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What Private Bankers could be willing to learn from other industries

By
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Over the last 12-24 months Private Banks and Wealth Managers have been encountering numerous challenges, notably volatile markets due to increased risk aversion, continued macro uncertainty relating to ongoing trade tensions, Brexit and Italian politics, as well as increasing regulatory requirements, the emergence of digital players and actors repositioning themselves in the sector.

The bar for a satisfactory digital experience is continually rising, and clients such as high-net-worth individuals (HNWI) have become accustomed both to completing account activities anytime, anywhere, and with minimal effort, and reaching top-class experts providing real-time customised recommendations for their tailor-made portfolios. While onboarding is a pivotal stage in the client lifecycle, wealth firms consistently cite obstacles such as the number of forms and the amount of data requested on those forms as hurdles to onboarding HNWI.

Eurogroup Consulting performed a targeted study on the financial offering and emerging trends shaping the future of Private Banking and Wealth Management. The study includes the leading Private Banks and Wealth Managers across the European markets, with the exception of Switzerland.
Our study highlighted 6 key messages:

1. Offering Hybridisation

2. Robo-advisor Dynamics

3. Customer Segmentation

4. Cost-to-serve trends

5. Smart Compliance

6. Frugal Management

1. Hybridisation blurs traditional Discretionary and Advisory clusters in Private Banking with cross-fertilisation and mutualisation throughout the value chain, yet few players seem to have clearly identified the customers' call for hybrid products (designed as such). In contrast, the German automotive giants BMW and Daimler have combined their efforts by bringing together a new one billion-euro ($1.13 billion) mobility partnership with a set of uber-ised services to their 60 million customers: bike and scooter rentals, parking services, car-sharing services and an all-encompassing platform "Free now" for mobility management.

2. Artificial intelligence and data analytics offer enormous opportunities to make sure the private banker is close to his clients while being able to anticipate their needs. Interestingly, while the definition and scope of robo-advisor would vary across our respondents, only about a quarter of the participants (at the time of our discussion) have already invested or are currently testing the robo-advisor client and banker centric solutions. At the same time, within the healthcare sector, the next generation of personal healthcare robots (with a use of AI techniques) are starting to take over the job of the domestic nurse (e.g. medication reminders, coaching patients on the challenges of dealing with chronic illness, helping to track patient progress). The robots are not designed to replace the family doctor but are part of the home healthcare set-up. Moreover, AI-assisted surgery (still being in its infancy) is rapidly progressing as health systems collect and integrate data into their processes. AI can help surgeons perform better by reducing the variations that could affect patient recovery by leveraging best practices from the billions of data elements.

3. While the traditional customer segmentation (driven mainly by clients AuM) is still a reality for most of our respondents, very few players are already able to define (from the onboarding) a customer "portfolio of needs" and transform it into a "portfolio of assets" that the private banker will be following. Players able to propose a goal-based planning with 360 customer view approach seem to have the most competitive cost metrics offering on the European market. As an example, Burberry, making its historic transformation from the aging British icon to the global luxury brand, has also ensured the best example of blurring the physical and digital worlds and providing the integrated customer experience. It was mainly

driven by refocusing on the luxury customers of the future: millennials, while ensuring its leadership team masters digital technologies (being able to redesign the business strategy with digital in mind). The company has heavily invested in mastering social media marketing and storytelling (e.g. launching a checkout button on Instagram allowing one to purchase products directly from the Burberry Instagram shop), being among the first players to turn runway shows into digital happenings. Similarly, French food company Danone has started to segment its audience into "tribes" united by certain passion points. Procter & Gamble has shifted the focus of its segmentation strategy from "wasteful mass marketing" to "mass one-to-one" combining anonymous audience data from "generic demographic targets" (e.g. women or an age group between 18 to 49) to more than 350 precise "smart audiences".

4. While cost control is a pervasive topic for all Private Banks in all countries that we have covered, it is interesting to note that cost-to-serve metrics, in other words the contribution margin of every single offering is hard (or impossible) to capture for most of them. To our knowledge, at this stage, only few peers (strong leaders in their respective markets) are monitoring its cost-to-serve both by the customer segment and by financial offering. Correspondingly, telecom providers transform certain activities from staff-served to self-service to optimise their cost to serve, while, in parallel leveraging onshoring, nearshoring and offshoring opportunities.

