PRIVATE BANKING

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Testing times put focus on bright spots

Amid tougher rules and economic worries, banks are expanding in new markets and chasing the ultra rich, writes **Sharlene Goff**

It has been another tumultuous year for the world's biggest private banks.

Early optimism that the global economy would rebound in 2011, shaking off the horrors of the financial crisis after two painful years, was quickly snuffed out as the rot contained in the financial system spread to debt-laden governments around southern Europe.

The crisis has since engulfed Greece, Portugal and Italy, claiming the scalps of political leaders and demanding unprecedented bail-out packages – and spooking investors all over again.

After a brief respite in the first quarter of this year, asset prices plunged in the spring, sending shockwaves through global markets.

And with the previous safe haven of government bonds tarnished by the debt crisis sweeping through Europe, wealthy investors had fewer places to flee as they looked to protect the value of their assets and generate a return in difficult conditions.

"There was much more risk appetite earlier this year – that's gone now," says Declan Sheehan, regional chief executive for the UK and Channel Islands at HSBC Private Bank.

"General concerns about the eurozone, as well as the capital and liquidity positions of banks, mean that clients are staying away from complex products and more volatile markets."

At the same time, banks around the world have been grappling with a wave of tougher regulations as the deadlines for far-reaching reforms, from the global Basel III capital and liquidity rules, to the UK's shake-up of how retail products are sold, approach.

Throw into the mix a $2.3bn rogue-trading scandal at UBS, and a hefty fine for Coutts – one that threatened to taint the name of one of Britain's oldest and most prestigious private banks – and the challenges banks face as they attempt to rebuild their reputations become stark.

"Without a doubt, these are challenging times," says Jeremy Jensen, who is in the global private banking and wealth management team at PwC, the professional services firm.

"It is difficult for clients to know where to invest, while regulators are making it really tough. For the banks, doing enough just to stand still is hard."

To combat the difficult environment, banks are attempting to strengthen their presence in the fastest-growing and most profitable slices of the market.

For some this means an increased focus on emerging economies, particularly in Asia, which are less affected by the eurozone's sovereign debt crisis.

For others it has prompted a move up the wealth ladder, as banks sharpen their focus on so-called "ultra high net worth" individuals – their very richest, and most lucrative, clients.

Credit Suisse recently said that "ultra" customers represented the fastest-growing part of its private banking business and revealed plans to increase pretax income from these customers by half over the next three years.

The Swiss bank now counts 35 per cent of the world's billionaires among its clients, up from 25 per cent three years ago. Such customers are more profitable for private banks, as their needs are more akin to those of institutions than typical private banking clients.

While the "high net worth" group tend to stick to simpler low-risk investments that do not generate such big profits for the bank, the wealthier elite increasingly require higher-margin products and services – private equity deals, for example – that are traditionally sold to big companies.

Banks going down this route have an expanding pool of clients to target.

According to this year's world wealth survey from Merrill Lynch Global Wealth Management and Capgemini, the consultancy, the number of "ultra" investors – those with at least $30m of investable assets – rose by 10 per cent last year.

Meanwhile, the number and the combined wealth of individuals with at least $1m surpassed precrisis levels in 2010 in nearly every region. There were almost 11m of these people worldwide.

Strikingly, Asia-Pacific overtook Europe for the first time in

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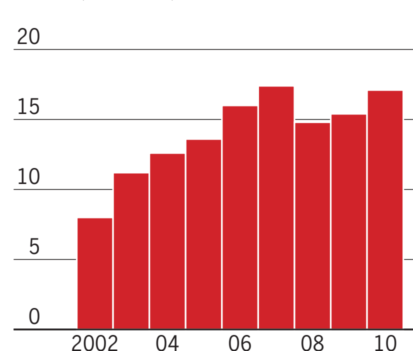
Shiny outlook: a gold Buddha for sale in a Shanghai jewellery shop Alamy

Estimated size of global private banking industry



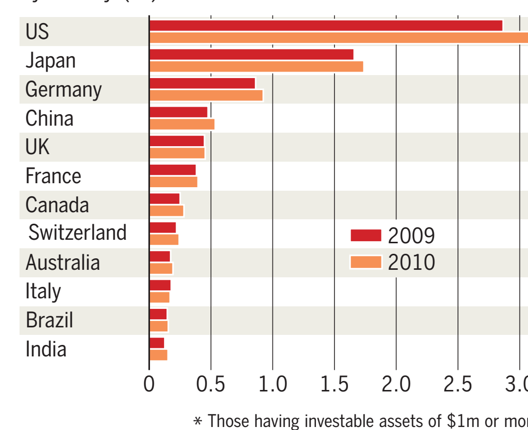
Sources: Capgemini; Merrill Lynch; Scorpio Partnership

Top 10 in private banking

2011

Institution	AUM ($bn)	2010 growth (%)
Bank of America	1,945	4.2
Morgan Stanley	1,628	7.96
UBS	1,560	6.6
Wells Fargo	1,398	14.78
Credit Suisse	865	11.56
Royal Bank of Canada	435	14.81
HSBC	390	6.27
Deutsche Bank	369	35.31
BNP Paribas	340	45.68
JP Morgan	284	5.19

High net worth* individuals by country



* Those having investable assets of $1m or more

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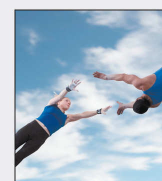

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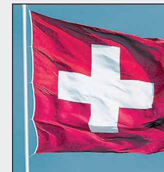

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A question of trust: clients need to have the confidence that private banks will keep their investments flying high Alamy

Wealth managers adjust their approach to help rebuild trust

Client relations

The sector is fighting back after private clients burnt their fingers during the financial crisis, says **Tanya Powley**

Private banks are fighting to win back the confidence of wealthy individuals by adapting their business models to meet the new needs of investors in the global downturn.

"Private banks still have a way to go to earn back client trust in the aftermath of the financial crisis," notes Jane Fraser, chief executive of Citi Private Bank.

"We think it will be a multi-year effort, as clients first and foremost continue to seek wealth preservation."

Wealth managers are hoping to restore the battered image of the sector, which saw private clients burn their fingers in the financial crisis and subsequently lose faith in investment advice.

The sector has been accused of focusing on pushing inappropriate products and failing to manage risk.

This month, Coutts, one of Britain's oldest banks, was fined £6.3m by the Financial Services Authority (FSA) for the way it sold savings products linked to failed US insurer AIG.

The FSA criticised the bank for failing adequately to explain the risks of AIG-backed savings products, or to warn clients of potential losses as market conditions soured in 2008.

Coutts has agreed to pay compensation to hundreds of wealthy clients who had money invested in the AIG Enhanced Variable Rate Fund when it was suspended in September 2008.

