Private Banking

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Managers of wealth need to be nimble

Firms are struggling to meet the demands of clients who are increasingly becoming more independent, reports *Sharlene Goff*

Protesters at an anti-austerity rally in Greece this month. Global political uncertainty has added to the sector's woes Reuters

There are still no easy answers for rich people looking for help with structuring their finances. Almost five years on from the start of the global financial meltdown, private bankers say the crisis afflicting much of the eurozone, as well as political unrest elsewhere, has meant markets remain gripped by uncertainty.

Even after multiple attempts to constrain the escalating eurozone debt crisis – including an unprecedented injection of liquidity late last year by the European Central Bank – senior politicians have cautioned that the end is not yet in sight.

Britain and Spain sank back into recession in the first quarter of the year as the full sting of governments' austerity programmes was felt. Days later, David Cameron, the British prime minister, warned that Europe was not even halfway through the crisis as eurozone members were still battling to agree the future of the single currency.

"The difference between this year and last is that geopolitical concerns have moved centre stage," says Jane Fraser, head of global private banking at Citigroup, the US bank.

She says it is not just the eurozone problems that have created jitters among investors. Following the dramatic Arab spring uprisings across parts of the Middle East and Africa that began in 2010, political uncertainty spread to the west as elections took place in the US and France.

Gary Dugan, chief investment officer for Asia and the Middle East at Coutts, the private bank part owned by Royal Bank of Scotland, said in a recent note that the immediate reaction to Barack Obama winning a second term as US president was a modest rally in equities and broad dollar weakness. He added: "However, gains may be capped by concerns that Obama may struggle with a divided Congress to avert the year-end 'fiscal cliff' of tax hikes and spending cuts."

Managers say clients are unnerved by unstable political environments. "When markets are volatile, people tend to sit on their hands," says Rory Tapner, head of wealth at RBS.

Among investors' chief priorities is holding a highly liquid and diversified portfolio of assets, so they do not find themselves locked into a risky asset or, crucially at this time, currency, just as values plummet.

Wealth advisers say clients have been increasingly focused on currency risk as the eurozone crisis has deepened. Investors in Greece have moved rapidly to shift funds out of their country into UK property, for example, while French and Italians have begun to follow suit.

"Cash is safe – but in what currency?" asks Ms Fraser. "Clients don't want to be in the euro. There is a lot of interest in baskets of currencies, which include Asian exposure and those of commodity-rich areas such as the Australian and Canadian dollar."

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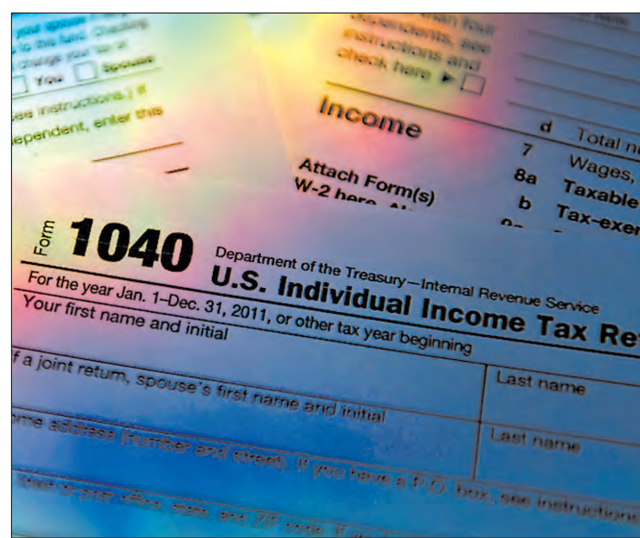

Swap: the IRS will get data on US citizens in the UK Bloomberg

One of the most important and draconian pieces of tax legislation to come out of the US in generations continues to cause anxiety and uncertainty among the world's biggest financial services groups.

A final draft of the Foreign Account Tax Compliance Act – or Fatca – billed as the first time a country will impose an overtly extraterritorial tax regime, was due out last month but is now not expected until next month and probably later.

Capco, the financial services consultancy, says the scope of Fatca is not yet fully defined and "keeps evolving".

"Until the regulations are out, we have nothing set in stone to work with," the head of one of the world's biggest fund managers says.

Fatca was drafted after the revelation in 2009 that UBS, the Swiss bank, had been helping thousands of US citizens avoid tax. UBS was forced to pay $780m and disclose information on some 5,000 account holders in settlement.

In 2010 the US government announced Fatca. The goal was to force non-US financial institutions – banks, fund managers, trusts, fiduciaries, custodians and depositaries – to provide it with data on US citizens with assets outside the US.

Under the original terms, all these institutions would have to identify and review the accounts of any US client on their books and report in the next three years. Accountants estimate the scheme as originally devised could raise up to $8bn in tax revenues by the next decade. But it could also cost institutions more than $100m to set up the systems needed for compliance.

In theory, if institutions do not comply, the US will withhold 30 per cent of any dividends, income and sale proceeds from US assets held by those companies, whether on behalf of themselves or of clients.

It will be up to financial groups that have undertaken to comply to levy the withholding tax on behalf of the Internal Revenue Service (IRS) in the US on any fellow institution that is deemed to be non-compliant. That will be disastrous for some companies, says one fund manager. "No one will want to work for or invest with a financial institution where that might happen."

The good news, says a tax expert at one bank, is that the US has extended the timetable for implementation. The deadline when US withholding agents are required to start holding back 30 per cent of money due to be paid out has been moved to the end of 2016.

The US government has made it clear that levying the tax is the ultimate sanction. Its goal is to make banks around the world hand over information and any evidence of tax evasion on US citizens.

> The US has outlined a lighter touch for some types of investment funds, including pensions

As a result, it has outlined a lighter touch for some types of investment funds, including pensions. It has also tried to address worries that Fatca will run up against state privacy laws and has developed a template for intergovernmental agreements (IGAs).

In September, the UK signed the pioneering IGA, which is expected to come into effect next year. This paves the way for an information swap, and exempts key government-backed investment and savings products, such as individual savings accounts and pensions, from reporting requirements.

Banks will pass on information on accounts of $50,000 or more to HM Revenue & Customs, which will transfer this to the US authorities. The IRS gets the information it wants on US citizens and the UK authorities gain data on UK nationals in the US.

