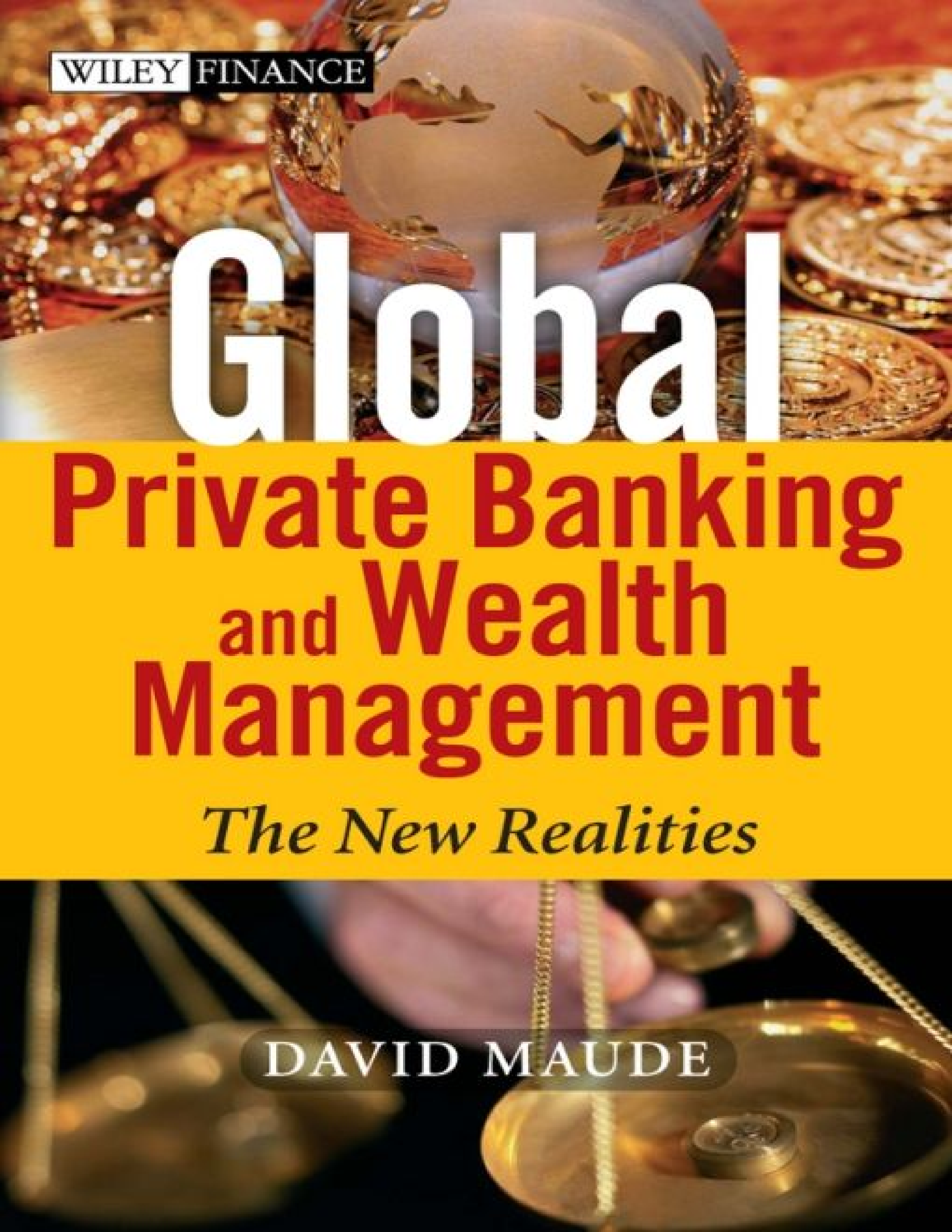

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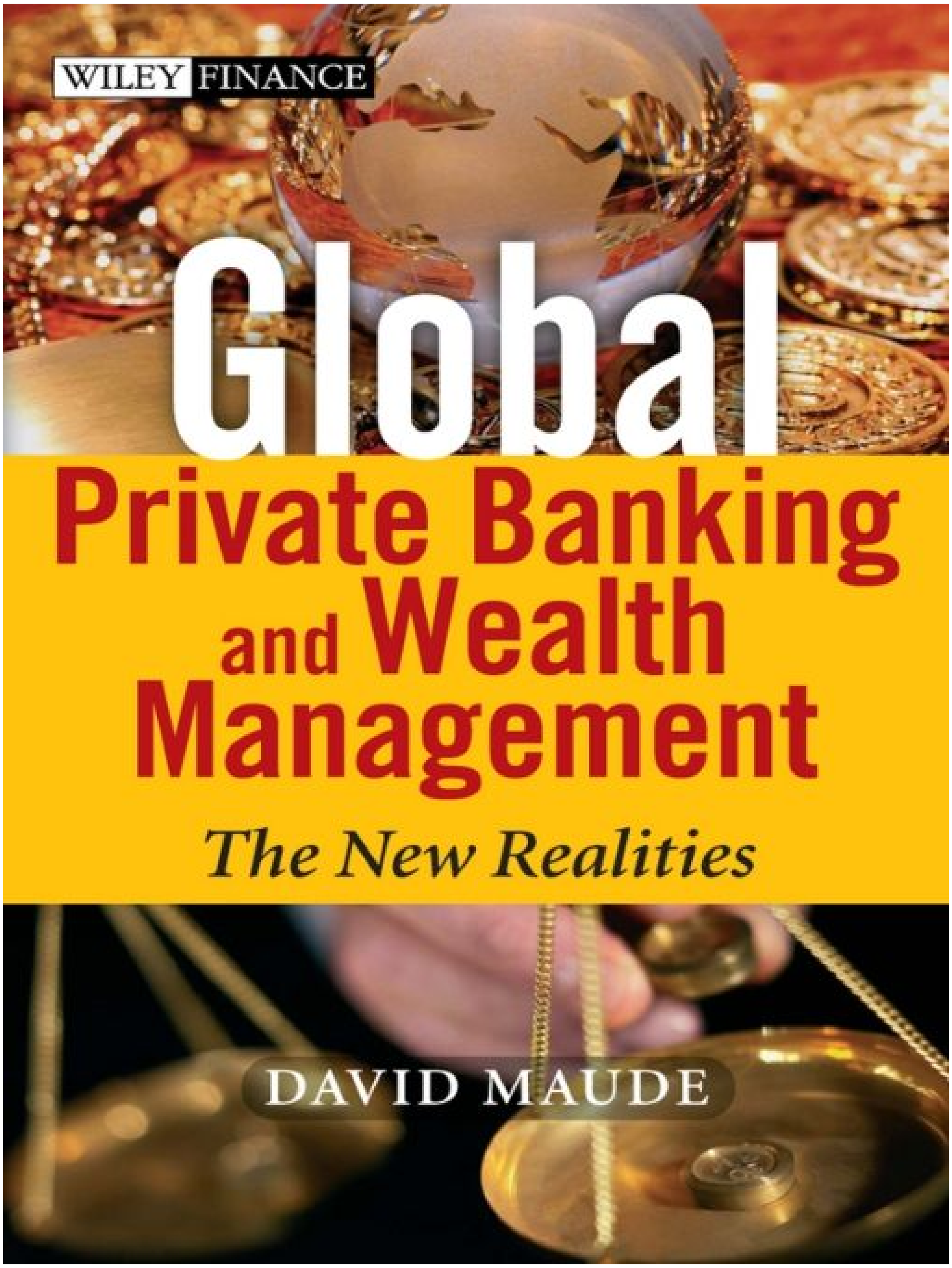
Global Private Banking and Wealth Management

The New Realities

DAVID MAUDE



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Global Private Banking and Wealth Management

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David Maude

John Wiley & Sons, Ltd

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Published 2006 by
John Wiley & Sons Ltd, The Atrium, Southern Gate, Chichester, West Sussex
PO19 8SQ, England
Telephone (+44) 1243 779777
Email (for orders and customer service enquiries): cs-books@wiley.co.uk
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Library of Congress Cataloging-in-Publication Data

Maude, David.
Global private banking and wealth management : the new realities / David Maude.
p. cm.
Includes bibliographical references.

eISBN : 978-0-470-68781-9
1. Private banks. 2. Banks and banking—Customer services. 3. Wealth—Management. I. Title. HG1978.M38 2006
332.1′23—dc22 2006005378

British Library Cataloguing in Publication Data

A catalogue record for this book is available from the British Library

Typeset in 10/12pt Times by TechBooks, New Delhi, India.
Printed and bound in Great Britain by Antony Rowe Ltd, Chippenham, Wiltshire.
This book is printed on acid-free paper responsibly manufactured from sustainable forestry
in which at least two trees are planted for each one used for paper production.