This year the FSA undertook a regulatory investigation of the sector and found that wealth managers were using out-of-date client information when making investment decisions. Its review of client portfolios at 16 wealth managers found that, in 14 cases, the level of risk did not match the objectives or circumstances of the investor.

"I think it would be fair to say that some private clients felt disillusioned or slightly let down by what they experienced over the credit-crunch from their wealth managers," says Oliver Gregson, head of investment advisory UK at Barclays Wealth.

Barclays Wealth is one manager that has sought to overhaul its approach.

"The financial crisis changed the investment landscape significantly," explains Mr Gregson. "Because of things that happened in the credit crunch, it would have been remiss of us if we hadn't gone back and reviewed our entire approach to managing our private client portfolios."

After a review at the end of 2009, Barclays Wealth has focused on developing an investment strategy designed solely for private clients, as opposed to using the same methodology that is used for institutions.

Other private banks have taken the opposite route, and have opted to offer the advice they give to institutions to their richest private investors.

Ms Fraser says Citi Private Bank focuses on ultra-wealthy clients – those with $25m or more of assets to invest – and gives them the same advice, service and ideas that it provides to its multinational corporate and government clients.

One of the ways Citi Private Bank is trying to rebuild trust with its private clients is by being more transparent and open, sourcing global investments from external providers, to reduce the potential for conflicts of interest.

"This makes it easier for us to tell them when to sell a given investment and for them to trust our advice," says Ms Fraser.

> 'We are giving much more importance to diversifiers of risk, such as commodities or gold, to protect client portfolios in volatile times'

A prevailing theme for private banks now is how to manage risk in clients' portfolios, particularly in volatile global stock markets.

Alan Higgins, head of investment strategy at Coutts, says he still has clients that want to invest 100 per cent in equities.

"Equities are still a key building block in most clients' portfolios," says Mr Higgins. "The big issue is how do you hedge those risk assets? There is a wider search by wealth managers for strategies that may hedge risk assets."

Coutts has attempted to do this by buying ultra long-dated corporate bonds, using Commodity Trading Advisers (CTA) – a hedge fund strategy that makes returns from managed investments in futures contracts – and holding emerging market debt.

Mr Higgins admits that the latter approach did not work in the third quarter when market sentiment turned negative, but he still believes that in the long run it will pay off.

Cesar Perez, head of investment strategies for Emea at JPMorgan Private Bank, agrees that investors are not taking less risk.

"We as wealth managers are using our risk budget more wisely. We are giving much more importance than before to diversifiers of risk, such as commodities, gold, or structures to protect clients' portfolios in volatile times," he explains.

According to Mr Perez, JPMorgan Private Bank now has as much as 35 per cent of its equity positions in structures that will protect part of its customers' money in the event of stock market falls.

He observes that money management has changed significantly compared with 10 years ago. "We come from a world where people were happy having just cash, bonds and equities. Now, clients are demanding more, and you need to be out there to give them the returns that make sense."

Stricter selling rules likely to bring upheaval

Retail distribution

Elaine Moore on the impact of changes to the way investment products can be sold

A long-awaited revamp of the way in which investment products can be sold in the UK is a little over a year away, yet there is still widespread disagreement in the industry over the changes.

"Things will not be the same as they have been over the past 100 years," says one wealth manager, commenting on the impact of the new regulations.

But the regulator maintains that, at a time when investors are showing interest in ever more complex investment options, the need for stricter rules surrounding their sale is growing.

A recent fine levied on one of the UK's most prestigious private banks has underscored the extent to which poor sales practices permeated the industry before the financial crisis.

More than 400 wealthy clients were found to have been sold investments between 2003-2008 by staff at Coutts & Co who failed to explain the risks involved – risks that became all too apparent when market conditions worsened in 2007.

The bank has been fined £6.3m by the UK's Financial Services Authority.

This is not a one-off event, according to the City of London watchdog. In its Retail Conduct Risk Outlook, published in February, the FSA found that banks with wealth management arms were encouraging clients to take on more risk, promoting unsuitable products based on poor risk profiling.

Explaining risk is a crucial factor in the FSA's retail distribution review (RDR), due to come into effect in 2013.

Once in place, the RDR programme will ban financial advisers from accepting commissions and will require them to have more training.

The idea is that every client sold an investment product is assessed as having a suitable risk appetite for it.

The outcome of this change will be remarkable, say advisers.

Ernst & Young has predicted that about 10,000 independent financial advisers will cease operating, and many more organisations will need radically to alter their business models.

Larger companies that already charge fees rather than accept commission for sales are expected to benefit from the upheaval by acquiring smaller rivals or poaching staff, and wealth managers say that the playing field will become more even.

"There is obvious bias in the current practice, which has been exposed by the FSA and will ultimately be banned," says Andrew Fisher, chief executive of Towry, the independent financial advisers.

In the future, he says, managers will be selected on the basis of performance and investment management costs, as opposed to "retrocessions" (kickbacks or finders fees paid by some banks) and whether or not they appear on a platform.

But not everyone appears to have grasped the significance of the RDR, according to Jonathan Chocqueel-Mangan, managing director of Tyler Mangan, a UK-based leadership consultancy.

"There is evidence that some private banks and wealth management firms have yet to understand properly the impact the RDR will have," he says.

The additional training and supervision required to meet the new standards increase the possibility of failure, he adds.

The success or otherwise of private banking and wealth management firms will depend on how well they invest in the development of their people at a level possibly not seen before in the industry.

"The potential rewards for getting this right are considerable, but failing to adapt in time could be catastrophic, not only for the providers but for customers," says Mr Chocqueel-Mangan.

Those left in the field face challenges in the way that they sell financial products.

David Scott sold his independent financial adviser business in 2004 to UBS before founding Vestra Wealth.

"When I set up Vestra in 2008, the main aim was to provide a credible alternative to the big banks and to highlight the lack of transparency in the industry," he says. He supports a review of the way investments such as structured products are sold, alongside the changes the RDR will bring.

"Currently, many firms do not fully disclose the costs or commissions that are received from these products, meaning that they are often sold to generate upfront fees in addition to the normal management fees.

Many firms do not disclose fully their costs or commissions, says Vestra Wealth founder David Scott

"Firms need to . . . charge clearly the fee they believe is appropriate for the service provided, without relying on kickbacks to supplement revenue."

Around the world banks face tough new regulations, from the global Basel III capital and liquidity rules, to the UK Vickers report aimed at making the UK banking sector sounder.

And if and when the moment comes to split investment and retail banks, providers will need to decide on which side of the fence private banks will be.

Mr Fisher at Towry says: "The future ringfencing of retail banks is likely to move the relationship between the retail private banker and investment banking products from one of a 'Chinese wall' to something more akin to the Great Wall of China."

He believes that private banking will fall outside the retail ringfenced sector, which will drive up the minimum assets that private bankers will consider on an individual basis.

