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Buried treasure

While some private banks recognize the opportunities that the internet holds out to tap into a bigger pool of wealthy clients, others find it incompatible with the sector's traditional face-to-face, bespoke service. Michael Imeson reports

The world has never had so many wealthy people, which is good news for bankers to the rich – if they are offering the right service. Time was when there were just two simple components in the private banking equation: wealth and relationship management. The first plus the second equalled private banking. It was as straightforward as that.

Recently a third component has been added to complicate the outcome: the internet.

Private banks were slightly slower than retail banks to set up websites to cater for their clients in the understandable but mistaken belief that they only wanted personal service from a client adviser, either face-to-face or by telephone – not an e-banking solution. By the time the first private banking websites were launched – primarily as marketing and information vehicles – retail banks had started fully-fledged online banking services that gave customers the ability to conduct many types of transactions.

The best that the private banks could do, if they were part of a retail banking group, was to allow their wealthy clients to link into their parent's retail online banking service or, if they were independent, to bury their heads in the sand and tell clients to use online banking services elsewhere.

Now there are signs that private banks are catching up. A few private bank websites have started to include value-added services in their internet site, such as account information, and a few have added own-brand online banking and/or online investment transaction functionality. However, a large minority of private banks still have no plans to match the range and versatility of retail online banking and investment transaction services. They are sticking to the argument that wealthy clients do not want these services or, if they do, they can use a retail banking or stockbroker site. Besides, runs their argument, it is not cost-effective for a private bank with a relatively small number of clients to offer a fully comprehensive, transactional internet service.

Analyst Datamonitor's report, *Private Banks on the Internet* (December 2004), looked at the role of the internet for private banks and what its future role could be. Although the report shows that private banks have embraced the internet, it also demonstrates that most services are just online marketing tools and information sources, usually with the parent bank's retail online banking service bolted on. A few offer added-value services, such as account reporting, to support wealth managers in their dealings with clients and hardly any offer fully comprehensive, own-branded banking and investment transaction services.

The ultimate private banking internet model (see panel, p38) may never happen on a wide scale because the essence of wealth management is a personalized, relationship-managed service. Certainly, wealthy clients use the internet for their financial planning and find it useful if they are in a hurry or want to make a simple transaction or look up information. But what they really want is their client adviser to do most of the complex, specialist cerebral work for them – and most of the donkey work too. What private banks should be using their internet services for is to ensure that they are sufficiently differentiated from their competitors.

Wealth creation

JP Morgan puts its wealthy clients into one of two segments: high-net-worth individuals (HNWIs) and ultra-HNWIs. JP Morgan Private Clients Service deals with the first segment, defined as those with \$1m–\$25m (£530,000–£13m) to invest, and is for the US market only. JP Morgan Private Bank deals with the second segment, people anywhere in the world with more than \$25m liquid assets.

Clients of JP Morgan Private Bank, who tend to be the bank's business clients too, prefer face-to-face contact, but in the US they can use JP Morgan internet banking services – Morgan OnLine – for banking transactions and investment account information, but not for investment transactions. It therefore conforms to the value-added internet banking model. Lex Zaharoff, head of the bank's advice lab,



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an internal think tank, says the internet is an important part of the bank's strategy for dealing with the ultra-wealthy. "We view the internet as an extension of our relationship with JP Morgan Private Bank clients," Zaharoff says.

"The importance of the medium varies depending on the client." Costs are an issue because "if done well, an internet service is an expensive technology", he says, but as clients find it valuable it is a worthwhile investment.

To be a leading private bank, argues Zaharoff, you need physical offices around the world, the ability to permit the client to call his or her advisers from anywhere, a willingness to visit the client when required "and a comprehensive and highly secure internet capability". UBS Private Clients caters to non-Swiss HNWIs with liquid assets of more than £500,000 or €500,000 (£340,000) – it offers

"Does any private banker want his exclusive communication to a client wedged between a spam and a free financial newsletter?"

Lyon Hardgrave

a degree of flexibility about the precise amount of wealth required. However, for Swiss HNWIs there is no lower assets limit because Private Clients is treated as part of UBS's retail banking service.

