Digital Transformation in European Private Banking

To create a distinctive customer experience, improve risk monitoring and regulatory compliance, and generate new operating efficiencies, European private banks need to double-down on digital technologies.
**Executive Summary**

European private banks are battling reduced profits and the unraveling of bank-client confidentiality, which has long been the backbone of offshore private banking. Several factors—including a wave of regulations following the global financial crisis, customers’ flagging trust in banking institutions and an increased demand for transparency—are forcing banks to invest in rewiring their back-end systems to improve data management, analytics and reporting.

Changing behaviors among customers are additional game-changers for European private banks, including the rise of tech-savvy, connected millennials, rapid adoption of digital technologies and demand for new kinds of services. A further challenge is posed by the rise of new competitors from outside the traditional banking sector that provide lower cost, transparent and tailored services powered by digital technologies, such as social, mobile, analytics and the cloud (i.e., the SMAC Stack™).

In this new digital era, European private banks must transform in order to innovate, deliver a meaningful customer experience and sharpen their competitive edge. By incorporating the SMAC Stack into their business and technology models, banks can be better equipped to offer a strong customer experience that meets client expectations for simplicity and convenience. Advisors, for example, can be more productive and interact with customers anytime and anywhere, across multiple channels. Digital tools and automation can also improve risk monitoring and compliance.

Banks embarking on a digital transformation must also focus on gaining complete knowledge about customers by leveraging what we call a Code Halo™—the digital information surrounding customers, organizations and devices. In addition to harvesting the insights that can be gleaned from this invaluable information, banks must also improve data security, manage organizational change and address their legacy infrastructures.

**A Period of Transition**

The European private banking industry has yet to recover from the 2008-2009 financial crisis, even as its counterparts in North America and Asia have returned to profitability. Industry profits in 2013 were roughly 20% less than pre-crisis levels and continue to be affected by lower interest rates and increasing regulatory costs.

Profit margins in 2013 were 25 basis points of assets under management, a far cry from the 35 basis points in 2007. Revenues per dollar of assets are 18% lower than pre-crisis levels.

Moreover, the financial crisis diminished client trust, causing many customers to demand transparency on fees and investment decisions. Competition is also heating up as new entrants use digital technologies to provide low-cost, on-demand advisory services. A summary of forces shaping the European private banking industry includes the following:

**Disappearing Protection for Bank Secrecy**

With international pressure mounting in the aftermath of the global financial crisis, many countries, including the tax havens in Europe, agreed to implement the Foreign Account Tax Compliance Act (FATCA) and a new global standard on automatic information exchange, which entails sharing account details with the depositor’s country, starting in 2017. This agreement ends bank secrecy in countries such as Switzerland, Luxembourg and Liechtenstein, removing the competitive advantage these nations have enjoyed in attracting offshore wealth. Further, Swiss private banks face numerous tax-evasion probes, and some institutions have been fined by the U.S., with the country’s oldest bank, Wegelin & Co., closing its doors permanently.

As a result of these changes, private banks will no longer be able to charge their clients a premium for their services. They will also incur costs to ensure their customers are tax-compliant in their home country, and will need to improve their IT infrastructure to comply with new legislation.

**Evolving Regulations**

European regulations have increased operational costs for private banks, and the average cost of customer management has risen by 20% to 30%. Under the Retail Distribution Review (RDR), wealth managers in the UK are prohibited from taking commissions from product providers and are required to disclose the cost of providing advice upfront. Meanwhile, many clients are turning to less expensive online advisory services. For instance, Nutmeg, an online investment firm, charges 0.6% per year (including VAT and trading costs) for a range of managed portfolios, compared with the 7.5% per year charges typical of many large private banks, according to Numis Securities. The Netherlands has banned...
indebtedness, and is on a slower growth trajectory compared with the U.S. and Asia, its strong wealth fundamentals are prompting many big banks to expand their footprint in Europe, posing a significant threat to domestic players.\textsuperscript{11}

The rise of robo-advisors is casting another shadow over the European private banking industry. Software-driven, automated advisory services are offered to clients at lower fees. Firms such as Vaamo and Nutmeg are luring clients by offering personalized portfolio management, periodic reviews and innovative tools to monitor investment performance in real time. Although the main target is younger clients with smaller portfolios who are early in their wealth accumulation phase, clients with bigger portfolios are beginning to offer some portion of their assets to these firms (see Figure 1).