That still presents complications, says Tom Humphreys, a tax partner at law firm Morrison & Foerster in New York. "The UK is technically becoming a part of the IRS system and UK institutions will need to familiarise themselves with the workings of the system and tax principles, which are inevitably rather complex," he says.

Under this agreement, however, all financial institutions will be deemed Fatca-compliant. All proceeds on US assets will be paid gross to UK institutions without the risk of 30 per cent being withheld. It removes much uncertainty for UK financial services businesses.

The UK's agreement heralds "a new phase in the international crackdown on tax evasion", says Withers, the law firm. Spain, France, Germany and Italy are expected to sign up to an IGA shortly, as are Ireland, Luxembourg and Japan.

The US, however, is still battling to get other countries and financial centres, such as Hong Kong, to make similar agreements. Without international ratification, Fatca will continue to cause uncertainty, warns Roger Exwood, emerging markets, Europe and Africa regional head of product tax at BlackRock, the fund manager.

He said: "Financial institutions need to be confident IGAs will be signed by every jurisdiction they operate in to avoid complications. For example, if an EU country does not have an IGA, a financial institution supplying information to the IRS could fall foul of the EU directive on personal data privacy.

"Businesses can only plan with confidence if the IGAs are not only signed but signed in good time."

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Disillusioned clients use multiple curators

Spreading risk

Many people now split assets between several banks, says *Tanya Powley*

The wealth management industry has a long way to go to win back the confidence of rich individuals in the aftermath of the financial crisis.

Disillusionment with poor returns and advice is driving a change of approach to banking. Rather than relying on a single institution for all their needs, a growing number of people are using the services of more than one bank.

"Clients have become more savvy about how they bank," says Cath Tillotson, managing partner at Scorpio Partnership, the wealth management consultancy.

Taking this approach means that investors have the opportunity to spread their risk between institutions, which gives them the option to pick and choose the most suitable bank to use for their different investment needs.

The importance of spreading savings across different banks as a way to limit risk has been heightened by the downturn, which demonstrated that even large institutions can fail.

This is a concern for wealthy individuals since deposit guarantee schemes often have relatively low limits. For example, the UK's Financial Services Compensation Scheme only guarantees up to £85,000 per saver if an institution should go under – and funds held in separate accounts in brands that are part of one group may not be protected individually.

Ms Tillotson believes that individuals have come to regard private banks mostly as product providers, which implies that they no longer value their advice as much as they used to.

"Individuals don't feel the same loyalty with one institution. Many have reviewed their arrangements and now work with more providers than they did in the past," she says.

According to Scorpio's research, wealthy investors in the UK and the US have on average about four and three-and-a-half providers respectively. Ms Tillotson says this would have been much lower five years ago.

The founders of a website that aims to match individuals with the right wealth manager for their needs say they have seen a trend for private clients seeking to spread their wealth.

"We have definitely noticed that people are more demanding," says Lee Goggin, co-founder of Findawealthmanager.com.

He says clients are seeking a more comprehensive overview of the services that are available to them from different providers, and opting to move their money to a number of institutions, knowing their assets are more secure if spread around.

A private client with more than £100m in wealth recently used the company's service to source additional private banks in order to diversify risk.

Cath Tillotson: rich get savvy

There is also a growing trend of rich people shifting their wealth away from the big private banks to smaller, independent wealth managers and boutiques in the search for independent advice.

David Scott, who left the Swiss bank UBS to set up Vestra Wealth, an independent wealth manager, in October 2008, says he has seen a "noticeable" shift in clients moving from the big private banks in the past six months.

"While many clients became disillusioned with the banks post financial crisis, many of them remained with the big banks in the hope that the inappropriate sales practices would cease," he says. "Four years on, no change is in sight, and clients now want to be with a company that they can trust.

"They want an organisation that does listen to what they want and recommends appropriate action accordingly. They want to know that they are not being led into investing in a product to meet a sales target."

Family offices have also benefited from this shift away from private banks as they have come to realise that the need for a trusted adviser may be best met by smaller independent institutions.

"It is not so much that families are deserting big institutions, but that they tend to use them for specific products and services, rather than seeing them as their lead advisers," says one family office specialist.

Industry commentators believe that rules banning all financial advisers from receiving commission from providers for selling their products will give private banks the chance to win back the trust of clients.

From January 1 2013, the UK's Retail Distribution Review (RDR) will outlaw the existing system of commission payments and will permit advisers only to accept payment from clients.

"It has become clear that there were excesses, some would say an overemphasis on product push, in significant parts of the industry," notes Ian Ewart, head of products, services and marketing at Coutts, the private bank.

"The introduction of RDR should now be seen as an opportunity for those that are truly advice led to make a positive difference in the way they serve their clients," he says. "It will make transparent what a client is paying and may help many financial institutions develop a more balanced compensation structure."

Recruiters raise the stakes in the hunt for talent

Asia

Good connections attract stellar pay, writes *Paul J Davies*

The ferocious rise in the number of Asia's wealthy is being matched only by the scramble by private bankers to influence what they do with their cash.

The region last year overtook the US for the first time in number of millionaires, 3.4m, according to a wealth industry survey. This group is growing at twice the average global rate.

"Every three to four minutes there is a new millionaire in Asia," says Didier von Daeniken, head of wealth management for Asia, the Middle East and Africa at Barclays Wealth.

This boom is attracting newcomers into the wealth industry, including mainland Chinese banks. Bank of China last month finally held the official launch of its offshore private banking business in Hong Kong after months of preparation – and a huge push in hiring.

It will be a long time, though, before Bank of China and its mainland rivals make real gains in market share, say industry experts. "Chinese banks have been building out aggressively, but because they think they ought to have a private bank, not because they are winning any clients," says one.

While the market is growing and some institutions are creating new businesses, the population of private bankers who are experienced in providing advice and selling products to Asia's wealthy is not growing to meet demand.

"It is an amazing time – the hiring is frantic," says Kenny Lam, Hong Kong-based co-leader of the Greater China financial institutions practice at McKinsey, the consultancy, which has been studying the changes in the industry in Asia. "The cost margin is getting very high because many people are bidding for the same relationship managers."

He adds that the focus for many institutions around China is moving from winning solely offshore business to reaching the clients more directly onshore on the mainland and Taiwan, through opening China-focused desks in Hong Kong. That China's wealthy are usually still running the company that made them rich means banks are also looking to hire a different sort of banker.