To Francesca and Antonio

Preface

“Let me tell you about the very rich” (with undisguised envy). *“They’re very different from you and me.”*

F. Scott Fitzgerald

“Yes” (taking a long pull from a thick Havana and pausing longer for dramatic effect). *“They have more money.”*[1]

Ernest Hemingway

It is easy to forget that only a few years ago, wealth management was the darling of the financial services industry. Highly profitable and growing rapidly, everyone wanted a piece of the action. Indeed, come 1999, it was difficult to find a bank of any stripe that was *not* targeting the wealth management business.

Driven by strong global economic growth and buoyant financial markets during the go-go years of the 1980s and 1990s, wealth managers were able to prosper simply by showing up, being there and standing relatively still. There was no great need to have a clear strategy or distinctive client proposition. In many cases, the assets - and profits - just flowed in.

So, what happened? The financial market turmoil of 2000-2002 left many wealth managers - old and new - highly exposed: exposed more than ever to the global equity market; and, in the case of the large number of integrated players, exposed, too, to accusations of inherent conflicts of interest. As Warren Buffet famously said, “It’s only when the tide goes out that you learn who's been swimming naked."[2] In short, for many players, at least for a while, wealth management lost its golden lustre.

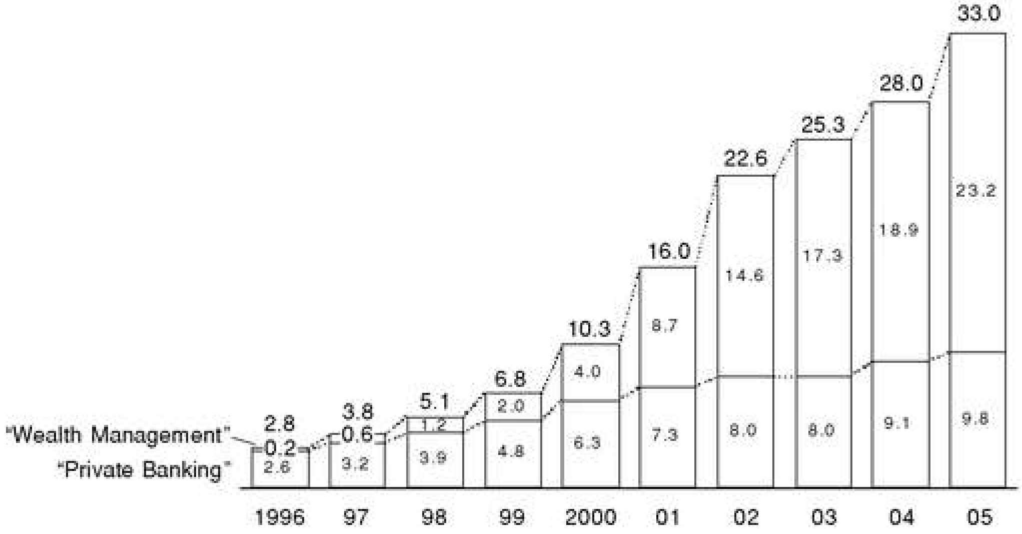
Today, with the recovery in financial markets, many players are refocusing on wealth management, and growth initiatives are firmly back on management agendas. The industry's profile has never been higher (see Figure 0.1).

Going forward, however, financial markets alone cannot be relied on to grow or even sustain profits. Many wealth managers' strategies are in flux and the pace of change is picking up. New initiatives are appearing by the week.

