

MEETING THE NEEDS OF THE HIGH-NET-WORTH CLIENT

BY ANDREW SINGER

FOR SEVERAL YEARS, the Money Management Institute (MMI) has been conducting meetings for bank industry executives interested in getting into managed accounts—an investment product targeted at the affluent client segment. “Each year these meetings have been getting larger and larger,” notes Christopher L. Davis, president of the Washington, DC-based MMI.

Indeed, Davis recalls being in an elevator with a group of bankers when the topic of managed accounts came up. One banker remarked, “We have no choice. We *must* do the managed account business.”

The bankers, Davis explained, had been given their marching orders from above: “Stop the hemorrhaging of trust assets.”

Losing ground

It is really no surprise that banks, like others in the financial services industry, are leveling their sights these days on the affluent customer. Yes, personal trust assets held by banks have declined about 10 percent over the past eight years from a peak of about \$1.1 trillion in 1999.¹ But that’s not all.

With the enormous wealth that is due to be passed between generations, there is now “extraordinary interest in serving high-net-worth [HNW] clients,” observes William Butcher, senior vice president for Bank Trust, Natixis Global Associates (Boston). Moreover, this comes at a time when banks are also finding it increasingly difficult to make money in their traditional ‘spread income’ businesses. They are focused on generating more fee income, which seems to be “less subject to the vagaries of the market,” including interest-rate volatility, adds Butcher, a former private banking officer with Bank of Boston.

“In a market where products are commodities, you add value in the way you put the pieces together for the client,” says David Hanson, president and CEO for Fulton Financial Advisors, the wealth management unit of Fulton Bank (Lancaster, PA). And there are simply more opportunities to customize (to put the pieces together) when working with HNW clients. They have needs when it comes to taxes, estate planning, philanthropy, and so on.

There’s also a kind of ‘awakening’ on the part of banks. “They want to compete with the wirehouses” who have snatched many of their trust clients in recent decades, comments Tim Clift,

chief investment officer at FundQuest (Boston).

Integrating trust and brokerage

In recent years, banks have begun to rethink their approaches to the HNW market. To cite one example: Traditionally, affluent clients were typically serviced by the trust department, observes Invest’s Lynn Niedermeier, with an emphasis on financial planning. Retail brokerage, by contrast, was product driven, and served the mass and (sometimes) mass-affluent client segments. Brokers had limits—usually somewhere between \$100,000 and \$500,000—above which an account had to be handed over to the trust department.



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Lately, there’s been a “huge change,” says Niedermeier, as banks realize that the model doesn’t work anymore. For one thing, banks typically undercharged clients in their trust departments, both with regard to administration and investment management fees.

A typical investment management fee today is about 100 basis points. Yet, some banks were charging only 20 basis points, observes Niedermeier. At that level, you can’t even make back your costs. In the past, trust was often a “loss leader,” designed to keep big-time bank clients happy.

Today, banks actually want to make money in this area. And one way they are doing this is by putting trust and brokerage together, under one umbrella, and offering so-called wealth-management solutions, says Niedermeier.

“The trust/brokerage wealth-management concept is picking up speed in banks,” says Niedermeier. The rules about handing off a brokerage client that is beyond a certain account size are

¹See Butcher, William C., “Trust departments playing catch-up with sophisticated clients,” *BISM Online*, http://bisnet.org/bism/2007/ixis_butcher.html.

becoming less common. The guiding idea today seems to be “wherever the client wants the relationship—that is where it should be.”

Hancock Bank’s ‘integrated model’

At Hancock Bank (Gulfport, MS), trust revenues have been growing at about 20-percent annually for close to a decade. Virtually all of this has been organic growth, according to Clifton J. Saik, executive vice president of Hancock’s Wealth Management division.

A key reason for this growth has been the “fully integrated model” that Hancock has embraced with regard to servicing the client. A private banker (i.e., a relationship manager, usually with a financial-planning background) will often make joint sales calls with a commercial banker; the private banker is prepared to offer financial planning or estate planning, or any other kind of wealth-management service to commercial bank clients where appropriate. Trust, private banking, brokerage, and insurance all report to Saik. (More on this later.)

