Private Banking Industry Analysis

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EFM Capital
Private banking

Over the years, private banking has become a very lucrative industry and a key component of the financial ecosystem, spurred by incredible growth of affluent families and individuals around the globe. This trend is predicted to continue at an exponential pace in the foreseeable future, creating further benefits to institutions and wealth managers. Nevertheless, the industry will also be facing key challenges derived from adaptations in the technological and user experience landscape.
Industry overview

The management of assets for High Net Worth Individuals (HNWIs) has generated a colossal industry for private banking that exceeds USD $150 trillion in Assets Under Management (AUMs), with forecasts by The Boston Consulting Group estimating this sector of the banking industry to surpass USD $200 trillion by 2020. Worldwide growth increased more than 6% in the last two years, with expansion in Latin America during the same period averaging just over 7%. The current wealth management market in Latin America holds AUMs of over USD $4 billion, with an expectation to reach more than USD $6 billion by 2020 (BCG, 2016).

The Latin-American private banking industry is substantially small compared to the overall market, and there is a marked differentiation in the type of assets held by HNWIs in this region as compared to the world average, where Cash and Options continue to be the most significant element of total assets held.

![Private Financial Wealth (Trillion USD)](image)

![Asset Allocation – Share of wealth by Asset Class](image)

Source: BCGPerspectives: Global Wealth 2016: Navigating the New Client Landscape
The recent data from BCG illustrates the precise breakdown of the distribution of the wealth segments around the world. Within the current structure, millionaires comprise 47% of the share of high net worth households, and this group is expected to grow to 52% in the next five years (BCG, 2016).

What stands out is the striking differences in growth between the lower and upper tier segments. The prevalent societal circumstance of “the rich getting richer” is evident even among the groups of HNWIs.

<table>
<thead>
<tr>
<th>Household Wealth (USD)</th>
<th>Est 5 year CAGR- 2020</th>
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<tbody>
<tr>
<td>&gt; 100 Million</td>
<td>▶ 9.5%</td>
</tr>
<tr>
<td>$20 - $100 Million</td>
<td>▶ 9.4%</td>
</tr>
<tr>
<td>$1 - $20 Million</td>
<td>▶ 7.5%</td>
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<tr>
<td>&lt;$1 Million</td>
<td>▶ 3.7%</td>
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Key players

The prominent players in the private banking industry include some of the major financial institutions in the world, encompassing firms from the United States, Canada, and Europe. Within this top group, the 3 most relevant banks are UBS, Bank of America Merrill Lynch, and Morgan Stanley; with rankings based on total Assets Under Management.

Most of the top private banking institutions have been affected by market volatility and weaker investor confidence. Of the top 10, only JPMorgan and Goldman Sachs increased their AUMs year over year with 2.1% and 1.7% growth respectively. Despite leading in growth, JPMorgan recently trimmed its international workforce by nearly 250 people, shifting its focus to ultra HNWIs which generate much higher profitability (Fortune, 2016). Global leader UBS underwent drastic reductions in profits in early 2016, enduring one of its most challenging stages in recent years. The financial giant has witnessed recent outflows by clients totaling 3.4 billion Swiss francs (Bloomberg, 2016).

Bank of America Merrill Lynch and Morgan Stanley have also been affected by turbulence in the markets. Bank of America saw its net inflows by clients in Q1 2016 fall to a negative USD $4.3 billion from USD $13.1 billion in the
previous year’s quarter. Morgan Stanley’s client inflows dropped from USD $13.3 billion to USD $5.9 billion in the same timeframe (AdvisorHub, 2016).

In addition to challenges derived from market uncertainty, financial institutions face stricter regulations. Government oversight has continued to increase ever since the latest financial crisis. Recent data from Euromoney confirms that over 40% of private banks consider that stiffer compliance requirements pose a challenge to profitability (Euromoney, 2016).
Technology trends and innovation

FinTech, or advanced technologies in finance, is gradually gaining traction as technological enhancements have begun to disrupt private banking. In an industry overly dominated by conservative stalwarts, startups have begun to stir the business relationships management landscape. One such element within FinTech is roboadvice. According to Deloitte, roboadvice has altered the approach to customer engagement as it offers cost-efficient, quality service not previously afforded by certain segments and enhancing the user experience of existing customers (Deloitte, 2016). Artificial intelligence and data analytics are substantially transforming the industry by enabling more sophisticated trend analysis, improved identification and management of individual risk tolerance, 24/7 response, and many other features. New technologies are penetrating beyond the younger generations. According to McKinsey, around 30 percent of clients across all age groups are open to “engaging remotely with an advisor who does not live near them” (McKinsey, 2016).
Two of the most important components of the private banking ecosystem are major international banks and regulatory agencies. In recent years, there has been a growing negative public sentiment toward this type of structure where huge players may seem to be benefitting from preferential treatment. What is your opinion?