The main aim of this book is to help wealth management players chart a course through the new, increasingly choppy, waters. I aim to provide a flavour of the key issues at stake, but the book certainly does not attempt to cover every possible aspect of wealth management. Along route, I hope to blow away some of the myths that have grown up around the industry.

Figure 0.1 The rise and rise of wealth management

Source: Factiva; author's analysis.



* English language only

Number of press articles* including given term
Thousands

The good news is that, looking ahead, the industry's intrinsic fundamentals are relatively solid. There are still fortunes to be made in wealth management. But one thing is clear: the private banking and wealth management business will not get any easier to manage.

David Maude
Verona, May 2006
david_maude@lycos.co.uk

Acknowledgements

This book was originally conceived back in 2002, but has taken far longer to bring to fruition than I originally intended. The sheer weight of client work over this period has been the main culprit. I therefore thank Philip Molyneux, Professor of Banking and Finance at the University of Wales, for stepping in to help write several chapters. Anna Omarini, Assistant Professor at Bocconi University, also kindly assisted with one of the chapters.

Several people helped out by reviewing draft chapters, including Helen Avery at *Euromoney*, Marc Kitten at Candesic and Sascha Schmidt at a-connect.

Various executives at the leading players provided insightful discussions and helped refine my thinking. Similarly, many clients, knowingly or unknowingly, have provided input over the years. However, all examples in the text are either drawn from public information or, where based on my professional experience, have been disguised to protect client confidentiality.

Special thanks go to Christian Casal, John Cheetham, Andrew Doman, Hugh Harper, Francesca Rizzi, Purnima Roy, Corrado Ruffini, Frederic Vandenberghe, Martha Whitmore and other former colleagues at McKinsey & Company, who provided extensive comments and source material.

I am also very grateful to a number of other people who generously devoted time and source material, including: Christian de Juniac, Boston Consulting Group; Ian Woodhouse, IBM Business Consulting Services; Bruce Weatherill, PricewaterhouseCoopers; Stephen Jarvis, Alberto Pagliarini and Huw van Steenis, Morgan Stanley; Liz Nesvold and Jennifer Sransky, Berkshire Capital; Gavin Houlgate, KPMG; Alan Gemes, Booz Allen Hamilton; Lauren Taylor, Mercer Oliver Wyman; Dominic Wilson, Goldman Sachs; Marc Rubinstein, Credit Suisse; Javier Lodeiro, Bank Sarasin; Jon Diat, Citigroup; Carolin Deutsch and Dana Grosser, SEI; Anne Bourgeois, Datamonitor; Karen Cohen, Renee Duvall, Petrina Dolby, Ronni Edens and Donie Lohan, Capgemini; Sierk Nawijn, ABN AMRO; Jon Peace, Fox-Pitt, Kelton; Conrad Ford and James Morris, Barclays; Christian Kwek, BNP Paribas; Matt Spick, Deutsche Bank; Daniel Davies, Exane BNP Paribas; Christopher Humphrey, Eden McCallum; Dr Bernhard Koye, Swiss Banking School, University of Zurich; and Richard Drew.

I also thank Sam Hartley, Emily Pears and Viv Wickham at John Wiley & Sons, Ltd, who kept me on the straight and narrow, and ensured that the publication process ran smoothly.

This book could not have been written without the love and support of my family. Extra special thanks go to my wife, Francesca, and to my son, Antonio, who had to put up with his Dad typing away for long hours instead of playing with him.

Needless to say, any errors in the text are mine alone.

DJM

1

Global Market Overview

In the late 1990s, wealth management was reported to be the fastest growing sector of the financial services industry. Though the 2000-2002 downturn took its toll on many wealth management providers, looking ahead, the industry remains attractive, with strong fundamentals. Globally, the number of millionaires continues to grow at more than 7% a year - around 6 times the pace of the population as a whole.[3] The industry is certainly up there with investment banking in terms of fun, glamour and glitz. However, to meet the evolving needs of clients, the industry has become increasingly broad and complex.

For decades, the industry was dominated by a select group of sleepy, very traditional players. But during the 1990s, the industry changed almost beyond recognition. There was a huge influx of new players offering a wide range of specialised products and services to a broader, ever more demanding client base.

