A shake-up and shake-out for global private banking

Former EFG Bank chief executive and industry veteran Lonnie Howell explains why the current business approach of global private banking is a thing of the past. Yet servicing HNW clients on a global basis still represents an exciting and growing opportunity.

Global private banking in its current form is an outdated business model that only a handful of the largest or most specialised players are capable of – or even interested in – making work.

The evidence to support this is mounting. The majority of institutions in this space have either been busy pulling out of certain markets, or withdrawing substantial parts of their business from them – in some cases reducing their overall market coverage by 60% to 80%. And this is expected to be an ongoing process, with operations likely to be further streamlined.

The largest global wealth firms like Credit Suisse and UBS, along with more specialised firms like Julius Baer, for example, have become the exception rather than the norm for their seemingly robust and sustainable strategies.

This is much more than just an identity crisis for this 300-year old industry. "[Banks need to] either refocus or get out of the industry," says Lonnie Howell, former chief executive of EFG Bank who now chairs UCAP Asset Management.

M&A SETTING THE TONE

The relatively recent sales of Coutts' international business, Societe Generale's Asian private banking division and BSI's global platform, are just a few of the headline-grabbers.

But the much broader shake-up that has been bubbling away under the surface is evident from research released in February 2015 by Scorpio Partnership. This showed that 14% of all AUM in Asia Pacific has changed hands among wealth management firms since 2008. In Europe and North America, meanwhile, there have been equivalent movements of assets of 60% and 23% respectively.

This latest assessment on M&A in global wealth management reveals the total volume of HNW assets purchased in the past seven years is US$2.2 trillion, of which around US$460 million was in 2014 alone.

LONNIE HOWELL
UCAP Asset Management

Last year was also the first time when the foundations of Swiss private banking were shaken so visibly. The volume of assets changing hands in Switzerland surpassed US$138 billion, said the Scorpio Partnership research, representing 59% of all assets changing firms in that market since 2008.

NO LONGER AT THE CORE

In the wake of this unprecedented level of industry consolidation, almost all banks are notable by their silence.

This has been a striking about-turn from the approach only two to three years ago, especially in Asia, when public declarations of growth and hiring were the norm.

> **"[Banks need to] either refocus or get out of the industry."**

Today, onlookers would be right in thinking that private banking is no longer a core business strategy for most.

There are several specific reasons why Howell believes current business models face such a bleak future.

While every institution has its own problems, it comes down to an aggregation of five key issues, he explains.

The first relates to the legacy issues each bank faces across the organisation as a whole, not just within the wealth division. The upshot of these is that it is difficult to justify to any stakeholders, ranging from shareholders to regulators, why the bank in question has any other priority than simply fixing the primary business. "That means getting one or more of retail banking, investment banking and corporate banking right first," explains Howell. "Banks shouldn't be diverted with anything which is not core to their mission."

He adds that the difference for a firm like Credit Suisse or UBS, for example, is that it is investment banking which is most likely to be cut back initially, given the focus on private banking and asset management.

A second significant issue that Howell says is driving a wedge within the industry is capital allocation. This comes down to where each bank is going to put its money, he explains.

"Capital availability is decreasing because capital ratios, leverage ratios, and liquidity ratios are escalating, forcing banks to narrow their focus."

This ties into private conversations banks are having with regulators, who would prefer not to see banks with significant global exposure and rather that each business is self-contained and stand-alone, preferably local.

An "onshoring" of investment management or its private banking equivalent, especially for smaller to medium-sized client portfolios, is therefore inevitable. This further diminishes and dilutes the benefits of global banking.

"Banks are more constrained in moving capital across their vehicles because they are in a local corporate structure rather than a branch one, and doing so would essentially create arm's length relationships between every one of the individual entities." explains Howell.

Caps on pay is a third game-changer impacting global private banking.

In reality, says Howell, in places like Europe where bonuses are generally restricted to two-times salary, at best, it is difficult for the more entrepreneurial individuals to stay motivated.

A fourth game-changer is the need for fully compliant and transparent banking – which is difficult for many players to do profitably without sufficient scale or a truly differentiated value proposition.

Stemming from these existing challenges is a fifth change-driver for global private banking – the fact that most institutions aren't actually run by private bankers or executives with much practical experience of the industry.

That breeds a lack of real understanding of the business, and by definition a focus on the businesses these executives understand well, says Howell.

So in anticipation of the complexities they now face, and potential losses and reputational damage they foresee, one hand is already on the exit. "Why put in the intellectual capital to figure out a new answer? Instead they will likely further reduce market coverage as they face ongoing pressure to refocus." ■