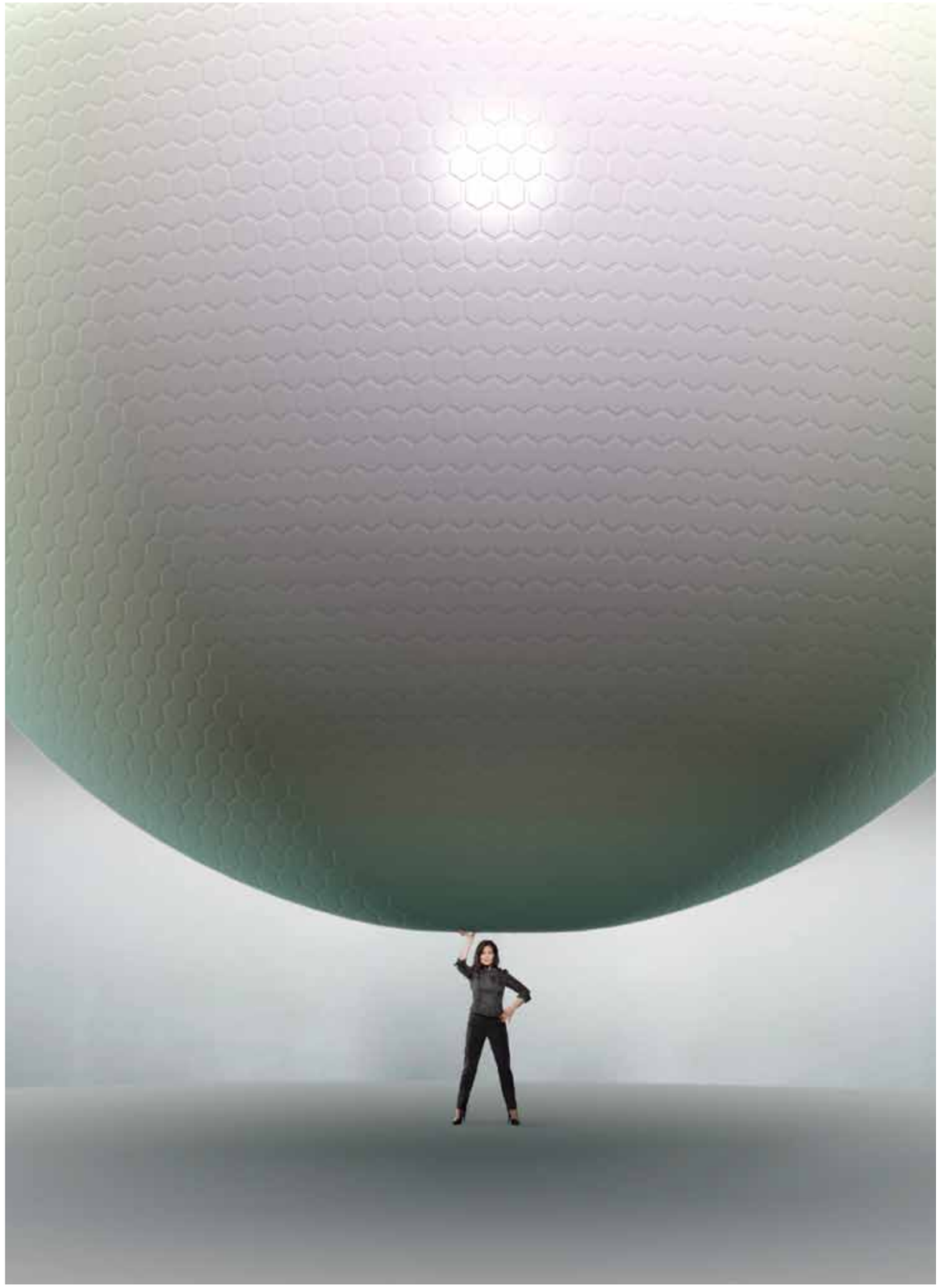

Finding the right balance

WRITTEN BY **YURI BENDER**

COVER STORY

Wealth managers lost control of their advisers during the financial crisis and are now looking to tighten the reins, but will this lead to one-size-fits all portfolios?

There is little argument that trust between private bankers and their clients broke down during the financial crisis of 2008. But what is sometimes overlooked is that one of the reasons for this was the erosion of a once-strong link between advisers and the teams at the fulcrum of wealth managers and retail banks, which make the asset allocations and draw up the list of approved products to populate these skeleton portfolios.

In fact, many firms have so lost control of what their advisers are actually putting in clients' portfolios that they are either vastly undercharging or overcharging their investors, claims US software technology group Bonaire, which provides private banks with revenue management services and has 15 clients in Europe, each with more than $50bn (€35bn) under management.

