INTRODUCTION

KEEPING CLIENTS' MONEY SAFE

The financial crisis has made private banking clients ultra cautious, and most are solely concerned with protecting their capital. Simpler products providing stable earnings may be the future, writes Yuri Bender

What are the attitudes of private clients in the current crisis and what type of strategies are their bankers suggesting to cope with the unfavourable financial climate?

There is certainly a move away from speculative assets, for which there would be a healthy demand among high net worth investors in a more benign environment, says Alexandre Zimmerman, group head of advisory and investment solutions at SG Hambros Private Banking in London.

"Clients are ultra cautious. The only thing we are doing is buying UK Treasury Bills and monitoring money market funds for exposure," says Mr Zimmerman, who runs more than €12bn for wealthy clients. In fact, there is such a huge demand for government issued paper among private clients, that Mr Zimmerman has taken on extra staff to man the overworked trading desk in his new offices, based in London's upmarket, "old money" district of St James's Square.

Currently, amidst huge daily market swings, the bank has shied away from providing any 'buy' signals or strategic advice to investors. "We are in a period when if you provide something like that to a client, you can lose all credibility and the client can say goodbye." This is no time to be promoting products, believes Mr Zimmerman. Even capital protected instruments, which have a central position in the offering of SG Hambros and most other private banks, do not look attractive, because the cost of the option mechanism, which provides the protection, is currently a too expensive part of the client's investment.

Liquidity funds are now routinely carefully scrutinised by portfolio managers at private banks. "Money market funds were the most preferred client solution during the summer, but some of these experienced quite bad surprises recently," says Mr Zimmerman, pointing out that some liquidity products lost 1 per cent of their net asset value. "Clients understand that even if 95 per cent of AUM is in government bonds or sovereign debt, the 5 per cent remainder could be at risk and the fund could go bust." This is the main reason most have switched out of such funds into direct holding of UK and US Treasury paper. Recently, the three month yield for US Treasuries dropped to zero, but Mr Zimmerman's clients were still prepared to buy them and effectively pay a premium to keep their money safe.

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At Deka, one of Germany's largest banks, Oliver Behrens, the board member responsible for asset management, reports negative flows from discretionary accounts and significant movement into cash and semi-cash. His team at Deka Investmentfonds, which runs €190bn, is currently devising a small number of new private banking and wealth management products to try and reverse the trend. "Our sector has identified big opportunities in the private banking world," says Mr Behrens. While private clients in Germany have traditionally been invested in certificates, real estate and covered mortgage bonds, known as pfandbrief, many of these investments have been called into question.

Clients invested in Lehman-issued certificates have seen their savings collapse, the real estate sector has

been battered by recent valuation scandals and pfandbrief jitters recently led some clients to suffer “sleepless nights”, despite the apparently conservative nature of their portfolios, according to Mr Behrens.

NO FEAR OF COLLAPSE

Sal. Oppenheim, Germany’s largest private bank, wrote to all clients to tell them their covered bond-based investments were safe. “We have absolutely no fear that a collapse could happen,” says Rupert Hengster, head of asset management at the bank. “It is a guaranteed, top quality product.”

Dr Hengster says that one of the results of the current crisis will be a much simpler offering for private clients. “There is now much more business going into old-fashioned mutual funds, and that will increase,” he says, predicting that the structured product and certificates business that has so captivated German clients in the past may not prove so popular going forward.

“Private banks, he says, need to adapt their business models to achieve lower, but more stable earnings from simpler, lower-risk mutual fund products, rather than peddling volatile, investment-bank manufactured structures. Sal. Oppenheim has also detected a definite trend of clients moving assets from banks which they thought were under threat to privately-owned institutions. “That has been exactly the case with us, though not as much as with Pictet and other Swiss banks,” volunteers Dr Hengster.

Independent consultant and former Commerzbank business strategist, Paul Burik, also believes private banking business and delivery models must change fundamentally to cope with the new, post-crisis reality, in which clients are putting a great premium on understanding their portfolios.

Currently, he says, private clients and their advisers are bombarded with information, often in the form of raw data, which does not necessarily contribute to understanding. “Clients need to have portfolio analytics put into context,” he ventures.

He gives the example of a typical international bond portfolio held by a wealthy individual. “Looking at the holdings report, a client typically sees a clump of government bonds, another clump of corporate bonds and various derivatives possibly along with simple diagnostics such as average duration and the mix of holdings by maturity, credit rating and currency,” says Mr Burik. “The accompanying commentary rarely allows the client to readily understand the connection between a manager's views and the portfolio's holdings.”

To make the information effective, these must be tied to the managers' expectations for the government yield curves, credit spreads, currencies and if relevant, segment – whether they are mortgage-backed - or industry sector spreads and stating the net effect of the derivative positions and why they were used.

There are also issues relating to third party manager

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selection on the equity investments side, believes Mr Burik. “Some equity managers are good at telling stories about why they own particular companies – they are always fascinating and appear to make sense,” he says.

“But suppose you are a private client and your wealth manager puts you in touch with six managers, all with good stories. Yet, the client may not know why the bank has mixed the managers in a particular way. Moreover, the client may see little relationship between the positioning of his/her fixed-income holdings and his equity holdings."

It may be relatively easy to talk to clients in terms of scenarios, thinks Mr Burik. However, it is no mean feat to relate a few simple scenarios to an investment programme, implemented using numerous specialist managers, all of whom make autonomous decisions with different scenarios of their own.

Profitability for private banking institutions has also been hit, believes Johan Martens, head of sales and marketing at Brussels-based technology provider Callatay & Wouters, which recently won the contract to provide Dresdner’s Belgian private banking arm with its Thaler Wealth Management system.

“Private banks are really suffering for the moment,” says Mr Martens. “Most of them have business models where they make money on trading activity. In the last three months, this has more than halved, resulting in pressure on their margins. I don’t hear any customer saying he is not affected.”

However, Mr Martens also backs up Dr Hengster’s observation of wealthy clients’ moving their assets between institutions. “There are some new customers for private banks,” he says. “ Wealthy individuals who still have part of their holdings with major universal banks are now shifting to private banks, who don’t have credit banks, and are seen as a safe haven for the moment.”