Additionally, younger and more tech-savvy clients often continue to work with these firms even after they accumulate wealth. The global assets under management (AuM) of the robo-advisor services are expected to grow from $14 billion to $255 billion between year-end 2014 and 2019, according to MyPrivateBanking Research.\textsuperscript{12}

Some private banking firms in the UK that focus solely on the ultra-high net worth (UHNW) retrocession payments\textsuperscript{6} since January 2014; more countries are expected to follow suit, forcing wealth managers to reduce the cost of providing advice and search for alternative sources of income.

A bigger challenge lies in complying with MiFID II (Markets in Financial Instruments Directive), which requires banks to regularly disclose to their clients all costs and charges, such as transaction costs, custody and research costs, performance fees and exit charges, along with the impact of costs on returns.\textsuperscript{7} Set to kick in by January 2017, MiFID II is expected to cost the European financial sector billions of euros\textsuperscript{8} in transaction monitoring, telephone recordings, overhauling the IT infrastructure to manage large amounts of transaction data, etc. By prohibiting wealth managers from receiving inducements, MiFID II is expected to cut private banking profits annually by 20% to 25% across Europe, according to McKinsey.\textsuperscript{9}

Increasing Competition
In 2013, European private wealth exceeded its pre-crisis peak, reaching an all-time high of €56 trillion, and is expected to reach €79 trillion by 2019, which is attracting big banks in the U.S., Canada and South America, according to a Julius Baer report.\textsuperscript{10} Though Europe is battling a prolonged economic crisis and sovereign

\section*{Competition from Non-traditional Players Expected to Increase}

Change in percentage of survey respondents indicating whether each option is a competitor.

<table>
<thead>
<tr>
<th>Category</th>
<th>Current</th>
<th>Future</th>
</tr>
</thead>
<tbody>
<tr>
<td>Online Wealth Managers</td>
<td>19%</td>
<td>11%</td>
</tr>
<tr>
<td>Non-financial Players</td>
<td>10%</td>
<td>9%</td>
</tr>
<tr>
<td>Online Brokers</td>
<td>4%</td>
<td>8%</td>
</tr>
<tr>
<td>Specialized Wealth Managers</td>
<td>2%</td>
<td>43%</td>
</tr>
<tr>
<td>Asset Managers</td>
<td>-6%</td>
<td>29%</td>
</tr>
<tr>
<td>Financial Advisors</td>
<td>-10%</td>
<td>28%</td>
</tr>
<tr>
<td>Premier Divisions of Retail Banks</td>
<td>-16%</td>
<td>28%</td>
</tr>
<tr>
<td>Large Wealth Managers</td>
<td>-16%</td>
<td>64%</td>
</tr>
</tbody>
</table>

Note: Numbers may not tie due to rounding.
The survey included 26 face-to-face interviews with CEOs and senior executives from 23 wealth managers across Europe and an online survey of another 136 industry professionals.

Source: JP Morgan-Oliver Wyman Future of European Wealth Management Survey

Figure 1
segment are moving down the ladder to focus on the high net worth (HNW) segment, which is witnessing asset inflow from emerging economies. However, big banks, when serving the lower strata, are not effective at personalizing their offers.

Another worrying trend for the big firms is HNW individuals’ increasing reluctance to do business with big banks. In a recent study, the majority of 270 UK millionaires surveyed (those with at least £1m in liquid assets) said they preferred to not work with large organizations, particularly if it meant dealing with a wide range of people, many of whom they might only speak with once.

Rising Costs; Falling Advisor Revenues
The cost-to-income ratio of European banks’ wealth management increased from 62.8% to 80.6% between 2008 and 2013, primarily due to higher legal, compliance and risk management costs, according to Scorpio Consultancy. During the 2010–2013 timeframe, meanwhile, net new assets per relationship manager (RM) by European onshore institutions were among the lowest in the world, at $4.9 million per RM vs. the global average of $7.3 million, according to a BCG report. Further, the payout as percentage of revenue for RMs decreased from 18% to 16%, the report said.

Advisor productivity is also impacted by growing regulatory requirements. In fact, about 70% of UK wealth managers’ time is consumed with compliance activities. Digital technologies such as mobile devices with interactive apps and video chats can improve advisor productivity by shortening turnaround times, easing compliance and improving their ability to deliver better customer service while reducing costs.

