Rethinking private banking in Asia-Pacific
An EY discussion paper for bank executives
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Introduction

Poised at the center of the world’s fastest growing and soon-to-be largest wealth markets, the potential upside for Asia-Pacific’s private banks and wealth managers is clear. Yet, realizing the exciting potential of the region’s wealth hubs is challenging. Making necessary investments in technology and talent to meet the regulatory demands for compliance and changing client needs, requires scale and long-term investor appetite that many private banks don’t have today. The sector’s traditional, resource-intensive relationship management models and currently, depressed revenue margins are making the cost-to-serve prohibitively high.

As this discussion paper reveals, to survive and thrive in this extraordinary time of challenge and opportunity, the region’s private banks need to rethink their:

- **Customer service models** – to build more targeted client engagement models, focusing on specific markets and customer segments to grow share of wallet
- **Technology strategies** – to facilitate control and compliance, enable analytics and respond to increasingly sophisticated client demands
- **Operating models** – to improve productivity and leverage scale.

Those banks that can reshape their strategies and operating models to capitalize on the region’s macro trends, leverage their investment in technology and respond to the increased sophistication of clients will be in a prime position to reap the opportunities in Asia Pacific’s burgeoning wealth markets.

We look forward to discussing these important issues with you.

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Financial Services
ASEAN

Jan Bellens
Banking & Capital Markets Leader
Asia-Pacific
The private banking potential is clear, with Asia-Pacific poised to overtake North America as the world’s largest wealth market.
Asia-Pacific dominates international private wealth growth

Asia-Pacific is the highest growth region for private banks and is soon expected to overtake North America as the largest market for High Net Worth Individuals (HNWIs) — customers with more than USD$1 million in investable assets.

In 2013, private wealth in Asia-Pacific (including Japan) rose by 18% to US$14.2 trillion, driven by high savings rates and strong growth in China and India. The gap between Asia-Pacific and North America is closing fast, with the difference in population calculated at fewer than 10,000 individuals: North America’s 4.33 million to Asia-Pacific’s 4.32 million. In 2013, Asia-Pacific’s HNWI wealth trailed North America’s by just US$700 billion.1

With Asia-Pacific’s HNWIs growing their wealth ahead of the rest of the world, the region is expected to reach the number one position by 2015. Between 2007 and 2012, Asian HNWIs expanded their wealth at a CAGR of 4.9%, surpassing the 1.6% CAGR of North America and the 0.5% CAGR of Europe.

The pace is expected to pick up even faster. With the global wealth market likely to grow at a CAGR of 5.4%, wealth in Asia-Pacific is expected to grow at a CAGR of 8.1% annually. By 2018, the region is expected to make up more than one-third of global wealth, with its private wealth forecast to reach USD$76.9 trillion.

By 2018, Asia-Pacific is expected to make up more than one-third of global wealth²

For HNWI assets placed with private banks, major foreign brands dominate today

According to data from Private Banker International, in 2012, foreign brands dominated the market, with domestic private banks accounting for just over 11% of Asia’s wealth.3 While the influence of domestic banks is growing rapidly, foreign brands are continuing to deliver both organic and inorganic growth. UBS, Citibank and Credit Suisse dominate the top three places in Asia-Pacific private banking.

Of the local banks, DBS says it has grown its private banking business by 20% per annum over the last three years,4 and they expect its Societe Generale acquisition to boost AUM by a further 23%.5 Bank of Singapore has more than doubled its AUM since its launch in 20106.

