2020 Private Banking Business Model: A sprint to the future

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2020 PRIVATE BANKING BUSINESS MODEL: A SPRINT TO THE FUTURE

The European changing environment has challenged the Private Banking industry to its foundation. Hence, a weak global economy, strong inflation regulation and low interest rate policy set by the ECB, threaten to lower profit over the next three years¹ causing a graduate margin erosion in Private Banking.² In that context, Private Banks new business model will have to be laid down by 2020.

Imagining the financial sector of tomorrow, it is both impossible and essential, but standing still is clearly not an option. Private Banks need to choose a clear strategy in order to adapt their business model.

Some questions need to be answered: Who will be the customers in 2020? What are their expectations? Does the private banker role need to be redefined to satisfy them? Is the role changing enough? Does the organization need to be adapted too? Do new services need to be developed and launched? Let’s find out.

CUSTOMER SEGMENTATION

Revenue streams need to be managed by Private Banks through a renewal of customer generations. There are two main trends to focus on: the highest wealth as the core-business and the millennial generation as an opportunity to seize.

![Evoltion of Wealth Bands](image)

**Concentration on the richest clientele**

A customer repositioning will be one of the major challenges to fulfil. 2020 Private Banks focus on High Net Worth Individuals (HNWI) and Ultra High Net Worth Individuals (UHNWI)³ to insure sufficient margin.

According to the 2017 Knight Frank wealth report, there is +42% of HNWI and UHNWI from 2006 to 2016, and +20% expected from 2016 to 2026. However, the bearish trend of Asset under Management (AuM) in the “Affluent” customers compare to the HNWI continues to be marked (cf. chart below⁴).

Private Banks tend to offer to the “Affluent” segments standardized products of low complexity which represents low-margin profitability. In this way, the HNWI and UHNWI segment seems to offer a lot of opportunities to Private Banks today and even more in 2020.

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⁴ ABBL Private Banking Group, Luxembourg (PBGL), June 2016.
Some players have already established strategies to reach customers. JP Morgan has increased the minimum AuM level in order to have access to wealth management services from $5m to $10m. Natixis Wealth Management has caught the trend too, resulting in a repositioning in the upmarket’s strategy selling services as “Selection 1818” to Nortia (a platform dedicated to less wealthy client) in order to focus on UHNWI. Those strategies show the strong determination of Private Banks set up to reposition by 2020. In that regards, the demographic evolution is a very important variable to take into account.

**The demographic evolution**

Over the next few years, the aging baby boomers will begin to pass their wealth down to the millenial generation. It will probably be the highest wealth transfer in history. Therefore, retaining this younger clientele will be a forefront stake for Private Banks.

Millenials' confidence in the traditional banking is all but relative. They could switch easily to another bank, creating, therefore, a trust shortage. In fact, the "attrition rate" - the share of clients that are changing advisors - could reach 50% with the rise of this new generation among the banks' customers. They put high value in tailor-made advice which cannot be find on opensource websites such as Bloomberg, Reuters or any other specialised websites. They also want to play an active role participate actively in their portfolio management.

Private Banks have to consider new strategies to attract and keep this new generation that seems to highly value independence, rejecting the discretionary portfolio management. They are also tech savvy having been raised with technologies.

Yesterday, the bank secrecy justified the banks profit. Tomorrow, the added value will come from the quality of services. Banks must review their business model to better fit the needs of the new customer target.

**THE RENEWAL OF THE TRADITIONAL PRIVATE BANKER ROLE**

The role of the private banker profession needs to be adapted to this new customer segmentation that cherishes its digital toys and expect savvy expertise from advisors.

**Machine vs Human**

This is why the evolution of digitalization is such a huge advantage. With the use of digital tools, bankers will have the opportunity to focus on customer relationship as a core-business. In the horizon 2020, Human relationship still plays an important role but is added to a robotization consideration.

Technologies are deeply transforming the profession. Nowadays, Private Banks are seeking competitive edge through miscellaneous digital projects to gain in productivity, generate revenues

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and to reduce costs. Private Banks need to ask themselves “Where can I get added value from by managing internal resources?”

The answer may lie in outsourcing the non-core functions to focus on its core-business: the direct-communication with the client to bring added value. This is where the robo-advisor is considered.

Robo-advisors are used as a decision support system. Based on algorithm and big data, they provide complementary investment advices to advisors in order to help him reaching his client’s objectives. From the client’s point of view, it represents a “low-cost” or, more precisely, a “fair-price” tool. From the banks’ point of view, a complementary tool that permit to advisors to focus on the customer relationship itself.

Nevertheless, are clients ready to be fully managed by robots? According to the 5th annual international survey conducted by the Dutch bank ING Group, 91% of the 15,000 customers-respondents will not let robo-advisors act unilaterally. It can be summarised as the investors’ fear of being subjected to the whims of a machine, that somehow works alone, without any intervention or explanation by their banker. For that reason, the development, in the next few years, of an hybrid-approach would be preferable: the use of the machines’ advice coupled to a final approval by a human wealth advisor looks like the perfect mixt, the best of both worlds.

The use of machines is definitely reshuffling the Private Banks’ profession. Current talent force needs to evolve accordingly.