A number of private banks have already raised the minimum requirement for client assets (*see page 4*), and the repercussions of additional liquidity requirements could exacerbate this.

Clients who meet the grade may benefit from an industry that is more focused on them, but those with more modest funds are likely to find themselves left out in the cold.

Managers wary of taking too much 'hot money'

Hedge funds

The industry is wooing a fresh set of customers after huge withdrawals by the private banks, writes **Sam Jones**

The hedge fund industry has a reputation to shake off: for most outsiders, it remains a club where the very wealthy manage assets for the merely rich.

Yet since the financial crisis hit in 2008, the industry has been all but transformed.

A wave of private money flew out of hedge funds in the months after the collapse of Lehman Brothers and much has yet to return.

Where money has come back, it has been from an altogether different base of investors: the pension funds, insurance companies and endowments with which managers in the industry are now so keen to cultivate relationships. Private banks have gone from being one of the key conduits of investment into the hedge fund industry to being niche players.

But many observers are predicting a return of high net worth individuals to the industry – particularly after these individuals' traditional investment portfolios have suffered so badly this year.

"Demand always depends on performance," says Peter Rigg, the global head of HSBC's alternative investments group, which sits within the company's private banking arm.

"We have seen quite significant losses in European equities and even US equities are down for the year," points out Mr Rigg, noting that while performance of hedge funds has hardly been spectacular, it has been good in relative terms.

According to Hedge Fund Research, the average hedge fund manager has lost 3.3 per cent so far this year.

Investments by wealthy individuals – and private banks – in the hedge fund industry have a long way to go to regain their peak, however.

At the height of the credit boom, the hedge fund industry drove a big expansion for many large private banking institutions.

Leading the pack was Union Bancaire Privée, which became the world's single largest investor in hedge funds. UBP, at its peak, had more than $42bn invested in the industry.

> We've turned down a lot of fund of fund money. What the industry needs is longer term investors'

The Swiss private bank's reversal in fortune in 2008 was typical.

Panicked private investors redeemed from hedge funds en masse, unsure, in an environment characterised by mistrust, of exactly what they had invested in.

UBP's small but damaging investment in a hedge fund that had in turn invested in Bernard Madoff's fund hardly helped matters. At the beginning of 2011, after a mass of redemptions from clients, UBP had seen its hedge fund investments dwindle to just $14bn.

Moreover, precisely because private banks and private clients pulled so much money from hedge funds during the crisis, many managers are reluctant to take too much of what they consider to be "hot money".

"We're very careful about managing our investor base," says one multibillion US fund manager who declined to be named. "We've turned down a lot of fund of fund money. What the industry needs is longer term investors."

But how long will managers be willing to turn down private investors as fundraising becomes more difficult remains to be seen, however.

Private bank investments in hedge funds are slowly picking up, but there have still been a fair share of negative headlines to discourage clients.

Most private banks have dipped their toes back in the water, by investing with big, reliable blue-chip names among fund managers. And it has been precisely such names that in some cases have been hit hardest this year.

Paulson & Co is perhaps the best example. The US firm – a favourite of private clients – made a name for itself during the financial crisis thanks to its huge returns as a result of a collapse in the subprime housing market.

The past 10 months, however, have been painful for the firm. Its flagship fund dipped by as much as 47 per cent, thanks to its bullish positions in US equities.

Where private banks are trying to encourage their clients to invest in hedge funds, they are having to be more creative in the products and opportunities they are selling. Many banks are keen to encourage clients to stop viewing hedge funds as absolute return products and instead view them as relative return offerings or portfolio diversifiers – a shift that has already taken place among institutional investors in hedge funds.

There is also a shift in the kind of managers banks are encouraging their clients to look at. HSBC, for example, has recently started a programme for clients to invest money in smaller, emerging managers – fees are lower and returns are often better.

"Smaller managers are typically more nimble," says Mr Rigg. "Clients still have a portfolio of big name funds, but then they'll have a satellite allocation to our smaller emerging managers."

"A lot of private clients are attracted to the idea of investing with the next generation of fund managers: the future Julian Robertsons or George Soroses or Paul Tudor Joneses."

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New life at the frontier of emerging markets

Growth

Sharlene Goff looks at where the best opportunities are expected to be

Ask big international private banks where they expect the strongest growth opportunities to come from in the next few years and they talk increasingly of "emerging Asia".

The tagline has caught on as, after years of rampant expansion, the region is polarising into more mature markets such as Hong Kong and Singapore and others that still have the potential for faster growth.

Many private banks are looking beyond the most competitive Asian hot spots to the next tier of emerging markets, whether that means Chinese cities outside Beijing or parts of the Middle East and India they have not yet tackled.

"Frankly, if you don't already have decades-long on-the-ground relationships in at least 18 emerging market countries by my count, you're at a big disadvantage," says Jane Fraser, chief executive of Citigroup's private bank.

Ms Fraser says wealth creation in Asia has been "astounding", particularly among entrepreneurs in Chinese cities outside Beijing, such as Chengdu and Chongqing.

"Clients have got richer faster than they could have imagined," she adds.

But, as banks' overall profitability is squeezed by costly regulatory changes, fierce competition for talented staff and a weaker global economy, they are having to be selective about the areas they target.

Rather than the scattergun approach some have adopted in the past, building small presences in many countries, banks now recognise they need economies of scale to remain profitable.

"In general, the cost of doing business in private banking has increased," says Shayne Nelson, chief executive of Standard Chartered's private bank.

On reflection: a night view of Chongqing, one of the Chinese cities witnessing 'astounding' wealth creation Dreamstime

"The challenge lies in maintaining strong growth at healthy cost/income levels. Private banks need to be clear and focused about where they want to be and who to serve."

He says banks have seen a sharp rise in their cost-to-income ratios – a measure of how much they have to spend to generate revenue – as clients shift from equities to lower-margin products, such as cash, deposits and fixed income.

One big factor is the price banks pay to retain staff, particularly in emerging markets.

Salaries have risen fast, as banks become aggressive about poaching from each other.

This has been a longstanding problem in Hong Kong and Singapore and is now spreading to other areas.

Alex Classen, who heads the international business at Coutts, the private bank owned by Royal Bank of Scotland, says the pool of talent in the Middle East, for example, is "small and dry".

Coutts has big ambitions for its international division, including doubling its asset base by 2015, after a series of high-profile staff defections knocked the business following the financial crisis.

But it is nevertheless retrenching from about half of its 150 markets, as it concentrates on those where it sees the strongest potential for growth.

"We are not going to dilute ourselves too thinly by going into smaller markets," says Mr Classen.

In Asia, for example, Coutts is focusing on key growth areas including Taiwan and Indonesia as well as the bigger markets such as Hong Kong, China and Singapore. It is withdrawing from smaller regions such as Thailand.