"Previously, private banks would have looked at people from the broader wealth managers such as HSBC or Citigold and trained them to move up to private banking," he says. "Now, they are looking to hire corporate bankers who already have the contacts in companies on the mainland."

Mr Von Daeniken agrees this is true to a degree but says it is not as simple as just bringing a corporate banker into the private banking world.

"Today, people are downsizing investment banking. Does that mean the supply constraints on talent for private banking are easing? Perhaps a little, but it doesn't always work out," he says. "That person may have access to the entrepreneurs, but will they be able to switch that conversation from the corporate one to one where they are able to sell private banking services? The hit rate is often very low."

However, Nick Lambe, a private banking specialist at Morgan McKinley Hong Kong, the recruitment company, thinks the scramble for private banking talent is still focused on people with a good record of keeping a pool of clients who have plenty of funds happy – and who can bring those clients with them to a new employer.

"The battle for people with five years plus experience and who have \$300m-\$500m in assets under management is still pretty hot," he says.

"If someone can demonstrate they can bring over a good chunk of those assets and the clients have a risk appetite that matches the bank's strategy, that person will always be hired. A job would be created for them."

Those bankers are expected to bring over at least 30 per cent of their assets under management or, if the relationships are really good, 50 per cent or more, Mr Lambe adds.

Mark O'Reilly, managing director of Asia-Pacific at Astbury Marsden, another financial recruitment company in Hong Kong, says it is not only about these relationship managers who bring in the money but also increasingly about all the people in the background who ensure a private bank runs smoothly and complies with regulations.

"It is not just on the revenue making side but also on the infrastructure side," he says.

> 'Chinese banks think they ought to have a private bank but are not winning any clients'

"Private banks are investing a lot in their risk functions as the business grows out here."

All of this means pay is increasing in a number of areas, although for the vast majority it is far from the levels of boom-era investment banking. But for the limited number of very well-connected relationship-managing private bankers with the clients who will invest in higher-margin products, the pay can be stellar.

With that pay coming directly out of clients' pockets, no one in the industry is prepared to go into details. But the talent war – and the connection between wealth management and winning investment banking business in Asia – means the best people command big bids to move.

"People think we have reached a level of compensation that is unsustainable," says Mr Von Daeniken. "There are a few people who are very well paid, but there is a big gap with the average."

Mr Lambe agrees, saying this disparity has only increased. "The disparity between the bonuses of the really good performers and the others is greater than it has ever been because there is less in the pot overall."

Due diligence is vital to ensure charity reaches its targets

Philanthropy A few basic steps should prevent funds being squandered, writes *Elaine Moore*

Local "impact" philanthropy that allows people to see the effect their donation has on their community has become one of the most popular forms of altruism in the past decade.

But judging the success of gifts made overseas, in countries the donor may not know well or visit regularly, presents more of a challenge.

Many of the countries with the greatest needs also pose some of the greatest risks that the money provided will not reach its intended destination because of fraud, corruption or poor management.

Choosing a project to become involved with can be a lengthy process. Corruption is common in countries where there is no regulation of charities, says Emma Turner, head of client philanthropy at Barclays Wealth.

Unless there is reassurance on these points, Barclays advises giving money through a UK-based charity that is accountable to the donor and should have rigorous due diligence in place.

Last year Madonna, the singer, was involved in a case that highlighted the pitfalls of donation when her plans for a school in Malawi were scrapped two years after they began, and with \$3.8m spent.

Jon Needham, global head of fiduciary services at SGPB Hambros, says the way wealthy families and individuals donate money has changed in recent years. "Gifting money to charities is not enough," he says. "Instead, the very wealthy want to set up a sustainable philanthropic legacy in which they and their families can take an active role."

But wealthy individuals often have more success by working in partnership with non-profit organisations that already operate overseas, rather than going it alone.

As well as setting up new organisations, Mr Needham has assisted a number of clients to establish their own charitable structures in partnership with a recognised charity in the field they wish to be involved in.

"This gives them the opportunity to be much more hands-on and in many cases allows donors not only to contribute financially but also their skill, knowledge and experience in a way that is personally more rewarding," he says.

Effective donation means having a strategy so that donations are not wasted, but it should also ensure gifts do no harm, says Maya Prabhu, head of UK philanthropy at Coutts.

"We encourage donors to consider local funding intermediaries, including community foundations, that have a good track record," she says. Ms Prabhu also suggests "collaborating with other funders that have experience of working in the communities you wish to support and conducting site visits".

Collaboration can also benefit the charities. In the US, the Center on Philanthropy at Indiana University found that donors were more likely to increase donations to charities with which they were personally involved.

Karin Jestin, head of philanthropy at Geneva-based Lombard Odier, worked with a wealthy European donor who wanted to help underprivileged children overseas. Although he had worked with disabled children he had no idea how to find the right projects.

A homeless boy in India: good philanthropy is not about donating blindly Reuters

The bank, she says, suggested some projects and accompanied him when visiting them on the ground to carry out due diligence.

The charity he chose, Future Hope, was founded in 1987 by Tim Grandage, a former banker, and helps children in Calcutta, India, to leave the streets, providing them with a healthy and secure environment. Every night, the founder drives to railway stations and other public places to pick up homeless, often orphaned, children.

Rebecca Eastmond, head of philanthropic services for Europe, the Middle East and Africa at JPMorgan Private Bank, says good philanthropy means thinking about the challenges, rather than donating blindly. Investment in the right places can, she says, help communities and countries build their own capacity and break the cycle of dependence.

Acumen Fund is one example she cites of a foundation that uses donors' funds and invests them in businesses in the developing world that provide essential services to the very poorest.

Donating larger amounts to fewer causes is also a wise choice, she advises, because it allows donors to do comprehensive due diligence on the organisations they support.

Russell Prior, head of philanthropy at HSBC Private Bank, says negotiating due diligence is the biggest challenge when giving money overseas.

"Funds distributed into poorer countries can go further and achieve a greater impact," he says. "But the legal, regulatory and risk hurdles are much higher than giving locally."

For smaller donations made overseas, HSBC recommends working through reputable international non-governmental organisations. For larger donations, where greater due diligence is required, the bank recommends seeking advice from professionals working in this area.