There are no hard-and-fast rules for determining whether a client qualifies for trust at Johnson Bank, a Wisconsin-based institution that boasts almost \$5 billion in assets under management. Much depends on where a client is in his/her wealth cycle. A young client with strong economic prospects could qualify for trust with only \$250,000 in investable assets. “Our teams assess where the right place is” for that client, says Brian Lucareli, senior vice president and director of Wealth Advisory Services. Conversely, a recently retired client with a large 401(k) rollover might be served capably on the consumer or brokerage side of the bank.

Geography is also taken into account. Johnson operates in two states, Wisconsin and Arizona, and eight regions. At least \$500,000 in investable assets might be an appropriate minimum for trust in Racine, Wisconsin, but a \$1 million minimum might be more realistic in affluent Scottsdale, Arizona. Again, the watchword is flexibility.

Johnson Bank uses a hub-and-spoke model with regard to the affluent. There is a relationship manager in the center who draws on a team of experts. The four disciplines represented are trust, brokerage, private banking (credit products), and insurance. Trust, brokerage, and private banking report to Lucareli.

It is the customer who selects the



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relationship manager. In theory, an insurance rep could be the relationship manager, and he/she might call in a trust officer to set up a trust for the client, if needed. If the client is an active

trader, a brokerage rep could be the relationship manager. If the client has neither the time, skills, nor inclination to manage his/her money, that individual might opt for a discretionary account in which the trust officer acts as the relationship manager.

Over the past five years, Johnson’s trust business has produced annual double-digit revenue growth as well as double-digit net income gains, primarily through organic growth. “It has to be all about the clients, and if you don’t put the client in the middle, you won’t be successful,” says Lucareli. But you also need the right people. “The hardest part is retention and devel-



Today’s affluent and Baby Boomers are savvier than their parents when it comes to wealth-management issues, and as a consequence, banks must recognize that ‘we may not be the total solution.’

—Brian Lucareli, Johnson Bank

opment of talent.” Lucareli sees a greater demand these days for wealth advisors with post-graduate degrees and certifications.

Johnson has about 30 relationship managers in the trust area and 13 dedicated financial consultants in the brokerage area under Sharon George.

Banks traditionally have had good relationships with HNW clients, says Michael Gregson, senior vice president for Wealth Management, LPL Financial Institutions Services (Charlotte, NC); but this relationship has been mostly confined to traditional banking services, like deposits and loans. Banks now realize they must offer these customers more, including brokerage, insurance, and fixed-income products.

In the past, the customer went through one door for trust and another door for brokerage. But now the HNW customer is serviced from one central location—maybe not by a single person, but at least there is one place where that individual can go and find the required expertise in these other ancillary areas (e.g., insurance) if and when they are needed.

Eliminating ‘lines in the sand’

Fewer ‘silly rules’ are being seen in banks—such as a ‘line in the sand’ with regard to investable assets, above which the client has to be handed off from brokerage to trust, say, according to Gregson. At least that is happening at the “early adopters” among institutions. It is also “where the market is going,” suggests Gregson. Eliminating the ‘line in the sand’ appears to be one of the “more popular first steps” in developing an integrated approach toward serving the HNW client.

But banks also need to align products. It can be confusing if certain investment products—like fee-based products (e.g.,

mutual fund wraps, managed accounts) are available in trust, but nowhere else in the institution. It may be better to offer a simpler version of an advisory product somewhere within brokerage, too, for instance.

At Hancock Bank, a client with \$25 million in investable assets can sometimes best be serviced in brokerage, in Saik's view—if that client wants to do his/her own trading. Below a certain level (\$500,000), however, the client must go to brokerage. It simply isn't cost-effective for such a client to be serviced in the trust department.

Above \$500,000, though, the client goes to a private banker, and the private banker decides where the client's investment needs would be best served—by a broker under Randy Bluth, head of Hancock Investment Services, Inc., say, or a trust officer.