The aims of this introductory chapter are to:

- Define the wealth management market and provide an idea of its size and recent growth.
- Examine the key drivers of the wealth management industry.
- Outline the economics of the industry.
- Briefly describe the competitive landscape.

Most of the themes introduced here will be explored in more detail in later chapters.

1.1 THE WEALTH MANAGEMENT MARKET

There is no generally accepted standard definition of wealth management - both in terms of the products and services provided and the constitution of the client base served - but a basic definition would be financial services provided to wealthy clients, mainly individuals and their families.

Private banking forms an important, more exclusive, subset of wealth management. At least until recently, it largely consisted of banking services (deposit taking and payments), discretionary asset management, brokerage, limited tax advisory services and some basic concierge-type services, offered by a single designated relationship manager. On the whole, many clients trusted their private banking relationship manager to ‘get on with it’, and took a largely passive approach to financial decision making.

Private banking has a very long pedigree, stretching back at least as far as the seventeeth century in the case of some British private banks.[4] It is, however, only really over the last 15 years or so that the term ‘wealth management’ has found its way into common industry parlance. It developed in response to the arrival of mass affluence during the latter part of the twentieth century; more sophisticated client needs throughout the wealth spectrum; a desire among some clients to be more actively involved in the management of their money; a willingness on the part of some types of financial services players, such as retail banks and brokerages, to extend their offerings to meet the new demand; and, more generally, a recognition among providers that, for many clients, conventional mass-market retail financial services are inadequate. Wealth management is therefore a broader area of financial services than private banking in two main ways:

- *Product range*. As in private banking, asset management services are at the heart of the wealth management industry. But wealth management is more than asset management. It focuses on both sides of the client’s balance sheet. Wealth management has a greater emphasis on financial advice and is concerned with gathering, maintaining, preserving, enhancing and transferring wealth. It includes the following types of products and services:
  a. Brokerage.
  b. Core banking-type products, such as current accounts, time deposits and liquidity management.
  c. Lending products, such as margin lending, credit cards, mortgages and private jet finance.
  d. Insurance and protection products, such as property and health insurance, life assurance and pensions.
  e. Asset management in its broadest sense: discretionary and advisory, financial and non-financial assets (such as real estate, commodities, wine and art), conventional, structured and alternative investments.
  f. Advice in all shapes and forms: asset allocation, wealth structuring, tax and trusts, various types of planning (financial, inheritance, pensions, philanthropic), family-dispute arbitration - even psychotherapy to children suffering from ‘affluenza’.
  g. A wide range of concierge-type services, including yacht broking, art storage, real estate location, and hotel, restaurant and theatre booking.

  Based on research by BCG, non-cash investments may account for no more than c.36% of the global wealth management revenue pool (see Figure 1.1).

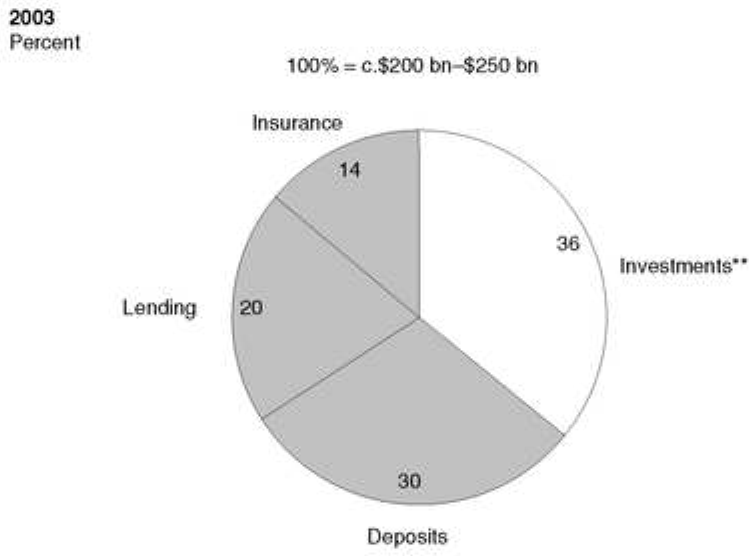
- *Client segments*. Private banking targets only the very wealthiest clients or high net worth individuals (HNWIs): broadly speaking, those with more than around $1 million in investable assets. Wealth management, by contrast, targets clients with assets as low as $100 000, i.e. affluent as well as high net worth (HNW) clients.

