Adapt or die-out in a new world of private banking

Private banking business models are set for a wake-up call sooner rather than later, says Michael Benz, threatening an overhaul for the industry as a whole.

Private banking is facing one of its toughest times ever as an industry.

This is due to the combination of four key challenges, which render the past growth strategies ineffective: ultra-low interest rates, high regulation, technology innovation and changing client expectations towards more tailored product and service offerings, based on past investment activities.

"The winning formula for private banks as it was in the past decade won't work going forward," says Michael Benz, former group head of private banking at Standard Chartered Bank.

Yet the number of institutions in Asia which seem capable of adapting and evolving their business model to tackle mounting challenges are few and far between.

As a result, 2016 is likely to be the year of reckoning for private banking.

UNDER THE SPOTLIGHT – IT IS ALL ABOUT COSTS

It is now stark to all players that chasing net new money (NNM) for the sake of just increasing the asset base doesn't pay the bills.

This is based on the assumption (of many industry insiders) that private banks, on average, will see percentage drops in revenue in the region of the high teens to 20s over the course of this year. And Benz concurs with these estimates.

More than ever, therefore, the challenge for the industry is centred on the management of the cost base.

And this will remain the case for at least as long as ultra-low rates persist and make it unavoidable for banks to adjust their fee levels downwards, predicts Benz.

As part of this cost crackdown, he believes that any non-client facing role, and potentially even any non-relationship manager (RM) roles in general, will come under intense scrutiny. Where possible, explains Benz, they will be streamlined, automated and outsourced.

MICHAEL BENZ

This is one of the big opportunities which technology innovation and digitisation offer to the private banking businesses – ie. the fundamental reassessment and redesign of front-to-back processes.

Benz says this will lead to the redundancy of more and more product, middle- and back-office functions, either because of automation or outsourcing to specialist service providers. "The focus, more than ever, will now be on the RMs, especially their (lack of) high investment skills. Entrepreneurial behaviour and networking skills are just pre-conditions for RMs today."

GET THE PROPOSITION RIGHT – PERFORMANCE MATTERS MOST

Ultimately, Benz believes, only those private banks which eventually get the client proposition right, will manage to attract additional funds from clients.

This means, that management needs to keep a sharper eye on achieving the financial goals of its clients, at the heart of which lies investment performance. "High-quality NNM is not easy to get any longer," explains Benz. "Banks have to earn it by delivering the proof of helping clients to achieve their financial goals," he adds.

However, such proof, which in essence means achieving investment targets, can only be delivered if there is an explicit agreement between RMs and clients on the latter's financial goals.

"This is essentially a back-to-basics approach in today's technology-driven world," says Benz. But technology is the great facilitator.

Digitisation is not only helping to reduce costs and make the cost base of banks more flexible, it plays another very important role: use of technology to create more exciting and tailored client experiences.

Over the medium term, and with increasingly younger people getting their hands around the wealth of their parents, it is essential for private banks to deliver experiences which are more similar to what anybody today can get when shopping online. "Many clients will enjoy the new empowerment offered by digital channels, and the more relevant investment ideas suggested to them through digital channels," says Benz. "In turn, this will lead to more activities for the bank and will free-up capacity of the RMs."

FEES CAN ONLY GO IN ONE DIRECTION

Despite all those challenges, he sees some scope for optimism. Increasingly, he says clients are realising – driven by the very challenging investment environment – that longer-term portfolio investment approaches and fee-based compensation of banks are more successful than short-term transactional ones.

Indeed, an obvious and much talked about way for private banks to create a more sustainable and predictable revenue stream would be to make fee-for-advice more prominent as part of their offering.

But this seems a distant dream for many institutions. Not only the low interest rate environment, which Benz sees as the single biggest challenge for the industry overall, makes the prospect of charging clients an advisory fee less of a reality than before.

Further, he adds, it would seem that if advisers had a clearer understanding of what their clients wanted to achieve with their financial assets, then it would help satisfy some of the regulatory scrutiny in Hong Kong, in particular, over the suitability of products and appropriateness of fee levels.

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At the same time, one of the areas where the private banking industry has indeed made progress since 2008, he believes, is in relation to the fairness and transparency of fees.

SELECTIVE SUCCESS

Ultimately, he believes, only those private banks which eventually get the client proposition right, will manage to attract additional funds from clients. This requires any bank to fully leverage the power of digitisation to rethink of their core processes and the creation of more exciting and relevant client experiences. This needs to happen while every bit of management attention is given to achieving a client's financial goals. ■