dovey, managing partner at Scorpio.

The top 20 command more than three-quarters of total assets under management, as wealthy clients often want a single bank relationship. Squeezed margins and tougher regulation, meanwhile, are hitting smaller rivals disproportionately.

"The barriers to entry have become huge," says Jürg Zeltner, head of UBS's wealth management arm, which last year overtook Bank of America as the largest private banking operation in the world measured by assets under management.

"To be able to deal with clients' cross-border demands, with regulatory compliance and to make money in an area that is under margin pressure is quite an agenda," he adds. "This is an annuity business and you need a sustainable growing asset base."

Large global banks including Morgan Stanley, Deutsche Bank and Goldman Sachs have in recent years rediscovered wealth management as profits have come under pressure in traditional areas such as investment banking. UBS itself launched a strategy to concentrate on its core wealth management business by drastically pruning the bond trading business of its investment bank.

Large and diversified banks have been more successful in containing costs than pure-play private banks. The former spend 75 cents for every dollar they earn in revenues in their wealth-management arms, while banks focused solely on wealth management had a cost-income ratio of 88 per cent in the past year.

Large and diversified banks have been more successful in containing costs than private banks

Diversified groups can reduce costs by centralising certain administrative, compliance and portfolio management functions. They can tap into their retail banking network to build a presence in growth markets.

Smaller operators, on the other hand, are struggling to keep costs in check amid myriad regulatory and risk-management demands.

"All the trends in the market are pushing you to be bigger, whether it is regulation, service models or internationalisation," says Tim Monger, financial institutions partner at Boston Consulting Group.

Even the largest players have been forced to curb some of their activities amid relentless pressure on costs and profit margins.

Rapidly rising expenditure to make sure banks do not break anti-money laundering rules are making it particularly uneconomic for all but the leading global wealth managers to remain active in smaller markets.

Barclays this year announced it would pull out of more than 100 markets and cut staff in its wealth management business to boost the unit's feeble profitability.

The UK bank said it would reduce the number of countries in which it provides wealth and investment management services from about 200 to 70 by the end of 2016.

Its decision followed rival Credit Suisse's announcement this year that its private bank would exit or withdraw from about 50 markets worldwide by 2014 to bolster profitability. HSBC also wound down its Irish private banking arm in October last year.

"There was a dash five years ago to open up booking centres across the globe, only for the banks to realise later that they are not profitable," Mr Monger says. "Now this is reversing."

A string of other large banks including Bank of America Merrill Lynch and Morgan Stanley have sold overseas operations. This represents an attempt to concentrate on those core regions where they are among the market leaders.

"Critical mass is becoming more and more important in order to be able to achieve the right economics," says Jeroen Rijpkema, chief executive of ABN Amro Private Banking.

"Even the bigger players think about which markets they are good in and which smaller ones they won't make a difference in and where it is better to exit."

ABN Amro Private Banking is an example of this trend. It sold its Swiss private banking operation two years ago and bought LGT Bank in Germany, a market in which it already had reasonable scale.

Bankers say the consolidation trend will continue. The biggest wealth managers look likely both to spin off regional entities and act as buyers of private banking operations.

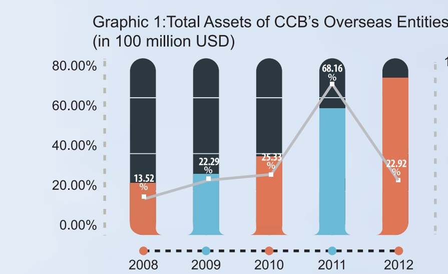
UBS's Mr Zeltner adds: "We are a natural consolidator in this industry. We are always looking for very targeted acquisitions that either give us further scale or an entry into a new market."

China Construction Bank Corporation (abbreviated as "CCB" or the "Bank"), established in 1954 and headquartered in Beijing, is a domestic world-leading and world-renowned shareholding joint-stock commercial bank. The Bank has won and maintained a leading position among its peers in many businesses, including wholesale and retail lending, investment and wealth management services. While keeping its advantage in traditional businesses, such as infrastructure loan and residential mortgage services, CCB also keenly develops emerging businesses, such as e-banking, private banking and credit card services, and maintains a strong competitive edge in the market. As a banking group, CCB has established subsidiaries in non-banking business fields like investment banking, mutual funds, trust, leasing and insurance.