The Private Clients website takes up only a few pages in the general UBS website. Clients wanting to make online banking and investment transactions are directed to "UBS e-banking", available to all customers, from modest means to rich. In one sense, then, UBS Private Clients follows the basic internet banking model because customers have to use the main UBS website to do anything meaningful. However, in another sense, it follows the fully comprehensive model because UBS is such an upmarket Swiss bank that it does not need to hard-sell its private banking credentials and its open-to-all e-banking service allows banking and investment transactions.

Other features of the service include secure messaging to client advisers, checking investment accounts, market information and investment transactions. But UBS Private Clients has no plans to offer a separate e-banking service for private banking customers. "We don't see e-banking as a killer application for private banking," says a spokesman. Private banking is relationship management-led, he says, so e-banking represents only a small element of the overall proposition. By contrast, Lloyds TSB Private Banking service clearly follows the basic model. Its internet offering is a few pages in the main Lloyds TSB website, which simply outline its services and products and provides a small amount of information. Clients who want online banking are directed to the bank's standard retail offering.

The bank's Private Banking management is unapologetic about this approach. "Our service is predominantly relationship management-based, our clients want a personal service as their financial situations tend to be complex, so the internet is less

important than for retail clients," says a spokeswoman. "We accept that private clients are using internet banking more, but we have taken the view that the best way to provide e-banking is through the main Lloyds TSB site. We will continue to monitor the situation, but do not believe there is a demand for a separate online service for private banking."

The benefits of online banking for private clients are the same as for retail customers. It is convenient, can be used from virtually any location, is available around the clock, is a great source of financial information and market news, can provide a comprehensive overview of a client's accounts and conduct transactions. The benefits for private bankers are obvious too. The internet allows them to offer clients an additional banking channel, it gives them further marketing opportunities to differentiate their wealth management service and reduces costs for basic transactions and information provision.

However, according to a Forrester Research study of 50 leading global private banks, 68 per cent of executives said that keeping up with web developments was their single biggest headache. There is also the big risk of the internet disintermediating clients as it allows them to do things without the need of a relationship manager.

This whittling away of the personal relationship creates problems for the customer by reducing the level of valuable personal advice and creates problems for the bank by reducing the opportunities for its client advisers to promote the brand, products and services face-to-face with the customer. But JP Morgan's Zaharoff says there is no

danger of distancing – or disintermediating – clients from the bank "because our internet service is an additional mode of communication and will never be a total replacement for a phone call or personal visit." Lyon Hardgrave, in an article in the *Journal of Financial Transformation* on how the internet is affecting private banking (August 2002), points a finger of blame at email. "Including email as part of a relationship management strategy is tricky," writes Hardgrave. "Email has become the main form of communication for many people, but is less personal than a phone call or personal visit. Does any private banker want his exclusive communication to a client sandwiched between a piece of spam and a free financial newsletter?"

Hardgrave also makes the point that despite the cost advantage of the internet for individual transactions a private banker still has to provide personal service via branch and phone so the internet is an additional cost. This is in contrast to retail banking where many customers can be totally or largely migrated to internet banking so big cost savings can be made in personal service. "For most businesses integration of web technologies promise substantially reduced costs," writes Hardgrave. "For private banks, the web is a fiscal black hole."

He also highlights the operational risk challenges, potential security breaches, compliance problems and legal



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issues surrounding internet services. For example, a bank that is not licensed to operate domestic banking services in a territory cannot market in that territory using, say, leaflets or television advertisements. But the internet jumps these barriers so a bank's website and marketing can be seen in territories it is not licensed in.

Private thoughts

There are three main schools of thought on where private banks are going with the internet. At one extreme is the belief that the internet is already one of the most vital components of private banking and has to be fully embraced, otherwise banks will disappear. "The internet will force the industry to restructure and within a decade its visage will be markedly different," Hardgrave writes.

"Consolidation and specialization will redefine the roles of private bankers. Nonetheless, those who adapt will thrive as the number of HNWI's multiply. There are 4,000 private banks. Internet banking will contribute to consolidation because the costs of building and running websites will be high: Those that do not consolidate will die or become specialists – [specializing] in say, offshore banking, inheritance planning or trusts."