Elsewhere, it has picked a few crucial areas – Saudi Arabia in the Middle East, for example, and Russia, Ukraine and Kazakhstan in eastern Europe – and will no longer have a physical presence in countries such as Poland and the Czech Republic.

> 'Brazilian clients used to have to go through New York to invest in India. Now they go right to India'

Other banks have turned away from markets where there is strong competition from local rivals.

HSBC is pulling back from Russia, for example, which it says is "incredibly well served" by its own banks. It will still target Russian clients – but plans to do so outside the country, from London or Switzerland, for example.

This refocusing is indicative of the bank's broader aim of using relationship managers in developed markets to serve clients in emerging economies.

Declan Sheehan at HSBC Private Bank says that international clients are increasingly looking to diversify their holdings, with Asian and Latin American customers using wealth mangers in Europe, for example.

While 60 per cent of HSBC's private banking business comes from emerging markets, only about half of that is booked in those markets.

"There is lots of wealth being created in Latin America but that doesn't mean rich Brazilian clients do all their banking in Brazil," says Mr Sheehan.

"They want to diversify – and do a good chunk in other places."

For other banks, the aim now is to leverage their international presence to build better connections between the emerging markets.

Citigroup, for example, is attempting to connect the client franchises it has in emerging Asia with those in other high-growth areas such as Latin America and the Middle East.

"Brazilian clients used to have to go through New York to invest in India. Now they go right to India; it's a network, not a hub and spoke model now," says Ms Fraser at Citi's private bank.

Case study India

Wealth in India has been growing at one of the fastest rates of all the emerging nations, writes **Sharlene Goff**.

Its population of individuals with at least $1m to invest became the world's 12th largest in 2010, according to a study by Merrill Lynch Wealth Management and Capgemini.

This year, some of the world's biggest banks were hailing the country as the next big opportunity, attempting to build networks there as quickly as tight local regulations would allow.

But the country has since been suffering a series of difficulties, including rapidly rising inflation, a string of interest rate rises to combat that inflation, deteriorating asset quality at banks and a slowdown in gross domestic product growth.

GDP growth, running above 9 per cent in 2010, eased to 7.7 per cent in the second quarter of this year.

At the same time, confidence has been undermined as corruption inquiries into licence awards hit the willingness of businesses to invest.

"The banking market has a fairly complex, tough regulatory environment," says someone at a big international bank operating in the country.

There was some brighter news for international banks last month, when the government moved to inject fresh competition into the savings market by giving banks the freedom to set their own interest rates.

This is expected to benefit big foreign banks that have the fire power to offer more aggressive rates. These groups are keen to offer on-the-ground private banking services in a number of cities.

Some smaller overseas private banks, however, are pulling back, as domestic competitors raise their game.

Some have struggled to attract staff, as they say the pool of talent in the country is limited and competition for the best people fierce.

Switzerland moves to avert threat to privacy privileges

Confidentiality

Haig Simonian on deals with the UK and Germany. Worrying tensions remain with the US

Switzerland has made extraordinary progress towards a goal that many thought unachievable as recently as a year ago.

Rather than being forced to do away with its hallowed secrecy arrangements for private banking clients, in August it signed deals with Germany and the UK that preserve confidentiality.

More such agreements may be in the pipeline: Italy and France, two neighbouring countries that have traditionally provided much business for Swiss banks, have shown cautious interest and Greece has held direct talks with Bern.

These developments come less than two years after private banking in Switzerland appeared to be in trouble, as UBS was forced to divulge the names of 255 rich US clients.

That, along with $780m paid as part of the bank's deferred prosecution agreement, settled criminal charges that it had allegedly helped rich Americans evade tax.

Months later, Bern sanctioned the transfer of 4,450 more names. At about the same time, bank secrecy for clients from Switzerland's European neighbours looked set to be blown, as tax authorities in Germany and beyond enthusiastically bought stolen data on undeclared accounts.

In a separate move, the Organisation for Economic Co-operation and Development – the rich nations' club of which Switzerland is a member – was intensifying its lobbying for tax transparency via automatic information exchanges – anathema to the Swiss.

How did the pendulum swing back so rapidly?

First, the UBS affair belatedly alerted Bern to the scale of the threat.

The government launched a diplomatic blitz, and created a section in the finance ministry that is mostly devoted to handling bank secrecy and is headed by the country's top diplomat.

Second, Switzerland's banks, which were previously deeply divided over privacy, grasped the urgent need to present a common front.

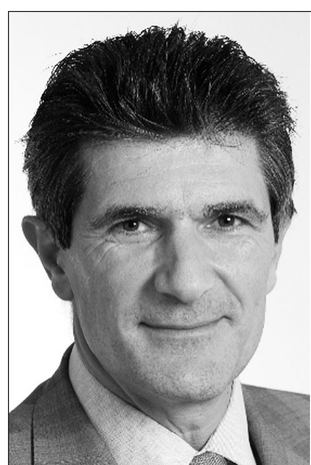
All but the most stubborn acknowledged that the strictest levels of secrecy were no longer tenable, and that they had to show some flexibility on client confidentiality.

A final decisive factor was that Switzerland was able to take advantage of the financial needs of its neighbours.

Before the credit crunch, one UK minister insisted he would never settle for anything less from Switzerland than client names.

Four years on, strains on national budgets have changed views, and Bern's suggestion that problems with tax evasion could be resolved via a financial settlement – while still preserving confidentiality – have gained a much more sympathetic hearing.

Under the scheme now accepted by Germany and the UK and being considered by others, income on undeclared accounts will be taxed at mutually agreed rates, while clients' failure to pay tax on former earnings will be addressed by a one-off penalty.



Patrick Odier: 'fair solution'

All the sums involved will be calculated and remitted by the Swiss banks concerned. Thereafter, the accounts will be considered as regularised, without the holders' names being revealed.

To sweeten matters – and underline Switzerland's commitment to implementation – the banks will pay significant upfront lump sums, which will be deducted from future payments streams.

The banks say the deal will be costly and complex – above all because of the significant extra IT investment that will be required to produce the tax-compliant data for tax authorities in Germany and the UK. But they are broadly happy with the solution.

> All but the most stubborn agreed the strictest levels of secrecy were no longer tenable

"Overall, my assessment of the tax agreements is positive," says Patrick Odier, chairman of the Swiss Bankers Association.

"As a banker, I am especially grateful that clients have been offered a fair solution for regularising their assets."

Under the deal with Germany, the banks will make a SFr2bn ($2.2bn) payment on implementation in 2013.

In the case of the UK, which has fewer estimated clients at Swiss banks, the sum will be SFr500m.

The deal also commits Germany to stop buying stolen client data, and – as with the UK – to drop legal action against Swiss bankers allegedly aiding tax evasion. It also offers Swiss banks better access to the German and UK markets – an important consideration for non-EU Switzerland.