1. Development of CCB's overseas entities

Since CCB launched its first overseas entity, the London Representative Office in 1991, it has been increasing its presence overseas and boosting the scale of its business over the past two decades. So far, the Bank has 17 overseas entities, including 11 tier-one branches in Hong Kong, Singapore, Frankfurt, Johannesburg, Tokyo, Seoul, New York, Ho Chi Minh City, Sydney, Taipei and Luxembourg, and six wholly-owned operating subsidiaries, namely CCB Asia, CCB London, CCB Russia, CCB Dubai, CCB Europe and CCB International, covering 15 countries and regions worldwide.

Graphic 1:Total Assets of CCB's Overseas Entities (in 100 million USD)



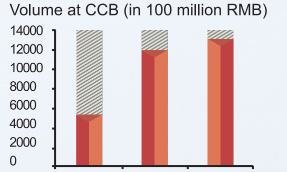
2. Development of CCB's overseas assets

CCB's overseas offices are mostly located in international or regional financial centers that are relatively mature and developed. By strictly following local regulatory requirements and rules on operations and management, and establishing an improved internal control system, the Bank's overseas entities are all in good shape. In recent years, CCB has seen accelerated growth in its overseas business – the size of its overseas assets has been growing, and the overseas business profitability has improved year on year.

3. Layout of CCB' entities in Hong Kong, Macao, Taiwan and overseas markets

Tokyo • Melbourne • Taipei • Macao • Hong Kong • Ho Chi Minh City • Singapore • Osaka • Sydney • Seoul • Moscow • Frankfurt • Johannesburg • London • New York • Luxembourg • Dubai

Graphic 2: Cross-border RMB Business Volume at CCB (in 100 million RMB)



4. Superior cross-border RMB service.

CCB has built a comprehensive product line, equipped with excellent service capability, in offshore RMB loans and deposits, cross-border RMB settlement and RMB clearing. To further meet clients' requirements, the Bank will continue to support its overseas entities in terms of RMB funding and resource allocation, aiming to provide industry-leading products and services in overseas offshore RMB business segments.

Well-defined client and product positioning.

Regarding product positioning, CCB gives priority to developing and marketing products on offshore loans against domestic guarantee, trade, finance, clearing and settlement, foreign exchange and cash management. In accordance with local conditions, the Bank will also actively introduce bilateral and syndicated loans, commodity financing, wealth management, investment banking and retail services.

Graphic 3: International Settlement Volume at CCB (in 10 thousand USD)

120,000,000 / 100,000,000 / 80,000,000 / 60,000,000 / 40,000,000 / 20,000,000
2009 2010 2011 2012 2013.8

A comprehensive domestic-and-overseas collaboration platform.

CCB focuses on reinforcement of client services, making efforts to constantly optimize its product structure, push forward innovation of linkage products and improve service in order to satisfy the "going global" demands from real economy. On the Group level, the Bank has also established and improved cross-border service that is well-equipped, multi-layered and automated.

Graphic 4: Balance of Trade Finance at CCB (in 100 million RMB)

Year	Value
2010	2622
2011	3694
2012	4570
2013.9	7215

0 2000 4000 6000 8000

5. Awards

The Banker magazine: 2nd in the "Top 1000 World Banks" with respect to profitability (2012)

Forbes magazine: Ranked 2nd in the "Forbes Global 2000" (2013)

Asia Risk magazine: House of the Year, China (2012)

Global Finance magazine: Ranked 22nd in the "World's Top Safest Banks", and Best Infrastructure Bank (2012)

Fortune magazine: Ranked 24th on the Corporate Social Responsibility List (2013)

中国建设银行 China Construction Bank

Service Hotline: 95533
Website: www.ccb.com

Wealthy investors find that good things come in small packages

Local operators

Clients are playing the simplicity card, writes *Sharlene Goff*

The wave of scandals that has engulfed global banks since the financial crisis has created opportunities for smaller, family-focused wealth managers, as clients favour a return to simpler banking relationships.

Bankers say that some wealthy clients are dismayed by the seemingly never-ending stream of misconduct at big banks, from a series of rate-rigging investigations to the mis-selling of mortgage and insurance products.

As a result, clients are willing to sacrifice the broader investment choice offered by bigger institutions for a more personalised, traditional service at family-run businesses.

Under pressure to cut costs, clean up their operations and meet tougher regulations, many of the biggest international banks have also been forced to trim their wealth management businesses, according to analysts, giving clients further reason to look elsewhere.

"The private banking industry has lost its focus," says Matthew Parden, managing director at Duncan Lawrie Private Bank, which targets clients in the south-east of England and the Isle of Man with £500,000 to £5m of investable assets.

