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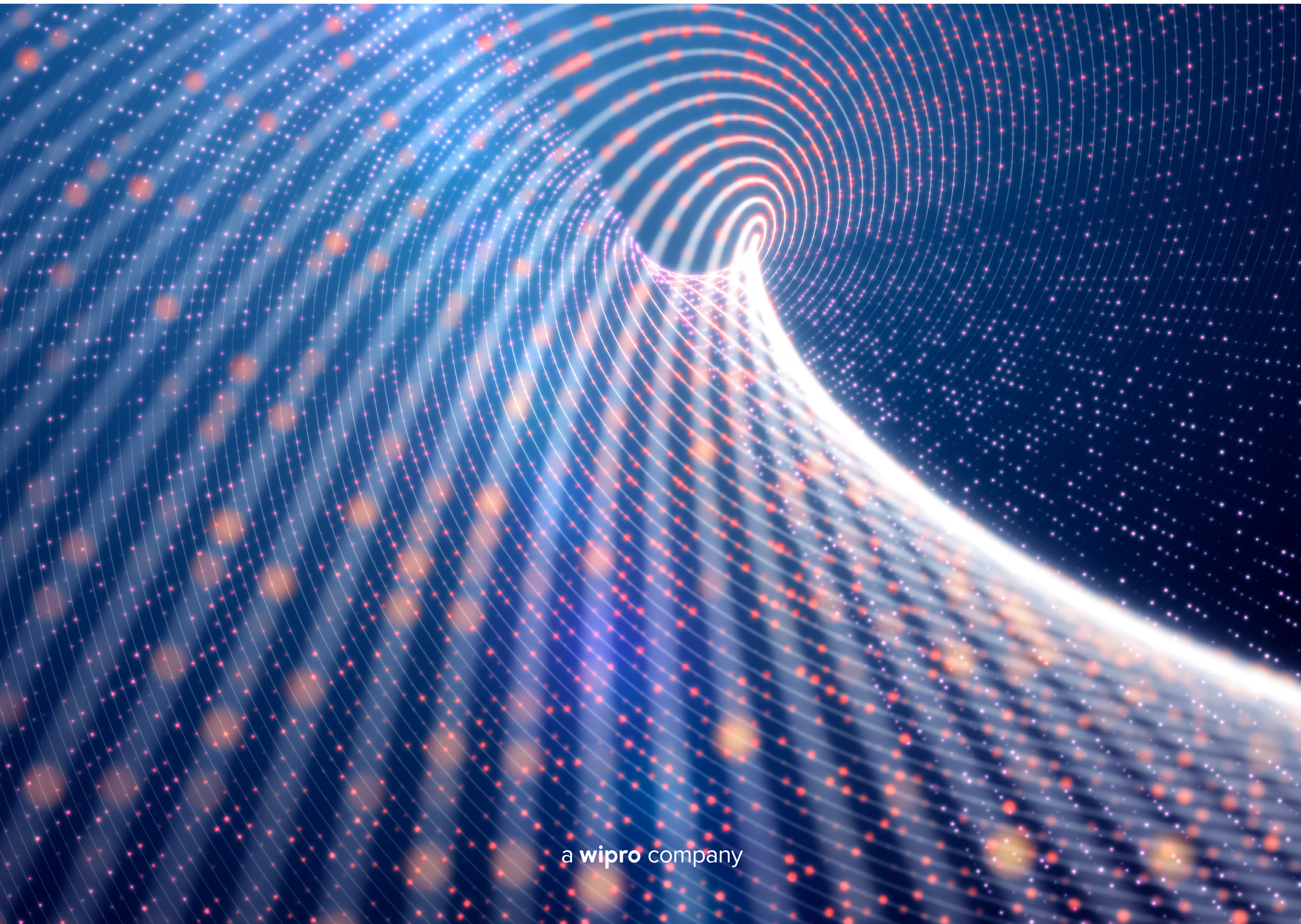
PROVIDING CUSTODY SERVICES TO THE EXTERNAL ASSET MANAGEMENT SECTOR:
TRENDS AND FUTURE PROSPECTS



INTRODUCTION

As the wealth management industry continues to evolve and consolidate, there is increasing opportunity for new entrants to disrupt the sector. External asset managers (EAMs), working in partnership with private banks that provide custody services, are at the forefront of industry developments.

EAMs, also known as financial intermediaries (FIM) and independent asset managers (IAM), are an expanding and an increasingly important provider of wealth management solutions to high net worth (HNW) and ultra-high net worth (UHNW) clients. Whilst firms differ in the breadth of services offered, they can often provide a more streamlined and boutique proposition to investors than the incumbent wealth management providers, specifically the established private banks.

EAMs have historically emerged in key global wealth booking centres, namely London, Geneva, Zürich and New York. Hong Kong and Singapore are now providing mature regulatory and operational infrastructure to support rapid wealth generation taking place across mainland China and South-East Asia, which is forecast to increase by between 5.1% and 7.4% annually to 2024.

Having moved from global private banks and their vast support networks of product specialists, investment advisors and wealth planners, senior Private Bankers and Relationship Managers have established EAMs with a view to offering unbiased and independent advice, less incentivised to market high revenue generating solutions such as structured products and life insurance. As EAMs become an increasingly attractive destination for industry talent, banks should consider reviewing remuneration structures in an attempt to retain their most productive sales teams.