Now there are regulatory drivers, such as the Markets in Financial Instruments Directive (Mifid) in Europe and the Retail Distribution Review (RDR) in the UK, forcing wealth groups to re-examine compliance apparatus and re-assess profitability models, believes Bonaire's chief executive Chris John. "The model has changed significantly," he says, looking in particular at developments since the crisis. "There is now more oversight requirement in the industry to sell appropriate products to appropriate people, rather than the broad brush approach. Previously, the distribution model, in some way, got out of whack. It is now being looked at again, for good reason."

The model's partial collapse has seen European majors, including Credit Suisse, UBS and Deutsche Bank address the deterioration of this vital link, connecting centre to periphery, which in some places, had become little more than a fragile thread.

In some banks, lists of officially-approved products were updated on a daily basis, but not always communicated effectively to advisers, leading to significant client losses after the Madoff debacle. Now the Swiss banks in particular, are not just beefing up product creation teams, but making sure control of advisers is also being strengthened.

Those looking for conspiracy theories of private banks trying to line their pockets ahead of clients, both before and after the crisis, may be disappointed, according to Jonathan Chocqueel-Mangan of leadership consultancy Tyler Mangan, who works closely with wealth managers, including Lloyds Private Bank, on infrastructure development and change management. "The temptation to assume everyone was purely acting in their self-interest should be avoided," he says.

"While there is some evidence centrally imposed asset allocations and recommendations may have been more in the banks' self interests than in those of the customer, there is considerable evidence that advisers went 'off piste' in an attempt to take a stand against this and meet customer needs. On top of that, customers themselves were demanding access to products they may not have fully understood, while advisers were keen to be seen as responsive as well as not lose business."

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>
> *Daniel Brüesch, Vontobel*

In Mr Chocqueel-Mangan's analysis, all parties were either overtly or unintentionally colluding with a "flawed system". Compliance with regulations, including the UK's RDR, are among key drivers which will ensure advisers improve their technical skills and product knowledge, he says. "Private banks are being forced to invest properly in systems and processes – a level of expenditure that some may not be able to afford, which may lead to a degree of consolidation in the industry."

These processes, needs and trends are exactly the same at the mid-tier wealth managers as the global giants, says Daniel Brüesch, head of investment consulting at Vontobel Private Banking in Zurich, who says regulatory issues in particular necessitate a strengthening of controls. "Nowadays, clients want to participate in the market, but don't want to lose out when there is a downturn," says Mr Brüesch, who oversees communications between the bank and its 700 client advisers.

"It is very important to have an asset allocation delivered by the investment committee

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Jonathan Chocqueel-Mangan, Tyler Mangan

and taken into consideration by all the relationship managers."

One of the key channels of central influence and control of advisers is sending out electronic alerts, informing them clients' portfolios, which are screened every night, have deviated from the recommended position. Each relationship manager (RM), typically dealing with portfolios of between 100 and 250 private clients, is also informed on a daily basis by head office about asset realignments which might be needed in the near future.

"This is not about trying to sell stocks and structured products, but about giving the investor the best profile and combination of assets," says Mr Brüesch.

In one recent such re-aligmnent, Vontobel's investment committee added extra emerging market bonds and equities plus precious metals to the asset allocation, while reducing fixed income content. "Over the next few years, we think it might prove very hard to make a return on bonds," believes Mr Brüesch.

He made sure the vast majority of clients have been contacted since the Japanese disaster. Constantly gathering, comparing and summarising internal and external analysts' reports, his team is asking RMs to persuade clients to sit tight in their portfolios, as the worldwide GDP is unlikely to fall more than 0.4 per cent as a result. "Other countries should be able to stabilise their growth, so we are sticking to our slightly overweight allocation in equities. But people see these situations on TV and YouTube and they just get scared. There may be no rationale for a sell-off, although nobody can judge the scale of the nuclear disaster in the Fukushima plant."

It is not always possible for a relationship manager to prevent a twitchy client from selling up. "It's the client's decision at the end of the day. If they think their exposure to risky assets is too high, then they can reduce it."

Regional offices and portfolio managers of large banks need to be given some flexibility in order to implement customers' wishes and attempt to deliver the client-centric service which their marketing material promises.

"Most banks recognise this and provide guidelines on when and how individual portfolio managers can deviate from the standard models," reveals Cath Tillotson, one of the founders of wealth management think-tank Scorpio Partnership. "But the Madoff scandal in particular highlighted the weaknesses in this approach. It was a 'must have' fund for many Swiss clients, who pro-actively asked their bankers to access the fund on their behalf. That damage was compounded by central due diligence failing that meant the fund got through screenings onto buy lists."