"It was traditionally about offering a superior service with a personal commitment to clients as individuals. But for many banks it is now about cost-income ratios and bottom-line service," he says.

One reason for the change. Mr Parden says, is that many larger private banks are tied to the fortunes of their high-street parent companies, some of which are reducing branch numbers and closing private banking operations.

A recent report from Ledbury, a market research group focused on wealthy individuals worldwide, found that a number of big banks – including Credit Suisse, Barclays, HSBC, Lloyds Banking Group and Citigroup – had outlined plans to pull back from some private banking activities in recent months.

This withdrawal is driving some clients to more traditional, family-owned wealth managers, which say they offer a more personalised service, as they are too small to need call centres and have fewer customers per manager.

The Ledbury report supports that view. James Lawson, a director at the company, says client satisfaction tends to be higher at the smaller houses.

"Our report found that client satisfaction among the smaller financial advisers was about 80 per cent – almost twice as high as the typical client of a larger international provider," he says.

Roger Weatherby, chief executive of Weatherbys Bank, a 240-year old family-owned private bank that has its roots in the British horseracing industry, says demand for more traditional banking has been amplified by the financial crisis.

"Clients who thought they had a close relationship with their bank suddenly find their wealth manager has gone – they might have three relationship managers a year and don't feel known any more."

Mr Weatherby also says the big banks have been under pressure since the crisis to reduce their loan-to-deposit ratios, meaning many have been forced to cut lending.

Boutique private banks, whose growth is limited to retained earnings because they lack a diverse shareholder base to tap for funds, have kept to more conservative lending ratios.

Another attraction of small family-owned groups is that the family's own wealth is typically managed alongside clients' investments, providing an added incentive for vigilance.

James Hoare, portfolio manager at 350-year-old C. Hoare & Co, says there has been a significant "flight to quality" since the financial crisis.

"A lot of that is based on the unique corporate structure of unlimited liability partner banks, where the family's wealth is completely aligned to customers," he says. "During the recent crisis, customers have appreciated that."

There are a number of drawbacks to family-owned private banks, however.

One pitfall is that they generally cannot compete with the dominant high-street providers on choice.

Banks such as Barclays, Credit Suisse and UBS can offer clients a far more sophisticated range of products, including access to their investment banking operations.

Indeed, Ledbury's research shows that, rather than deserting the big players, some clients are moving in the opposite direction, consolidating their holdings with them.

Its report showed that the proportion of wealthy clients that have at least 75 per cent of their investment portfolio with their main bank has risen from 22 per cent to 33 per cent in the past year.

"The pendulum has swung. Where before, clients wanted to mitigate risks by diversifying their portfolios, some clients are now more comfortable with the convenience of one provider," says Mr Lawson.

"Local providers may well have the ability to build and maintain strong relationships, but they won't always have the most suitable offerings."

Among the worst hit by this shift are the wealth operations of some of the UK retail banking brands, which sit in the middle ground between the biggest international banks and local family-owned banks.

Ledbury's report showed this group of banks had suffered a 7 percentage point fall in market share to 18 per cent in the past year.

Profile C. Hoare & Co

C. Hoare & Co may have been founded during the reign of Charles II, but the once seemingly antiquated partnership structure of the world's oldest family-owned bank is regaining fresh attention, **writes Daniel Schäfer**.

Its owners – seven descendants of the founding family – have unlimited liability for all its actions. As a result, the London-based private bank likes to play it safe. It hoards a third of customer deposits at the Bank of England and has handed out the equivalent of only 40 per cent of its deposits as loans.

The bank also likes to stay small. It has only two branches and caters to fewer than 7,000 families and wealthy individuals.

Instead of grandiose plans, it prefers spending a sizeable amount of its profits on technology such as its mobile and online banking applications.

"Forty years ago people were wondering if two branches were really enough for us. But the rise of online banking shows that if you just wait long enough, then things come back to you," says Jeremy Marshall, chief executive.

Jeremy Marshall: having two branches is enough

Wealth dips in Brazil and China

Emerging markets Managers predict growth in ultra rich despite hiccup, writes *Paul J Davies*

Eike Batista, one-time richest man in Brazil, is not the only former billionaire in the developing world.

His spectacular rise to outrageous fortune has been followed by an even more spectacular collapse into personal bankruptcy. Mr Batista was undone when his oil company failed to find any of the black stuff, sparking a cash crunch across his network of companies.