There is also, he notes, a difference in the tax treatment of donations made overseas compared with those made locally. "Giving to local charities in your own country is, in many countries, tax effective, whereas personal charitable donations made overseas rarely are," he says.

Managers of wealth need to be nimble as they look to regain trust

Continued from Page 1

For sophisticated investors with more of a stomach for distressed assets, the eurozone crisis is expected to create some opportunities in the next year as banks restructure and trim balance sheets. Wealth managers believe asset prices remain too high – and there is a long way to drop – but they expect some buying opportunities to emerge around property and corporate loans.

While Europe is believed to be at the beginning of a decade-long economic adjustment, more positive signs are surfacing in the US as confidence creeps back into the economy.

Citigroup says it has seen renewed signs of life among entrepreneurs as confidence returns and, with it, a greater appetite for investing.

As Europe falls deeper into the downturn, however, the gulf between eastern and western markets is becoming ever more apparent.

Wealth managers say entrepreneurs and investors in emerging markets are aware that growth will be more difficult over the next five years than it was in the previous five, but that they still expect gross domestic product in developing areas to increase at a faster rate than in the west.

A big driver is the rapid expansion of the middle classes, particularly in China, Hong Kong and Singapore, but also in smaller markets such as Indonesia and the Philippines.

Growing businesses are also finding it easier to access finance in the market rather than relying on family wealth.

"Bit by bit, Asia is moving to a more classic wealth management model," says Mr Tapner at RBS. "There is more growth, more risk."

Back in Europe, muted appetite for risk meant that investors missed out on an opportunity to bolster their portfolios in the early months of this year.

Equities had a good run at the start of 2012 – the Dow Jones Industrial Average increased 7 per cent in the first three months, while the FTSE All-Share rose about 5 per cent.

However, antipathy towards the markets meant that few private investors took advantage of this rise. Instead they are still favouring cash or cash-related short-term securities, even though the returns on these have been curbed by high demand and low interest rates.

Clients are also chasing investments that provide capital gains because the taxes on these can be lower than on those that generate income – although the greater demand means returns on these instruments are being squeezed.

It is not just investors that are facing a tough environment. The banks themselves are battling against not just difficult market conditions but a string of other challenges.

"Given the tougher regulatory backdrop, the continuing eurozone crisis and an increased focus on tax transparency, there is now even greater pressure for private banks to maintain their margins, control costs and find new avenues of revenue growth," says Jeremy Jensen, head of private banking and wealth management in Europe, the Middle East and Asia at PwC, the professional services firm. "Standing still is no longer an option and institutions must quickly adapt now, or face being left behind."

Recent months have also produced some reputational issues for the industry. The Financial Services Authority, the UK regulator, branded private banking and wealth management an "emerging risk", rocking the traditionally conservative image of private bankers.

> 'Today's client is cautious, smart, less loyal'

The watchdog found evidence that many firms were selling unsuitable products and prioritising their own incentives over customers' needs. A review followed a string of FSA penalties against some of the most prestigious names in financial services, including Coutts and JPMorgan, the US bank.

These reproaches, and the disappointing investment performance of many asset classes since the crisis, have left banks facing an uphill struggle to win back trust. "Today's client is cautious, smart, less loyal, expects a greater level of service and clear value," says Mr Jensen.

"Private clients have traditionally been relatively easy to manage, but they are now taking a much more active interest, and wealth managers will have to work harder to earn clients' long-term loyalty and trust."

Ms Fraser at Citigroup adds: "Trust will have to be regained client by client through back-to-basics relationships. If the industry focuses on core relationships, it will be a much healthier financial system."

Experts offer guidance on how to keep it in the family

Inheritance Imaginative schemes exist to train the scions of wealthy families to manage their fortunes, says *Lucy Warwick-Ching*

Family fortunes: Dudley Moore as 'Arthur' (1981), whose behaviour puts his legacy at risk Warner Bros

Private banks are thinking of innovative ways to get youngsters interested in the language of finance. Some hold tutorials to teach children about wealth while others run competitions or set up interactive virtual portfolios to give them a taste for finance.

"One of the challenges we run," says Charlie Hoffman, managing director of HSBC Private Bank, "involves giving children £1,000 each and asking them to use it to make as much difference to the world as they can with it."

He says the idea of the competition is to teach the value of money. "For example, we might tell them how much it costs in Africa to save someone's sight or to supply a family with water for the year," he says.

"The idea is that at the end of the project the child will understand what £1,000 can do so that when that child grows up and goes into a nightclub and considers buying a bottle of Cristal, he or she might think twice."

Others, such as Fleming Family & Partners, run *Dragon's Den*-style courses, in which attendees, in teams, come up with entrepreneurial ideas to present at the end of the week to the "Dragons" – industry experts and their parents.

But what is the point of these courses? Private banks say that failure to carry out cross-generational succession planning can have a more dramatic effect on a family's finances than a banking crisis or a collapse in market confidence.

This is because most family fortunes fail to survive three generations and the absence of clear leadership, effective communication and well-documented governance structures can cause uncertainty and division, which is particularly damaging if there are directly held business assets.

Andrew Nolan, head of the family office division at Stonehage, the wealth manager, says: "At its mildest, this disagreement can result in a loss of direction and leadership and, at its worst, can result in a full-scale family war as different family members fight each other for the assets, the legacy or the family leadership.

"By the third or fourth generation, the chances are very high that those who inherit were brought up in luxury with little concept of the work ethic on which the family fortune was founded. The increasing independence of younger generations today, who are less likely to take the helm of a family business, is also an emerging issue."

> 'By the third generation, the chances are that those who inherit were brought up in luxury with little concept of a work ethic'

The problem, says Catherine Grum, head of wealth advisory at Barclays Wealth, is that many families do not like talking about their wealth. "But if people don't have the discussions then the family won't know what to do once the matriarch or patriarch dies," she adds. "Most of the conflict I see is based on a lack of communication between the generations."

She says one of the biggest concerns for many families is divorce. "Wealthy families worry that their children will be seen as a target," she says. "One of our clients was so concerned about it they had a family rule that for the first three years of marriage each child's wealth was limited so they gave the marriage a chance of success."

Société Générale Private Banking says it runs a number of technical workshops for clients' children, which focus heavily on succession and transgenerational planning. It also runs investment games where students manage virtual portfolios.