Robert J. McCann, President of the Private Client Group at Merrill Lynch, provided a succinct definition of wealth management at a recent industry conference:

> [Wealth management] addresses every aspect of a client's financial life in a consultative and a highly individualised way. It uses a complete range of products, services and strategies. A wealth manager has to gather information both financial and personal to create an individualised series of recommendations, and be able to make those recommendations completely tailored to each client. Off the shelf - it won't do. What [wealth management] requires is connecting with clients on a personal level that is way beyond the [retail financial services] industry norm.

Figure 1.1 Wealth management revenue pool* by product

Source: Boston Consulting Group; author's calculations.



*From households with AuM > $100,000
**Including managed funds and directly held securities

When asked to describe the factors that distinguish their services from other types of retail financial institution, wealth managers emphasise the uniqueness of their client relationships - relationships that are *broad*, in that they encompass all areas of a client's financial life, and *deep* with respect to the advisor's intimate knowledge of a client's values and priorities. In turn, this breadth and depth of relationship enables the wealth manager to develop and implement highly tailored solutions that address all aspects of a client's financial well-being. At a minimum, the following three criteria differentiate a firm as a wealth manager:

- The *relationship* that wealth managers have with their clients, both in terms of breadth (where providers emphasise terms such as 'holistic', 'comprehensive' and 'all-inclusive') and depth ('intimate' and 'individualised').
- The *products and services* provided, with a particular emphasis on estate planning and multigenerational

planning services, as well as tax advisory expertise and alternative investments.
- The *specific objectives of wealthy clients*, such as investment performance, wealth preservation or wealth transfer.

1.1.1 Investment mandates

Wealth managers may serve clients under different types of investment mandate. At the most basic level, the wealth manager may act as a pure *custodian* for a client's assets. That involves, essentially, asset safekeeping, income collection, fund disbursement and associated reporting.

Under an *execution-only mandate*, the wealth manager executes, or selects brokers to execute, securities transactions on behalf of the client. The wealth manager does not provide investment advice, so this service is aimed primarily at self-directed clients. The wealth manager is typically required to seek 'best execution' for client transactions, i.e. executing transactions so that the client's total cost, or proceeds, in each transaction is as favourable as possible to the client under the particular circumstances at that time.

The next level of investment mandate is a formal service-level contract, of which there are two types:

- *Advisory mandate*, under which the wealth manager will discuss and advise the client on investment opportunities. The client then makes the buying and selling decisions based on a combination of his or her own ideas and the investment advice of the wealth manager. The wealth manager will not make any investment decision without the client's prior approval. The wealth manager is generally paid a commission based on the volume of executed trades, plus custody fees.

- *Discretionary mandate*, under which the wealth manager usually has sole authority to buy and sell assets and execute transactions for the benefit of the client, in addition to providing investment advice. Discretionary management works by starting off with the construction of a brief with the client, detailing investment aims, level of risk-aversion and other factors that will influence the portfolio. In some discretionary accounts, the wealth manager is given only limited investment authority. However, in all cases, major investment decisions, such as changing the account's investment strategy or asset allocation guidelines, may be subject to the client's approval. The wealth manager is generally paid on the basis of a flat-fee arrangement linked to the value of the assets under management. The gross revenue margin of a discretionary mandate is typically at least double that of an execution-only mandate.

The proportion of clients using advisory mandates is, in general, relatively stable across the various client wealth bands. Execution-only mandates become more prevalent, and discretionary mandates less prevalent, as client wealth rises. That typically reflects a greater degree of financial sophistication among the wealthier clients.

Wealth management can mean different things in different geographic regions. The US and Europe have traditionally stood at two extremes in this regard. In the US, wealth management is more closely allied to transaction-driven brokerage and is typically investment-product driven. In Europe, the term is more synonymous with traditional private banking, with its greater emphasis on advice and exclusivity.