But the wider slowdown in Brazil's economy also hurt him, as it has hundreds of others in the ultra-wealthy bracket – generally defined as people with net assets of at least $30m.

It might seem unnecessarily elitist to focus only on the waxing and waning wealth of a global group of just 199,235 people, but this is exactly where the world's private banks put their efforts. Individuals with just $5m or $10m do not have enough cash to play with to cover the costs of the highest level of private service.

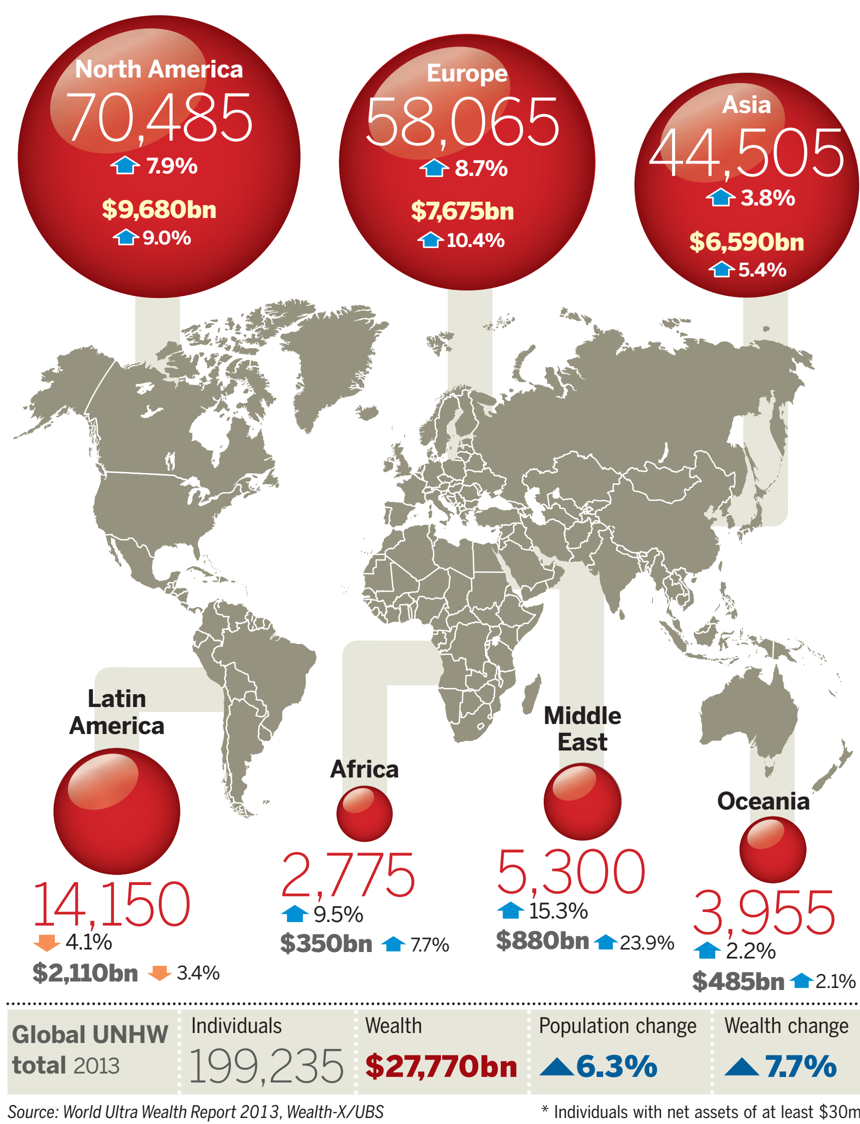
Brazil was one of less than a dozen countries that saw the number of its super-rich decline this year, according to an annual report by Wealth-X and UBS. More than 600 people dropped out of this league in Brazil, as the total assets of this group fell almost $100bn from 2012 to $770bn.

China, the next biggest loser, lost almost 600 multimillionaires and the group's total assets fell by $65bn to $1.5tn. The other two Bric nations, Russia and India, registered a small rise in ultra-rich numbers and wealth.

All the other countries that saw their ultra-wealthy populations shrink were also emerging markets, apart from Canada and Finland.

Chile, Colombia, Kazakhstan, Peru, South Africa, Syria and Tunisia all lost members of their super wealthy clubs, according to Wealth-X.

Developed countries by contrast did rather well. Germany saw more than 2,000 people join or re-enter this league, while Europe as a whole added almost 5,000 and the US gained more than that. These two blocs between them added $1.5tn in assets this year – as much as all Chinese super-rich hold. The total wealth of the US and European ultra rich is a staggering $16.76tn, out of a global total of $27.77tn.