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3. “UBS clinches back top spot from Citi Private Bank as largest private bank in Asia Pacific,” Private Banker International, 14 October 2013
4. “DBS bulks up in battle for Asia’s billionaires,” Finance Asia, 17 March 2014
5. “DBS to acquire Societe Generale’s private banking business in Asia,” DBS press release, 17 March 2014
6. “Private banking a tough sell in rising Asia,” The Straits Times, 8 April 2014

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Asia-Pacific HNWI population (millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>25%</th>
<th>10%</th>
<th>3%</th>
<th>9%</th>
<th>16%</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>3.0</td>
<td>3.3</td>
<td>3.4</td>
<td>3.7</td>
<td>4.3</td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>2011</td>
<td></td>
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<td>2012</td>
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<td></td>
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<tr>
<td>2013</td>
<td></td>
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</tbody>
</table>

Source: CapGemini and RBC Wealth Management, World Wealth Report 2014 includes Japan and India

Asia-Pacific HNWI wealth (US$t)

<table>
<thead>
<tr>
<th>Year</th>
<th>32%</th>
<th>11%</th>
<th>1%</th>
<th>12%</th>
<th>18%</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>9.7</td>
<td>10.8</td>
<td>10.7</td>
<td>12.0</td>
<td>14.2</td>
</tr>
<tr>
<td>2010</td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
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<td>2013</td>
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</tbody>
</table>

Source: CapGemini and RBC Wealth Management, World Wealth Report 2014 includes Japan and India
Asia-Pacific is notable for the proportion of wealth of HNWIs not currently with private banks. Whereas in the US or Europe 70-80% of these consumers are accessing private banking services, whereas in Asia-Pacific, private banks have only captured 10-20% of the potential HNWI market – a major opportunity for growth. But these HNWIs not with private banks are often satisfied customers with traditional retail banks, family offices and other wealth managers. Many customers do not see the added value of a private bank, hence putting a very high bar on the banks to acquire them.

Growth does not mean profit: margins are tight and cost-to-serve is high

The success stories of some international private banks mask a tough reality. Faced with the high costs of servicing price sensitive Asian clients with traditional models, many private banks with sub scale operations do not generate much profit and several of them are withdrawing or downsizing. For example, RBS is seeking to divest its Coutts International operations; and Swiss boutique Falcon Private Bank sold its Hong Kong operations to EFC Private Bank in January 2014.

Scale is critical to profitability

We consider that Asia-Pacific private banks typically require AUM of more than US$20 billion before their asset base will generate enough revenue to be profitable. This is due to low revenue margins in the current market context – margins have fallen from a high of 90 to 100 bps over AUM a few years ago to closer to 60-70 bps today, depending on asset mix. At the same time, operating costs are high and rising, generated by: expensive relationship managers (RMs) and frontline staff, the rising costs of regulatory compliance and the required investments in technology.

The result is high cost to incomes ratios. In 2014, the average operating cost to income ratio for private banks in Asia was around 75%. Given the major players with scale, or those that share cost platforms, operate with ratios in the low 60s, many smaller private banks are operating with ratios in the 80s and 90s and beyond. Not surprisingly, the top performers have focused on improving processing efficiency and investment knowledge of frontline staff to boost performance. As a rapid improvement in revenue margins is unlikely and the costs of compliance continue to rise, we expect many institutions to take a very hard look at their portfolio and their business model.

### Major foreign brands top Asia-Pacific private bank rankings

<table>
<thead>
<tr>
<th>2013 ranking</th>
<th>Private banks</th>
<th>Asia AUM (US$ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>2012</td>
</tr>
<tr>
<td>1</td>
<td>UBS</td>
<td>207</td>
</tr>
<tr>
<td>2</td>
<td>Citibank</td>
<td>210</td>
</tr>
<tr>
<td>3</td>
<td>Credit Suisse</td>
<td>121</td>
</tr>
<tr>
<td>4</td>
<td>HSBC</td>
<td>91</td>
</tr>
<tr>
<td>5</td>
<td>Deutsche Bank</td>
<td>84</td>
</tr>
<tr>
<td>6</td>
<td>JP Morgan</td>
<td>70</td>
</tr>
<tr>
<td>7</td>
<td>Julius Baer</td>
<td>60</td>
</tr>
<tr>
<td>8</td>
<td>DBS</td>
<td>46</td>
</tr>
<tr>
<td>9</td>
<td>Morgan Stanley</td>
<td>58</td>
</tr>
<tr>
<td>10</td>
<td>BNP Paribas</td>
<td>42</td>
</tr>
<tr>
<td>11</td>
<td>Bank of Singapore</td>
<td>43</td>
</tr>
<tr>
<td>12</td>
<td>Goldman Sachs</td>
<td>38</td>
</tr>
<tr>
<td>13</td>
<td>Standard Chartered</td>
<td>35</td>
</tr>
<tr>
<td>14</td>
<td>Barclays</td>
<td>25</td>
</tr>
<tr>
<td>15</td>
<td>Coutts</td>
<td>16</td>
</tr>
<tr>
<td>16</td>
<td>EFG Bank</td>
<td>19</td>
</tr>
<tr>
<td>17</td>
<td>ABN Amro</td>
<td>17</td>
</tr>
<tr>
<td>18</td>
<td>LGT</td>
<td>15</td>
</tr>
<tr>
<td>19</td>
<td>RBC</td>
<td>11</td>
</tr>
</tbody>
</table>