At the other extreme are people like Nick Griffin, a partner in KPMG's transaction services practice, who advises private banks on acquisitions and divestments. He does not believe the internet is central to private banks' product and customer strategies, but is more about information and support. Banks will, therefore, continue to develop their web services, but how well they do so, and how comprehensive they are, is not critical.


"There's a cost and a benefit, and the size of the prize isn't sufficient to warrant massive investment," says Griffin. "Wealthier

clients prefer a more personalized service. The internet will be a moderate differentiator, but it will not transform the private banking business model." Nor will it threaten to derail slow adopters. There's also a school of thought somewhere in-between. The view here is that an

online channel is an essential part of a private bank's overall strategy, but is complementary to all the other channels and must support the relationship managers. Banks will embrace the internet more fully in the coming years, but they won't be forced out of business if they do not. Other factors – such as lack of size and scale, ineffective branding, declining cost-efficiency, weak products and poor relationship management – are more crucial determinants of failure.

Daniel Hallac, global head of e-business at HSBC Private Bank, sits on this middle ground. He is optimistic about the internet's potential for wealth management, but does not see it posing any great threats because banks will have time to adjust. "We have not even begun to reap the full potential of the internet in this industry," he says. "We

need to constantly re-evaluate our understanding of the precise needs of clients as we move forward. Mobile banking is another growth area. There are more mobile phone users today than internet users. Unfortunately no one has yet figured out how to make mobile banking practical and usable. Given the demand, I can assure you that there are a lot of very smart people trying to solve this problem.

"We believe that online banking is fast becoming the preferred channel for many services, especially for the more 'active' segment of HNWI's, with some studies predicting that it will become the preferred channel, even for personalized advice, in the very near future. At some point we will not be able to imagine private banking without the internet." There are plenty of practitioners and consultants who disagree with Hallac's forecasts. But bearing in mind HSBC's long-established record right across the financial services spectrum, I know whose predictions I would bet on. 

Michael Imeson is editor of *Business Money International* and a contributor to *Private Banker International*.

The rise of the super rich

According to the *World Wealth Report 2004*, published by Capgemini and Merrill Lynch, the global population of high-net-worth individuals (HNWI's) grew to 7.7 million in 2003, up 7.5 per cent on 2002. The combined wealth of these individuals grew to \$28.8tn in 2003, up nearly 8 per cent on 2002.

The authors define a HNWI as someone with more than \$1m (£0.5m) of investable assets – also known as "liquid" or "free" assets – which therefore excludes assets like antiques, paintings and the main home, but not other properties (although some banks exclude all residential properties from their calculation of investable assets). The report forecasts that HNWI wealth will grow by an average of 7 per cent a year, to reach \$40tn by 2008. The fastest growth is taking place in North America and Asia Pacific, and the slowest in Europe and Latin America.

The economic drivers behind this increasing wealth are global GDP growth (3.5 per cent in 2003, compared with 2.3 per cent in 2002) and stock market gains, supported by healthy corporate finances and low interest rates.



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AT A GLANCE

- Private banking organizations have exhibited a mixed response to the arrival of the internet.
- While some recognize the internet's ability to offer clients the means to contact their advisers anytime, anywhere, others see it as secondary to their face-to-face service.
- The future of the internet in the private banking sector will depend on customers becoming more "active" in their dealings with their bank, and banks' willingness to develop a separate online service that is not simply bolted on to its main site.



A private function

Private banks currently operate one of the following three internet banking models:

1. **The basic model.** This model, the most common, provides the customer with product and service information, financial news and telephone and email contact points. For the bank it is a useful marketing tool. Online banking, if available, is provided through the retail division of the parent bank.
2. **The value-added model.** This provides the same as the basic model, plus a few extra services such as a consolidated overview of the client's accounts held with the bank, and possibly accounts held with other financial institutions. Only a few banks offer this kind of service and even fewer, if any, provide true account aggregation, showing all of the client's accounts held with all financial institutions.
3. **The fully comprehensive transactional model.** This provides all of the above, plus the ability to conduct banking and investment transactions online, using the private bank's branded website.