Recovery in equity markets and other asset prices because of the flood of central bank money is behind most of this growth in wealth rather than fresh entrepreneurial success or economic growth.

For private banks, however, the emerging markets still merit close attention. Bassam Salem, chief executive of Citi's private bank in Asia, says the emerging markets of the Middle East, Latin America and Asia make up roughly half the global private banking business and will pull ahead of the developed world. "The emerging economies are slowing, but they are still producing better growth than the developed world," he says.

> Emerging economies are slowing, but they are still producing better growth than the developed world

Wealth among the rich in emerging markets has grown with great rapidity in recent years, even if it is stuttering slightly now. The Middle East has continued to boom, adding more than 700 to its super-rich population and $170bn in assets.

However, it is often harder than people expect to make money out of the wealthy in emerging markets, Mr Salem reckons, because much of their wealth is often tied up in their businesses, while the costs of running a private bank in terms of property, people and regulatory compliance are high and increasing.

Staff – especially the vital relationship managers – can be very expensive in Asia and other emerging markets, because they are in very short supply. Barend Janssens, head of emerging markets at RBC Wealth Management, says the talent shortage is a big inhibitor to private banks.

"Good private bankers who speak local languages and understand local customs are highly sought after, and with demand for their skills higher than supply, costs are going up," he says. "The industry needs to find a way to groom talent in sufficient numbers to keep up with high client demand."

The demand is there and should keep growing – in spite of this year's hiccups. Roland Berger, the strategy consultancy, predicts that global bankable assets will grow to almost €40tn by 2017, from €29tn at the end of 2012. The fastest growth, it predicts, will come from Asia-Pacific, which it forecasts will see assets increase by 10 per cent annually to reach about €14tn by 2017.

UBS for one still sees Asia as the most promising market in the years ahead. Kathryn Shih, head of UBS Wealth Management Asia Pacific, says it will see the fastest growth out of all the emerging markets.

"Asia-Pacific has been growing faster than other emerging markets because it has had more political stability, which promotes economic stability," she says.

Unlikely pairing may point the way ahead

Asia

Intense competition is likely to lead to more tie-ups, reports *Jeremy Grant*

When Vontobel signed a preliminary agreement with ANZ bank in Singapore this month, it brought together what appeared to be two unlikely financial partners.

Vontobel is a Swiss-based private bank with heritage stretching back to the 19th century. The other is a Melbourne-based banking group that generates almost 18 per cent of its profits from Asia, outside Australia and New Zealand.

But on closer inspection, the two banks need each other in the highly competitive world of Asian private banking, where there are many players – yet few, if any, with a sufficiently established regional brand to attract a critical mass of customers.

Vontobel will obtain access to ANZ's growing presence – and thus clients – in Asia, while ANZ will be able to use Vontobel's "strong global equity asset management capability", says Stewart Brentnall, chief investment officer of ANZ Global Wealth. "Putting the two together will allow a more rapid growth than either bank would achieve on its own."

Whether other banks will emulate this kind of arrangement – so far rare in the Asian private banking business – remains to be seen. But the forces behind it are here to stay.

McKinsey, the consultancy, said in its 2013 annual global private banking survey that, while assets under management grew 17 per cent in Asia last year – which is more than double the rate for North America or western Europe – profit margins were just 17 basis points. That compares with 23bps in western Europe and 32bps in North America.

Intense competition, a tendency for wealthy Asians to use multiple private bankers, and high staff costs are likely to force consolidation in the wealth management business in Singapore and could push operators out of business, top private bankers say.

Deepak Sharma, chairman of Citi Private Bank and co-chair of the Singapore Private Banking Industry Group, says the business is "under tremendous test".

Société Générale, the French bank, is looking to sell the rest of its private banking business in Asia, following the recent disposal of its Japanese unit, according to people familiar with the process.

The move reflects the French group's cost-cutting and disposal programme, but it is also a sign of how intense the competition is in private banking in Singapore.

It may not always necessarily be the smallest banks that are forced to cut back, however. "Smaller specialist shops are far more agile than the bigger banks, because of internal inertia, compliance pressures and external headquarters making excessive demands," says Tim Gibson-Tullberg, head of southeast Asia at Sheffield Haworth, a recruitment company.

Western banks also face cultural hurdles. Their Asian rivals have been pushing into wealth management in recent years, in some cases making a virtue out of a decades-long presence servicing southeast Asia's ethnic Chinese community, which is highly entrepreneurial and accounts for a disproportionate share of the region's wealth.

