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WEALTH

Wealth management for high net worth individuals

BY SELINA HARRISON

As the financial crisis took hold, high net worth individuals (HNWIs) watched their wealth decline and quickly lost faith in their wealth managers. Many withdrew assets or left their wealth management firms altogether. But as the economy improves, wealth management firms are seeking ways to alter their business models and provide a better service to their increasingly risk-averse clients, who are demanding more transparency on how their fortunes are managed.

Post-crisis management

Despite the upheaval in the industry, wealth management services still fared better than other financial services in 2008, particularly the investment banking and commercial banking sectors, which bore the brunt of the effects of the financial crisis. Even so, the world's population of HNWIs was down 14.9 percent in 2008 from the previous year, and their wealth dropped 19.5 percent, wiping out two years of robust growth in 2006 and 2007, according to the latest 'World Wealth Report' published by Merrill Lynch and Capgemini in June 2009. "A year ago, there was quite a lot of concern in the wealth management industry about the onset of the credit crunch – the issues surrounding it were at their peak, with the collapse of Lehman Brothers and so on," confirms Carlos Pimentel, a partner at Appleby. "Demand was fairly static, because people were looking at these unprecedented events and wanting to take stock, to see where the industry was going," he says. Consequently, demand for wealth management services stalled, as HNWIs held onto their cash rather than sought new investments.

Ultimately, very few HNWIs have been unaffected by post-crisis issues, such as the vast decline in asset values. Many have shifted wealth to safer, more conventional and liquid investments. In addition, some HNWIs have also spread their assets across more institutions as a means of mitigating risks. But things are beginning to change, and now that the economy is showing signs of recovery, HNWIs are once again expressing interest in the services of wealth management firms. However, they now expect more from their wealth managers. "HNWIs, many of whom are corporate executives, have become significantly more aware that wealth management services involve more than just investment advisory services. With the change in the economy and all too often diminished investment portfolios, our clients are requesting additional services to help achieve some of their financial goals," observes Daniel Kesner, a partner at Marks Paneth & Shron. Furthermore, "they are scrutinising the value of the providers and questioning what they are paying for" adds Mary Ann Mancini, a partner at Bryan Cave LLP.

It is clear that the trust and confidence HNWIs placed in markets, regulators, financial institutions and portfolio management have been shaken. As such, "high net worth clients have become much more focused on the importance of protecting their financial assets and businesses, which they have worked so hard to establish. Wealthy individuals are realising the importance of having sound financial advice and working with a firm that can provide them with a broad range of financial expertise," notes Mr Kesner. Indeed, prior to the financial crisis, many wealth management firms regularly failed to convey the implications of product risks to their clients. But now, those weaknesses in due diligence and risk assessment practices have come to the fore. For example, in the aftermath of various high-profile global fraud cases, such as Bernard Madoff's Ponzi scheme, some clients discovered they had been exposed to these schemes via their advisers without even realising it. In light of these scandals, wealthy individuals are much more cautious about their investments and want to see evidence that any growth on their returns is genuine. "Certainly, in terms of direct financial services providers. Investment strategies are being examined and providers are being held to account much more. Investors are actually getting into the books, getting the managers to come out and explain their processes, and demanding a certain level of auditing from the top accounting firms," explains Mr Pimentel. Consequently, advisers and wealth management firms are working with HNWIs to enhance communication and restore confidence.

Adapting to a new environment

Clearly then, private banks will have to provide more detailed investment advice and comply with tighter tax rules if they are to retain clients, attract new ones and capture the expected growth in global wealth. This requires wealth managers to spend more time on research and knowledge, so they can advise clients at a time when they are backing away from risky products and looking to pay lower fees. There will be a lot more focus on inves-

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tor education, but this transparency will come at a cost. Profits in the industry are expected to fall as the sector implements new practices. This is likely to be exacerbated by stricter tax regulations, particularly on tax avoidance, which has placed additional burdens on the sector. For example, in the UK, amid fears of new regulation, including a new top tax rate of 50 percent, HNWIs are considering relocating to a jurisdiction with a lower tax rate. As such, wealth management firms in the UK have begun to adjust their business models to attract individuals of a slightly lower net worth who work and live in the UK, as opposed to geographically-mobile HNWIs, whose increasingly costly demands can eat into profits.

Indeed, it is vital that wealth management firms are able to adapt to the changes in their business environment. In June, Merrill Lynch Wealth and Capgemini published their latest 'World Wealth Report', questioning HNWIs and wealth management advisers to ascertain why so many HNWIs left their wealth management firms in 2008, and to discover how firms that managed to retain clients did so. Reportedly, a combination of online access and capabilities, statement and reporting quality, risk management and due diligence capabilities, and reasonable fee structures encouraged many HNWIs to stay with their wealth manager. However, these factors, which should be taken into account by wealth management firms looking to improve their business models, were often underestimated by advisers. Interestingly, of those advisers who were able to retain clients, 62 percent were 41 or older. This suggests that clients value experience in an adviser, particularly when being guided through a financial crisis.

It is more important than ever that this sort of research is heeded. Prior to the financial crisis, many HNWIs deliberately chose independent wealth advisers over banks. But the recent spate of high-profile fraud scandals has undermined HNWIs' confidence in the ability of independent advisers to provide adequate due diligence and risk management capabilities. Local and regional banks are poised to take advantage of this sea of change, and it is likely that wealth management will become a bigger industry within financial services, as they are perceived to provide safer investment environments. "In the past, clients often looked at banks mainly as a place to obtain personal loans and to make cash deposits. Clients are now realising that having strong banking relationships is extremely valuable and critical to the services that we provide to them. Our solid relationships with banks underscores this now more than ever," agrees Mr Kesner.

However, Mr Pimentel believes wealth management services will be more driven by taxation issues. "The wealth management industry is likely to become bigger, certainly within financial services. The main drivers behind that growth, at this stage, are going to be the increasingly tough tax and regulatory environment in places like the UK and the US, where you are having 50 percent plus rates of taxation affecting HNWIs. There is going to be resistance to living in that kind of fiscal environment." He adds that the trend among HNWIs, particularly in the UK hedge fund industry, to move to places like Switzerland, is likely to continue. These individuals will increase the demand for wealth management services in these offshore locations, as they will need a proper investment strategy and advice, particularly on tax and other regulatory matters.

Overall, in order for wealth management to retain and attract new clients, advisers must work on rebuilding confidence and client-adviser trust. The capacity of HNWIs to defect is high, and wealth managers need to understand and improve on factors that increase the retention of clients and their assets. HNWIs themselves have expressed the need for more transparency on portfolio performance and a better quality of service and investment advice. It is in the interests of wealth managers to change their outlook and internal processes to meet the new demands of their key clients in the post-recessionary era. ■

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