**Human resources: talents evolution**

In horizon 2020, the new talent profile of Private Banks will no longer be “Finance only”. The most performing banks will hire data scientists, experts in behavioural sciences, economists and anthropologists to improve the client experience. This is an open door to a new value proposition widening the field of career opportunities in the profession. Does that mean that a restructuration plan will soon take place threatening the current talents within the organizations? Yes, current talents are moving, and they need to be trained to transform properly. Nevertheless, this does not have to be seen as a threat but as an evolution and thus, an opportunity.

Private Banks must train its current talents to adapt to new needs. The Private Banking Group Luxembourg (PBGL) of the Luxembourg Bankers’ Association (ABBL) want to establish an advisory certification to increase the advice quality in the Private Banks. In a context of migration of its Information Technology system to a private cloud, AXA has hired a Human Resources transformation director. To insure the digital transformation, the 40%-50% of the 165,000 current talents of the company need to be trained as their jobs are in the process of being transformed, representing a total cost of €143,000,000.

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NEW ORGANIZATION DEVELOPMENT

New client segmentation is resulting in the development of internal talents. Nevertheless, this is not enough. The banks’ organization needs to be more agile and digitalized too to match the clients’ needs.

Cloud as a new IT system

The previous example of AXA cloud is not an isolated case; the cloud is subject to a multiplication of applications in Europe and Luxembourg every day.

Cloud computing systems can be used in three ways: Software as a Service (SaaS), Infrastructure as a Service (IaaS) and Platform as a Service (PaaS). Cloud computing systems are useful for Private Banks as they do not need to install softwares (SaaS), build infrastructure (IaaS) or applications (PaaS), everything is available online – in the cloud – and available in its latest version. It represents an outsourcing of a non-core business: the information technology infrastructure which turns out to be expensive and quickly obsolete. The cloud allows an effective cost reduction, ensure up-to-date systems, on top of more flexibility and rapidity, answering in this way to the new client segmentation stake. The main cloud suppliers are well established names (IBM, Amazon Web Services – AWS, HP or Microsoft Azure) ensuring a certain level of guarantee/quality.

Outsourcing non-core business is expected to be one of the main trend by 2020, including a collaborative approach between traditional banks and new entrants.

2020: Era of collaboration between traditional banks and new entrants

Key partners have to be defined in 2020 to acquire key resources. Fintech have disrupted the business model of traditional Private Banks. Those non-traditional competitors forced them to review their value proposition between business and technology.

Fintech is offering the digital interaction needed by banks to satisfy the technology needs of the new target clientele. In this way, collaboration between traditional banks and non-traditional banks will be one of the major stakes in 2020. In line with its 2020 strategic plan, BNP Paribas Asset Management have recently acquired Gambit Financial Solutions, a robo-advisory solution provider.

WHAT IS NEXT?

After reaching new customers target, adapting resources, organization and collaborating with new tech players, what is next? Some European players have already opened the doors to new services offering in wealth management.

Crypto-currencies: new asset to manage?

The trending market of crypto-currencies is remaining a niche with high volatility and high risk. Traditional banks remain refractory to Initial Coin Offerings (ICOs), cautious of the blurred lines behind it. However, the crypto-currencies niche remains an interesting business to develop. Other institutions have a better risk aversion. Some European banks are daringly engaged in, opening the door to a new segment of young clientele, less traditional, that wants to have access to crypto-currencies advisory and trading.

The Swiss Private Bank Falcon is one of them. By having obtained the approval of FINMA (the Swiss Financial Market Supervisory Authority), the bank offers the possibility to their clients to diversify their bitcoins’ assets or any other digital assets. The activity remains limited as they are not involved in the
ICOs, especially for regulation reasons. Although limited, the crypto-currency activity is already profitable according to the Falcon Bank.  

The crypto-currency niche could be a new activity to develop by 2020 in Luxembourg. Provided that, beside the Private Banks being willing to take this risk, the Luxembourg law framework will be adapted in this sense.

CONCLUSION

Private Banks have key considerations of their business model as the customer segmentation, the renewal of traditional private banker role and new organization to develop by 2020 in Luxembourg. Subject to new client behaviour, Private Banks must gain in agility and flexibility by 2020. The new client segmentation of HNWI/UHNWI and millennials have to be the main point of consideration of Private Banks- resulting in a disruption of the internal organization.

2020 Private Banks’ human capital will be technology and client behavioural oriented to provide quick, digital and tailor-made advices. This is going through various internal projects such as the outsourcing of non-core businesses. And the collaboration with Fintech seems a great solution to increase the flexibility of traditional banks. Additionally, one of the challenges of Luxembourgish Private Banks is their risk aversion’s choice in 2020. Are they ready to answer to clients’ new services expectations, especially in regards of the crypto-currencies niche showing such strong potential?

About Initio

Initio is a business consultancy firm specialized in the Financial Industry. Every day, our consultants contribute to the successful delivery of business projects by transferring their expertise to our client's management and internal teams.

Initio operates in the financial sector, servicing a wide range of clients. Our offering is focused on business consultancy combined with project methodology in order to assist our clients on the whole project cycle.

We have offices in Brussels, Luxembourg & Geneva. Through close collaboration, we can react swiftly on a wide scope of services in order to meet client needs rapidly with the highest industry standards.

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