Successful Private Banking Business Models

How to capture growth in a complex regulatory environment

September 2023

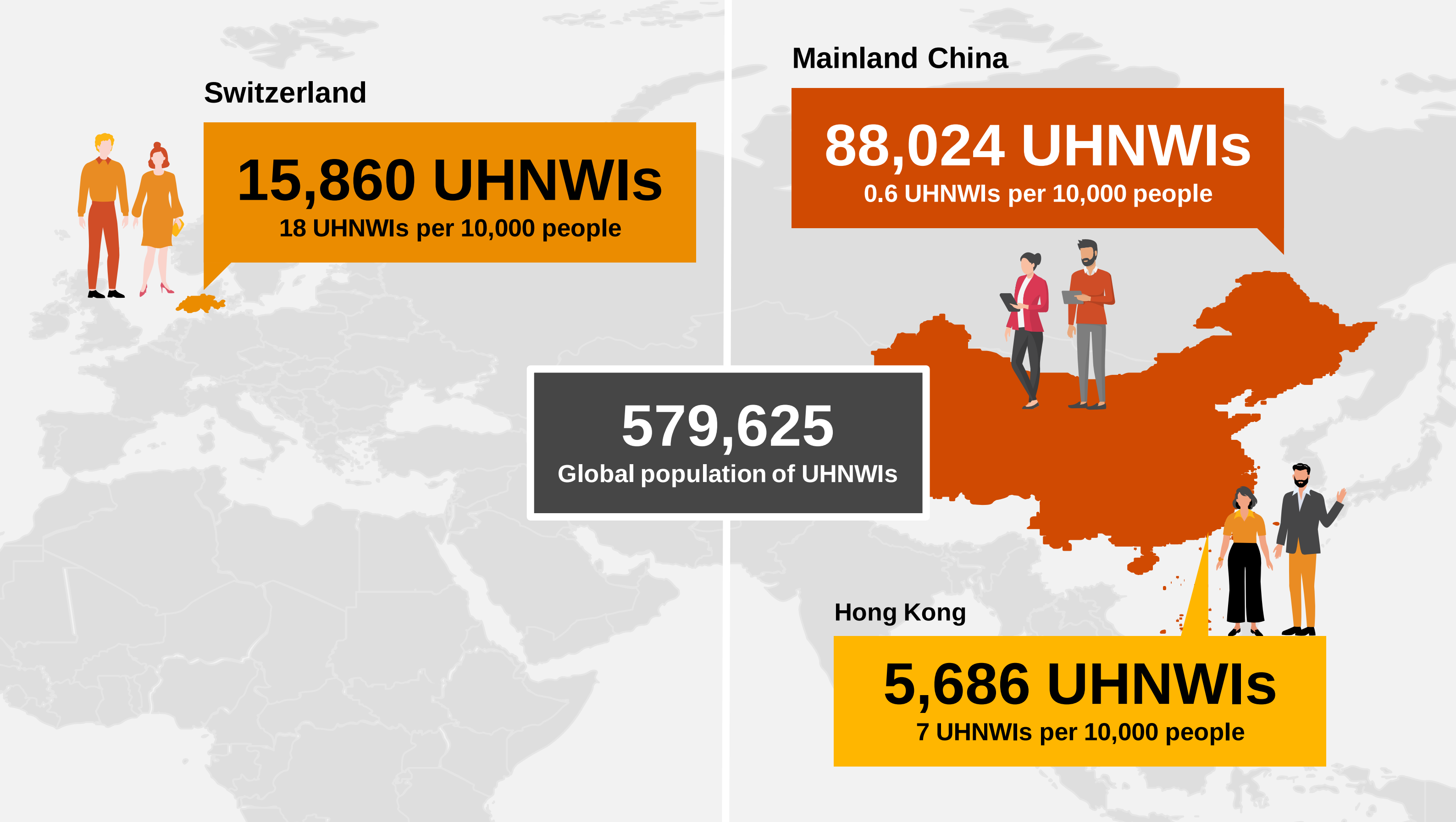
pwc

Contents

Introduction

The Asia Pacific region is expected to see an increase in Assets Under Management (AUM) from US$20.2 trillion in 2022 to US$28.1 trillion by 2027[1]. The region is home to 40.6%[2] of the world's billionaires and 29.5%[3] of Ultra-High Net Worth[4] (UHNW) individuals. In Hong Kong, private wealth management AUM stood at HK$9 trillion (equivalent to US$1.15 trillion) in 2022[5].

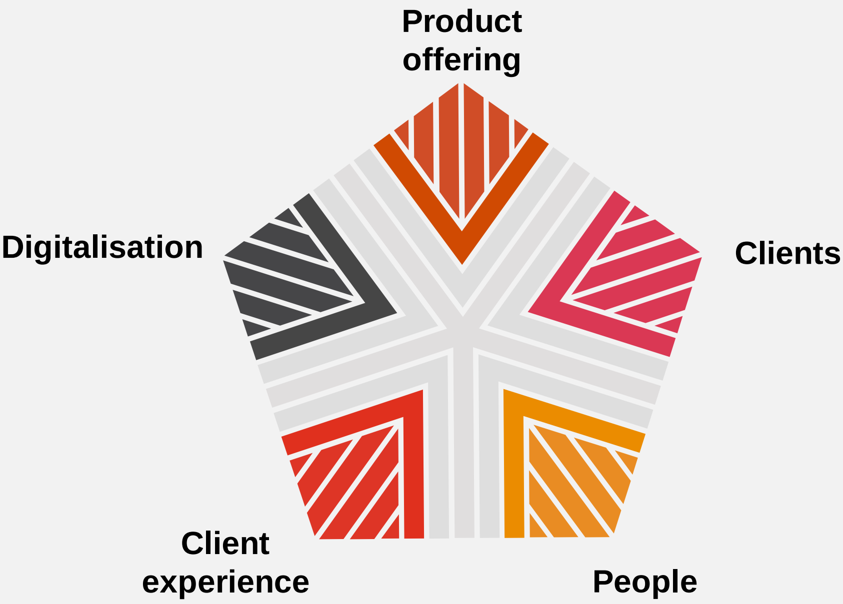
Ultra High Net Worth Individual population in 2022