Then there is the Coutts Academy, run by Coutts private bank. One of its courses, Finance "101" – which derives its name from basic university courses in the US and elsewhere – is designed to help 18-30-year-olds have an understanding of personal finance. It has an online classroom for people around the world to help younger clients establish a network of contacts.

Experts say many families have not seen the levels of growth they had before the financial crisis and need to adapt. "The crisis has continued for such a long time – and looks likely to continue – that families are increasingly being forced to look at next generation planning through necessity as much as by desire," says Paul James, chief executive of Citi Private Bank's trust business.

Richard Brass, director at Berenberg Bank, agrees. "The crisis has brought about a great awareness of volatility, the risk of negative performance and the vulnerability of family estates. Families are looking to be more involved in preserving their wealth.

"Mapping the overall wealth of a family and its ability to support future philanthropic projects is therefore important alongside determining an investment strategy," he says.

"This creates a two-way dialogue. The current generation can reassess existing strategies, while the future generation learns about the family's vision and approach to wealth."

Higher risk equities displace safe bonds in quest for better yields

Investment

New strategies have to be found to counter low percentage returns, says *Tanya Powley*

Private banks are starting to turn to higher risk assets to preserve the wealth of their clients as returns from fixed-income fade and rates on cash remain low.

Bonds have been the asset class of choice for wealth managers as their priority has been to focus on wealth preservation for their clients amid volatile global stock markets.

But as yields on fixed-income have fallen, private banks have had few options but to increase risk, often moving more money into equities in the search for real returns.

"We see many of our clients who have become frustrated with deposit rates, and this is the challenge for investors right now: where to achieve inflation-beating returns without taking on too much risk?" says Alan Higgins, chief investment officer UK at Coutts, the private bank.

He points out that many of the traditional haven asset classes, such as government bonds, now offer negative real returns.

This has led many wealth managers to shift away from government gilts and into investment-grade, high-yield and emerging market bonds.

SGPB Hambros, the wealth manager, has been investing and telling its clients to allocate a large portion of their portfolio in corporate bonds with strong fundamentals.

"These assets have delivered double digit returns on a year-to-date basis," notes Eric Verleyen, chief investment officer at SGPB Hambros.

SGPB Hambros has increased the resources it devotes to bonds to make sure its selection process is very robust.

"As co-operatives are now financing themselves at lower rates, there is not much yield remaining on top-quality bonds. The bonds universe needs now to be enlarged to the so-called high-yield bonds," says Mr Verleyen.

"There are some very good names in that sphere and our role is to identify those companies with great prospects that create opportunities for our clients," he adds.

Over the past year, Citi Private Bank has advised clients to invest in long-dated, good-quality corporate bonds. According to Alexander Godwin, global head of asset allocation, US corporate investment-grade bonds with maturities over 10 years would have returned 13 per cent for investors in the year to date.

However, with corporate bond yields falling and some concerns over liquidity risks, some private banks are now looking to the equity market for more attractive returns.

"Much of the focus has been on corporate bonds, which have become so popular that trading turnover has risen fourfold since the credit crisis, and yields are the lowest since records began in 1973 at 2.8 per cent," says Mr Higgins.

In the past month, Coutts has been switching out of cash and investment-grade bonds into equities. "We are looking to high-yielding equities as a counter to the low interest-rate environment," he says.

Citi Private Bank has taken a similar approach. "With fixed-income yields so low, many stocks offer high yields through their dividend payments," says Mr Godwin.

However, he says that attention needs to be paid to the sustainability of the stocks' dividends based on the strength of the company's cash flows and balance sheet.

ABN Amro has also become more positive on equities, moving to an overweight position in early September. It also reduced its exposure to cash from 16 per cent to 4 per cent.

"People are starting to look at the equity markets to find new kinds of havens. They are doing this by default because bonds are too expensive," explains Didier Duret, chief investment officer at ABN Amro. He says that, while clients are looking for ways to preserve their wealth, this can no longer be achieved in the traditional ways, such as cash and the safest government bonds.

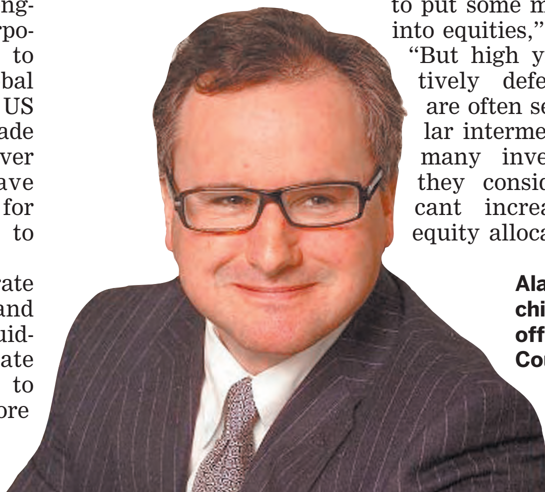
Investors with longer-term horizons should focus on increasing equity allocations, according to Willem Sels, UK head of investment strategy at HSBC Private Bank.

"We're overweight equities in most portfolios and believe that valuations are still attractive in most countries," he notes.

However, many investors are reluctant to increase their risk despite the allure of possible higher returns.

"Low cash and bond returns are starting to incentivise more investors to put some money to work into equities," says Mr Sels.

"But high yield and relatively defensive stocks are often seen as a popular intermediary step for many investors, before they consider a significant increase to their equity allocation."