Source: Private Banker International (2013); company reports
Growing trends require new thinking

Although wealth is growing fast in Asia-Pacific, the region is challenging for private banks, with a wide array of rapidly evolving international and local regulatory requirements, very high customer expectations, an outdated sales and service model and fierce competition.
Greater compliance, risk and governance requirements

Across the world, the evolution of increasingly stringent standards for know your customer (KYC), anti-money laundering (AML) and Tax transparency is creating spiraling costs and complexity for private banks. This is particularly true in Asia-Pacific, where multiple jurisdictions come into play, requiring private banks to obtain more data and more documentation from their clients, on a more frequent basis, to comply with regulatory demands.

When it comes to KYC compliance, Asia-Pacific’s multiple jurisdictions often present private banks with difficult dilemmas. For example, Korea’s privacy regulations say that data cannot go outside the country. But this presents a problem for HNWIs domiciled in Korea trying to provide a bank in Hong Kong with their information. Similarly, in Japan, a bank cannot share information between its own internal entities. This extra layer of complexity will only get worse as other markets implement new privacy laws. In March 2014, the Australian Privacy Amendment Act came into effect, stipulating that all banks, pension funds and asset managers must obtain express consent to use personal information at the point of collection.

At the same time, regulators in the region and around the world are developing and implementing stringent new AML regulations. For example, Singapore has designated serious tax offenses as money laundering predicate offenses, and has since proposed further tightening of its AML regulations. We are also seeing growing interest at director level, as regulators in the region require boards to demonstrate active management of money laundering and terrorist financing risks, develop a robust risk culture within their organizations, and ensure adequate resourcing of their AML compliance.

International governments also continue to implement AML and counter terrorism financing regimes in compliance with international standards. Among others, this includes the United Nations Sanctions Ordinance, which prohibits making funds, financial assets or economic resources available to terrorists.

On the tax transparency front, FATCA has expanded the customary requirements for client due diligence under KYC protocols, necessitating ongoing, not periodic, review.

The net result is that client due diligence now includes, not only identifying and verifying the customer, but also identifying their beneficial ownership and control — and conducting ongoing due diligence and scrutiny, via transaction surveillance systems, throughout the course of the business relationship.

All of this requires private banks to make significant changes to internal systems, corporate governance, control frameworks, processes and procedures to meet multiple, highly complex and ever shifting requirements. This is driving up the cost and resources required for compliance — for both the bank and its clients. For smaller players especially, the expense of ensuring compliance can be out of proportion to business volume. Many are justifiably concerned about their capability to support compliance, given its demands on staffing, expertise, technology, oversight and training.

It is starkly apparent that the increased counterparty risk associated with each client and transaction will have a direct impact on the bank’s underlying profitability. With recent AML transgressions resulting in a scathing public reaction and multi-billion dollar fines, all banks are under extreme pressure to avoid this type of brand and financial damage. In Asia, where HNWIs typically only invest 10% to 20% of their wealth with any institution, building and maintaining client trust and confidence has never been more important.

Private banks that outsource onboarding or compliance processes need to be particularly careful. Institutions can outsource a function, but they cannot outsource accountability. Following a number of dramatic failures, regulators are now looking to banks to strengthen their outsourcing controls and put in place robust governance structures. This issue will continue to be a challenge for private banks for years to come.