Hancock Bank's 12 private bankers act as the HNW client's relationship manager—his/her 'quarterback.' The private banker does not conduct any transactions. Rather, he/she assigns the client to the appropriate expert, such as an insurance specialist.

If the private banker is not sure where a client belongs, he/she may talk to the broker and the trust officer, ask where *they* believe the client belongs, and hear the pros and cons from each, says Saik.

The breaking down of silos as well as "eliminating the 'line in the sand' is a trend—which is a good thing," says Gregson. It's still not found at the majority of banks, "but it is a big topic of conversation now."

FundQuest's Clift notes that more banks are taking a single-product platform approach. A client might



'If you are going to open architecture, do it on both sides.' That is, offer outside investment management on both the trust and brokerage sides.

—Tim Clift, FundQuest

start out with a mutual fund or a mutual fund wrap account and then migrate into a UMA (unified management account) or SMA (separately managed account), and finally gravitate into the trust department or private bank. "The underlying process is not that different. There is less to manage as an infrastructure," says Clift.

Cultural differences remain, of course. There's often a difference in 'understanding' between the brokerage and the trust constituencies in banks. "The broker/dealer 'gets' the managed account concept," says MMI's Davis. The broker/dealer manager is typically more sales-oriented and receptive to new ways of doing business, he suggests. The trust department traditionally handled business that "walked through the door." They weren't particularly pro-active.

Open architecture

Bank trust departments traditionally managed HNW clients' money themselves, but increasingly they are embracing open

architectures—such as, using third-party money managers for investment management, observes Davis. This marks a big change in banks' thinking.

Indeed, the trust officer today is often more of a relationship manager and less of a portfolio manager, suggests FundQuest's Clift. The trust officer still has input, but he/she often isn't picking stocks anymore. Nor is he/she even the overlay manager in many cases, although the trust officer may determine the sorts of things the overlay manager should do for a given client.



'The trust/brokerage wealth-management concept is picking up speed in banks.' The rules about handing off a brokerage client beyond a certain account size are becoming less common.

—Lynn Niedermeier, Invest

"We've moved to [an] open architecture ourselves," says Hancock Bank's Saik. "We're taking the offensive," telling clients about their various investment options up front.

Open architecture is really a boon for the sales process, Saik notes. "It's a great sounding story." The relationship manager says, "I'll stay on top of it..." If the outside investment manager isn't performing, "I'll get rid of him." The banker outlines the options, pointing out where Hancock, itself, is competitive as regards investment management, such as large capitalization stocks, for instance, or multi-cap or value-oriented equities with some growth, or fixed income instruments. (And their charges are lower, too.) But if the client wants small-cap stocks or international equities/bonds, the banker presents the options *outside* the institution.

Hancock currently has \$2.7 billion in assets under management. The vast majority of these are still managed in house. Only about \$100 million is outsourced. "We just started with open architecture in the last year," admits Saik.

When it comes to investment management at Fulton Bank, 35 percent (in the equities sphere) is proprietary—that is, managed in house. The bank has a good large-cap stock capability, says Hanson. They use third-party managers, however, for SMAs, index funds, and ETFs, among other things. Looking ahead, Hanson expects to "increasingly use third-party solutions."

At Johnson Bank, "we are a hybrid," says Lucareli. Johnson Bank does all its asset-allocation modeling in house. "We are proprietary asset allocators," he says. Their clients expect objective advice—demanding, in effect, "find us the right managers."

One caveat: "If you are going to open architecture, do it on both sides," says FundQuest's Clift. That is, do it on both the trust and brokerage sides. He recalls a bank that went to open architecture in its retail brokerage unit, but not in its trust depart-

Continued on page 42

HIGH-NET-WORTH CLIENTS

Continued from page 24

ment. The result: Trust clients began to migrate to the brokerage department in order to take advantage of all those attractive, outside investment options.