But its escape from the squeeze on secrecy, does not mean all challenges have disappeared.

In Germany especially, the agreement has been fiercely criticised by the opposition Social Democrats (SPD).

Some SPD-governed states have vowed to block legislation in the Bundesrat – the upper chamber of parliament, where the states are represented.

As the coalition government of Angela Merkel, the chancellor, has lost its Bundesrat majority, the deal could yet fail.

Moreover, the recent G20 meeting again highlighted the emphasis in many countries on countering tax evasion, with international leaders attacking "tax havens" and hinting Switzerland should do more.

Most ominous are continuing tensions with the US.

While the UBS settlement temporarily resolved differences, new strains have emerged.

US investigators have shed light on the practices of other Swiss banks, finding that many were enthusiastic to open accounts for former UBS customers, even after the crackdown by the US authorities became public.

As this report went to press, it remained unclear whether Switzerland and the US might reach a new accord. If they did, the Swiss banks involved, led now by Credit Suisse, would pay a huge settlement and probably be obliged to transfer thousands of US client names.

In its third-quarter results on November 1, Credit Suisse revealed a SFr295m provision for its share of a settlement.

However, other banks involved, such as Julius Baer, say they have not set any money aside.

Alternatively, Switzerland and the US may be set for a bitter battle, in which the US authorities would harness the vast quantities of information gathered since the initial UBS probe to prosecute further US taxpayers and indict more Swiss bankers.

At worst, the US could threaten to indict one or more Swiss banks – a tactic, in US eyes, that was used to good effect against UBS.

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London calling: there has been a surge of foreign entrants into the market for million-pound-plus mortgages as overseas buyers snap up trophy homes in the UK capital Rosie Hallam

Political stability offers haven for investors

London property market

Tanya Powley explains why the UK capital has remained so popular

Niche foreign private banks are emerging as a growing force in the £1m-pound-plus mortgage market, as they follow the huge flow of money from rich international buyers into prime London property, viewed by many as a safe haven for wealth.

Once the preserve of traditional UK-based private banks such as Coutts & Co, the private bank that counts the Queen among its clients, and Barclays Wealth, the past few years has seen a growing number of overseas private banks entering the large loan market in the UK.

This surge of foreign entrants ranges from Nordic banks such as SEB Private Bank and Nordea Bank; to Asian banks, including OCBC, a Singapore-based private bank. Other entrants have included Butterfield, a private bank established in Bermuda; EFG, a Swiss bank; and First Bank of Nigeria (FBN).

In total, there are more than 40 private banks active in the UK lending market, says Mark Harris, director of SPF Private Clients, a high-end mortgage broker.

"Over the past two years, there has been a noticeable increase of foreign private banks. London is seen as politically safe and the property market in particular is viewed as robust," he says.

Mr Harris believes these new lending entrants are following the movement of global wealth to the London property market, as overseas buyers continue to snap up trophy homes in the capital.

According to Hamptons International, an estate agency that specialises in selling homes in the affluent property markets of London and south-east England, as much as 75 per cent of all purchasers in the prime London property market are now international, up from 50 per cent in 2007.

In the 18 months to June this year, a net £6bn flowed into the second-hand and new-build markets of prime London from overseas buyers.

Savills, another high-end property agent, believes this demand from wealthy international buyers is likely to continue. It is forecasting prime property values in the capital to rise 22.7 per cent in the five years to 2016, making the million-pound mortgage market appear a safe bet for many private banks.

"Prime real estate has proved itself a stable safe deposit in uncertain times and in an investment world searching for yield and security, the five-year outlook for prime property is compelling," says Yolande Barnes of Savills.

Jack Jones, head of specialised banking at Investec, the South African private bank, says most of its lending is to clients in Kensington and Chelsea, and Mayfair. "The super prime property market is attractive because it is large and growing. Our research shows that there were more than 21,000 residential properties on the market for £1m or more during the second quarter of 2011, which is 10 per cent higher than the same period in 2010," he notes.

Butterfield, a private bank established in Bermuda in 1858, has recently increased its property lending to take advantage of the surge of interest in trophy homes in the capital. While the bank entered the UK market in 2001, it has only recently become active in the large loan mortgage market.

"I think we've found over the past year or so that lending high-value loans, particularly against prime central London properties, form a useful part to a banking relationship," says Andrew Jackson of Butterfield Private Bank.

"We quite often find lending is the first step along the road that hopefully leads to a wider relationship with investment management and other wealth management services."

Mr Jackson says the bank typically lends only on expensive properties in the prime locations of London. It will consider lending on properties outside of London only to existing customers that already have a relationship with the bank.

"We're particularly focused on prime central London property. You don't have to look at many of the property reports, such as Knight Frank or Savills, to see that these areas continue to increase steadily and surely in value," he notes.

Nigel Bedford of Largemortgageloans.com, a mortgage broker, says property location is a common theme among all the private banks active in the large loan market. "Outside prime central London, they are not really interested," he notes.

Although there has been an increase in the number of overseas private banks entering the market, many of the most competitive rates are offered via well known, more established private banking names.

According to mortgage brokers, Deutsche Bank, UBS, Royal Bank of Canada and JPMorgan offer some of the most competitive rates to customers that will transfer assets to the private bank.

Barclays Wealth and RBS Private Bank are among the private banks that are attractively priced for those that do not have assets to invest.

The big attraction of offering loans, for both traditional players and the newer entrants, is the ability to create a long-term asset-based relationship with wealthy individuals and their families.

Most private banks believe providing a mortgage for an individual's home will help form the cornerstone of a longer lasting relationship and open the door to a larger share of the client's future asset management and banking.

To access the lowest rates via a private bank, clients will usually have to invest other assets with the bank's wealth management arm – but the amount of funds will depend on the bank.

Simon Gammon of Knight Frank Finance says some banks will price their rates based on how much in assets the customer will invest with them. For example, Deutsche Bank will offer mortgage rates at about 1.25 per cent over three-month Libor to those that invest 25 per cent of the loan amount, dropping to 1 per cent over three-month Libor to those that invest as much as 50 per cent.

Most private banks will err on the safe side and lend at lower loan-to-values of about 50 to 60 per cent. Mortgages via a private bank will also be much more flexible than through the high street banks and building societies. Loans can be secured against a variety of assets, including property, shares, investment holdings and offshore deposits, and are available in a number of currencies.

New charges aimed at less lucrative clients

Changing strategies

Higher fees seem to be one response to lower interest rates, writes **Lucy Warwick-Ching**

Private banks are throwing their weight behind their investment management arms and levying fees on customers who are not making the most of the full range of services on offer.

Coutts & Co, the Queen's bank, charges £600 a year to customers with a basic current account, unless they have £250,000 of savings, investments, a mortgage or a combination of these things with the bank. This fee has been in place for some time, but until recently clients with just £10,000 on deposit were exempt from the charge.