Higher expectations of sophisticated HNWIs

With the growing Asia-Pacific wealth market seeded by an unusually high proportion of self-made, first-time HNWIs, private banks must adapt to meet the broader product and higher service expectations of this entrepreneurial new customer segment. HNWIs across the wealth bands are demanding tailored advisory services, alternative investments and a multi-channel experience.

Unlike European or US HNWIs, where a large proportion of assets still originates from inherited or professional wealth, Asia’s private banking customers are often entrepreneurs, who are focused on building their business(es). These individuals have a higher tolerance for risk than traditional banking customers — and high expectations of returns. Given they always have the alternative option of investing in their own enterprises, where they may be used to getting more than 10% returns and potential leverage, they are unlikely to be satisfied with traditional investment products.
As the region's wealth moves into the second and third generation, the private banking product mix is likely to move to longer-term, recurring-fee products, such as funds, discretionary mandates and wealth protection. Private banks need to respond to these shifts in customer expectations, the increasing demand for cross-border asset allocations and the significant number of HNWIs holding a large proportion of assets in real estate investments.

**Outdated advisor service model**

Traditionally, staff and front office costs have been a private bank's biggest expense. Today, this expense is weighing the banks down with low productivity and high cost to serve. Put simply, RMs are not paying their way.

Three issues complicate this situation. First, some customers simply don't see the value in their RM, instead preferring self-directed, digital channels. Providing such customers with an expensive RM is both a waste of resources and goes against client preferences. Second, Asian customers don't expect to pay for advice, so private banks don't have the option of charging a reasonable fee for service. Third, for customers who want an RM, the growth of HNWIs has outstripped the supply of experienced advisory talent. Some private bankers have left the wealth segment to work within alternative investment firms or family offices, reducing the experienced talent pool even further. As a result, many advisers are not sufficiently experienced or qualified to spot opportunities and provide tailored investment advice – particularly at the upper end of the client spectrum. Quality advisors are scarce, much sought after and expensive to retain.

The incentive to move to a smaller advisory model is high, but it requires a highly strategic approach. Some private banks have tried a simple segmentation method, where RMs only work with higher value customers, with limited success. The problem is that self-directed customers don't cut across wealth bands.

**Private banks lagging in digital services**

For several years, the major retail banks have been using digital services to transform their operating models, take the costs out of compliance and improve customer service. Private banks have similar scope to pursue digital strategies to support compliance in emerging markets, where onboarding is still paper-based, and improve the client experience and product offering in developed markets.

At a time when Asia-Pacific customers lead the world in their preference for digital contact, private banks can no longer get away with legacy systems that provide a poor understanding of customer data and inconsistent information across channels. They need a world-class digital offering.

**Private banks need a world-class digital offering**

**Asia-Pacific clients prefer digital to direct contact**

<table>
<thead>
<tr>
<th>Region</th>
<th>Direct contact</th>
<th>Digital contact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Middle East &amp; Africa</td>
<td>41.6%</td>
<td>58.4%</td>
</tr>
<tr>
<td>Latin America</td>
<td>39.8%</td>
<td>60.2%</td>
</tr>
<tr>
<td>North America</td>
<td>37.8%</td>
<td>62.2%</td>
</tr>
<tr>
<td>Europe</td>
<td>30.4%</td>
<td>69.6%</td>
</tr>
<tr>
<td>Asia-Pacific (ex Japan)</td>
<td>28.4%</td>
<td>71.6%</td>
</tr>
<tr>
<td>Japan</td>
<td>19.4%</td>
<td>80.6%</td>
</tr>
<tr>
<td>Global</td>
<td>26.4%</td>
<td>73.6%</td>
</tr>
</tbody>
</table>

Source: CapGemini, RBC Wealth Management and Scorpio Partnership Global HNW Insights Survey 2014

The move to digital is presenting traditional private banks with massive challenges, as RMs face customers who are often more digitally sophisticated than they are. As the custodian of a customer's wealth and source of advice, a private bank cannot be seen to be a step behind its customers.
New competition from non-traditional players

Not only are the prime private banking markets saturated, but HNWIs looking for alternatives to private banks have plenty of other options. For example, the number of single and multi-family offices in Asia is growing – albeit slowly. Although numbers remain low, it is significant that most of the large global banks, including Credit Suisse, UBS, and Citigroup, have launched units to service family offices.