Source: The Wealth Report – Wealth Populations, Knight Frank

[1] PwC – Asset and wealth management revolution 2023: The new context
[2] UBS Billionaire Ambitions Report 2022
[3] The Wealth Report - Wealth Populations, Knight Frank
[4] Ultra-High Net Worth individuals are individuals with a net worth of US$30m or more.
[5] SFC Asset and Wealth Management Activities Survey 2022

This report is based on a survey of twenty C-Suite professionals (including CEOs, Heads of Business and Heads of Compliance) from Hong Kong-based private banks and in-depth interviews, as well as extensive research. The aim of the report is to highlight emerging trends and how they may reshape the private banking landscape. We focused on the following areas:



A recent publication from PwC Switzerland[6] offers an overview of the Swiss private banking sector and examines some of its critical success factors.

Undoubtedly, Hong Kong and Switzerland are very different markets. The multi-generational nature of the latter is just one obvious distinction. In this publication we analyse the differences between these two important private banking markets and what they may indicate about Hong Kong's likely future development.

[6] PwC – Successful private banking business models: What gives smaller players giant-sized powers?

Key highlights from survey

Product Offering	• Advisory mandates are more popular than discretionary mandates among private banking clients in Hong Kong. • Traditional asset classes, such as equities and bonds, are preferred by private banking clients.
Clients	• 48% of clients are based in Hong Kong while 33% are from Mainland China. The remainder are from overseas locations such as Singapore.
People	• Turnover among relationship managers (RMs) continues to be high in the private banking sector in Hong Kong.
Client Experience	• 61% of Hong Kong private banks surveyed have a combination of face-to-face and virtual meetings; 39% mainly hold face-to-face meetings with their clients.
Digitalisation	• Leading private banks in Hong Kong have been actively investing in digital capabilities. • Technology will further shape the ways investors manage their portfolios.

What's next?

Product offering

Broaden offerings to meet the rising demand for advisory mandates and discretionary portfolio management

People

Enrich the pool of talent and implement retention measures by offering career opportunities and competitive packages

Digitalisation

Continue to invest in digital platforms to increase client engagement, as well as RMs' productivity

Clients

Greater understanding of emerging client segments, such as the next generation, will help evolve private banking platforms to cater to the needs of wealthy individuals and families

Client Experience

Embrace hybrid servicing model, with both in-person and virtual options available to support interactions with clients

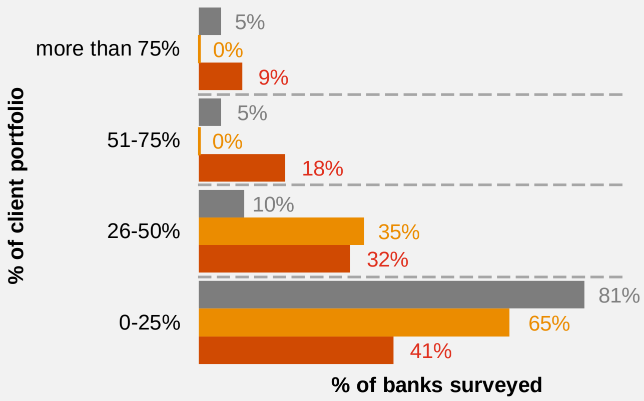
Product offering

Mandates

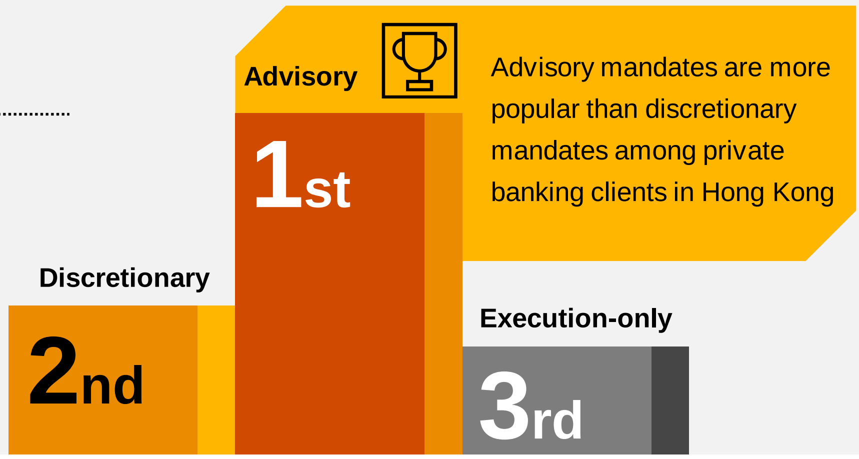
Advisory mandates are far more common than discretionary ones. Execution-only transactions are the least favoured option for Hong Kong's private banking clients.

Percentage of clients' portfolios managed via different mandates

- Execution-only
- Discretionary Portfolio Mandate
- Advisory Portfolio Mandate



Investment mandate preferences



The Swiss perspective:

In Switzerland, the five best-performing private banks surveyed[7] manage more than 55% of client portfolios as discretionary mandates, while the lower performing banks have a 25% share of discretionary mandates.