Other banks to have increased the minimum threshold for free banking in the past year include C Hoare & Co, which now charges £60 a month for each current account with less than £25,000, up from a previous minimum of £10,000. And Weatherbys private bank charges £480 a year for its core banking services, but waives this for deposits, loans or investments of £250,000 or more.

"With interest rates so low at the moment, it is just not sustainable for private banks to have a large number of clients holding small amounts of cash on deposit," says Christine Ross, group head of financial planning at Société Générale.

"That said, clients who want a personalised service often don't mind paying a small fee to get a better level of service. For example, those people who want to be able to phone their bank and speak to someone they know often understand that this personalised service will come at a cost."

Some experts suggest the fees for nominal bank holdings could be aimed at pushing less profitable clients back on to the high street while encouraging wealthier clients to hold more of their assets with a single bank.

"Fundamental banking capabilities have been pretty unfashionable among private banks for some time," says Sebastian Dovey of specialist wealth management consultancy Scorpio Partnership. "Many of the operators in the UK really don't actively promote their interest in this area unless they are forced to."

He says that while C Hoare & Co. has been one of the few banks to celebrate its banking services, others, including Coutts, have become focused on investment management in recent months "because this is where the higher revenue streams are".

James Fleming, managing director of Coutts' London business, agrees and says the bank is now putting more emphasis on its investment management service as it is "beefing up its investment capability".

"The costs of this industry are rising, so in a falling interest rate environment we need the business to be more efficient," says Mr Fleming. "As competition in the market has been increasing, we have upped our game to create a better offering for the client – investment management is one area that people are particularly interested in."

> There has been a focus on investment management in recent months 'because this is where the higher revenue streams are'

Another area in which private banks have sought to tie in clients in recent months is through lending, with some tightening their lending criteria for large mortgages, insisting that clients invest cash with them in return for a loan, or to get the best rates.

Barclays Wealth this year introduced two tiers for lending, based on whether a client invests with it.

It now applies a higher rate of interest on loans to clients who hold only current accounts with relatively small sums and a lower lending rate to those with accounts of more than £500,000 or other assets placed under management.

"Private banks have always given preferential rates to individuals who invest all their cash with them, but now some banks are introducing stricter conditions for lending," explains Nigel Bedford at largemortgageloans.com.

"To access the lowest rates via a private bank, clients often have to invest other assets with the bank's wealth management arm, but the amount of funds will depend on the bank."

Other banks are expanding their services to catch the most desirable clients.

Philip Grant, managing director of Lloyds TSB Private Banking and Bank of Scotland Private Banking, says: "Quality can only be reached by building a strong, lasting relationship with the client, where the managers and advisers gain a deep understanding of each individual's circumstances, including their short, medium and long term financial goals.

"Something that we have found particularly useful is developing professional specialisms within the private bank, so we can provide a more tailored and knowledgeable service."

The banks say the slight shift in sentiment away from current accounts reflects the tough economic climate in which they are now operating.

Declan Sheehan, chief executive at HSBC Private Bank UK, says transactional banking is a core part of the bank's service, but points out that the cost of providing current accounts has gone up, so the bank needs to make sure people have sufficient balances to pay for the extra level of service that clients expect from a private bank

"Retail banks charge fees for services such as cheques and overdrafts," he says. "Within private banks there is less opportunity to charge for these services so, over the long term, we look to earn some margin on clients' balances and through maintenance fees.

"Unfortunately, with interest rates close to zero now, all banks are earning little on client balances. Hence, the greater discipline about who is offered private banking services and the increase in account maintenance fees."

For some people – who are happy to do their banking online and do not need a relationship manager – HSBC's Premier Banking Service could be more suitable, says Mr Sheehan.

HSBC is one of many UK banks that now stipulate the value of assets the client must have.

For example, HSBC Private Bank will consider only those with £2m to invest, while Goldman Sachs International demands investable assets of £5m before it will look at new clients and Standard Chartered requires borrowers to have at least £1m in investable assets.

Coutts asks for clients to have £1m of assets and RBS Private Bank wants borrowers to open a bank account with them.

Some say the reason behind the increase in bank charges for individuals with lower deposits and the raising of the minimum assets held by a client is simple.

"Raising the minimums can provide a pretty simple screening process for getting the right type of clients," says Mr Dovey.

"Clients with that amount of cash have a higher probability of having at least five times that amount in investment funds and most probably have a lot more."

Coutts has raised its minimum threshold for free banking Corbis

Only the trilingual, numerate and personable need apply

Search for talent

Ever greater abilities are required of staff, reports **Elaine Moore**

What skills make the perfect wealth manager?

Charm, certainly. Contacts, maybe. But as the private banking industry seeks to attract a new generation of clients across a wider map than ever before, a new set of talents is in demand.

Multi-lingual, personable graduates equally at ease discussing complex structured products and safe haven assets are needed by private banks to fill offices in some of the world's fastest growing economies.

But finding the right recruits is not easy.

HSBC has increased the number of places on its graduate scheme in the last year, but requirements are tough.

Prospective hires must be proficient in at least three languages, have a strong academic background and a genuine enthusiasm for the financial world, says Charles Hoffman, managing director at HSBC Private Bank.

Those who make the grade are offered a four- to eight-week graduate programme, followed by three six-month rotations, during which they are seated with experienced private bankers who specialise in client relationship management, support functions or product development. At the end of the process the new recruits should be ready to take on their own clients.

Carol Costa joined the HSBC scheme from her home country of Brazil and is embedded in the London office on her first rotation.

She says the worldwide movement and opportunity to spend time with senior management is an amazing way to start a career, although the reality of training has differed from her expectations of instant glamour and client meetings.

The first month of technical instruction underlined the fact that a career in private banking requires knowledge of services and products, not just client relationship building.

And finding the people with the right mix of talents who can fulfil these roles can be hard. In search of fresh pools of talent many private banks have been increasingly turning to lateral hires.

Coutts, one of the UK's oldest private banks, has launched a pilot programme aimed at employees in different areas of the financial industry as well as its own staff who understand the high net worth market and can be trained in its own platform and products to become private bankers.

The bank has been explicit about its hopes to drive up revenue in its overseas business by more than half in the next few years.

Along with much of the industry, it is hoping to expand its remit from conventional private banking to investment management, and has raised its minimum requirement for investable assets that clients must hold from £500,000 to £1m.

Seeking out those with a non-private banking background who may have the right relationship skills, or have experience in a particular area outside the world of wealth management, has been a success, says Elsa Critchley, head of HR at Coutts.

SGPB Hambro uses a variety of methods to find and develop wealth managers, says Phil Mcilwraith

This is particularly the case in those markets where there is a wide shortage of quality private bankers, such as Asia.

In countries that lack a large pool of candidates from which to pick, other banks have been setting up schools to train graduates in the art of wealth management.