Alan Higgins, chief investment officer UK at Coutts

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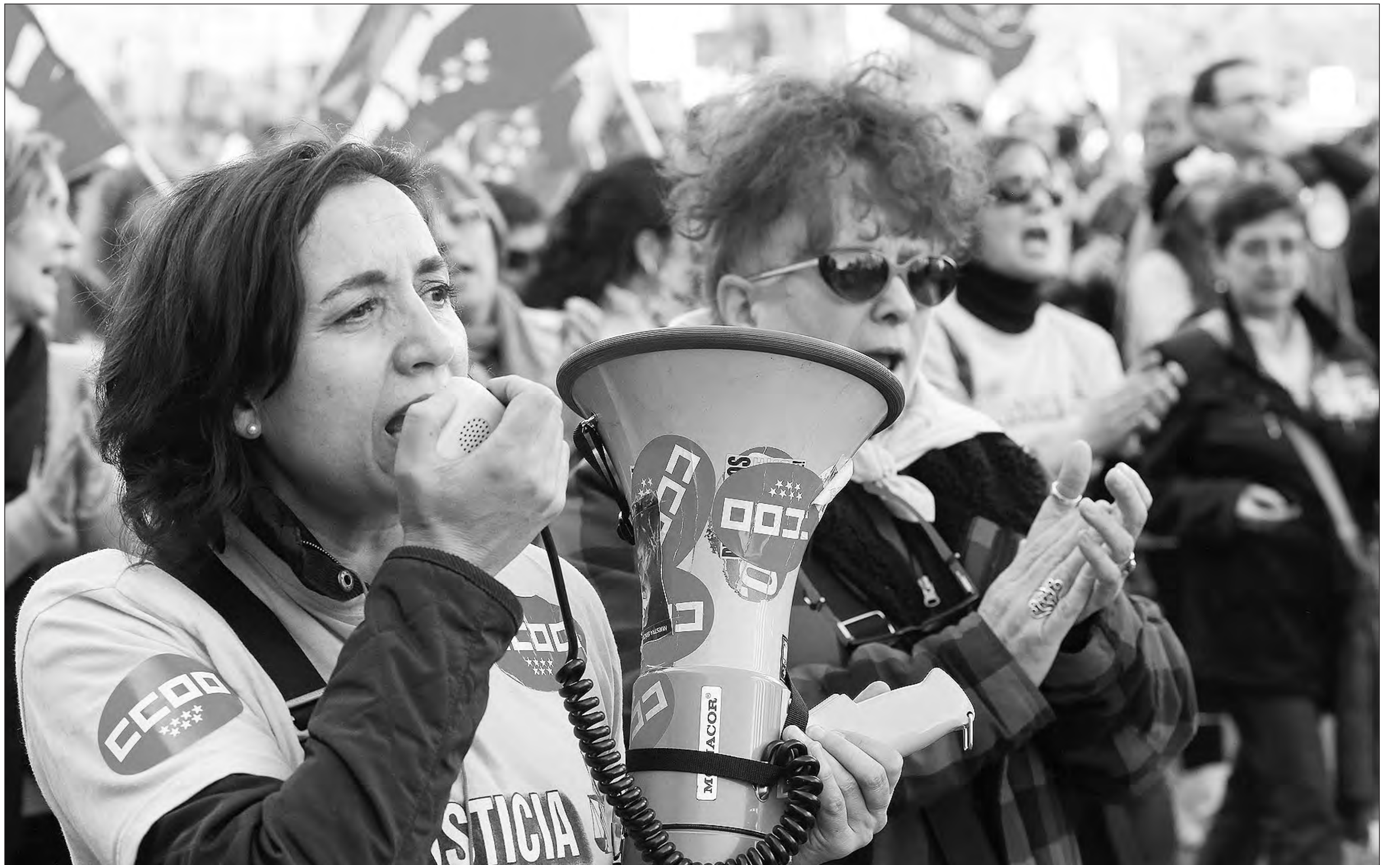
Spanish investors look for secure growth abroad

Eurozone fallout The wealthy are seeking to invest away from the continent by turning to emerging markets, reports *Miles Johnson*



Protest: demonstrators taking part in a general strike in Madrid in November. Economic clouds have led to a demand for assets held outside the country Getty

During a year in which the value of Spanish government bonds has gyrated wildly, it is sometimes easy to forget that the European debt crisis has transformed what were once sturdy, if somewhat dull, assets into almost speculative investments.

For rich Spaniards who, after their country joined the single currency, believed they had left behind the days of currency devaluations and sovereign risk, the concerns over Spain's place in the euro has triggered a reassessment of what, if anything, can be deemed a safe investment in a suddenly highly uncertain world.

While the verbal intervention of Mario Draghi, president of the European Central Bank, has reassured investors that Spain will not be leaving the single currency any time soon, lingering fears have seen many wealthy Spaniards increasingly divert investments abroad.

Many of the country's private banks have reported that their clients are more concerned than ever before with the risks that are now present when investing in shares, bonds or property based in their home country, and many have sought increasing diversification into investments elsewhere.

For two years they have been asking where should they invest. The focus of families used to be profitability, now it is which bank can they trust in, with people looking for solid, strong institutions. As a result, wealthy families are seeking diversification both in Spain and outside it and the eurozone.

"In the short term, no one thinks the euro will break, but in the medium term there is less certainty," says Ana Figaredo, Spanish head of Lombard Odier, the Swiss private bank. "There is a lot of tension about what will happen in Greece, as people think that could lead to a chain reaction of countries leaving. No one knows how a country leaving the euro would work."

This uncertainty has increased demand for assets that are not denominated in euros and for companies that have large parts of their businesses outside the region.

Some private banks also report rising demand for gold investments, while others offer to locate funds outside Spain.

"We are seeing people want to reduce their exposure to Spain, and look more for international companies to invest in, or at least Spanish companies with international businesses," says Ms Figaredo.

Retail and private bank client demand for gold holdings has risen around the world since the unleashing of unorthodox monetary policy by central banks during the crisis. This was due to increased concerns over currency debasement, and private bankers in Spain note that very few clients had ever made such a request until the recent past.

"Three years ago it would have been very rare for a client to want gold. People are now willing to sacrifice profitability for perceived safety," says Ms Figaredo.

Although private banks are loath to reveal the activities and investments of their clients, anecdotal evidence suggests that there has been an increase in wealthier Spaniards looking to move funds outside the euro and Spain.

Another risk that many are keen to avoid is expected tax increases over the next five years as the Spanish government attempts to find new ways to reduce its budget deficit.

Private bankers report rising demand for so-called Sicav investment vehicles – collective investment schemes that are taxed at a significantly lower rate than standard investments and which are registered in Luxembourg or other locations away from Spain.

Antonio Salgado, general director of Banque Privée Edmond de Rothschild in Spain, also argues that while many wealthy families in Spain were once just interested in the level of returns being generated for them by their wealth manager, many now concentrate more on the financial strength of their banks and the experience of the staff they hire.