[7] The participating banks in the PwC Switzerland Survey were grouped into three categories (Top 5, Medium and Bottom 5 performers) based on their financial results from 2019 to 2021.

Discretionary vs Advisory vs Execution-only Mandates

Hong Kong-based clients typically opt for advisory mandates, as these provide them with greater autonomy and the flexibility to be actively involved in the investment process, while benefiting from the expertise and guidance of their private banks. Discretionary mandates involve a pre-determined or customised investment strategy, with decisions being made by investment advisors within the boundaries of this strategy. Discretionary mandates are seen as granting less direct control with higher management fees. But the contrast with Swiss private banks can also be attributed to the long-standing, multi-generational relationships that are common in Europe. These banks have had time to establish the relationships of deep trust that are the prerequisite for a discretionary mandate.

Mandate preferences in this market differ sharply from those captured by PwC Switzerland - reflecting clients' investment appetites.

It should also be noted that there are different regulatory requirements for banks offering discretionary or advisory mandates. When a discretionary mandate is agreed with the client, the bank is required to conduct a holistic suitability assessment to determine whether the overall risk profile of the mandate is appropriate for the client, based on their risk appetite and personal circumstances. Portfolio managers also perform regular reviews to ensure that the investment composition within the portfolio is aligned with the client's investment objectives, strategies, restrictions and asset allocations as agreed upfront in the discretionary mandate.

For advisory mandates, banks typically perform suitability assessments on a transaction level, rather than portfolio-based suitability assessment. With a portfolio-based approach, a high-risk product can be sold to a low- or medium-risk client without triggering a 'risk mismatch', provided that the overall product risk on a portfolio level is within the client's risk tolerance.

This approach may provide clients with some flexibility in their asset allocations. With appropriate distribution of product types of different risk levels and time horizons, an overall risk level that is commensurate with a client's risk appetite can be achieved. Clients can then benefit from diversification (rather than over-concentrating on a specific product type) to achieve a more optimal return on investment. The private banking sector is looking to engage regulators in discussions on the benefits and drawbacks of these different approaches.

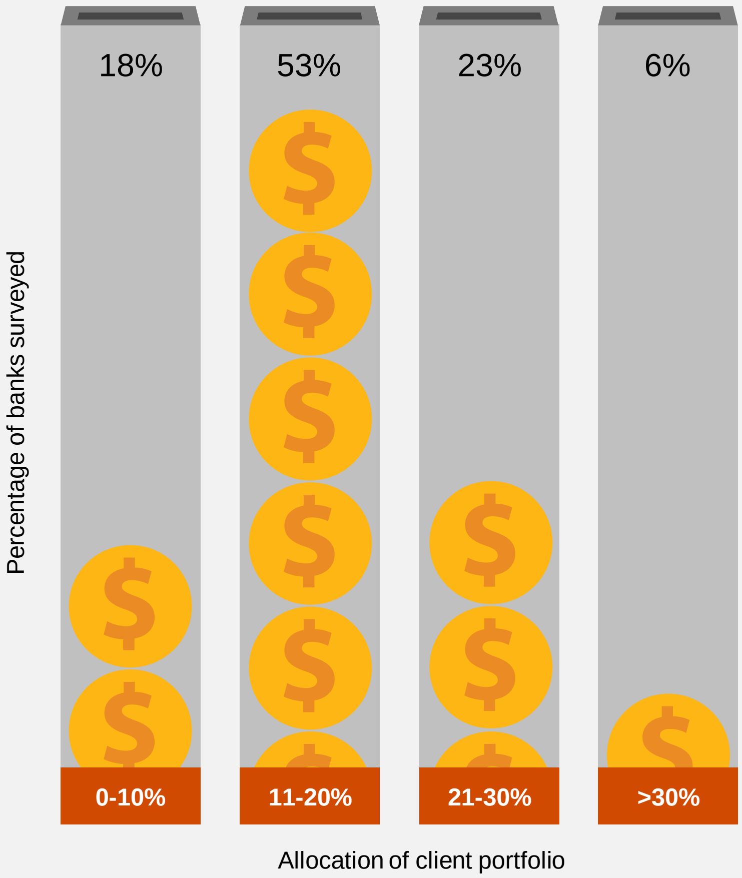
Asset classes

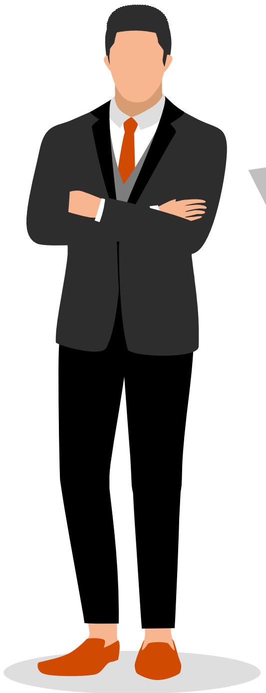
Traditional asset classes, such as equities and bonds, are preferred by the clients of the private banks we surveyed. These are closely followed by structured products and derivatives. The present high interest rate environment is leading to greater interest in cash, fixed income and insurance products. Life insurance products continue to gain in popularity – particularly among Mainland Chinese clients – due to their use for family inheritance and estate tax planning. Premium financing for insurance products is less attractive as a result of the interest rate hikes over the past 18-24 months. There is currently less interest in equities as a consequence. Many clients maintain some holdings in alternatives such as hedge funds, but this is chiefly for diversification.

53%

of private banks surveyed allocated 11-20% of client portfolios to cash so that clients can invest as soon as opportunities arise.

Cash allocation within client portfolios





"Second-generation customers are mostly very eager to learn about environmental, social, and governance (ESG) portfolios. But there is only limited action in terms of ESG mandates. The ESG investors that are currently with us are actually much older.
They only invest a small proportion, but at least it's something."