Credit Suisse runs its own corporate university with a business school in Singapore and Hong Kong. Citigroup has also run a wealth management associates programme at Citi Private Bank Asia Pacific since 2006 to funnel a pool of potential employees through its doors.

But the effort involved pays off, according to Paul Patterson, global head of trust at RBC Wealth Management, and goes beyond the individual's contribution to the bank.

"Our experience is that our graduate trainees relate to, and become important advocates of, our corporate culture, which we see as a key differentiator in the market," he says.

But smaller wealth managers without the resources to set up their own schools or schemes have had to take a more informal approach.

Société Générale Private Banking Hambros says it uses a variety of methods to find and develop wealth managers.

"Being a relatively small bank we do not have a formal structured graduate trainee scheme," says Phil Mcilwraith, group commercial director. "Our approach is more informal, recruiting both experienced wealth managers and other individuals with the potential to succeed."

This process allows managers to work with SGPB Hambros teams in different locations or in different parts of the organisation.

The scheme may be less formal, but the time the bank spends educating new recruits on its own product range is substantial, and reducing attrition is essential for schemes like this one to earn its keep.

The answer, according to some, is to ensure that graduates forge connections across the bank that will last beyond the specific time of the training scheme. In other words: mentors.

HSBC, for example, appoints mentors who are responsible for graduates throughout their rotations and can provide guidance, support and encouragement during and after the programme.

This year Coutts began a slightly different mentoring model. Its reverse mentoring scheme requires young members of the private bank, typically graduate trainees, to be allocated senior executives and tasked with educating them in the mysterious world of social networking, virals and trolls in a process that lasts between six months to a year.

The purpose is to help senior bank staff gain a better grip of the ways that young clients might communicate and interact – typically through technology – and to encourage new employees to make connections with established bankers.

Coutts says it plans to roll out the scheme across all of its offices.

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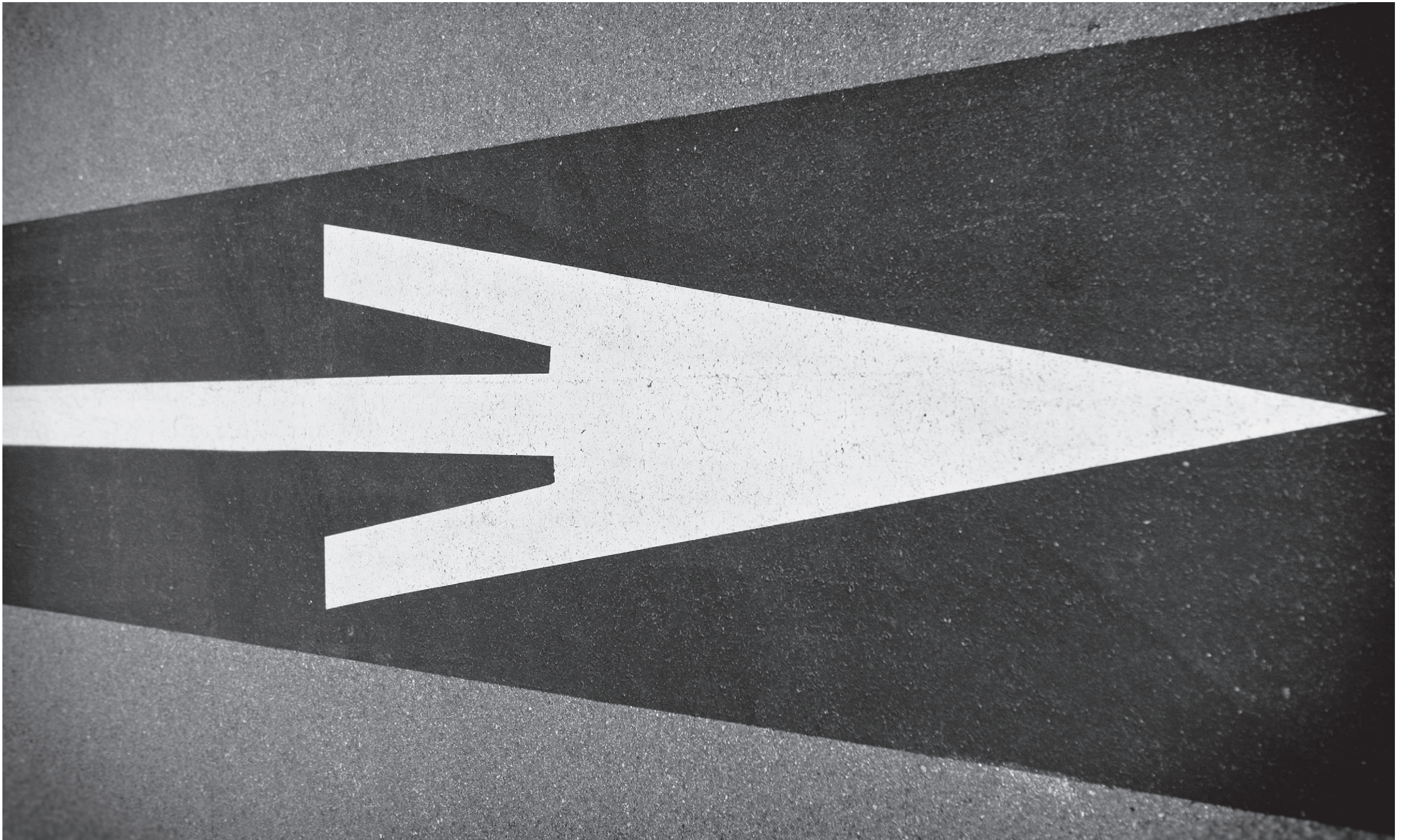

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Independent minds

The art of investing in paintings and wine

Non-core services

Clients are being offered advice on a wide range of topics, says **Lucy Warwick-Ching**

Banks are advising clients on collectables including art. Pictured is a work by US artist Shepard Fairey on sale at a Bonhams auction in September Getty

A wealthy client stepping into the offices of a private bank is just as likely to be offered advice on which wine to buy, or the ever increasing opportunities for philanthropy, as they are to get help with their investments.

Nowadays, private banks are ramping up their services to cater for a new generation of individuals seeking more than traditional banking and wealth management.

Services include philanthropy and advice on collectables, such as art, wine and cars. Some banks are also branching out to offer help with property sales and large mortgage lending. Other non-core offerings include ancillary services such as estate and trust management.

"More and more banks are getting involved in this space, because typically this is where clients are most animated and engaged," says Sebastian Dovey, managing partner at Scorpio Partnership, a global consulting think-tank.

"I mean, who really wants to talk Sharpe ratios [for measuring risk-adjusted performance] all day long, except the banker. Most people would much rather debate the consequences of a bad winter to the Merlot grape, or the impact their money can have on changing social conditions."