5. In our Smart Compliance approach, the definition of the «right» compliance bar is a strategic choice aimed at meeting the triple challenge of compliance, cost control and optimising the customer experience. The objectives are to be meeting regulatory requirements by considering customer needs and experience, defining the positioning of the compliance function in relation to the business lines and dimensioning the resources allocated to compliance. In the automotive industry, while the compliance rules (e.g. safety standards) are strictly fixed, there are up to 3 times difference in terms of compliance cost spent between an automotive player with low cost approach and one with clear client focus. In the banking world, there is room for norms interpretation enabling players to drive all 3 levers.

6. Driving cost reductions by challenging service levels across various (project) deliveries, our Frugal Management methodology involves setting the bar against a «Good / Better / Best" framework, acting on both hard and soft levers to design solutions that capture the essential value and align stakeholders. It provides decision-makers with a structured tool to define a workable compromise between value, cost and deadlines, enabling potential Capex savings of 10-35%. This approach is specifically useful for Private Banks that require to consider the demands for ongoing and upcoming regulatory projects, helping to define and nail down the expected level of value, cost and service and match it with alternative solutions, multiple roadmap versions and drive budget-optimising decisions.

Moving forward, Private Banking is going through a dynamic phase of change with similar challenges that some other industries have gone through in their own time. Eurogroup Consulting considers that **while reviewing its offering strategy with inner vision and convictions in mind, Private Banks and Wealth Managers should also build up on the best in class learning experiences from other industries.**

Assets Industrialisation can structurally solve the current challenges burdening CIBs

By
Matthew WESTON

Corporate and Investment Banks, in particular European institutions, are currently suffering from rising costs due to inefficient operational models, shrinking revenues and weak client experience, increasing global competition (e.g. US banks, new emerging market entrants, fintechs, alternative financing players), slow uptake of digitalisation, enhanced regulations, and complex risk and capital management. This environment does not bode well for CIBs and **in order to overcome these difficulties in a structural manner, Assets Industrialisation is becoming a hot topic for CIBs** (especially European banks).

Assets Industrialisation is an approach that identifies resources and assets that can be extracted and pooled together with potential partner(s) through a separate vehicle to extract possible short and long-term synergies. It offers the opportunity, via structural change, to:

- **Disrupt cost structure by on average 20-40% savings** (e.g. economies of scale)
- **Create commercial value - valuation of Tech companies average x2-5 more than banks on an EBITDA multiple basis** (e.g. initiate a commercial entity attracting third-party investments and fees from external users)
- **Improve efficiency** (e.g. standardisation of processes and methods, including regulatory requirements)
- **Leverage best practice** (e.g. institutions' core capabilities)
- **Address balance sheet constraints** (e.g. many banks are encountering Capex challenges from recent restructurings)

There have been over 45 Asset Industrialisation solutions already formed within financial services to date across a varied number of functions and services. Particular areas of focus have been within compliance as a service (primarily KYC onboarding), reference data, post trade services and collateral management.

One leading financial services example is Aladdin, which was devised by BlackRock. As part of Blackrock's aim to increase revenues from technology to 30 percent of the firm's total by 2022, the Aladdin platform was set-up to combine sophisticated risk analytics with portfolio management, trading and operations tools in a single solution to answer market demand. More than 200 institutions and around 25,000 investment professionals now use Aladdin, with circa USD 18 trillion managed on the platform. Aladdin's success is further illustrated by their recent 2019 expansion via acquiring alternative risk analytics provider eFront for USD 1.3 billion. Within the CIB arena, this topic is still in its infancy and two large European banks are in advanced discussions over combining a number of their operations functions.

In addition, outside of financial services there are many successful historic use cases that illustrate embracing structural change when an industry's business environment is struggling, is a smart choice. For example Amadeus was devised by Air France, Lufthansa and Iberia in 2010 to create a common ticketing service platform that could be shared not only by the founder airlines, but also by every airline and travel agency. It currently has a market capitalisation of circa EUR 30bn from EUR 7bn in 2010, and is achieving strong profitable performance.