Changing Customer Landscape
Following the global economic crisis, customers now demand better performance and more transparency on fees, products and investment decisions made by wealth managers. Clients hold more cash in deposits and are investing directly in private equity and real estate.

As baby boomers age, private banks are now targeting the next generation of customers, who represent a significant opportunity, with nearly 50% of current wealth expected to be transferred to this segment in the next 20 to 30 years, according to the European Central Bank.

In addition to the heirs of existing clients, this group includes entrepreneurs who are digitally-savvy, independent, risk-taking, knowledgeable about investments and more self-directed than their predecessors. They are accustomed to the highly personalized services offered by companies such as Apple, Google, Amazon, Starbucks, etc., and they expect similar services from other industries and prefer organizations that offer high-quality service on-demand.

In addition to millennials, wealthy customers are generally ahead of private banks in terms of their level of digital adoption. Affluent Europeans have used mobile devices longer than non-affluent individuals, with close to 70% of millionaires 40 years old and younger accessing their portfolios remotely in 2013, according to Financial Times. Wealthy customers in Europe are expected to increase their digital media use for communicating with their financial providers by 2017 (see Figure 2, next page), according to Scorpio Partnership.

Globally, more than 80% of the affluent use apps or mobile Web sites for financial transactions and information. About 96% of affluent and HNW Chinese bank customers use mobile technology for financial matters, followed by the U.S. (74%) and Germany (71%), according to MyPrivateBanking Research. Affluent and HNW clients in the UK, France and Germany are ahead of the U.S. in terms of technology-friendliness, the firm says. While clients continue to prefer in-person service with wealth managers for complex issues such as wealth transfers, philanthropy, etc., digital channels are fast replacing human contact for most transactions.

Wealthy Europeans are highly social, with 43% using social networking sites several times a day. These customers expect banks to provide personalized services, such as online access to their accounts, real-time portfolio performance and reporting, and service across multiple touchpoints.
Winning in such conditions requires private banks to take the following actions:

- Provide seamless support to a wide range of customers, from older generations, to the self-driven, digitally-savvy neo-rich.
- Offer customer advice consistently across channels.
- Support more customers without a dip in service quality even as margin pressures loom.

The Digital Advantage

Digital technologies can help private banks secure customer loyalty and compete effectively. Some large private banks offer basic online services and mobile apps to carry out simple transactions and share market news and information with clients, and are planning to grow their digital offerings. However, a majority of institutions – for instance Swiss banks – have yet to take serious steps due to factors such as declining profits, lower IT budgets, the cost of complying with new regulations and increased tax probes.

Private banks that leverage digital technologies such as the SMAC Stack and the Internet of Things stand to gain significantly by simplifying service across communication channels, empowering customers and employees, improving compliance and monitoring, and increasing transparency, as witnessed by organizations in other industries. However, in Europe – where customers still value the highly personal touch for complex transactions but want the convenience of digital interactions for routine transactions and reporting – the key will continue to be balancing a traditional approach with digital enablement technology.

Enhancing Customer Service

Private banking is all about creating a differentiated customer experience. However, a survey of 425 wealthy European customers revealed dissatisfaction with wealth managers’ ability to deliver on aftercare, such as providing concierge services and offering invitations to financial and lifestyle events and loyalty schemes, according to a report by SEI, NPG Wealth Management and Scorpio Partnership (see Figure 3, next page).
For an industry driven by high-touch and high-quality service, digital solutions will provide new ways to engage with customers and deliver a highly personalized, seamless and integrated experience. These technologies can reduce response time, facilitate on-demand service, and provide real-time investment information and reports in a digestible format for customers. For instance, Citi Private in View platform provides customers with all the details of their portfolio and allows them to drill down to better understand portfolio performance, notifications and the latest research. It also offers a single point of contact to interact with bank reps and secure cloud storage for personal and account documents.26

Digital leaders such as Amazon, Apple and Google can provide banks with insights into simplified, effective customer service. For instance, Amazon allows its Kindle Fire HDX customers to connect and video-chat with a call-center executive at any time by simply clicking a button.28 Social media can also be used to create exclusive networks for clients based on their interests, ambitions and social status, enabling banks to engage with multiple customers in a meaningful way.

Empowering Clients
With HNW clients increasingly becoming self-directed, European private banks can compete effectively with online firms by offering online trading platforms on the device of their choice, along with on-demand customer support via chat, call centers, etc.