- CEO, private bank, Hong Kong

Getting started with ESG

Several of the banks surveyed are providing ESG training to their RMs. Private banks are aware of the risk of misrepresentation or of misleading ESG claims (greenwashing). This can undermine trust in ESG-related products and hamper the private banks in expanding their sustainable and green product offerings. To manage the risk of greenwashing, it is important to establish robust product governance frameworks, as well as comprehensive product due diligence and assessments to ensure that risks are identified and relevant information is appropriately disclosed to clients. This, in turn, will help promote the development of green products in Hong Kong.

While interest in crypto or virtual assets is not significant across this sector, there is 'a low but persistent interest' in this asset class. This was also one of the key findings of a recent PwC report[8]. The banks surveyed for this paper are reluctant to commit more time to this asset class until they can be sure of sufficient regulatory clarity without an excessive regulatory burden. This year, the Hong Kong Monetary Authority (HKMA) announced that it encouraged banks to provide banking services to virtual asset service providers. The Securities and Futures Commission (SFC) introduced rules and guidelines, including license regimes for virtual asset service providers, in May 2023. It will take some time for private banks to provide crypto trust services, which enable clients to integrate cryptocurrencies into their wealth management and succession plans.

The Swiss perspective:

Swiss private banks also cite traditional asset classes as most important, followed by alternative investments, such as private equity and hedge funds. Only a few institutions attach a very high importance to ESG, with most giving it medium importance. Crypto assets were assigned low importance by the banks surveyed.

Top five asset classes

1. Traditional asset classes (e.g. equities and bonds);
2. Derivatives and structured products;
3. Alternative investments (e.g. private equity, hedge funds);
4. ESG assets;
5. Crypto and digital assets

[8] PwC 2023 Global Crypto Hedge Fund Report

Clients

The product offering outlined in the previous section is heavily determined by the profile of the banks' clients. Perhaps the most significant differentiator between the Swiss and the Mainland China/ Hong Kong markets is the presence of first- and second-generation investors in the latter. They apply an entrepreneurial mindset to the management of their wealth.

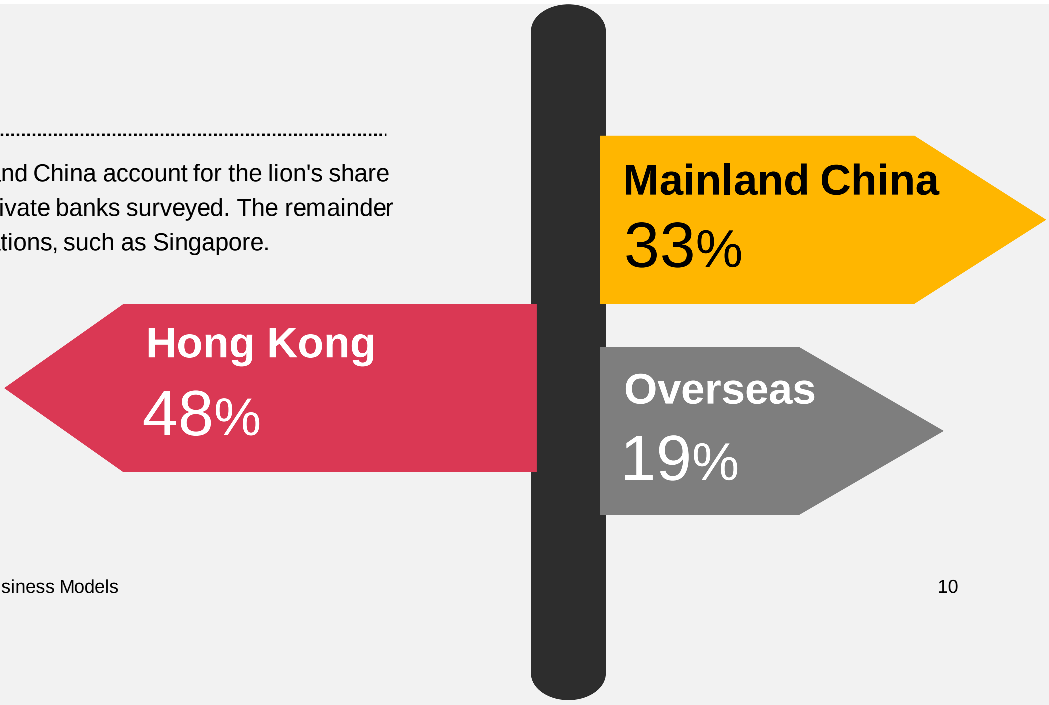
> "First generation entrepreneurs are not keen on discretionary mandates because they want to stay in control. They are not being risk averse – they feel that they may know the market better. This is especially true if they are investing in the same sector as their own business." Senior executive in the private banking sector.

As our interviewees tell us, the first generation – and even the next generation – are interested in asset allocation. As entrepreneurs, they are occupied with their business and may be less inclined to formulate an investment strategy based on a longer time horizon.

Investor education is critical to moving away from a short-term stock picking mentality towards a long-term investment mind-set which is conducive to wealth creation. Considering the culture and behaviour of the first and second generations in Asia, private banks could explore customised investment mandates with strategic asset allocations that focus on longer-term investment objectives. These would still allow clients to make tactical asset allocations within their portfolios.

Client locations

Hong Kong and Mainland China account for the lion's share of clients among the private banks surveyed. The remainder are from overseas locations, such as Singapore.