Leila Pillonel at Investec Trust says that there has been a degree of discontent with what people have been getting from various providers over the past few years. "Clients used to go to banks purely for financial investment advice, but with interest rates as low as they are, they are looking for new forms of investment," she says. "As a result, they are moving into artwork, philanthropy, private equity and property."

This movement into alternative investments and away from banking has been speeding up over the past decade, say experts.

"The challenge for most private banks moving into this area is to work out which ones are loss-leaders and which ones are actually revenue generators," says Mr Dovey.

"At the moment private banks are feeling pretty confused about this. We believe a lot has to do with which capabilities are in-house and which are offered externally."

One private bank that is changing its business model to cater for evolving client's demands is Coutts, which launched Knowledge Exchange, its online learning platform, in mid-October.

Jason Jarvis, head of Knowledge Exchange, says the platform aims to enhance the client's understanding around a range of wealth management areas including philanthropy and family business and will be extended next year to include entrepreneurs and investments. Among other elements, the service includes an interactive forum where clients can engage in topical discussions with experts and one another.

> 'The challenge for most private banks moving into this area is to work out which ones are loss-leaders'

Experts say the subject of social media is a positive new frontier in wealth management. "Clients are embracing this element of their life much faster than the wealth managers. The interest is around ease of engagement, connections and networks," says Mr Dovey.

"But the wealth industry is pretty puzzled by social media, with many fearing they will displace their importance to their client. But this is half-baked. What the industry should be afraid about is not operating properly in the social media world and being discredited," he adds.

Several private banks are recognising that clients are looking for more than simple, transactional banking.

HSBC, Investec and Barclays Wealth, among other mainstream private banks, also now offer a broad range of specialities, as they aim to strengthen ties to existing clients and recruit new ones.

"One of our big growth areas is philanthropy," says Russell Prior, head of philanthropy at HSBC Private Bank. "There is a new enthusiasm among wealthy clients to donate some of their riches to projects that improve the environment or society rather than leaving all their wealth to their children."

He says there are only three ways to dispose of wealth; spend it, pass it on, or give it away.

"The first two are already well-serviced by the industry, but the last is one where people are beginning to pay more attention," he adds.

Clients want banks to help them to ensure donations are tax-efficient, and some offer specialised charity accounts from which to donate and keep track for tax purposes.

Most UK private banks now offer either in-house philanthropy advice, or can put their clients in touch with a specialist.

The same holds for investing in art, providing knowledge on the best wines to buy, and help with purchasing classic cars for investment.

Advice on investment in property is one of the growth areas predicted for 2012.

HSBC Private Bank is already doing this, through Property Vision, its upmarket estate agency, which helps clients buy a house or country estate.

The advantage of using a private bank to purchase property, say experts, is that typically they can offer bespoke mortgages. This means some private banks are willing to be more creative with funding structures than high-street lenders, an important factor for wealthy clients who may have relatively modest basic salaries but large, regular bonuses as well as significant assets.

Another area is wealth preservation and inter-generational planning.

Société Générale Private Banking says it sees its Global Wealth Planning Solutions as part of its key growth strategy for clients.

"The desire to preserve wealth for future generations should not be underestimated," says Jon Needham, global head of fiduciary services for Société Générale private banking.

"Over the past 10 years, we have seen a number of fortunes made and an even larger number lost. In these challenging economic times, planning for wealth at a trans-generational level is increasingly important.

"As the sage of Omaha, Warren Buffett, once said: 'Someone's sitting in the shade today because someone planted a tree a long time ago.'

"We like to provide the tree."

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Testing times put the focus on bright spots

Continued from Page 1

terms of the number and combined wealth of millionaire investors. There were 3.3m of these clients in this region at the end of 2010, compared with 3.1m in Europe.

While the US remains the country with the largest single wealth market – it has the same number of millionaire investors as the whole of Asia – private banks are increasingly looking to strengthen their presence in emerging markets, albeit selectively.

"Asia is far and away the engine for growth," says Mr Jensen at PwC. "But [for private banks] it is all about choosing their territories carefully."

Hot spots such as Hong Kong, Singapore and Beijing remain a priority, but banks are also looking further afield to the next tier of emerging wealth – other fast-growing Chinese cities, for example, or parts of the Middle East.

As their overall profitability is squeezed by the cocktail of tougher regulation, lower margins and falling revenues, some banks are withdrawing from smaller markets where they do not have sufficient scale, to free investment for the most profitable areas.

UK banks are suffering more than others at the hands of a series of stringent new regulations. This requires a radical reshaping of their international footprint. Banks including HSBC and Coutts, which is owned by Royal Bank of Scotland, are considering exiting from up to half their international businesses.

While banks around the world are having to absorb tougher capital and liquidity rules, the UK banks, which were among the hardest hit in the financial crisis, are also having to get to grips with drastic changes to the way they sell products.

Coutts was fined £6.3m for failing adequately to explain the risks associated with a type of investment bond it sold to more than 400 of its wealthiest clients. This brought the kinds of irresponsible sales processes evident at banks in the run-up to the financial crisis into sharp focus.

> 'The wealthy will get wealthier and today's emerging markets will be tomorrow's developed markets'

This is changing. Banks can no longer sell complex, high-margin investments to anyone who wants them. They must ensure the products suit every client that buys them – and take care to explain the risks.

As a result, many of the products that once delivered big profits have been replaced by far simpler ones with clearer – but typically less lucrative – fee structures.

Window shoppers on affluent Fifth Avenue, New York Getty

At the same time, investments aimed at protecting clients' assets from taxes have become increasingly rare following renewed efforts from governments to clamp down on wealthy tax evaders.

Despite these hurdles – and the lacklustre growth prospects of the UK, US and Europe in coming years – banks are not writing off developed markets.

"I don't think these are terminal issues for London," says Mr Sheehan at HSBC. "In 2013, Asia will have the largest wealth of any region globally. But the US and Europe are not far behind. They are substantial wealth markets that will continue to be important."

Many banks are trying to use their more established markets as a base to target clients in those that are growing at a faster rate.

As wealthy investors become more international in their approach, with investments in many continents, banks say their clients are not so tied to banking in their home country. Customers in Brazil, for example, are increasingly looking to do a chunk of their banking in London or New York.

Other banks are focusing more on improving the connections between fast growing emerging markets. This would mean that clients in China or India, for example, can invest directly in Latin America, without having to divert their business through a more developed market.

As the world enters a second – and potentially more alarming – phase of the financial crisis, the challenges for private banks remain acute.

But experts say the extraordinary growth in the number of the world's wealthiest people means the opportunities for private banks still exist.

"The wealthy will get wealthier and today's emerging markets will be tomorrow's developed markets," says Mr Jensen.

"If banks structure their business efficiently, the demographics of the sector mean it is still attractive in the medium term."