For traditional clients, banks can provide self-service tools for simple transactions, such as money transfer, account opening, and planning and simulation tools for decision-making. Quick and simplified access to information on investment performance with timely alerts can go a long way toward building client trust, as would on-demand access to real-time account status on a mobile device, along with supporting research and market data and an option to chat live with an advisor.
Improving Advisor Productivity

Digital tools can provide advisors with complete, real-time information about customer investment performance, markets, etc., allowing them to respond to customers even when they are on the move. Customers increasingly want to substantiate the financial information provided to them. Advisors can conduct a quick video chat to respond to customer queries and offer more information or share links immediately. Providing advisors with complete information about a customer’s relationship history with the bank allows them to offer more tailored recommendations based on the client’s goals.

By analyzing vast amounts of customer data, such as profiles and investment choices, private banks can create templates for high-quality advice that can be customized for new clients with similar preferences. Banks can also use social media platforms such as Facebook and LinkedIn to create exclusive groups, enabling them to deliver meaningful customer engagement and attract new customers. Additionally, banks can listen to and analyze social media activity and responses to posts to ascertain customer sentiment about new products and their investment needs, which can be valuable input for new products or services. Using analytics, banks can harness customer Code Halos to identify customer segments that offer potential growth, discover cross-sell and upsell opportunities, and develop and test investment ideas and strategies. 29

A further productivity boost can be gained by digitally scanning documents, updating client information with back-end systems and embracing document management. All of these moves can reduce administrative burdens and free up time that can be used to acquire new clients and serve existing clients better.

In order to attract and retain independent financial advisors (IFAs), Swiss private banks—which manage about 14%30 of the total AUM in Switzerland—must provide dedicated IT platforms to support their client work, as well as online business platforms to share ideas and opinions, identify new business opportunities, connect with experts, etc. According to a 2014 survey that we conducted with IDC, roughly 35% of small private banks and 75% of IFAs and family offices in Switzerland and Luxembourg do not use their custodian bank infrastructure and perform most of their processes manually (see Figure 4). One of the major reasons cited is the lack of multi-custodian support from big banks, which results in data aggregation challenges.

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**Figure 4**

<table>
<thead>
<tr>
<th>Small Private Banks</th>
<th>IFAs and Family Offices</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>75%</strong> have a multi-custodian relationship.</td>
<td><strong>60%</strong> have a multi-custodian relationship.</td>
</tr>
<tr>
<td><strong>35%</strong> do not use any bank infrastructure.</td>
<td><strong>75%</strong> do not use any bank infrastructure.</td>
</tr>
<tr>
<td><strong>70%</strong> perform processes manually with ~90% handling trade and portfolio management and reporting manually.</td>
<td><strong>100%</strong> currently perform all their business operations manually.</td>
</tr>
<tr>
<td><strong>65%</strong> have clients with multiple custodian relationships and face challenges with data aggregation.</td>
<td><strong>40%</strong> have clients with multiple custodian relationships and face challenges with data aggregation.</td>
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</tbody>
</table>

Response base: 200 across Switzerland and Luxembourg; 118 IFAs, 16 family offices and 66 small private banks (median of 240 employees)

*Source: IDC and Cognizant survey, 2014*
Improving Compliance
A more strict and continuously evolving global regulatory environment requires banks to be more cautious about cross-border transactions and tax laws to avoid hefty fines and damage to their reputation. Digital technologies can help banks by providing a real-time view of risk exposure, as well as timely alerts. Advisors’ tablets can be equipped with risk management tools to check and report on potential risk and compliance issues early in a transaction, which saves time and reduces risk for customers, advisors and banks. Similarly, customers can be given tools that allow them to assess their risk, and automatically alert advisors to deviations. Such a setup can prevent violations during portfolio construction, trade execution, etc.

Increasing Transparency
To increase transparency, banks need to improve their reporting and communications on fees, investment decisions and products. However, few banks are making an effort to provide such information. For instance, bank fees differ for portfolio management services, making it difficult for customers to understand the charges. With regulations such as MiFID II coming into effect in the next few years, private banks must strive for greater transparency in their fee structures. As digital banks allow customers to compare fees and provide other tools that promote transparency, customers will be empowered with tools that calculate total costs (divided into advisory fee, transaction charges, service charge, etc.) based on their service requirements, which will result in heightened trust.

Banks can also offer customers apps that allow them to better understand their portfolios by comparing them with the market, their peers’ portfolios and portfolios created by other advisors.