Increasingly, Ultra-High/ High Net Worth (U/HNW) clients are establishing family offices to institutionalise the management of their wealth and align with their own unique set of wealth management needs and risk management policies. It is important, therefore, for them to have an effective governance structure and robust internal controls and operational processes to ensure they carry out their functions effectively and efficiently.

Family offices are an increasingly important client segment in Asia. This trend is expected to grow, with Hong Kong well placed to be a destination of choice. The Hong Kong Government has set a target of 200 family offices to set up or expand their existing operations in Hong Kong by the end of 2025. However, as we shall see in the next section, this may also require Hong Kong to boost the number of skilled professionals in the wealth management space.

While some family offices reportedly wish to be treated in the same way as institutional clients and seek to drive down fees, they may still be central to private banks' aspirations of achieving a higher share of discretionary mandates. Family offices may not have the skill sets to manage exposure to certain investments, such as alternatives. They may therefore wish to rely on an RM to make investment decisions.

The Swiss perspective:

The PwC Switzerland Survey found that Swiss private banks focus on Swiss residents as their client base. This is particularly true for smaller banks. The larger private banks have shifted their focus towards attracting clients from the rest of Europe or further abroad.

To enhance Hong Kong's position as a leading asset and wealth management hub, the HKMA and the SFC recently released new guidelines[9] on 'Sophisticated Professional Investors' (SPIs). These are required to have at least HK$40m of AUM or HK$80m in net assets and to meet the relevant criteria for knowledge or experience, as well as investment objectives. A corporation or family office which has investment holdings as its principal business and is wholly owned by one or more SPIs may be treated in the same way as an SPI. The regulators have waived certain suitability assessments for SPIs. These relaxations have smoothed the process for private banks when selling products to clients who qualify as SPIs. This provides some flexibility in terms of product offerings and an improved client experience, thus strengthening Hong Kong's wealth management industry[10].

Hong Kong – family office destination

Hong Kong targets to attract **200** family offices to the city by 2025

Minimum AUM of **HK$240** million	At least **2** financial professionals
No specific local investment restrictions	A nominal spending requirement

Source: Financial Services Development Council's "Hong Kong – Asia's premier hub for family offices"

[9] Streamlined approach for compliance with suitability obligations when dealing with sophisticated professional investors
[10] PwC - Hong Kong's regulators introduce a new category of professional investors and a streamlined approach to suitability assessments

People

A crucial issue when considering Hong Kong and competing jurisdictions is the size and depth of the talent pool. Turnover among RMs continues to be high in the private banking sector in Hong Kong. Reasons for this include potential career development and progression offered by other private bank, client relationships and cultural fit, in addition to compensation and incentives.

There are two critical factors here: the bankers we surveyed highlight the importance both of skill in managing relationships and of product knowledge. There is a general view that RMs are stronger at the former and that greater product knowledge could prove critical to building trust. Private banks can consider adopting a model with a team of RMs and product specialists to offer comprehensive, customised investment solutions to their clients, taking into account both their individual needs and market opportunities.

Some private banks are focused on expanding their Greater China-focused RM pool in Hong Kong. However, hiring more RMs is not the only way to grow. Rather, the banks should focus on enhancing the overall productivity of client-facing staff and the revenue they bring in.

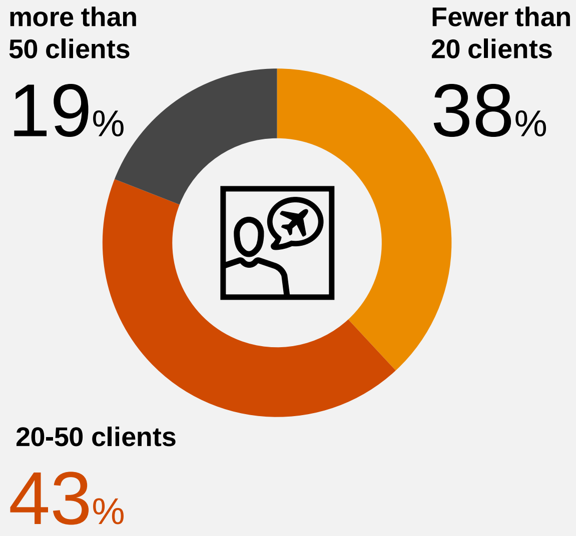
When evaluating the value of their people, private banks primarily focus on the revenue generated by each RM, rather than just the number of clients or level of AUM managed per RM.

As at 31 December 2022, the total number of staff engaged in the private banking and private wealth management business was 10,365, of which

3,492

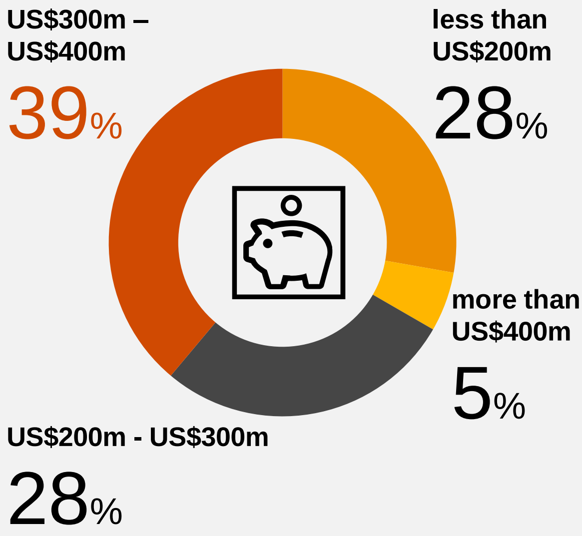
were Private Wealth Management Relevant Practitioners, including RMs, client-facing advisors, product specialists and fund managers.[11]

[11] SFC Asset and Wealth Management Activities Survey 2022



Average number of clients managed per RM

A plurality of Hong Kong private banks surveyed have 20-50 clients per RM. Less than 20% are having more than 50 clients per RM.