Mr Salgado says: "People are looking for solid, strong institutions, and families are seeking diversification, with part of their wealth in Spain, and a part outside Spain and the eurozone. We are recommending much more diversification than before, not only in bonds or shares, but also in emerging market bonds. We are also looking at alternative assets, such as gold and private equity, that can offer higher returns."

Yet for Mr Salgado, concerns over the possible exit of Spain from the eurozone are fading, and are no longer the main worry of clients. Instead, many are facing a similar problem to that of investors worldwide; to find any stable asset that can provide a satisfactory rate of return.

> 'There has been an increase in wealthier Spaniards looking to move funds outside the euro'

"The situation in Spain is one driver, but the main principle is that market conditions across the world have not been what people are used to," he says.

"Many families are looking for a way to have returns, which is not easy at the moment."

Even more dramatic outcomes, such as a Spanish government bailout, now appear to be less of a concern for clients, who have endured one of the roughest years that the Spanish markets have had to endure.

Ms Figaredo says the fear that has stalked many of the country's moneyed families during parts of this year has subsided, and she does not expect any significant panic should Mariano Rajoy, the prime minister, make a bailout request for European rescue funds.

"A big portion of our clients are now expecting a rescue, it is a question of when," she says. "It has been largely discounted, so I don't expect we are going to see panic."

Wealthy angels step into the lending breach

SMEs

Start-ups provide investment chances, writes *Kate Burgess*

In March, a UK government report said that the shortfall in credit faced by small British businesses could be as high as £60bn by 2016.

Its author Tim Breedon, former chief executive of Legal & General, urged the government to find ways of boosting small and medium-sized enterprises' access to alternative sources of funding, whether through pooled loan funds or private placements of debt.

Mr Breedon said companies should be encouraged to consider other innovative financing schemes, for example mezzanine finance and hybrid debt or peer-to-peer lending platforms.

Andy Haldane, head of financial stability at the Bank of England, said in a speech in New York the same month that: "Small peer-to-peer lenders . . . could in time replace high street banks."

Since then "crowd funding" and peer-to-peer lending to the enterprises supposed to fuel job growth and economic recovery have been much discussed.

Pundits and policymakers are asking how they can get a meaningful number of successful businesspeople, who have already made money, to invest in or lend to entrepreneurs and start-ups. After all, they have the ability to back and advise fledgling businesses.

For some time, private equity firms have been locking on to a new base of individual investors from private banks to supplement the sovereign wealth funds and large pension funds that have historically invested in their venture capital and buyout funds. More and more buyout fund managers are turning to private banks to help to distribute their private equity investment schemes to individuals who can afford a minimum investment of $1m. Carlyle, for example, has been using the Goldman Sachs private bank and KKR has been using JPMorgan to market funds to wealthy individuals.

Meanwhile, private banking clients, who have suffered nearly a decade of poor returns on public equity and now low yields on bonds, are eager for any investment that will pay decent returns.

Richard Hill, co-head of Fleming Family & Partners Advisory, which advises a number of wealthy families with £4bn of assets in total, says his clients invest in small and start-up businesses not because "they want to take on the role of banks [but] more that it's where they see opportunities for return".

John Veale, chief investment officer, Stonehage Investment Partners, a multi-family office, says:

> There are hurdles but the returns can be spectacular if investors back the right company

"The retreat of banks from the SME funding market over the past few years has created opportunities.

"Five years ago our clients would not have lent to SMEs at all. We don't facilitate direct lending, but a growing number of our clients do invest through fund structures."

He reckons that clients will typically have between five and 10 per cent of their portfolio allocated to private debt, which will include SMEs.

But many clients do not want to limit their investment to bonds or pooled funds. Taking direct equity stakes in start-ups may be higher risk and there are more regulatory hurdles, but the returns can be spectacular if investors back the right company.

In addition, says Andrew Haigh, head of client propositions at Coutts, the private banking arm of Royal Bank of Scotland, many wealthy investors who have made fortunes from business are not simply pursuing high returns.

Successful businessmen also back start-ups because they want to "give something back", according to the bank's survey of entrepreneurs, with 74 per cent keen to advise other businesses and 65 per cent prepared to invest in another venture.

Private bankers at HSBC note that clients who have built their wealth in sectors such as retailing or mining and resources, are usually so well plugged into their own network of contacts they rarely need help. They can find their own venture capital opportunities.

Coutts, however, says its clients like help in picking the right project. The bank is the private banking partner of a number of business angel networks that set out to match those who have made a success out of setting up a business with those who would emulate that success. For example, it is a partner to Envestors, a network that helps to match investors with start-ups needing expansion capital.

The service may not obviously reap high returns for the bank, says Mr Haigh, but it deepens the bank's relationship with clients.

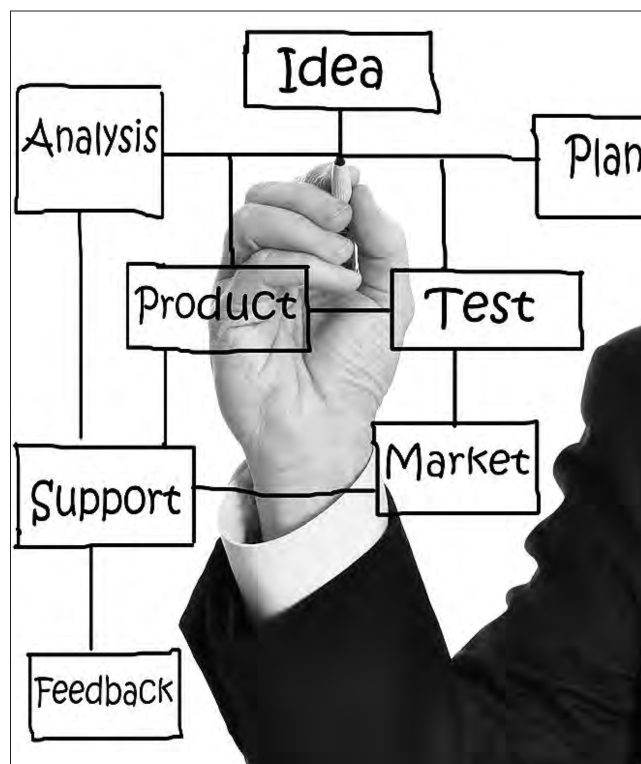
He says entrepreneurial clients want to know about business angel opportunities as "part of their wealth strategy. They want to lock part of their money up but they also want to do something emotionally and intellectually rewarding with their money."

