Private banking transformation

Reinvented proposition for higher customer value, B2C and B2B

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What trends are shaping the business

The recent financial crisis has led to a movement toward new and enhanced regulations as well as a push toward increased tax transparency aimed at protecting both the banking system and its clients. In addition, a combination of poor market performance and shifting client preferences is keeping the industry's revenue base under pressure, forcing private banks to rethink their vision as well as their business and operating models while coping with constant profitability concerns.

In terms of revenues, Europe is still a rather lucrative market with private banks reaching pre-tax profit margins of 25 to 27 bps on average, compared with 18 to 21 bps of Asia-Pacific institutions. The emergence of new actors such as independent financial advisers, however, forces private banks to find new ways of making profits while keeping prices low. **Luxembourg private banks, and private banks in developed countries more generally, have to optimize their value propositions in order to gain market share while focusing on cost efficiency.**

Private banking business models in Luxembourg were established based on historical relationships, with value propositions capitalizing in particular on offshore status. Private banks focused on attracting assets, while keeping comfortable pricing models and achieving maximum excellence or efficiency was not seen as the utmost priority. However, the landscape has changed considerably in the past decade.

Firstly, client needs are evolving, leading to clients having higher expectations and requiring new value-added services such as asset structuring, tax reclaim or opportunity to invest in collectible assets, etc. At the same time, several parallel evolutions are forcing banks to cut their prices. Clients' cost-sensitivity is increasing and new regulations are obliging banks to provide greater transparency and only price products and services that provide real added value to their clients. The challenge of the retrocession following MiFID II is perhaps the most pertinent example of this trend.

Moreover, following the financial crisis, there has been a considerable growth of External Asset Managers (EAMs) and Independent Financial Advisers (IFAs) who promise better, cheaper and unbiased services to their clients. Many clients choose to change from their private banks to these new actors as a result, and banks are forced to accept that a rising share of their business is introduced through business intermediaries.

The rise of these new actors and their increased importance in the wealth management landscape does not leave a lot of leeway for banks

All these changes in the financial marketplace necessitate the banks to reassess their value propositions, operating models and organizational structures. In particular private banks need to:

- **Recognize the importance of new actors**, such as IFAs and EAMs, as drivers of business and adapt their business models accordingly
- **Develop a clear value proposition** with the right level of service and expertise for clients (both direct and intermediary), and with the right pricing model
- **Maximize cross-selling** between different departments of the bank in order to deliver the best value to clients and optimize profitability

Emergence of business intermediaries

By having access to multiple sources of information (internet, relationship managers, mobile banking, etc.), clients not only benchmark the offering between players in terms of breadth, depth and quality of services but inevitably also in terms of pricing. Private banking clients are becoming more and more price-sensitive and can exert pressure on banks' pricing structures. In addition, the new generation of clients is also less loyal to their respective services providers and therefore more likely to swiftly move from one asset manager to another in the search for better service.

A couple of years ago, new actors such as IFAs started to emerge from a low base and now own a non-negligible share of the wealth management market. As a textbook example of open architecture, IFAs—as their name suggest—should be independent and therefore forced to search for the best products for their clients' asset allocation. This is highly appreciated by clients and creates a considerable degree of competition for private bankers. As a result, numerous private banking clients decided to re-evaluate the service offering of their banks and the value they are getting for their money, and a considerable share decided to switch to these new players in the market.

However, although these actors compete with private banks for clients, they also rely on them for support services, such as custody, transaction services and reporting, etc. This creates an enigma for private banks. To which extent shall they embrace the external parties as new clients and develop a real B2B value proposition, and to which extent shall they focus on direct private banking clients in the traditional sense? Banks often accept a certain level of business introduced to them through IFAs, as the client accounts continue to remain in custody with the bank. This arrangement is nevertheless not without conflict as the two players can have overlapping roles. Moreover, business intermediaries pose a financial challenge for banks considering that the revenues gained through assets in custody are considerably lower than those obtained through direct private banking services.

However, **the rise of these new actors and their increased importance in the wealth management landscape do not leave a lot of leeway for banks, and force them to consistently include IFAs, EAMs and other business introducers in their private banking strategies**. On the positive side, these intermediaries provide the banks with a new distribution channel for their own products and services, and in case of a compelling value proposition developed for these actors, the volume of business introduced through them will, to a certain extent, make up for the lower profitability.