FundQuest's Jim Graves notes that technology today offers more options and safeguards with regard to advisors. Banks can now provide advisors with their own 'passwords' that are linked to different levels of discretion. A new advisor typically has little discretion when it comes to investment decisions. The 'system' essentially makes the investment recommendations, something that protects the bank when it comes to suitability issues. As the advisor becomes more experienced, and accumulates



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—Christopher L. Davis, Money Management Institute

more licenses and designations, the password can be changed to give that advisor more discretion. The customer remains in that single platform. "The bank doesn't have to move all the accounts," says Graves.

All of this is possible because of technology—software and computers—as well as organizational innovations; for example, 50 asset managers are now willing to sell their collective intellectual property to a middle man (at FundQuest, say) running a UMA platform.

Fees when outsourcing

When a bank embraces 'open architecture'—steering high-net-worth clients toward outside (non-proprietary) investment management products—what happens to fees? Doesn't the bank have to give up something?

"Pricing non-proprietary investments has always been a challenge for banks," observes MMI's Davis, "Non-proprietary SMA investments have a higher fee structure that banks have found difficult to explain to clients." Some banks have overcome this issue by "explaining that the higher fee structure was associated with bringing in outside expertise, which simply costs more," adds Davis.

The banks enjoy higher margins when they manage the investment portfolios themselves. When they outsource, they have to make up for slimmer margins with larger business volume. On the plus side, when they move to open architecture, this often

frees up the trust officer to handle more clients.

"For the bank, it's revenue neutral," says Hancock's Saik, speaking about 'open architecture.' It is more expensive for the Hancock client, however, and costs roughly 40 basis points more, although this may vary depending on whether the investment-management services are for bonds, say, or equities.

Do clients resist paying the higher fees associated with 'open architecture'? "We've had no resistance from clients," says Saik, "but we do get resistance from trust administrators." The trust officer's reaction is "How can you charge that!"

The loss of fees from outsourcing the investment-management functions is often offset by the reduction in expenses, notes Butcher. If a bank moves to full open architecture, it doesn't need a trading desk or analysts or investment officers, presumably. Outside management will cost banks only 35–45 basis points more, on balance, he suggests.

What about fees to clients? These are largely "fee neutral," says Butcher, with perhaps a 10-percent increase—nothing significant, in his view.

But if regional banks don't go to 100-percent open architecture, but rather favor a mixed platform—as many still do—don't they still have to support that expensive infrastructure (e.g., trading desk, analysts, etc.)? Not necessarily, says Butcher. The third-party overlay portfolio managers could handle these functions.

Fee revenues actually go up when a bank outsources, argues David Campbell, senior vice president of Worldwide Banking Strategy and product manager for SEI (Oak, PA), whose firm is a third-party investment manager. Admittedly, he has an interest in encouraging bank outsourcing. A bank that is able to differentiate itself by offering more exciting products and services will simply attract more business.

"The costs to serve are flat or down," says Campbell. That's because banks that outsource can put their resources in places where they can generate greater revenue.



'Finding the right individual and keeping them has been a struggle.' The moment a bank finds an advisor who can build a fee-based business, a competitor steals that person away.

—David Campbell, SEI

They can increase and upgrade their sales force, for instance.

In any event, "Getting the best investment management available on the street is recognized as important," says LPL's Gregson with regard to the 'open architecture' question. "It's not just lip service." The larger banks will still keep some of the investment-management business for themselves, he suggests, but only where they are competitive, such as in the managing of large capitalization stocks.

Overlay management

Banks simply have many more options today when outsourcing. They need to make wise choices. The outside manager should be able to customize their offerings to the bank's needs, says Butcher. Some trust accounts may have account restrictions. They may require only 'socially responsible' investments, for example. Or, on the fixed-income side, they may require that all investments be in investment-grade bonds. No junk bonds allowed. (Many fixed-income models, for instance, usually have at least a 'sprinkling' of high-yield bonds.) The outside partner should be able to accommodate them.



Another key function is rebal-

'Banks have become very competitive. For a lot of years, they weren't sure if it [outsourcing] was the right solution, and the technology couldn't support it.' But things have changed.