There are 3 main routes to market for Assets Industrialisation by a CIB:

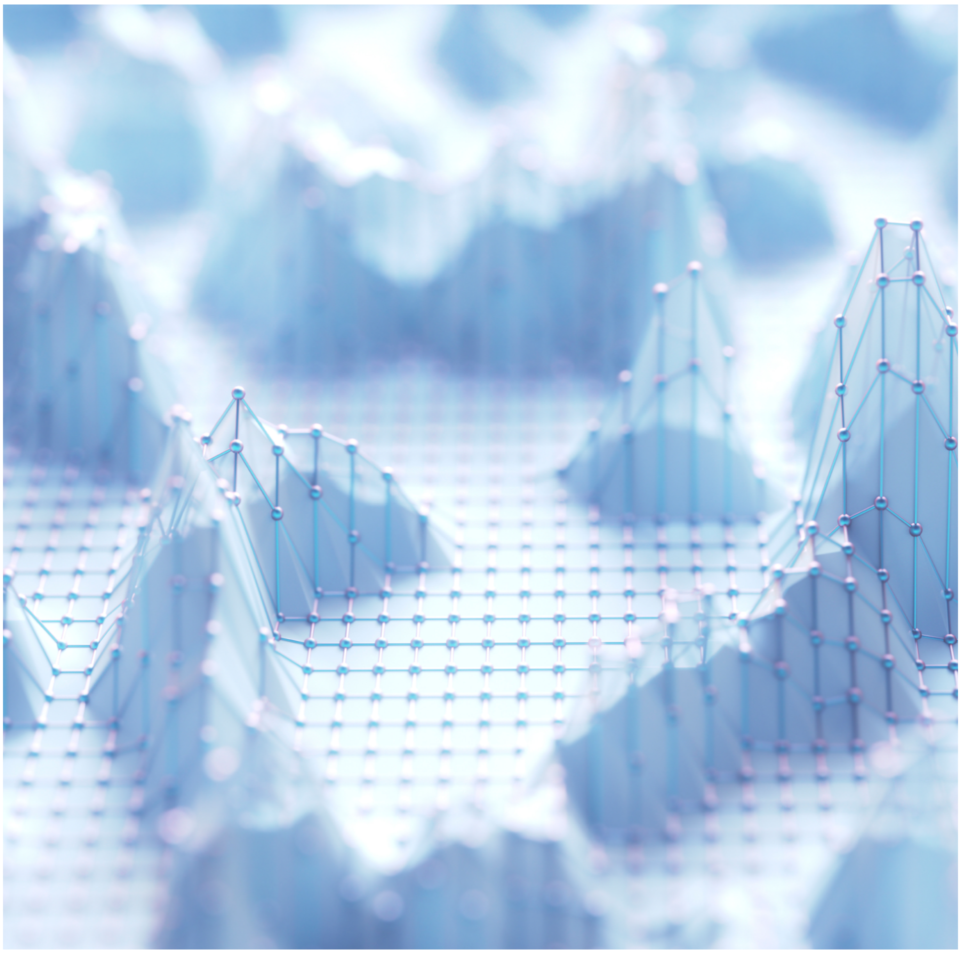
1. Utility: join an existing market utility set up privately by an organisation (that sells its services to banks) or by a syndicate of institutions. Existing functions or assets within the CIB are now superseded by the market utility service

2. Asset monetisation: monetise existing assets (e.g. functions), usually 'best in class', on the balance sheet. It could be via combining assets with other bank(s) to pool resources or engaging individually with an external vendor to perform a sale and lease back of the service. An external vendor can be from a broad pool, including significant digital players (e.g. Amazon) and sovereign wealth funds (e.g. Norway's Global Pension Fund). A new independent entity (potentially partially owned by the bank) can be set-up where the assets will continue servicing the CIB

3. Joint venture: establish a new JV with a partner (e.g. bank, software provider, fintech) for particular assets mutualisation, using 'best in class' or greenfield solutions, to service not only the bank and its partner, but also additional banks as third-party clients.

Going forward, **Eurogroup Consulting estimates that Assets Industrialisation will extract the most value creation (i.e. revenue and cost benefits) within back office and support functions.** Assets selection and setting the ambition level are 2 crucial initial steps for any CIB considering Assets Industrialisation. This would be followed by choosing the right option (from the 3 main routes), selecting a suitable partner and formalising the business case (including asset valuation, deal structuring, tax, legal, financial objectives and transition management) and a comprehensive roadmap to fulfil the chosen Assets Industrialisation route.

CIBs need to consider Assets Industrialisation now in order to be at the forefront of the market and pro-actively overcome their current challenges via structural change that could potentially generate a successful commercial venture and an array of long-term positives.