The evolving digital landscape and development of new technologies has also enabled new, non-traditional competitors to emerge, including online investment platforms and peer-to-peer (P2P) lending. Online trading and brokerage and investment platforms offer HNWIs low-cost, automated solutions for services such as investing, asset allocation and portfolio management. Interest is being driven by recent developments in China, where e-commerce players are partnering with asset management companies to offer fund products online.

For example, China’s e-commerce market Alibaba, launched a Chinese internet money market fund (Yu’e Bao), which now has more investors than the country’s equity markets and US$92 billion in deposits. As of 30 June 2014, it was the fourth largest money market fund in the world. Alibaba has also launched a wealth management platform.
Rethinking the future of private banking

Responding to new market trends will require different business and service models
The shape of the future private banking model depends on its starting point. During the last three decades, private banking businesses have evolved enormously, branching into three basic models:

- **Integrated banks** – these are part of and supported by universal banks, such as HSBC, CitiBank and Standard Chartered, as well as local Asia-Pacific banks, such as DBS, OCBC, Bank of China.

- **Standalone private banks, often with Swiss heritage** – these funds-focused brands, such as Julius Baer, Credit Suisse and UBS, offer the full suite of private banking products aimed at HNWIs.

- **Broker/dealer** – this largely US-based investment bank/broker model includes institutions such as Morgan Stanley and Goldman Sachs. It survives on entrenched relationships between dealers and customers.

To survive, banks must consider how they will move from their current models to:

- Transform service models for customer needs and compliance
- Leverage digital transformation
- Change their operating models for scale and efficiency

**Transform service models for customer needs and compliance**

Private banks must adapt to meet diverging customer needs. They still have large groups of “traditional” private banking customers, who appreciate the existing RM-based model. However, our focus groups with HNWIs reveal a wide array of customer profiles with diverse needs, beyond the traditional RM service – and rapidly evolving expectations, including digital services and real-time financial information. To capture a wider share of HNWI assets, we believe that private banks, of all models, must find new niche areas to provide differentiation, focusing on rapid product and service innovation. This will include a superior, digitally based personalized client experience that also meets regulation and compliance requirements, factors that often make such innovation challenging.

The traditional models of customer segmentation across wealth bands make economic sense, but are not customer-centric. Currently, private banks are failing to reach at least 80% of the US$1 million–5 million wealth segment, where customers have a historic reliance on transactional banking and a tendency to spread their assets across multiple banks and their own investments. Capturing share of wallet will require private banks to use analytics to enable deeper segmentation, multichannel integration, and better lead generation and management. This will require technology investment, cultural change and upskilling, but it should result in models that enhance RM productivity and profitability.

Part of the required service upgrade will be a multichannel, digital model that meets customer expectations of options, speed and transparency. The shift toward mobility of services and information will see some entrepreneurial customers becoming largely self-directed and seeing little value in their RM. Others will require their RM to interact with them and provide account updates “on the go” with relevant, real time information. Customers will self-select their interaction mode.

To further adapt to customer needs, institutions should consider broadening their offering, potentially via partnerships and alliances, to include real estate, private equity/venture capital and alternative investments cost-effectively. They should also rethink how they can both serve and market their services to these customers, leveraging digital technology to create more opportunities for customer engagement.
Leverage digital transformation

To deliver these new customer strategies and offerings, private banks will need a technology platform that enables their execution. Institutions (both traditional and new entrants) that are able to seamlessly integrate digital capabilities in their business models will be the winners in Asia-Pacific.