—William Butcher, Natixis

ancing. A portfolio model that calls for 80-percent equities and 20-percent fixed income can fall out of kilter and drift to 75-percent equities and 25-percent fixed income, say. "The overlay manager handles that and should be able to rebalance at the account level, as well," says Butcher. In other words, the overlay manager has to be able to say: "Rebalance Account A, but not Account B—which was opened only two months ago."

The modern overlay manager also deals with tax optimization. You want to make sure that when you sell those 100 shares of IBM that you are going to be paying taxes on long-term gains, not short-term gains, for instance.

The overlay manager function can be conducted internally, within the bank, but it can often be done more efficiently (among other reasons) through a third party, in Butcher's view, because they can control the order in which a trade is conducted. (If a trade is delayed in a queue for a day or two or three, it can sometimes have negative effects. This problem is mitigated with centralized overlay management, according to Butcher.)

"Overlay management is absolutely here to stay," notes Fulton Bank's Hanson. It lowers expenses and allows for tax optimization. Hanson has seen studies that suggest it can add as much as one to two percent in this regard. It also allows the screening out of certain sectors—such as pharmaceutical stocks that the client doesn't want because he/she just retired with a bundle of drug company stock.

A more skilled broker?

If all this sounds a bit complex, what does it mean for the typical bank broker? Given the focus on the HNW client, is a

higher quality broker required?

Yes, says Gregson, who traces this movement back to the big stock market drop in 2000–2001, when many wirehouse advisors migrated to the bank space. "Now you see a higher level of rep."

Typically, a client walked into a bank branch and the rep sold him/her a \$25,000 annuity, observes Invest's Niedermeier. Now they meet with the client, ask questions, maybe do a simplified financial plan, and review the plan at a second meeting; they might not actually sell a product until the third meeting. That represents a big change in the way business is being conducted.

"The rep has to change. Those who don't change will be left behind.... They'll be left with scraps," says Niedermeier, who adds that banks are hiring more independent financial planners, often CFPs (certified financial planners).

The talk about bank brokerages moving to a fee-based model has been "pretty loud" in recent years, notes SEI's Campbell. "Finding the right individual and keeping them has been a struggle. There is a lot of 'takeaway.'" That is, the moment a bank finds an advisor who can build a fee-based business, a competitor steals that person away.

Reps have to move to a more advisory role. "Some are kicking and screaming along the way," says Niedermeier. Others are embracing the change.

HNW clients and community banks

Typically, trust and wealth management are not associated with community banks, but this, too, could be changing. Community and regional banks are "well positioned to be successful if they put their minds to it," says Gregson. After all, they have the client relationships (albeit mostly traditional banking relationships—deposits and loans), access to sophisticated investment products, and also access to better financial advisors, "so there is no reason that community and regional institutions shouldn't be successful over the next 8 to 10 years," says Gregson.

Regional and community banks view wealth management as a way to differentiate themselves from their competitors, adds SEI's Campbell. SEI has some 330 private banking clients globally who use the firm's asset-management solutions. About 75 percent of these are regional or community banks, he says.

Community banks have always "paid a great deal of attention to our 'best customers'"—that is, HNW clients, because that (personal service) is where community banks have had their competitive edge, says Camden R. Fine, president and CEO of Independent Community Bankers of America (Washington, DC).

That said, "Community banks have broadened the array of product offerings to high-net-worth clients over the past 7–10 years," adds Fine. Many already had small trust departments, but they didn't focus on them so much. But with the enormous wealth transfer that is going on—and which is expected to continue going on—they are now offering "a broader array of trust services, personalization of offerings, and new delivery channels," specifically for HNW clients. They are being more aggressive now.

What larger banks might call "investment management" is often called "financial services" in community banks, and many are setting up such departments for HNW clients; here they can buy stocks, bonds, and Treasuries, among other products. If they

have trust departments, they are expanding them, says Fine.

Are community banks seeking more sources of fee income overall? The community bank culture is changing some, comments Fine, “but it’s probably an exaggeration to say that they are getting away from ‘spread’ banking,” which remains their core business. But they are “trending” more toward fee income as margins narrow, he adds.