> 'Nothing can replace local knowledge and the spirit of a handshake'

United Overseas Bank, Singapore's third largest by assets, has a long history of serving the commercial banking and resulting wealth management needs of the Chinese minority in the region.

In Malaysia, where the bank opened its first branch 60 years ago, it is especially strong in cities with a higher concentration of Chinese businesses such as Ipoh, Kota Kinabalu and Penang.

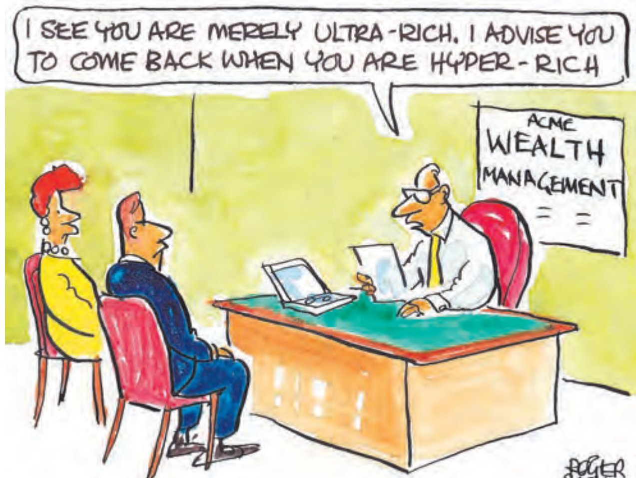
That means it is well positioned to attract business from people who may have relatively modest wealth now, but that is set to grow as their businesses expand.

Jean Khong, a UOB spokeswoman, says: "We don't believe in 'suitcase bankers', because nothing can replace local knowledge and the spirit of a handshake."

Surge in Asian millionaire clients provides lucrative opportunities

New rich

China takes a leading role in adding glitz, says *Paul J Davies*



The Louis XIII casino and hotel in Macau will be something to marvel at even in the midst of one of the most gaudy and ludicrous cities in the world.

This $1bn resort is expected to have a giant ruby coloured illuminated "jewel" above its entrance and will charge a minimum HK$10,000 (US$1,290) a night for the most basic of its 236 rooms. The smallest bets on its 66 gaming tables will be HK$5,000 and shopping at the Graff Diamonds store and other luxury outlets in its mall will be by appointment only.

Welcome to the world of Asia's rich.

Asia is producing more new wealth than any other part of the world at any point in history. Over the past five years, the assets of rich individuals have grown at triple the rate of the wealthy elsewhere, while the number of rich people has increased by twice that of other regions, according to the recent annual survey by Capgemini and Royal Bank of Canada.

Their number grew by almost 10 per cent to reach 3.7m last year, according to the survey, while their wealth expanded by 12 per cent to $12tn.

For "ultra-high-net-worth" people, who have more than $30m in net assets, the story is a little different. More people from the US and Europe entered this club in the past year than from anywhere else – the population in China and Brazil actually declined slightly – according to research by Wealth-X and UBS *(see story above)*.

There are only 199,235 such individuals in the whole world, but unsurprisingly they are the main focus of private banks and wealth managers. They will often have $20m tied in a business, with $5m in property and $5m to play with, says Mykolas Rambus, chief executive of Wealth-X.

"The reason this market is so lucrative is that a lot of the wealth is not very liquid yet," he says. "They are likely to have a monetising event within a couple of years, like a listing, and they tend to spread their wealth around among a number of banks."

There are many more potential clients among those with $5m or less, but they might only have liquid assets of $250,000 or less. "You cannot make money out of that in today's high cost regimes," Mr Rambus adds.

The newly rich can be much more demanding clients for private banks and other wealth managers, partly because they can take some convincing that a service they have never used or thought about is worth paying for.

On top of this, as they are normally still tied in with their businesses, their investment expectations are for much higher returns than those who have been wealthier for longer and are more interested in preservation.

"For the new rich, investments in wealth management compete directly with their businesses for capital, so any investment needs to generate a higher return than they could get by reinvesting in the company," says Kathryn Shih, head of UBS Wealth Management Asia Pacific. "Also, they have a home bias; they like to know the companies they are going to invest in."

Of course, those whose wealth is really new are also more interested in flaunting it – or at least buying some of the trappings such as cars, watches, properties and so on.

But private banking executives say these things are bought early – and often with borrowed money – by the merely affluent, rather than the really rich.