How organisations can survive and thrive in turbulent times

By
Dipen PATEL

Brexit should no longer be thought about as a one-off moment in history. Often described as a complex and chaotic process from a political perspective, a disruptive mechanism of unbuilding several layers of EU regulations, Brexit offers an unexpected opportunity for strategic change and organisations should use this to their advantage. Adopting an "Agile Operating Model" may well become a compass for organisations to navigate and strategise through the uncertain waters of the changing geopolitical environment.

Brexit has impacted both the UK and EU economies and will continue to do so until there is clarity and a final deal has been reached and agreed. UK GDP in 2018 slowed to 1.4%, and the Bank of England predicts the worst year of growth since 2009 with 1.2% in 2019(1). This detrimental uncertainty is creating complexity in various industries, and it comes as no surprise that the Financial Services (FS) industry is being significantly impacted. The Corporate and Investment Banking (CIB) sector within the FS industry has been the most affected, over the past 12 months, European CIBs shares have fallen by 22%, revenues declined by 4% and return on equity has shrunk to 6.5%(2). As our research indicates, this will only get worse post-Brexit with estimated revenues to decline to as much as 15% and return on equity to drop a further 60-90bps due to an expected surge on incremental operational complexity and capital costs. Unfortunately, with European banks already struggling to compete with global competitors, the revenue extraction benefactors will most likely be US and Asian banks.

Illustrative Case Study

A leading European CIB recently implemented an Agile Operating Model to support their ongoing Brexit strategy and wider ambitions of growth and increased profitability.

As part of their Brexit strategy, the bank had decided to simplify its legal entity structure by consolidating its European set-up. This simplification enabled the bank to optimise its booking model and enhanced client servicing.

As a result of this optimisation and simplification, the European branches were able to utilise the head office as a service centre to reduce costs which resulted in a c.10% increase in profitability during FY18.

The ability to respond rapidly, whether addressing a problem or demonstrating incremental improvements to a service, is a key component in maintaining competitive advantage. CIBs and other financial institutions should now consider strategically "adapting" to become more receptive to change in the future. Implementing an Agile Operating Model will support Banks to make the best of any short-term Brexit scenario whilst also ensuring they are fully equipped for the long-term post-Brexit environment looking at all possible eventualities going forward.

When implementing an Agile Operating Model, CIBs and other financial institutions will need to consider and define various factors such as infrastructure capability, governance and people set up, and regulatory and tax implications and should focus on:

- Enhancing client service
- Simplifying legal entity structures
- Optimising booking models
- Securing capital and funding

To enhance client service, banks will need to understand which clients and segments within that are not achieving the required rate of return in the post-Brexit set-up, from both a revenue and profitability perspective and either stop servicing these clients or migrate them to the most efficient entities or jurisdictions. Whilst focusing on their own offering, banks will also need to understand their competitor's ability to offer clients alternative choices around trading entities and be able to increase agility to cope with any additional demands that may or may not be Brexit related.

To simplify the entity structure and infrastructure, Brexit offers the strategic opportunity to consolidate businesses in hubs which may lead to improved netting, margining, and clearing house relationships and removing split hedges. The European Central Bank (ECB) has made it clear that it will not tolerate shell companies or permanent back-to-back booking to London to maintain the ability to service EU clients and passport. London based banks need to fully establish or expand subsidiaries in the Continent and revise their branch networks.

To restructure and optimise booking models, banks will need to take into consideration the local regulatory preferences for subsidiaries versus branches, with an increase in transparency and control, and enhanced reporting requirements. There is a regulatory pressure on remote booking models; the ECB and NCAs expect market risk will move to the credit risk booking entity in the medium-term and day 1 back-to-back/remote booking models could lead to capital and organisational inefficiencies (e.g. via increased inter/intra company transactions and fragmentation of market and credit risk management). Banks should therefore consider utilising strategic digital initiatives to review and optimise their long-term booking model options.

To secure capital and funding in the post Brexit environment, banks will need to continue to assess the impact on their balance sheet ratios across the various jurisdictions whilst also monitoring the credit rating and cost of capital arbitrage between different entities. Access to capital and funding is a vital component of the agile operating model.

With the pace of change present in the economy, accompanied by the growing Brexit-related uncertainty, banks and other organisations must demonstrate their strategic intellect and their ability to be agile and adaptable to face current and future disruption. Banks need to embark on this agility to continue servicing their clients regardless of location, to adapt to new entity structures, to optimise booking models and as a result, to be in a position to capture new revenue flows.

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