From a client perspective, there are a number of benefits of using an EAM, notably efficiency and responsiveness due to the leaner EAM operating model. This promise of enhanced efficiency has contributed to increases in AuM managed by EAMs: in Switzerland, for example, the market's 2,500 EAMs are today estimated to manage around CHF400bn – approximately 10% of the country's private wealth market.

Although EAMs continue to play a more prominent role in global wealth management, as noted they cannot operate without a private bank custodian authorised to provide safe custody of assets. This role is typically fulfilled by the leading global private banking brands, as the segment provides lucrative revenue opportunities due to fee-sharing agreements. The tripartite account relationship that exists between the end client, EAM and private bank custodian, can create its own complexities. The EAM sources client relationships and provides investment management services, either via advisory or discretionary agreements. The private bank custodian then provides trade execution capability, processes corporate actions, and can offer additional access to investment research and the bank's broader platform, such as credit solutions. The bank has little to no contact with the end client, who has to endure two separate account opening processes for both the EAM and private bank custodian. Whilst EAMs can advise their end clients on preferred private bank custodian options, clients will often select a banking brand that they are aware of and feel comfortable with – for example, a Singapore-headquartered private bank for an onshore Singaporean client, via a local EAM.

While the aforementioned tripartite relationship can offer the end clients a number of benefits, pain points do exist and have to be acknowledged. EAMs and private bank custodians must look to address these as they attempt to enhance their market share, whilst at the same time improving the client experience.

Pricing continues to be a key differential in wealth management, and is especially important when private bank custodians are servicing their EAMs. Those banks that lack scale within the EAM market may struggle to offer competitive pricing. In addition, banks that are able to offer their EAMs access to lending solutions, such as Lombard loans, are in a position to offer a more holistic platform, ideally across multiple currencies.

Moreover, it is imperative that the credit submission and approval process is as efficient as possible, so that EAMs can quickly take advantage of any market volatility.

As mentioned, the requirement to complete account opening processes with both the EAM and private bank custodian has the potential to be the most severe pain point in the end client relationship. Although the KYC/source of wealth due diligence that private banks complete on their clients is quite rightly more thorough than in the past, the fact that this process must essentially be completed twice complicates an area of the wealth management industry that prides itself on its supposed efficiency.

RAISING THE BAR

IIt is evident that there are improvement opportunities for both EAMs and private bank custodians. Private banks can look to better structure their dedicated EAM desk, or establish one if they have not already done so, across business development, support staff and account opening functions. Business development initiatives need to be coordinated between booking centres, with appropriate referral agreements in place in order to retain business and offer a connected proposition.

From an account opening perspective, improved onboarding and KYC processes would strengthen the client experience and the private bank's brand, namely through the establishment of dedicated internal teams for EAMs. Digitalisation is today a necessity for private bank custodians, a 'must-have' rather than a 'nice-to-have' if they are to position their IT platform as truly market-leading. Can EAMs monitor their client portfolios and investment performance effectively? Can they transact on behalf of clients online? How 'paper-based' are their transactions? These are all key considerations for both private bank custodians and EAMs.

The introduction of legislation in Switzerland specific to EAMs highlights the extent of the segment's growth and development. In accordance with the 2020 Swiss Financial Institutions Act (FinIA), EAMs in Switzerland must now apply for a license from FINMA, the Swiss Financial Market Supervisory Authority, an attempt by the regulator to strengthen client protection. EAMs incorporated in Switzerland will now be subject to capital and structural requirements, likely prompting consolidation. As the EAM segment continues to expand across APAC, the introduction of further legislation in the region is also likely, mirroring the industry's maturity in Switzerland.

In line with consolidation witnessed across the broader wealth and asset management sector, merger and acquisition (M&A) activity in the EAM space will require foresight and planning to ensure that the client experience is not impacted and the platform offering remains relevant. In particular, many EAMs were established to ensure that independent advice could be offered, a differentiated approach to more commoditised private banking services; if significant M&A activity occurs in the EAM space, then this smaller, boutique environment may be compromised.

SUMMARY

The EAM segment is well positioned to expand organically as wealth generation continues, particularly in high growth regions such as APAC and as client awareness of boutique wealth management providers increases. Expansion in the EAM industry is more likely to be focused on increases in AuM, rather than new firms coming to market, as regulatory pressures and consolidation trends take hold.

Certainly, there is a high degree of optimism around this expanding segment, but both EAMs and private bank custodians must adapt to the heightened expectations of end clients as financial literacy and awareness continues to advance in growth-oriented emerging markets.

We recommend that private bank custodians consider the following to overcome their challenges in delivering exceptional client service and to win market share in the EAM space:

- A strategic review of their operating and business models, inclusive of product offering (specifically ESG solutions and Lombard loans) and front-to-back platform
- Analysing their client journeys to smooth pain points across global booking centres, focusing on onboarding and credit submission processes, thereby enhancing client centricity and providing a powered, optimised experience for EAMs and their end clients
- A review of IT providers and technology to identify more evolved, best-of-breed digital solutions and potential fintech partners

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