For those with $30m or more, the first thing they want to buy once they hit that bracket is an aircraft, according to Bassam Salem, chief executive of Citi's private bank in Asia.

"The newly rich are a bit more exuberant in terms of showing their wealth initially," he says. "But it takes a little while to become ultra-wealthy for most. The richer you are, the less you want to show it in many countries."

The exception to this is mainland China, where more people have become vastly rich in a much shorter time because of the explosive pace of growth in recent years. The average age of Citi's ultra-rich clients in Asia excluding Japan is about 70, according to Mr Salem, whereas in China it is 35.

Mr Rambus makes a similar observation, noting that the average age of millionaires in China is about 33, but that of the world's ultra-wealthy is 52.

In spite of cathedrals to excess such as the coming Louis XIII resort in Macau, Mr Rambus says the super wealthy in Asia, as in other parts of the world, are becoming less visible in terms of splashing the cash.

"There are many countries where visibility is not good culturally and where it is becoming less advisable if you want to keep your wealth," he says.

So, once the Louis XIII opens to its exclusive clientele in 2015, it is more likely that anyone who makes a noise about having stayed there is perhaps either lying, or at the lower end of that casino's clientele.

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Tighter rules lead institutions to restructure

Regulation Compliance can put pressure on already squeezed margins, writes *Sharlene Goff*

Testing times: new regulations following the collapse of Lehman Brothers are 'the single biggest challenge facing the wealth management industry' PA

It is hardly likely to trigger an outpouring of sympathy, but global banks and wealth managers are warning that a sharp increase in regulatory requirements is one of the biggest challenges they face in the post-crisis environment.

Banks say they are being bombarded with complex and time-consuming compliance requests from regulators, which are costing them tens of billions of pounds.

While few dispute that regulation was too lax before the crisis – an opportunity that many banks exploited – institutions say a tightening of the rules needs to be balanced against efforts to foster a recovery.

Some critics fear global regulators are taking too retrospective a view – burdening banks with onerous requests that are aimed at tackling past problems, such as high leverage – rather than focusing on where the next risks could emerge.

"Regulatory change is the single biggest challenge facing the wealth management industry," says David Wilson, head of strategic analysis at Capgemini Financial Services, the consultancy.

"The volume, breadth and long-term impact of regulations are significantly affecting the top and bottom line for firms, at a time when the industry is still dealing with thin margins after the crisis years."

Mr Wilson highlights the different types of costs linked to tougher regulation. First, he says, are the direct costs that come from hiring more compliance staff, producing more documentation and upgrading IT systems.

Then there are a number of indirect costs, such as the loss of revenue, as wealth managers are more restricted in the types of products they can sell and in the way they treat clients.

In addition, says Mr Wilson, wealth managers need to be braced for more punitive fines if they are found to have breached the tougher compliance rules.

"The cost of non-compliance has become very significant, both in terms of fines and costs for putting mistakes right, but also in terms of reputational damage," he says.

There has been a spate of recent big fines on banks, and analysts say the penalties from regulators have harsher.

"Banks have been fined, not just for actual misconduct but for not being able to give proof they have complied," says Christine Ciriani, a partner in the Geneva office of Capco, the financial services consultancy.

She says the tougher compliance rules require an entire change in culture. "It used to be the case that as long as banks could show they had done their best to manage risks, they should be OK.

"Now they have to prove . . . they have done controls. That requires huge investment to put systems in place to capture an act they may always have done but couldn't prove," says Ms Ciriani.

She says these developments mean banks are likely to reassess the kinds of operations they do in-house.

Whereas, before the financial crisis, compliance costs would typically account for about 10-20 per cent of the money set aside each year for internal investment, that has now risen to about 50 per cent, says Capco.

That expense, as well as increased nervousness about fines, has prompted some big global banks to outsource parts of their business to specialist companies.

Banks are also leaving markets.

This year, Lloyds Banking Group sold its international private banking arm to Swiss wealth management specialist Union Bancaire Privée, for example, while last year Bank of America Merrill Lynch merged part of its wealth arm with Julius Baer.

Capgemini's Mr Wilson says banks will also attempt to combat the higher costs by imposing new demands on clients, such as minimum account balances, and limiting face-to-face advice to customers with larger portfolios.

"Overall, it will be increasingly difficult for firms to offer all services to all clients in all markets," he says.

"Future leaders of the sector are likely to be agile firms with niche offerings and large firms that can . . . use the compliance challenge as a catalyst for a more strategic transformation built around technology and process innovation."