Average AUM managed per RM

A plurality of the Hong Kong private banks surveyed have an average of US$300 – US$400m AUM managed per RM. 5% have an average of more than US$400m AUM managed per RM.

A key challenge for banks is how to attract a new generation of RMs and retain them. In addition to offering competitive packages with variable compensation, private banks offer strong brand recognition, company culture and career opportunities, development and training.

47% of Hong Kong private banks surveyed have more than 25% of total compensation package to RM being variable compensations (e.g. performance based). 29% of them with 15 – 25% of their salary package being variable compensations.

The Swiss perspective:

The PwC Switzerland Survey shows that most top-performing private banks offer a variable compensation component of more than 25%. This is attractive to well-connected and performance-oriented RMs. It also aligns with what we have observed in the Hong Kong survey.

Another metric used to measure productivity and efficiency by private banks in Switzerland is the AUM per RM. Most top-performing banks have an average AUM per RM of more than US$17m (CHF 15m), with clearly lower levels among mid- to lower-tier banks.

Client experience

A widely debated issue among our interviewees is the extent to which clients became used to digital forms of communication during the COVID-19 pandemic and whether this will lead to a permanent change in how they interact.

Communication channels between RMs and clients

Many of the bankers we interviewed suggest that we are going through a period of 'revenge travel' and that it is probably still too early to see a clear trend. However, most of them expressed a preference for face-to-face meetings with clients to fully understand their concerns and motivations and to build trust.

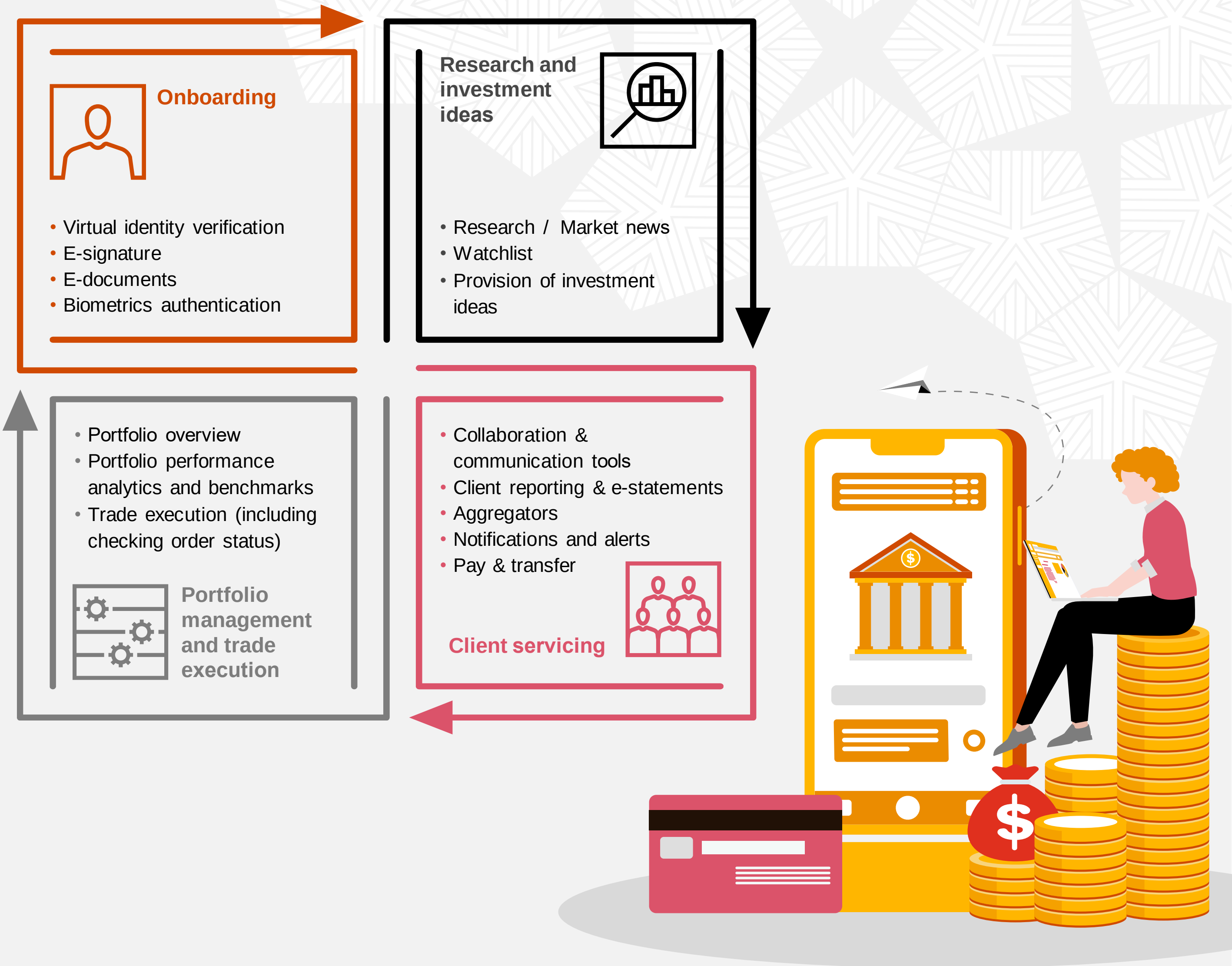
The Swiss perspective:

In Switzerland, physical meetings remains crucial for client interaction and for establishing trust and credibility. Combining both face-to-face and virtual meetings does not yet play an important role.