As private banking digitizes, financial institutions will move from a traditional, point-to-point interaction model, via RMs, to a collaborative eco system supporting multiple touch points between clients, RMs, and the bank. Digital transformation, or digitization, is not just online banking. It will fundamentally change how clients, RMs, staff, and the bank interact and execute business, dramatically improving business agility. It will be realized across the bank front to back through: use of mobility, channel expansion, automation/streamlining, insight, security, collaboration, cultural change and data integration (structured and unstructured/internal and external).

Institutions embracing the digital transformation agenda will have the following capabilities:

- Enabled anytime, anywhere, ubiquitous and consistent interactions and experiences for all participants (clients, RMs, staff) within a collaborative eco system that supports advice, transacting, collaborating and understanding.
- Uniquely tailored service offerings, in terms of interactions and advice, at the individual client level.
- Streamlined and automated delivery of all business operations, complying with more stringent regulatory requirements while achieving lower cost-to-serve.
- Transparency within the financial advice process and management, providing a clear visualization of what is “best” for the client against the universe of options.
- Securing and protecting the bank and its clients from fraud, data theft/misuse, and the new financial/technology crimes of the 21st century.
- Insight delivered at the right time and place for clients, RMs, and business operations.
- A distribution platform that will enable a viable financial channel for the under-penetrated HNWI segments, which are too costly to serve via the traditional service model.

For those just beginning the digital journey, the starting place is focused on the following three critical, foundational building blocks:

1. A flexible core platform – stable, efficient, meeting time to market demands.
2. Integrated client information – consistent, complete, accurate.
3. A highly secure and controlled environment.

Based on the experiences of a number of Asia-Pacific institutions that have invested significantly in these foundational capabilities as a launching pad for the digital transformation, we estimate that private banks will need to invest between 1-3% of revenues to support the build out of their digital capability.

From this foundation, private banks can then take advantage of business process management, process automation, electronic documents, analytics, collaboration, mobile tools and capabilities. Prime targets for digital transformation include the compliance burdens for KYC and AML. Manual compliance with new regulations for onboarding requires significant investments of time and effort from staff. Leveraging a number of new technology capabilities will allow private banks to automate client and account onboarding processes and support the vetting of clients and transactions. This will significantly reduce resourcing requirements, while enabling bank and regulatory policies to be implemented effectively and consistently.
Once private banks have dealt with basic automation, they can then look at enterprise intelligence solutions to help aggregate and analyze data from multiple internal and external sources – creating a step change in value. Integrating multiple data sources will give private banks an in-depth understanding of individual clients – their preferences, behaviors and relationships – creating real competitive advantage for institutions. Already, leading players are using data analytics to differentiate themselves in quality of advice and client experience – offering personalized advice. For example, DBS is deploying IBM’s Watson Engagement Adviser to enable more customised advice through analyzing vast amounts of data.

In future, we expect private banks to effectively institutionalize portfolio advisory services, while providing a tailored and differentiated investment advisory experience for their clients, using:

- Systematic portfolio advisory services and analytics to provide actionable ideas to clients, encouraging cross-selling
- Personalized market data and investment insights, including product proposals to clients
- Engagement with clients via new media, enhanced campaign management and social collaboration
- Client profiling and analytics to improve quality of client interaction and provide targeted advice

Already private banks are equipping their RMs with digital toolkits

Many banks are starting to invest heavily in “digitizing” their customers, focusing on their direct channels. But, for some, this is at the cost of under-investing in “digitizing” their sales force. A sizeable portion of customers are still interested in talking to an RM – if the RM can provide added value. Unfortunately, many customers are disappointed with their advisory experience – especially where RMs are poorly equipped (and trained) to deal with those who are digitally savvy and have time to do their own extensive research on their personal portfolio and investment offerings.

Some private banks are catching up rapidly in this space, developing the capability to present their clients with real-time information – not three-month-old portfolio reports. Instead, the leading private banks are providing their RMs with up-to-the-minute information that might affect a client’s risk profile, new market intelligence, or live portfolio rebalancing recommendations. Without this real-time support, RMs will lose opportunities to add value for their clients and drive wallet share.

