Surviving Asia's streamlined private banking landscape

Industry leaders in Hong Kong are more sharply-focused than ever on recurring fees as being increasingly important to deal with thin margins and shaky client loyalty, according to a high-level discussion in September co-hosted by Thomson Reuters and Hubbis.

The irrational euphoria that has characterised private banking in Asia over recent years has quickly given way to more rational approaches to growing the business.

Continued consolidation among some of the leading industry names has been coupled with a mind-set shift among other firms towards 'optimisation' – or, more aptly, 'cost cutting'.

From some perspectives, this is long overdue. The institutional banking world, for example, tends to be dominated by six or seven large firms; by contrast, the private banking landscape is flooded with a mix of players of all sizes, yet none have a dominate market share, at least in percentage terms.

An obvious question, therefore, is why do we need so many banks? And how can they all attract the right amount of talent required to give the right level of service to customers?

With MiFID II in Europe as an example, a lot more transparency is being imposed by regulators on institutions. Combined with the influence of technology and alternative advice options in the form of the growing number of independent firms in Singapore and Hong Kong, being rewarded today relies on advisers being able to generate value for their clients.

This comes back to the same dilemma: how can most banks attract enough of the right type of talent to deliver this and therefore appeal to investors?

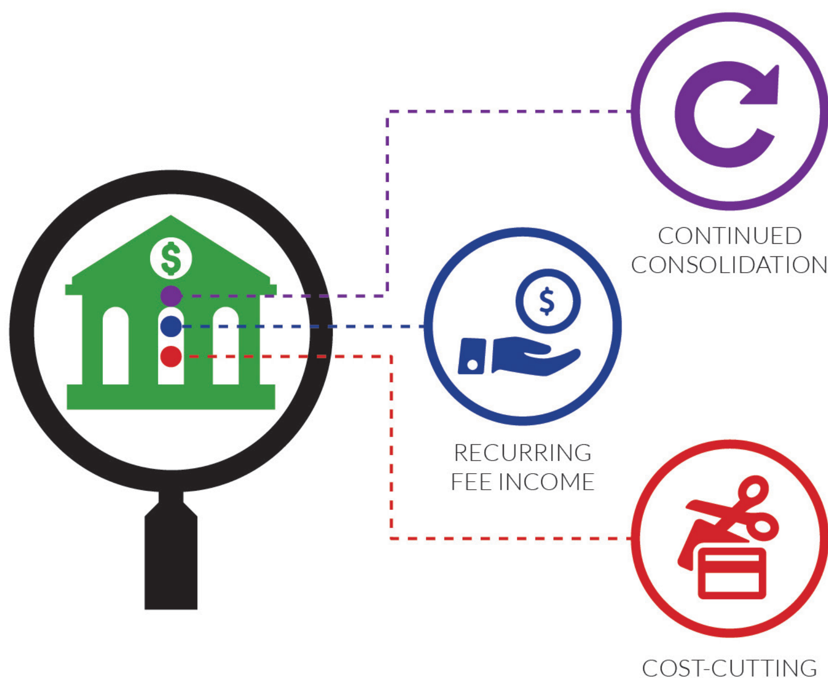
The odds are getting shorter in Asia, especially as many HNW clients multi-bank with the objective of being able to compare products and pricing.

As a result, the next 12 to 18 months will be critical for the industry in terms of seeing how each bank evolves; either they need to focus on their core competency or exit completely.

Key take-aways

- *As the number of international private banks in Hong Kong / Singapore dwindles – senior management need to find ways to create a sustainable business*
- *Creating real value for clients to cement relationships, along with consistent recurring streams of revenue, will set banks apart over the next 12 to 18 months*
- *International private banks either need to focus on their core competency or exit Asia*
- *The HKMA is watching to see if banks can promote "a sound corporate culture" – set from the top – to eradicate undesirable behaviour*
- *The rise of the independent asset management (IAM) model will challenge private banking going forward*

To cope, HK private banks focus on:



Without a model that is sustainable – such as being backed by a healthy chunk of recurring fee income – survival prospects look relatively bleak.

These were among the take-aways from a thought-leadership discussion with industry leaders in private banking and wealth management in Hong Kong, co-hosted by Thomson Reuters and Hubbis.

NEW LANDSCAPE EMERGING

The volume and pace of the expansion of wealth in Asia to date has enabled many institutions to mask the many challenges to profitability.

Plus, regulations in this region are yet to fully catch up.

This has meant there has been sufficient margin for more players to flourish than arguably should have been allowed to. Today, however, the divergence happening in the industry is gathering momentum.

At one extreme, a client can get a very personalised experience, whereas on the other hand, some institutions are deploying a lot of technology to help them deliver scale and the consistency they strive for in terms of the customer experience.

As a result, the middle-tier players are finding it increasingly difficult to survive.

The rise of the independent asset management (IAM) model in Singapore and Hong Kong reflects this (see box).

This should also give clients a choice in how much they pay for their advice.

Either it should cost them 1% to 1.25% for a high-quality, customised portfolio, or 15 basis points for a machine-driven ETF portfolio.

CULTURE LEADING CONDUCT

The fact that fees-for-advice are still hard to come by, and IAMs have started to appear in ever-larger numbers, is arguably a self-inflicted problem that the industry has created.