Called to account European banks in line of fire

New regulations will have a particular impact on banks in Europe. KPMG, the accounting firm, identifies 10 key regulatory reforms facing the sector in 2013. These include:

Capital EU directive CRD4, which implements the global Basel III standards for capital reserves, and the Financial Stability Board's capital surcharge rules increase the amount and quality of capital banks must hold against their assets.

Liquidity Banks must hold more liquid assets to meet a potential run on funds. KPMG says an extension to the range of assets qualifying as high quality liquid assets may ease concerns.

Customer treatment A series of new rules – from the European Mifid directive to the UK's Retail Distribution Review – aim to ensure customers are sold suitable products.

Systemic risk European banks, particularly, will be affected by new proposals to reduce risks to financial stability, including the structural reforms proposed by the UK's Independent Commission on Banking (ICB) and the EU's Liikanen report.

Investment bank staff find havens from lay-offs

Recruitment

The newly wealthy are lifting demand for specialist advice, writes *Camilla Hall*

Five years after the collapse of Lehman Brothers, the world's investment bankers are still suffering from the hangover – but finding solace in a switch to private banking.

With hundreds of thousands of lay-offs, the financial services industry has offered few safe havens for investment bankers who have either been fired or are living with the axe hovering above their jobs.

Even now, while economic improvement lifts hirings in some areas, firings are continuing, with declining mortgage lending and soft fixed income trading.

However, private banking and wealth management have become a familiar home for investment bankers, as their skills are increasingly relevant to a more knowledgeable client.

Over the past year, Citigroup, the third-biggest US bank by assets, has transferred some of its high-profile investment bankers into the private bank.

Eduardo Martinez-Campos, global head of investments at Citi Private Bank and So-Yon Sohn, head of investments for Asia Pacific, both moved from the capital markets business in the past year, the bank says.

Clients are more hands-on when they think about their wealth – Mark Mason

Mark Mason, chief executive of Citigroup Private Bank, says: "With new emerging wealth, there has been increased interest from clients in having product expertise."

The continuing growth of private wealth is creating opportunities for the world's financial advisers.

By 2017, global private wealth could reach $171.2tn, as Latin America and Asian high net worth individuals drive growth, says Boston Consulting Group (BCG).

As a result, western private banks are boosting their expertise overseas.

Morgan Stanley recently said that its Japanese joint venture would take a majority stake in partner Mitsubishi's wealth management business, underscoring the expansion that banks see in Asian private wealth.

As the segment swells, it is new money that is driving growth. New wealth will account for about 80 per cent of growth for private banks until 2017, factoring in moderate asset returns, according to BCG.

The source of that wealth is also changing, with entrepreneurship becoming the dominant factor.

For financial advisers, that has brought a big change in the understanding that clients have concerning the management of their finances.

"For a wealthier client, their individual and personal needs often blur with their institutional needs – that's what an investment banking professional can bring," says John Mathews, head of private wealth management at UBS Wealth Management Americas.

Underscoring the changing face of clients, technology entrepreneurs have accumulated their money more quickly than those with interests in other sectors, according to analysis from Barclays Wealth and Investment Management.

The financial crisis has also changed the behaviour of many wealthy clients, bankers say. Such people are keeping a closer eye on their money, as well as demanding more from their private bankers.

"Clients are more hands-on in terms of how they think about their wealth. Hence, the rise in family offices in recent years," says Citi's Mr Mason.

Bank executives also say they have moved further towards a team model for financial advisers, as opposed to individuals serving clients' needs. Having former investment bankers on the team can help.

"[Wealthy clients] demand so much more, the only way to deliver that is to have different specialists on their teams," says Mr Mathews at UBS.

Emerging competitors such as Wells Fargo are hiring thousands into their brokerage, private banking and retirement business, creating a more competitive jobs market.

Executive search firms say the trend of hiring investment bankers into the private banks has been going on for some time, reaching its height immediately after the financial crisis.

"Private banks are keen to tap into the products of an investment bank, as customers become more sophisticated," says William Foley, partner at Hammond Partners, the executive search firm, in London.

"Having technical private bankers is also a bonus for the investment bank, as the private bank is an obvious area for them to distribute products to," he adds.

But John Thiel, head of US wealth management and private banking for Merrill Lynch Global Wealth Management, does not think investment bankers always make the best fit for wealth management, as they can be more focused on transactions than relationships.

"If you get too focused on transactions, you can destroy the relationship," he says.

What's the best route to recovery?

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