CHRIS JOHN, BONAIRE

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LOUAY AL-DOORY REYL & CIE

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The idea of a bespoke portfolio is fast-becoming an impossibility, she believes. "The last thing a bank wants is to face criticism that some clients received favourable or unfavourable treatment," she says. "Standardising is a very effective way to protect against this. But how do you serve three masters? You have your own commercial interests. Then you have the client, who wants a tailored portfolio and increasingly, the regulator, who wants to make sure that customers' individual needs are met. It is a tricky balancing act."

There is also a danger of banks using regulations as an excuse to deliver standardised products and strategies, believes Tyler Mangan's Mr Chocqueel-Mangan. "Some banks don't want to think quite so hard, and the RDR offers a chance to blame their inability to be innovative on the constraints imposed by regulators. We saw similar responses to Sarbanes-Oxley in other industries."

The so-called factory banks, including the likes of Credit Suisse and UBS, are fast moving more towards an asset allocation-led model of delivery, confirms Louay Al-Doory, head of business development at Geneva boutique Reyl & Cie and a previous boss of the UBS product creation department. "But because their product shelves are so wide, they are shrinking their selection and making it easier to navigate for client advisers. They are making improvements in how content is delivered to end clients. They are seeking more control."

Although the change is clearly driven by both regulation and profitability considerations, the question remains whether it is fundamentally better for the client. "I would say yes, it is better," agrees Mr Al-Doory.

Clients are not generally hard done by, he says, claiming big banks are constrained by their business models, which entail selling commoditised products to the mass market. "The more latitude a client adviser has, the more volatile is the performance of the portfolio. You have to channel all the strategies into a few basic ideas."

Yet there is a danger that simplified portfolios can also lead clients to miss the big opportunities. "We are seeing costs for clients going down, with more use of ETFs and passive investments and less funds of hedge funds," he says. "And this is probably the right time to be in hedge funds."

Although the large wealth managers are finally paying much more attention to how they manage clients, they remain factory-led manufacturers and distributors, believes Mr Al-Doory. "What these guys give you is an off-the-shelf business," he says. "Their clients think they are going to Fortnum & Mason, but at the end of the day, they are Tesco through and through. Don't be under the illusion that a big bank can give you a bespoke service."

This perception problem persists among many clients of large banks, believes James Bevan chief investment officer at charity specialists CCLA and previously head of investments at the UK branch network of Spanish finance giant Santander.

While there is strong regulatory pressure to offer standardised portfolios and banks' structures have been designed to include a strong central products selection and construction team, this does not necessarily match customer needs. In his days as a product design boss, Mr Bevan was highly constrained by big-bank economics, which limited the time advisers could actually spend with clients. "The problem relates to customer expectation. A number of high net worth investors want a deeply personalised service, which can run counter to the house view."

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James Bevan, CCLA

There is a demand for a new kind of institution and service, believes Mr Bevan, "for a highly skilled and well-resourced private bank, which operates to provide a level of customised analysis, research and product configuration, which will be hard for global banks to replicate."

For SG Hambros, the UK private banking arm of French lender Société Générale, managing client assets of more than £11bn (€12.7bn), the answer lies in an advisory process, where the bank's central allocation from Paris is adapted to local needs. "The process we follow is a local, not centrally-designed process," says Alexandre Zimmermann, head of Investment Solutions at the London-based unit. "It is extremely performance-driven. The first step is to review the investment strategy of the bank, to identify the themes where we have a strong conviction, then to structure and design the investment solution for the client."

If, for instance, the bank makes a strong call on Chinese equities, this can be accessed through a variety of channels, including buying shares, structured notes, Asian equity mutual funds or long/short funds on the Lyxor managed account platform. "Our job is to identify the best or most appropriate investment structure for our clients," he says.

"What we don't do – and this is the criticism of a lot of banks we hear from clients – is to promote an investment solution like a structured note, trying to push income as much as possible, resulting in the limited probability of achieving that income."

This current economic era may prove the ideal time to set up and grow a new style of wealth management business."I know of a CEO of a national wealth management company who gets three or four calls a month from smaller firms who want to sell up because they need a home for their customers, staff and themselves as the costs of compliance begin to hit them," says Mr Chocqueel-Mangan. "He says he has a wonderful opportunity to steal a march on the big boys. It's an exciting time for those who take this perspective.●

EXAMPLE STRUCTURE OF THE 'NEW BALANCED' PORTFOLIO

Source: Vontobel