One of the biggest challenges is the huge cultural shift this represents. Digital services enable clients to interact with institutions the way they want to, rather than having private banks dictate how and when they deal with customers. Instead of an RM’s product pitch, clients expect a multi point, collaborative interaction model that delivers a highly tailored, high-value service. Many RMs, used to the practice of everything being funnelled through them, are apprehensive about the loss of control. To be kept on board, they need to quickly see the empowering nature of digitally supported advice.
Change operating models for efficiency and scale

After more than five years of very thin margins, private banking in Asia Pacific has become a volume business. Although margins improved slightly in 2012-13, they have failed to bounce back to levels that would enable smaller private banks to survive into the future at their current size. Given the market’s US$20 billion AUM breakeven point, smaller private banks must find a way to scale and grow, whether through M&A or partnerships.

Currently, the scale achieved by the top banks enables them to operate at significantly better economic ratios than those in the lower tiers. Yet, even those with sufficient scale will benefit from revisiting their operating models to drive efficiency. For example, every private bank will benefit from continuously reviewing front-to-back service delivery for opportunities to streamline, automate and transform processes, including the use of alternative sourcing arrangements to continue to take costs out of banking operations.

Global and local integrated banks that are currently running their private banks separately need to revisit their cost structures and start sharing the cost and risk of compliance right across the organization. Integrated into the broader bank, the private bank can spread its fixed costs, integrate compliance and maximize its cost synergies by extending shared services capabilities further up the value chain of operations. It can also upscale the large pools of HNWI retail customers into the private banking system.

Such changes are not without their challenges. Intercompany and third party services are now subject to new regulatory requirements, such as the guidelines on outsourcing set out by the Monetary Authority of Singapore. Private banks adopting new resourcing models must adapt their governance, controls and compliance accordingly.

International banks will find advantages in reviewing and optimizing their location strategies, leveraging global delivery centers to drive further economies of scale. They also need to evaluate their booking models to concentrate execution scale, looking for benefits in operational scale and capital efficiencies.

To reach the growing onshore markets, private banks of all models need to consider an optimized “hub and spoke” delivery model, both supporting core hubs in Singapore and Hong Kong and extending delivery into the most promising onshore territories.

Institutions with broader banking offerings still need to build a distribution capability that allows them to develop integrated offerings across traditional private bank offerings to increase share of wallet. Private banks that can offer commercial services (cash management and liquidity, credit facilities, commercial lending) and capital markets services (prime brokerage, securities borrow/loans, structured products) will increase client stickiness.

Consolidation is inevitable

The inevitable market consolidation has been stalled until now, because many private banks have long been seen as a source of low-cost funding for their parent group. Private banks are part of a value chain, providing liquidities through the deposits placed by the private bank customers – and their parent banks have made the most of this advantage. In addition, private banking customers also invest in structured products manufactured by the parent bank, enabling cross selling of profitable products. In effect, the private bank has been treated as a useful sales platform.

Moreover, private banks – on a standalone basis – are not subject to the same capital requirements as banks. Thus, there is less pressure for the parent group to take action on the basis of capital requirements, especially as having a private bank for HNWIs is an important part of the parent’s branding strategy. Also because top line growth – particularly AUM growth – has long been a key performance indicator for banks.
Dealing with the low returns experienced by private banks has simply not been a priority for parent banks to address. There has been sufficient upside to retaining the private bank – at least until now. But now, owing to significant capital constraints, under pressure from market forces and needing to realign strategy to refocus on their core businesses, banks are looking to divest their loss-making private operations. Recently, Societe Generale sold its sub scale Asian private banking operations to DBS Bank. And other private banks are reassessing their strategy in Asia: either acquire, or be acquired.

Be prepared for acquisitions

In the inevitable consolidation, winners will be those who get acquisitions right. Identifying the right acquisition requires a large number of strategic considerations. For example, if the target business is being carved out of an institutional asset manager or large financial institution, the vendor may be providing certain services that cannot be easily replicated within a standalone wealth business. We recently saw a transaction where the target had received fund management and fund administration support from the vendor. But, given the scale of the business, it was not commercially viable to outsource these services to a third party, so the acquirer had to develop new standalone capabilities at an additional cost.