Private banks in Hong Kong are embracing an integrated strategy that connects client servicing with their backend support systems, with the aim of establishing an effective hybrid model to cater to clients' needs. There has been a growing demand among private banking clients in Hong Kong for the greater convenience that can be delivered through digital servicing and execution channels. By leveraging data analytics to conduct client profiling and segmentation, private banks can gain a competitive edge through tailoring personalised client experiences across various servicing channels, including digital platforms and marketing channels.

The digital platform features that we consistently hear matter most to clients and bankers range from onboarding to investment ideas and trade execution.

Key digital platform features



Digitalisation

Over the last few years, leading private banks in Hong Kong have been actively investing in in digital capabilities, ranging from client interfaces to back-end support systems. This strategic move aims to enrich the client experience. The inclusion of features such as online trading and market insights empowers clients to self-serve and engage with the bank through digital applications. Greater proficiency among the new generation of clients has created a growing demand for the digitalisation of services, thereby driving continuous innovation across the client lifecycle and along the wealth management value chain.

Digitalising the Wealth Management value chain

Onboarding → Wealth planning → Relationship development → Maintain relationship

Initial engagement

- Smart **reuse of client data** and **automatic checks** for regulatory compliance
- Remote **identity verification**
- **Tailored** digital onboarding pack
- **Electronic** document signature
- **Perpetual KYC for** monitoring of events that would require review and update on client information

Investment objective analysis

- **Review and assessment** with RMs and product specialists on a face-to-face/remote and secure basis
- **Real time evaluation** on the **impact of investment choices** on digital platform for visual and interactive meetings among clients, RMs and specialists
- **Pre-populated proposal** to improve client experience of meetings

Insights

- **Personalised investment insights** from market experts through clients' preferred channel

Digital portfolio advisory

- **Timely advice** on clients' portfolio with provision of **relevant and tailored measures**
- **Algorithm-based recommendations** based on client's objectives
- **Impact simulation** of investment choices, supported by a **seamless trading flow** if clients choose to self-serve

Financing

- **Online liquidity management** on Lombard Loans, including lending values of clients' collateral, credit usage and available limit

Online trading

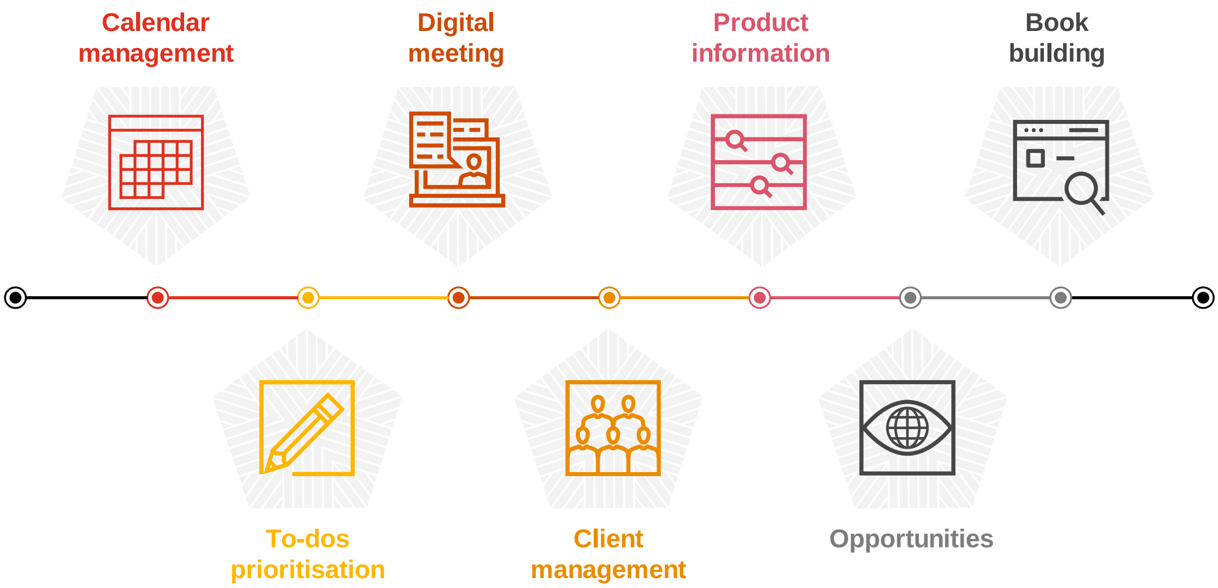
- **Direct access to various asset classes** (e.g. equities, exchange traded funds, FX, funds, structured products)
- **Up-to-date quotes and price charts** to help clients make **informed investment decisions**

The Swiss perspective:

In Switzerland, the Top 5 banks operate at one or more branches with no sophisticated digital offering in place. Medium and low performers emphasise other channels, such as e-banking or mobile apps.

Private banks are exploring new ways to differentiate their digital servicing capabilities. In addition to traditional e-banking services, private banks are enhancing and differentiating their digital experience for clients with broader and more customised services and capabilities, such as adding more investment products that can be traded online, tailoring research content and investment ideas delivered via push notifications and providing analytical tools for clients to better understand and manage their assets.

From our point of view, digitalisation is not only targeted to improve client engagement with the private bank. It is also to enhance the overall experience for RMs, product specialists and operation teams to increase productivity and efficiency. Leading private banks start to equip their RMs with productivity tools, such as messaging and collaboration tools, calendar management, prospect management and book building that are integrated on a tech-enabled workbench to provide RMs with a dynamic and unified client-centric engagement platform.