Mr Haigh says that while the amounts handed to each start-up may be small, "they are becoming material in aggregate".

And successful businessmen make good investors for small companies, he adds, saying: "Entrepreneurs are more patient. They roll their sleeves up and get involved."

When things turn sour, they are often philosophical. They understand the risks of trying to start out on one's own, he says.

Finally, he adds, clients get a certain satisfaction even if their investments do not all pay out stellar returns. Backing a breakthrough start-up makes for a much better dinner party topic of conversation than a tale about a diversified investment portfolio managed by their banker.



Businessmen are good investors for new companies Dreamstime

Sectors move closer but client relations remain key

Manager co-operation

Advisers should err on side of caution, says *Daniel Schäfer*

Tying the adrenalin-driven world of investment banking to the distinguished universe of wealth management never really seemed a good match.

"Taking investment bankers and turning them into private bankers is fraught with problems," says Penney Frohling, a partner at Booz & Company, a global management consultancy. "They are dealmakers and not relationship bankers."

Regardless of the differences between short-term dealmaking and long-term relationships, both businesses have moved closer in the past few years.

Investment banks from Goldman Sachs to Barclays have sought to strengthen their wealth management arms in the past few years, while others such as Credit Suisse and Citigroup have deepened co-operation between their vast wealth management arms and their corporate and investment banks.

The reasons are twofold. First, both sides can feed each other existing clients. Second, wealthy clients often ask for investment banking expertise.

Tom Kalaris, head of wealth and investment management at Barclays, says: "We share infrastructure and research with the investment bank and we sometimes partner with them, especially with key clients at the top end of the spectrum, whose needs often mirror those of investment banking clients."

This is particularly true in Asia and other emerging regions, where private wealth and entrepreneurship go hand in hand.

An entrepreneur who lists his company on the Hong Kong stock exchange will want to invest this payout elsewhere. In Asia, more than 60 per cent of rich clients are business executives and they regularly seek corporate finance advice.

Christopher Wheeler, analyst at Mediobanca, the investment bank, says: "If you don't have an investment bank in Asia you won't be able to get business from ultra high net worth entrepreneurs there."

This is the reason why some pure-play private banks have opted for partnerships. Julius Baer, the Swiss bank, has strategic partnerships with Australian investment bank Macquarie in the region, as well as with Bank of China.

A tighter union between investment banking and wealth management has also become more important in the US and Europe.

One particular area is equities trading and public listings. Ms Frohling at Booz & Co says: "You want to give your ultra high net worth individuals the first look at IPOs.

"This is how investment banks can make inroads in wealth management."

In a similar manner, some banks are also giving their wealthy clients access to services long reserved for institutional customers – such as research and wholesale pricing. Some banks even have private bankers sitting at trading desks to better understand capital flows and the pricing of block trades or foreign exchange transactions.

Investment banks' prime brokerage relationships can also lead to the referral of clients. Hedge fund managers typically do not want to pay a high fee for private banking. Some investment banks therefore look at client relationships from a holistic perspective, lowering the margins on one side of the business for the benefit of the other.

> Wealthy people often ask for investment banking expertise

But a strategy to bring the two sides of banking closer together can also have drawbacks. The most difficult hurdle is bridging the cultural differences and the preparedness of the two sides to share revenues.

Ms Frohling says: "The ability and willingness to look at revenues across the group has always been a stumbling block."

Some banks have been better at incentivising their staff to co-operate. Credit Suisse even publishes "collaboration" revenues of its asset and wealth management and the investment bank, for which it has a target range of 18 to 20 per cent of net revenues.

Deutsche Bank, seeking to emulate this strategy, set up a joint venture in 2008. But this year it launched a deeper push that will see the investment bank providing trading, structuring and execution expertise to wealth management clients, giving access to investment opportunities in capital markets and cross-referring clients.

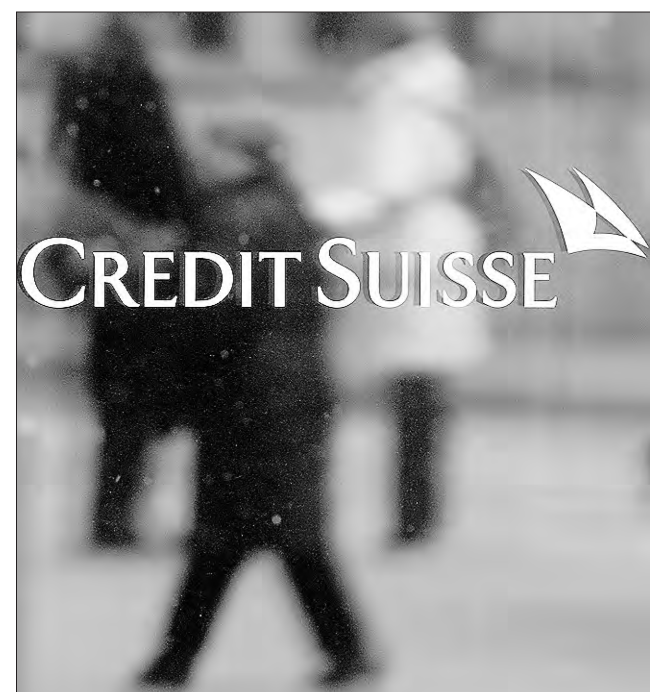
At Deutsche, as at other banks, an integrated approach had been opposed as bankers feared it would turn a relationship-driven unit into a sales machine for the investment bank.

Jacques de Saussure, senior managing partner of Pictet & Cie, the Swiss private bank and fund manager, says: "There is a tendency by investment bankers who run wealth management businesses to look at it as a channel for their products."

Some analysts say it is a question of setting the right incentives. "You have to make sure that your relationship manager is and remains the gatekeeper," Ms Frohling says.

Tim Monger, financial institutions partner at The Boston Consulting Group, adds: "The relationship is much more important than product X or Y, which you can buy anywhere else."

He thinks that, despite some advantages, there is no need for a wealth manager to have an in-house investment bank. "It is not a necessity. There are plenty of wealth managers that don't have investment banks attached."



The Swiss bank publishes 'collaboration' revenues of its asset and wealth managers and the investment bank Reuters