For instance, in losing a certain amount of credibility as professionals who really take their fiduciary responsibility seriously, the private banks have created room for new people to fill the void.

And despite the emerging threat of new business models, what if anything has changed in a way that private banks and private bankers conduct themselves today?

A lot of policies are in place today that make it much more difficult for clients to sue banks.

However, admit many industry leaders, fundamentally not enough has changed.

This has led to more attention from the Hong Kong Monetary Authority (HKMA), for example.

In March 2017, it set out in a paper to the chief executives of all authorised institutions in the city, the pressing need to promote "a sound corporate culture that supports prudent risk management and contributes towards incentivising proper staff behaviour leading to positive customer outcomes and high ethical standards in the banking industry."

This essentially calls for all players to strike the right tone from the top. This is mainly in terms of governance and other practices – including remuneration not being linked only to revenue.

HKMA

HK banking regulator has asked CEOs of all authorised institutions in the city to promote **"a sound corporate culture"**

The regulator's aim is to eradicate undesirable behaviour.

Yet it has taken nearly 10 years since the latest financial crisis for this to arise, only once realisation dawned that prescriptive rules and regulations have not had any influence culturally on many practitioners.

A number of organisations have already take steps in this direction.

For instance, they have linked compensations with financial plans and client assets – not just revenue.

But while the trend is heading in the right direction, the HKMA letter is an example of the fact that much more needs to be done, and by a larger number of organisations.

SELF-INFLICTED FEE STRUGGLE

While some rules seem to have come into play more quickly in Europe, such as MiFID II, Asia is still awaiting such a sweeping overhaul.

The outcome of the recent regulatory-led consultation in Hong Kong around fees and retrocessions, for example, seems to suggest that the business model in this market is, for the time being, relatively stuck – and at odds with the direction that many of the developed markets around the world are moving in.

More generally in Asia, the majority of industry players have convinced themselves that local clients don't like to pay for advice.

Yet this is also a self-fulfilling prophecy; if everyone keeps telling each other this, it becomes true.

But industry practitioners need to position themselves as 'professionals' who add clear value; then clients can understand why they need to pay for advice, and will be more willing to do so.

European-style regulations will help in this effort, believe some practitioners.

The industry will then be left with no choice other than to tell clients how much revenue it makes from them, and it will have to move towards the advisory model.

In the next 12-24 months focus should be on:

CHANGE INEVITABLE

Yet although the private banking industry became more realistic – and less enthusiastic – on the back of some tough years from 2014 to 2016, a caveat has been the bull market in the first half of 2017.

With market conditions making it easy again for private banks to make money, there is a question-mark again over their incentive – if any – to change.

One of the main ways in which change will come about, believe banking leaders, will be via digitisation and the resultant transparency it forces on institutions and advisers.

And with the subsequent greater awareness among customers, more pressure will also be placed on fees.

Broadly, industry leaders believe that changes to the business model in Hong Kong are inevitable, even if not brought about by regulatory reform initially.

Banks need to stop losing credibility as professionals who really take their fiduciary responsibility seriously

RECURRING INCOME A PRIORITY

The only way that business heads believe they can earn a premium in terms of fees, is through the quality of their relationships and customer loyalty.

The sustainability of the private banking business in Hong Kong, therefore, is partly dependent on firms being able to improve their ratio of recurring fee income.

This is connected to credibility for the industry, since recurring income is a clear sign of client trust.

Banks that are unable to do this – and grow it to 30% or more – face a big challenge to stay in business, say market leaders.

The focus for the next 12 to 24 months, therefore, needs to be raising the conviction level of bankers, so that they can give more relevant and effective advice to clients to add real value when it comes to managing their assets. And with this comes more confidence to ask clients to pay.

TAKING THE FEE INITIATIVE

Some banking leaders believe there is no better time to push the fee-for-advice agenda than now.

With the regulator pushing for change, continuing to do transactions on a day-to-day basis will lead to a dead end in terms of recurring revenue and sustainability of the business model.

Further, with the volume of paperwork required today, doing a similar number of trades per day as 10 years ago, for example, is no longer viable. Newer entrants to the private wealth landscape in Hong Kong might have an advantage to some extent in this way. Without the transactional legacy, reputation and client perception, for instance, new clients who are onboarded can get a different proposition. ■

Being more independent

In Hong Kong and Singapore, the proliferation of IAMs being set up by experienced RMs who are leaving the largest private banks has contributed to the numbers of private bankers seemingly going backwards.

Combined with the heavier regulatory and compliance burden that bankers face, more and more individuals are looking outside the larger institutions for their next career move.

Seasoned private bankers with 20+ year relationships with some clients are able to make the independent model work largely due to the trust their clients place in them. In turn, the incumbent private banks face challenges in terms of how to retain their senior staff.

To deal with this outflow of quality talent, some industry leaders urge private banks to forge agreement with the departing RMs to custodise all the assets of their clients – not just let AUM 'walk out the door'.

On the flipside, some practitioners believe those banks that rush to service a multi-family office or IAM are running franchise and regulatory risks. After all, clients would still most likely look to the larger institution with the 'deeper pickets' if anything goes wrong.