With the HKMA's emphasis on a balanced regulatory approach, we expect more private banks to explore and adopt Regtech solutions and tools to enhance their Anti-Money Laundering (AML) and Counter-Financing of Terrorism (CFT) workflows. These digital solutions can also support suitability assessment of investment products, as well as monitoring of customer interactions, sales practices and adherence to regulatory requirements. Above all, more efficient and automated processes will offer a better client experience.

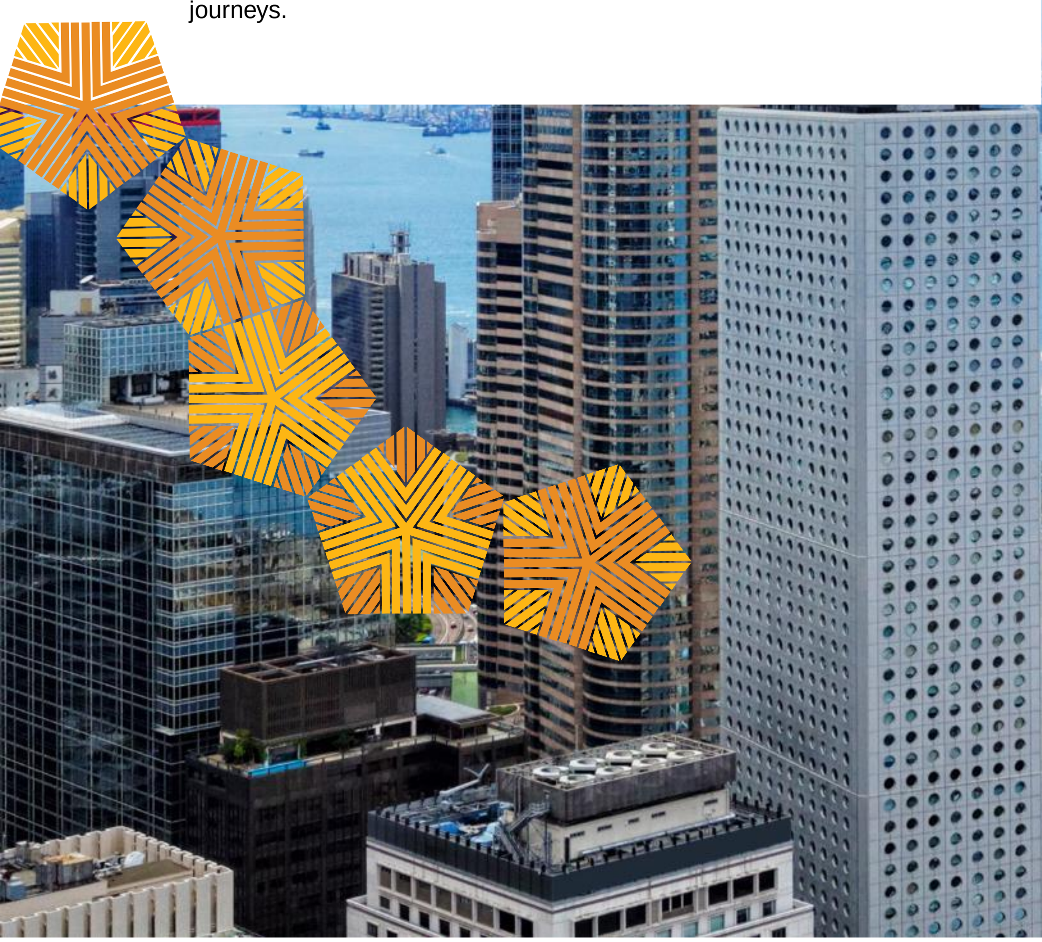
Going forward, technology will further shape the ways investors manage their portfolios. For instance, the HKMA has recently requested selected banks to participate in a pilot programme for the Interbank Account Data Sharing Initiative, paving the way for banks to be able to access, subject to clients' consent, their clients' data held with other banks. This will enable private banks to perform better suitability assessment; provide more comprehensive investment advice; and offer more value-added services (e.g. providing a holistic investment and risk profile analysis by having the client's net worth data and investment information/ data collected from different banks).

Looking forward

Hong Kong is on the right trajectory to become a prominent private banking centre, and should continue to develop its wealth management infrastructure, which includes talent and expertise. It should expand its service and product offerings, and adapt to market trends in order to further strengthen its position in the global private banking landscape.

Clients' expectations, preferences and behaviours will be key to shaping the development of the wealth management industry. The integration of digital solutions and offerings in wealth management will greatly enhance the client experience, while complementing the traditional interpersonal relations between RMs and clients.

Now it is the time for private banks in Hong Kong to refresh and refocus strategies for targeting and servicing the growing wealthy individuals and their families. Furthermore, optimising the business operating models will create fully client-centric wealth management platforms enabling the RMs to meet the evolving needs of their clients, strengthen client relationships and position themselves as trusted partners in their clients' financial journeys.



About Us

At PwC, our purpose is to build trust in society and solve important problems. It is this focus which informs the services we provide and the decisions we make.

Your PwC Private Banking Team

John Wong
Partner
Family Business and
Private Client Services Leader,
PwC Hong Kong
+852 2289 1810
john.cw.wong@hk.pwc.com

Antoinette Hoon
Partner
Financial Services Assurance,
PwC Hong Kong
+852 2289 2742
antoinette.hoon@hk.pwc.com

Hilda Tang
Partner
Financial Services Risk
and Regulation,
PwC Hong Kong
+852 2289 6900
hilda.ht.tang@hk.pwc.com

Julie Chan
Partner
Financial Services Advisory,
PwC Hong Kong
+852 2289 2432
julie.py.chan@hk.pwc.com

Please visit our website at https://www.pwchk.com/en/industries/financial-services/banking-and-capital-markets/private-banking.html and contact us to find out more.