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How Will Wealth Management Adapt To The Challenges of 2009?

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Editor

As high net worth investors lick their wounds after markets crashed last year, wealth managers with the strongest track records for protecting assets and delivering simple products will fare best in what is likely to prove a demanding test of their business in 2009.

The industry, which has boomed on the back of a surge in global wealth for much of the decade, will have to fight to keep or build a share of a relatively static or declining pool of wealth in 2009 unless markets quickly rebound. As a result, there will be consolidation in the still heavily fractured industry, particularly as margins come under pressure not just from a revenue slowdown but also from higher costs caused by tighter regulations on financial services, industry analysts and executives say.

However, although some firms may be taken over – such as the $50 billion purchase last year of **Merrill Lynch** by **Bank of America** – also expect to see more boutique businesses being created by groups such as break-away teams from large banks, analysts have told us. The UK market witnessed a high-profile example of such shifts in 2008 with the launch of London-based **Vestra Wealth**. Vestra poached a large team of advisors from UBS. Expect, meanwhile, more independent financial advisory firms to market themselves more emphatically as wealth advisors, moving away from commission-based revenues to a more fee-based model of doing business.

The massive losses sustained by some all-service banking groups such as UBS and Citi also suggest that wealth managers which are not tainted by big investment banking losses are likely to cope relatively well, industry analysts and consultants say. Last year, "pure-play" wealth managers such as Julius Baer and some of the Swiss private banks prospered at the expense of the bulge-bracket rivals.

For example, **Morgan Stanley** analysts put **Julius Baer** as a stock among their "best ideas" portfolio. It is, however, premature to suppose that all-service banking groups will lose ground: some firms, such as Barclays Wealth and Credit Suisse continue to stress the synergies offered by placing private banking, investment banking and asset management divisions under the same roof. Even with UBS, Morgan Stanley, for example, reckons the Zurich-listed firm should be on the recovery track by the end of the decade, if not sooner.

Another big issue in 2009 and thereafter will the search for new customers to replace the ageing Baby Boom generation and those individuals who have lost a fortune in the market turmoil. Russian and Middle Eastern millionaires have been a source of ready funds in recent years, but as the oil price has crashed from its recent high over $140 a barrel, that source of riches is in danger of slowing somewhat.

Last summer, the Merrill Lynch/Capgemini annual survey of the assets and number of high net worth individuals showed that despite any relatively short term snags caused by the credit crunch, over the medium term, the wealth and number of rich individuals is expected to rise to $59.1 trillion by 2012, equating an annual rise of 7.7 per cent over the next four years. Even a downward revision to such a forecast would still represent a healthy growth rate.

There is likely to be less stress on pushing out products in 2009. Industry executives say there will be more emphasis on good and regular advice, particularly as investors have become jaundiced over weak performance of many assets as well as products such as hedge funds that carry relatively high fees. The bankruptcy of **Lehman Brothers** last September, which hit confidence in the structured products sector, and the bailout of US insurer **AIG**, means there will have to be a much tougher scrutiny of counterparty risk.

Cutting Costs, Finding New Clients

Cost-cutting will inevitably be a feature of the industry in 2009, predicts **Ray Soudah**, founder of wealth management mergers and acquisition advisory firm **Millennium Associates**. "Cost cutting will accelerate in non-core areas, unprofitable units will be closed or disposed of, albeit at low prices, and remuneration will be reviewed even for important client advisors," he said.

"Some [firms] will try and merge but the culture of the management of such firms doesn't lend itself to mergers until events become of a forced rescue nature," Mr Soudah said.

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"Short term headcount adjustments have been made in the back office and the product areas with many expecting this focus to move to underperforming relationship managers in 2009 and adjustments will also be made to compensation approaches," said **Ian Woodhouse**, a consultant to the wealth management industry. "In the medium term more focused investment in upgrading key operational processes and systems as well as more outsourcing will be further efficiency enablers," he said.

He continued: "Several [firms] are revamping their organisation, governance and risk management approaches to allow for more decentralised but centrally guided risk control and decision making at the front line to address identified deficiencies in key areas and enable greater flexibility in the rapidly changing environment."

"Doing nothing is not an option given the current environment," he added.

But trimming any fat is not a long-term policy. The industry needs to figure out how it brings in new clients and retains them. The hunt for new clients, such as entrepreneurs, means banks will increasingly have to ensure they can offer a full range of services to business-folk if they want to nuture fresh clients over the long haul, says Michael Maslinksi, who runs the eponymous Maslinski & Co consultancy.

"If you are focusing on entrepreneurs, there is a lot of money to be made in supporting a business and its investment activities in a number of ways. Banks that have significant lending capabilities and are capable of understanding deals that entrepreneurs do will be at a huge advantage. There are very few private bankers who are remotely capable of serving the broad-based needs of entrepreneurial clients," Mr Maslinski said.

A crucial battleground in 2009 will distribution of wealth products, reckons **Sebastian Dovey**, managing partner of the **Scorpio Partnership** consultancy. "Access to clients, and their assets, is a key to the fortunes of many banking groups. The difficulty is that clients will be less willing to be shifting assets in volatile conditions," he said.

"Added to this, the assets parked at many firms are in low fee products - mostly cash or fixed income. Some banks claim to be overflowing with cash, but the key will be to work to shift these assets quickly as the markets improve. If they do not do this, then the cost base of many wealth managers will be punishing," Mr Dovey said.

But on a more upbeat note, Mr Dovey said this year will see more efforts by some firms to raise their profile to attract clients. As Mr Dovey never tires of pointing out, at least 35 per cent of private client bookable assets are not yet run by wealth managers, which means that even if markets are flat this year, there is enormous potential for growth.

Less Product Push

As more money has been pumped into lower fee-earning sectors such as fixed income and cash at the expense of equities, margins will come under pressure, explained **Bernard Coucke**, deputy chief executive, **ING Private Banking**, and head of ING Private Banking Europe. "This means that ING Private Banking will manage its costs in line with this leaner environment," he said.

"The global credit crisis will boost calls for tougher regulation and greater transparency on banking fees which will put the industry's traditionally healthy margins to come under pressure in the longer term," Mr Coucke said.

And Mr Coucke said the product-push approach of many firms, which was an easy option during the bull market, will be less prominent. "Clients are increasingly seeking guidance in how to protect their wealth. There is an increased need for sound advice. Clients seek guidelines and an advisor who acts on behalf of the client in a very professional way in the markets," he said.

"There will be an evolution of the business towards simplicity of products and investments, towards more long-term investments. That will be particularly true from the equities perspective and also on the commodities side," **Patrick Odier**, senior partner at **Lombard Odier Darier Hentsch & Cie**, told *WealthBriefing*.

"It will be important to monitor the currency situation, as well as swings in the real economies of the world which have an impact on currencies. That will require skills from our industry," he said.

And a clear message is that simplicity of product, not clever financial engineering, will be a watchword in 2009. As a spokesperson for Italian bank **UniCredit** put it to *WealthBriefing*: "While in the past wealth managers placed the majority of clients' assets in complex structured products, the appetite for these products has decreased dramatically in recent months. Ultimately, performance based and simple products, cash or cash equivalents and products focused on asset protection will likely be privileged."

And ultimately, performance – both in preserving and growing wealth – is the test which counts. The next 12 months will provide a chance for the best managers to prove they can pass it with flying colours.

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