A more-demanding customer base

Overall, banks had better change if they are going to deal effectively with today’s more-demanding HNW customers. “Today’s affluent and Baby Boomers are savvier than their



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parents” when it comes to wealth-management issues; and as a consequence, banks must recognize that “we may not be the total solution,” says Johnson Bank’s Lucareli. That is, they recognize that they may now have to outsource some products and services. They also have to understand all the disciplines associated with wealth management. “If you are just focusing on one segment [portfolio management, say], you will lose the client.” A bank has to think in terms of financial planning and insurance, among other areas.

“There is no turning back if banks want to be competitive,” says Butcher about ‘open architecture.’ The wirehouses accumulated billions in trust assets by getting their own trust charters. They (wirehouses) also had extensive access to top-of-the-line third-party asset managers, adds Butcher. But now banks have that access, as well.

Banks need to do a better job of profiling their client base, so they know who actually is a HNW client; and then they need to do a better job of communicating what they do offer in the planning and investment management sphere, says Invest’s Niedermeier. “They still are focused [primarily] on deposits and loans.”

If you look at the various industries—banking, brokerage, and insurance—“all are going after the same customer,” says Hancock’s Saik. Each leads with their traditional specialty. “The banks focus on banking-type products.” The wirehouses lead with brokerage products. Insurance companies emphasize insurance solutions. The winner, however, will be the one who doesn’t focus on any given product—but on the needs of the client, says Saik. He favors a financial-planning model, in other words. “Everything else is just pushing product.”

The outlook for banks has grown more favorable, some contend. “The biggest growth area in the next five years for distribution of investment products will be the banking channel,” said Ian Rubin, senior vice president and director of retail investment markets and strategic advisory business at Financial

Research Corporation (Boston), recently in *InvestmentNews*.

If you look at mutual fund net sales and asset growth from 2007–2012, they are still dominated by the wirehouses and regional brokerages, says Rubin, “but the bank channel is growing at a faster pace than any other channel.”

After years of slow growth, why the pickup now? “Lots of things are happening,” Rubin told us. Traditional bank earnings were under pressure—even before the sub-prime crisis. More banks are looking to increase fee-based revenue streams. They see a lot of opportunity in this regard in asset management and wealth management.

In the past, the emphasis was on proprietary products, but now more banks are moving toward open architecture, says Rubin, seeking to offer “best in breed” investment management products.

Previously, too, it was often a ‘challenge’ for a third-party vendor to work with a bank. There was a series of silos—retail bank, private banking, trust department. A distributor would have to make a presentation to all those areas, which was often a chore. Today there is more cooperation among these different bank groups so the distributor may need to make only a single presentation.

His advice to banks? “Offer a competitive set of products,” says Rubin. They already have the good service and the high-touch relationships.

Can they recover lost ground?

As noted, U.S. banks’ firm hold on personal-trust assets slackened in recent decades. “Twenty years ago at a large Boston-based bank, the bank trust department had a virtual lock on the trust business,” writes Butcher. But no more. Are banks poised to recover lost ground? “Banks will become very aggressive. They won’t take this lying down,” Butcher told us. “Banks have become very competitive. For a lot of years, they weren’t sure if it [outsourcing] was the right solution, and the technology couldn’t support it. But this, coupled with their strong franchise in fiduciary services and estate planning,” means they are well positioned. They have the bricks-and-mortar infrastructure. An estate-planning attorney can sit down with a client, something that is “very powerful,” says Butcher.

Can banks ever turn the clock back to that time when they were the leading managers of HNW client assets? “The horse is out of the barn,” says Rubin. Banks can surely grow assets. “Today there are \$212 billion in assets under management in the banking channel. We expect that by 2012, that total will double to \$400 billion,” he said recently. “But so much money is now entrenched with wirehouses like Merrill Lynch and Morgan Stanley, [that] it will be hard to re-catch that,” he told us.

Davis notes that there may be opportunities for banks to “leapfrog the competition” with regard to wealth-management services. Many banks have developed UMA platforms and delivery platforms, he says, making them more competitive.

Moreover, “banks are viewed as being ‘trusted advisors,’” says Davis, “which is a significant competitive advantage.” □

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