Acquirers also need to consider:

- How much of an overlap will there be in the new private bank’s customer base?
- Where is the new AUM coming from? For example, if it is coming from Europe, what are the taxation and regulatory risks?
- What are the chances of post-transaction erosion?
- How will customers respond to being taken over by a new brand?
- How easy will it be to migrate to a single platform?
- Can you continue to support the product set that new customers are used to?
- How will the two sets of RMs be integrated?
- For assets used to getting HR and IT as shared services, how will this now be provided?
- How will integration be managed to ensure its efficiency and effectiveness?

Given the change and challenges facing private banks, we expect to see a dynamic, consolidating market in Asia-Pacific in the years to come. To adapt to the growing trends outlined in the previous section, we expect all private banks to undergo major

How to extract value post merger

Preventing M&A deals from destroying shareholder value over time is notoriously difficult. Market and academic research regularly cites 50–75% of transactions as failing to achieve their objectives. Based on EY’s recent experience, successfully integrating wealth management businesses requires a number of factors, including:

- Alignment of the investment proposition. The target may have fundamental differences in its investment universe, investment horizon and investment philosophy. Executives need a clear view on how the different propositions will fit together, as this will impact the sales process, client suitability process and marketing collateral.

- Selection of the right platform. Involve platform providers early in integration planning, as they will need to manage the platform migration alongside their existing change agendas and other client commitments.

- Careful management of bespoke client services. Bespoke services are often difficult to replicate. Buyers should aim to understand the level of customization during pre-deal due diligence. Management should be prepared to make difficult choices between client retention and absorbing operational complexity, which could burden the business for years to come.

- Creation of a consistent distribution model. End investors and intermediaries may have previously received differing levels of service and interaction with the buyer and acquired business. Executives need to decide how to create a consistent distribution and service model across the combined business.

- Retention of key employees. This issue is particularly acute in private banks where client relationships and investment expertise may be concentrated in a small number of individuals. Even where the transaction is not a “merger of equals,” involving key employees in the integration planning process can significantly improve retention rates.
A look into the future

We expect private banks to undergo major transformation in the next few years.
transformation in the next few years. The top tier will become digital private banks, with RMs used strategically, where they can demonstrably add client value. The middle layers will consolidate. Several boutiques keep going via personal relationships and a clearly differentiated offering.

With the wealth hubs of Hong Kong and Singapore highly saturated, the next battle ground will be onshore, in markets such as Mainland China and Indonesia. As yet, there are no clear contenders in these markets. The international banks will struggle to resonate with local customers in these territories; the local banks have yet to find the right model. Expensive advisors won’t work – and the regulatory component will be challenging. It may be that the HNWIs of Beijing and Shanghai will provide a useful spring board.

We envisage private banks of the future offering supporting/enabling platforms for HNWIs to hold their real estate assets with value-add services, such as financing, property management and tax planning. Wealth protection products will become standard and private banks may also start providing services to support P2P lending, such as borrowers’ screening and anti-money laundering checks. And security of information will become critically important, with private banks starting to use biometrics in response to increasingly sophisticated attempts to steal client information.

Looking out even further, we can also imagine the eventual uncoupling of advisory from execution, with some private banks stepping back from portfolio management, leading to an interesting bifurcation in the market. In this scenario, the role of the bank will change from selling a transactional product to protecting the client’s long-term well-being – far beyond recommending financial products. This may be the key to future competitive advantage, creating stronger relationships with HNWIs.
Questions for discussion

- How will you expand further in the strategic advisory space, taking into account the investment behavior of HNWIs in Asia?

- Can you capture a larger share of the clients’ wealth portfolio, considering the multiple banking relationships that most clients have?

- Do you need an acquisition or divestment strategy?
What opportunities do you have to increase your value offering to clients, such as through joint ventures with insurers and other financial intermediaries?

For domestic players: Will you diversify outside the Asian region to meet client appetite to invest globally?

For buyers: How will you maximize the chances of a successful integration?
Rethinking private banking in Asia-Pacific
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