From an organizational perspective, the question concerning the potential need for a "Chinese wall" between the pure private banking business and the IFA/EAM business at private banks arises, as these actors naturally feel at risk of being bypassed by the private bankers who might decide to target the final clients directly. Our market analysis clearly identified the need for such a Chinese wall from an IFA's/EAM's perspective. However, a real split is rather an exception than a rule in the marketplace today. The establishment of a Chinese wall would mean the creation of a separate department or desk as part of the bank's B2B activity and potentially lead to a duplication of certain processes and/or competencies (e.g., regarding commercial force etc.).

Increased importance of cross-selling

Moreover, not only are (U)HNWIs targeted by both private banks and the new actors in the market, large universal banks covering retail, private and corporate banking also target the same clients within their various departments, creating large clients overlaps. This often leads to clients having multiple points of contact at the same bank, and in some cases being exposed to different commercial offerings. The commercial risk of a client, be it a business intermediary or a private individual, receiving two different offers from the corporate and the private banking departments of a universal bank, or even from two different regional desks of one single private bank, is considerable.

Organizational and remuneration models need to be adapted to ensure that all experts and departments are incentivized to work together to provide clients with a single view and response

Therefore, avoiding silo effect through strong corporate governance is key. **Organizational and remuneration models need to be adapted to ensure that all experts and departments are incentivized to work together to provide clients with a single view and response.** Only serving the client with the best resources available at the most competent department of the bank for the specific service the client is looking for, will enable the bank to provide the highest value and ensure client satisfaction. The principle of remunerating teams and employees on the basis of the assets booked at their specific department only, is outdated. The challenge of today is to develop effective incentive schemes promoting cross-selling between the various departments of the same bank. Similarly, clear contacts, vis-a-vis clients, need to be established in order to eliminate the risk of double-treatment.

Changing role of the relationship manager

Coordination of activities may be ensured through the establishment of a Single Point Of Contact (SPOC) for each client. A SPOC can be seen as a modern relationship manager—a senior employee with extensive expertise and profound knowledge of the bank's service offering, who is able to direct the client to the various centers of expertise within the bank for the service in question, such as patrimonial services, credit structuring or the IT platform support team for IFA clients, etc.

The goal is to develop a strong integrated banking offering which combines traditional wealth management with loans, banking and other services enabled by the bank's infrastructure. Advisory models need to evolve to reflect the increasingly sophisticated client needs and bring more added value to clients. The relationship manager shall act as an assembler of know-how and remain the client's trusted adviser for any issue. **The client's specific needs, however, shall be met at the various competence centers within the bank.**

Summary: outstanding challenges

The central private banking challenge is how to maximize the value of existing wealth while also focusing on new wealth creation. However, as the strategies that might have worked in the past are no longer effective in this ever-changing market landscape, the traditional private banking players are forced to re-evaluate and adapt their business and governance models.

One of the main forces challenging the status quo are new actors, such as IFAs, entering the market. These do not only provide competition but also create a new client segment for private banks, leading to a transformation of private banking from a pure B2C to a mixed B2C/B2B business. The challenge is to carry out effective client segmentation and develop a clear value proposition for all target clients of the bank. **These elements are crucial in order to move from an inconsistent opportunistic approach to a consistent and structured strategic approach across all departments of the bank.**

At the same time, banks need to establish coordination mechanisms between departments and put effective cross-selling practices in place in order to ensure that existing and new clients are covered with the right offering and capabilities. Business models of private banks need to be built on core values and a clear definition of target clients and their needs. Moreover, the role of the relationship manager as a SPOC should ensure that the client is referred to the most knowledgeable department of the bank for the specific service in question. Only this approach will ensure client satisfaction and sustainable revenue generation.

New actors and developments in the marketplace create new challenges but at the same time new opportunities, and are forcing private banks to rethink their business models as a whole. **Only those institutions that manage to increase the real and perceived value of their products and services - while keeping its costs down - will be able to develop a sustainable business model and prosper in the future.**