The ecosystem is certainly a complex structure, but it operates with the simple objective of making money for all the parts. We have to remember that private banking is part of an immense financial system that plays a key role in economic development throughout the world.

Large institutions have become so ingrained in the structure that some of these groups have become what many refer to as “too big to fail”. Of course there are examples of failures in the past, but in general the system tries to protect the components from falling as much as it can, or otherwise risk massive chaos with profound effects. The issue lies in the fact that some big banks operate with a sense of “protection”.

What do you mean by “all making money”?

The regulatory agencies have a duty to oversee these large financial institutions. I say large because most of
them are huge. There are tremendous barriers to entry this industry. The government goes after the big players and levies big fines with certain frequency. We can discuss intent all day long, but at the end of the day it is a major source of income for the government. Additionally it has to justify its existence, so even beyond execution, it needs to portray a picture to the public that it functions as the watchdog. It goes out of its way to make sure that entangled big fish make the headlines. But if the government was really trying to protect the consumer, and not its interests, it could have avoided the last crisis...and the next one.

Who else is involved in this scheme?

Within the ecosystem, there are countless law firms, consulting firms, etc., that operate in the background and get paid to protect the interests of their clients (the big banks). At the end of the day, the integrity of some highly recognized independent outsourced firms could come into question. We have seen it in the past and it would be hard to deny its existence today.

So do you believe government intervention has been more beneficial or detrimental to the private banking industry?

The most affected parties are of course the end users. Heavy fines are considered as “cost of doing business”; so big banks pass their increased costs on to the individual customers as fees. Large firms in reality favor a system of increased regulations for the simple fact that it keeps others out. It is tremendously expensive for smaller firms to comply and even more expensive for them to pay fines. It goes back to the government’s objectives. It needs to check off boxes to justify its operation, so to answer your question, with the way the structure functions today, there are many benefits, but there just seem to be more detriments.

You mentioned a large system working in unity so to speak, but it is still hard to believe that with so many public and private institutions involved, a previous crisis could not have been avoided, do you agree?

This goes back to working in unison. If things are going great and everyone is making money, nobody wants to get off the train. Remember financial institutions have some of the smartest people working for them and around them (the government does too). Firms are very creative. They have been in the past, and continue to this day. The problem is that creativity can at times be shady. It has been proven that institutions bet in favor of a crisis to happen. We have seen the effects; it is difficult to stop.

So do you believe that greed is a factor?

Definitely. Of course market conditions force consumers and institutions to seek alternative financial instruments to make money. They have to cover inflation and then some. Extremely low interest rates make it difficult, so firms find a way to bundle products. Don’t think that because the bubble burst a few years ago it won’t happen again. It will. This is cyclical, but remember greed is not just from the private sector. The government makes huge money in this and it wants to look good as well. Incumbents from the government side will do all they can to maintain smooth sailing and keep kicking the can to the next term, even if it means artificially sustaining the economy. But you cannot fool the market, it eventually corrects itself.
Established private banking institutions have based their businesses on premium personal relationships. While this is the fundamental idea of private banking, recent technological advancements have altered the business relationship management landscape.

FinTech has become a major driver of change within the private banking industry. Startups will not overtake incumbents as we have witnessed in other industries such as vehicle transportation or hospitality, but incumbents will need to continue to invest in new technologies as customers become more accustomed to practical, online tools that are available 24/7. Private banking is about the customer first and foremost, so firms that have not yet embraced new technologies to boost their offering, will no doubt fall behind in their ability to fully engage with their clients. The private banking sector has been wringing extremely high profits for many years and it will continue to be one of the most important industries for years to come, but the era of relatively easy profitability will cease.
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