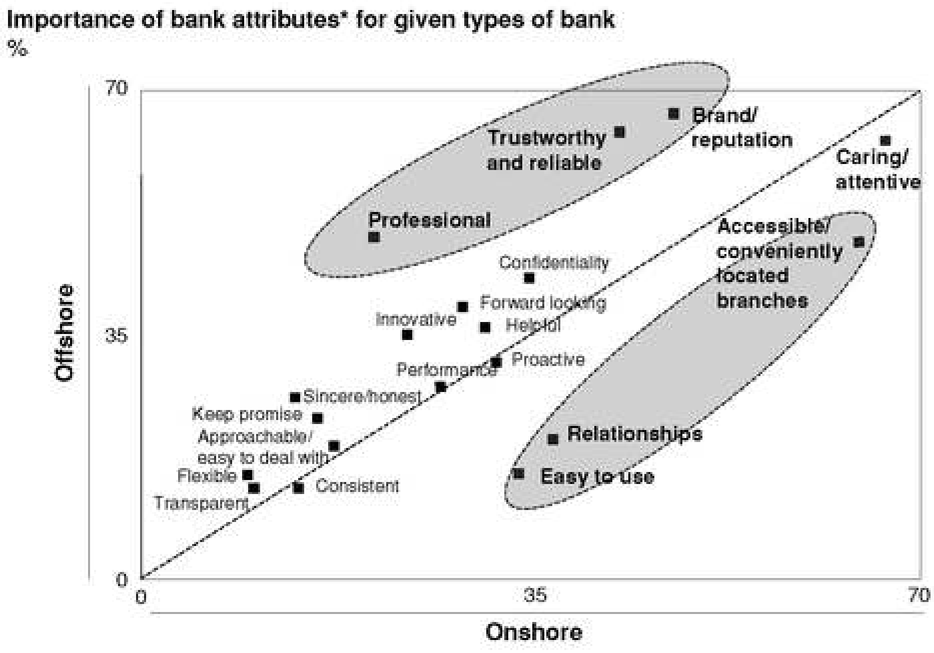
1.1.2 Offshore versus onshore

A fundamental distinction within wealth management is onshore versus offshore. Onshore wealth management is the provision of products and services within the client's main country of residence. Offshore wealth management, by contrast, serves clients wishing to manage their wealth outside their main country of residence for reasons such as: financial confidentiality; legal-system flexibility; tax considerations; the lack of appropriate products and services onshore; a low level of trust in domestic financial markets and governments; and the need for safety and geographical diversification in response to domestic political and macroeconomic risks. Indeed, some clients treat their offshore account(s) primarily as a 'vault'.

Some practitioners go further and refer to four types of wealth management. Take the example of a Swiss wealth manager. It will, of course, have a presence in Switzerland: its domestic business. Its domestic business will typically serve two types of clients. First, there are Swiss clients seeking to keep assets within their own country of residence, which is referred to as the wealth manager's domestic onshore business. Its domestic business may also serve clients from outside Switzerland, which is referred to as the wealth manager's domestic offshore business. The Swiss wealth manager may also have a presence outside Switzerland: its international business. That may include a presence in Italy, serving both Italian clients (i.e. its international onshore business) and non-Italian clients (i.e. its international offshore business).

Figure 1.2 Wealth manager attributes

Source: McKinsey & Company, 'Annual Investment and Wealth Management CEO Conference, 2005'. Reproduced by permission.



*Multiple answers possible

The onshore/offshore distinction matters because these two types of wealth management have very different client appeal, dynamics, product sets and economics (see below). Figure 1.2 illustrates that offshore private banks need, in particular, strong brands, trustworthiness and a high degree of professionalism. For onshore private banks, there is greater emphasis on local branch presence, strong relationships and 'user friendliness'.

As Figure 1.3 illustrates, the proportion of wealth managed offshore varies significantly across regions. There is a general trend for assets to shift onshore, particularly in Western Europe, which is primarily driven by a series of global tax initiatives (see Chapter 9). But that shift is happening at different speeds, and some regions - including Africa, the Middle East, Latin America and Eastern Europe - continue to have a sizeable offshore wealth component. At the client level, the proportion of wealth held offshore tends to rise in line with the level of wealth. In terms of offshore

[53] In 2004, Barclays integrated its wealth business with its investment banking and institutional fund management arm. Recent press statements from Barclays Wealth Management’s new management suggest that a product-led re-entry to the US is under consideration, on the basis that the US is too large a market to ignore for an aspiring global bank.

[54] The history here is interesting. Hentsch was the oldest Geneva-based private bank, founded in 1796. For the first two years of its life, the bank was, in fact, called Lombard Hentsch. The banks separated into Lombard Odier and Hentsh in 1798. Darier, another Geneva-based bank, was founded in 1837, and merged with Hentsch in 1991.

[55] In February 2003, UBS combined Basel-based Bank Ehinger, Bern-based Armand von Ernst, Zurich-based Cantrade Privatebank, Geneva-based Ferrier Lullin, Lugano-based Banco di Lugano and London-based GAM into a new holding company. The first three private banks were subsequently merged to form Ehinger & Armand von Ernst. These private banks were acquired by UBS and SBC mainly during the 1970s and 1980s. GAM was founded in 1983 by Gilbert de Botton, and acquired by UBS in 1999.

[56] European Wealth Management Initiative.

[57] Includes selected asset managers.

[58]

The focus here, and throughout this chapter, is on operations. Product sourcing and open product architecture approaches are covered in Chapter 4.

[59] This extended the partnership in the investment fund business which had existed between the two banks since 1994.

[60] Lean operations and Six Sigma are, in principle, distinct but complementary concepts: lean was originally designed to tackle waste; Six Sigma was originally targeted at variability. In practice, lean is a participative process, whilst Six Sigma is driven by a central group of resources. Lean can, in some instances, be combined with Six Sigma. See Drew, McCallum and Roggenhofer (2004).

[61] Though it is possible to capture the bulk of the initial benefit within as little as three months for a single process, achieving an *ongoing* benefit requires a change in management mindsets and behaviour which takes considerably longer.

[62] At the time of writing (April 2006), Credit Suisse announced plans to combine these banks (plus the securities dealer, Credit Suisse Fides) into a single entity - Clariden Leu - which will be Switzerland’s fifth-largest bank (behind UBS, Julius Baer, HSBC and, of course, its parent).

[63] The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act.

[64] ABN AMRO Bank NV, Bank of Tokyo-Mitsubishi Ltd, Barclays, Citigroup, Credit Suisse Group, Deutsche Bank AG, Goldman Sachs, HSBC, JP Morgan Private Bank, Santander Central Hispano, Société Générale and UBS AG.

[65] More detail on specific countries mentioned in this section can be found in Appendix 1.

[66] Forecasts for China, Russia and India are from The Boston Consulting Group (2005b).

[67] KPMG (2005), pages 19-22.

[68] Source: Capgemini/Merrill Lynch.

[69] Source: Boston Consulting Group (2004b); refers to household wealth >$100,000.

[70] Japan's dependency ratio, at c. 30%, is already one of the highest in the world. By 2050, it is expected to have reached c. 70%.

[71] 'Hispanic/Asian Affluent Study', April/May 2003.

[72] This section draws heavily from Datamonitor's work in this area - in particular, from its report, 'Incorporating Lifestyle

Services into the Wealth Management Proposition Survey’, May 2003.

[73] See, for example, Merrill Lynch Global Equity Research (2005a).

[74] Its April 2006 acquisition of the private client branch network of Piper Jaffray (90 branches, 842 advisors, $52 billion invested assets) may represent an important first step in that direction.

[75] See, for example, Tom Brown (2005).

[76] PricewaterhouseCoopers (2005) note that, ‘Open architecture is still a masquerade for many wealth managers and in reality only exists at the margin. Most wealth managers still manufacture products either themselves or via their parent’.

[77] Owned by Royal Bank of Scotland.

[78] Owned by Credit Suisse.

[79] Denotes private bank structured as partnership.

[80] Via its Austria office.

[81] Including Shanghai, Beijing, Guangzhou, Shenzhen, Tianjin, Hangzhou, Suzhou, Nanjing, Ningbo, Xiemen and Fuzhou.

[82] Mumbai, Delhi, Bangalore, Kolkata, Chennai, Hyderabad, Ahmedabad and Pune.