Key Considerations
Digitization is not a one-time effort or investment but rather a long journey toward creating a better way to interact and transact with clients. Achieving this transformation requires private banks to better understand their clients by leveraging Code Halos, revamping the existing IT infrastructure to support new technologies, managing change, and improving data security and customer privacy.

Leveraging Code Halo thinking
Offering individualized services and providing a richer experience requires a deeper understanding of customers. Private banks can leverage the data surrounding customers, organizations and devices to gain deeper insights about customers through their digital behaviors. By using advanced and predictive analytics, banks can harness Code Halos to learn more about prospects and customers in terms of their financial goals, needs (based on their life stage), tastes, interests, etc., as well as discover new correlations and business opportunities. These insights can be used to better target prospects, as well as cross-sell and upsell to

Quick Take
mBank’s Digital Technology Innovation
European private banks are still in the very early stages of digital transformation; however, some of their retail counterparts – such as Poland’s mBank – have been at the forefront of adopting new technologies to deliver superior customer service.

mBank started in November 2000 as an online retail bank. In 2012, when mobile technology was catching on with customers, the bank overhauled its back-end systems to offer customers the latest digital services and mobile capabilities, optimized for multiple devices and operating systems. The bank’s transactional architecture is on par with the top online retailers; for instance, customers can transfer money using SMS and Facebook, and experts are available 24x7 to help customers through video chat or voice. The bank’s mobile installment loan process is automated, and money is transferred to customer accounts within minutes of providing customer details and credit scores. The bank’s personal finance management tools offer budget management and provide a complete spending history, along with forecasts that are enhanced with graphics.
existing customers. For instance, customers announcing a major life event such as the birth of a child or their marriage on a social networking site can be approached with a suitable product, making the interaction more meaningful. (To learn more, read the book, “Code Halos: How the Digital Lives of People, Things, and Organizations are Changing the Rules of Business.”)

Change Management
Because digital transformation impacts multiple functions in the organization, it requires strong support from senior management. Organizational cultures need to change, extending beyond advising and managing wealth to empowering customers. It also requires changes in the bank’s governance structure to suit the new operating environment, such as the creation of new roles to lead the transformation and an altered reporting structure across the bank.

Security
As customer interactions increasingly take place over digital channels, banks need to take extra measures to protect customer, employee and other business data against theft, loss and cyberattacks. Multi-layered security, strict data security standards, advanced analytics and threat intelligence systems can ensure data privacy and security. Banks should continuously upgrade their security systems and prepare contingency plans while educating clients about potential fraud and cybersecurity. Private banks can take a cue from the airline industry, which has balanced its need for high security with advancements in the digital customer experience, resulting in enhanced customer service without affecting passenger safety.33

Revamping IT Infrastructure
Most banks still rely on legacy technologies that require manual intervention and do not fully support new Web services that enable delivery of real-time information to customers and advisors. Further, fragmented data infrastructures and poor data management practices create data inconsistency and inaccuracy, which prevents banks from meeting regulatory mandates and customer demands for transparency.

In order to reap the full benefits of digitization, banks should focus on automation and overhauling their technology infrastructure. Building an integrated, robust, scalable infrastructure will create new efficiencies, reduce maintenance costs and improve organizational flexibility, enabling private banks to fully realize the promise of digital.

Although banks can choose to replace multiple core systems with a universal solution, this approach will involve time, effort, risk and substantial investment. By working with vendors that provide modular and componentized core banking solutions, banks can cost-effectively replace systems based on their business needs and budgetary constraints. Another approach is to use middleware to reduce integration challenges and improve connectivity between core systems and new applications. A good example is Credit Suisse, which built a new digital organization in three to six months with the help of technology firms.34 (For more insight, read our white paper “Digital Banking: Enhancing Customer Experience; Generating Long-Term Loyalty.”)

Looking Ahead: The Digital Journey
Private banks embarking on a digital transformation can incorporate the following approaches for a smoother transition:

- **Have a strong vision concerning what the digital organization will look like following the transformation.** This requires an understanding of customer and organizational expectations and assessing future technology needs.

- **Involve employees** and share the vision with them.

- **Learn from new digital entrants and other industries** (see sidebar, previous page). By studying and emulating what others have done outside the financial industry with digital technologies, private banks can gain significant advantage over new competitors.
• **Deploy a dedicated team with a chief digital officer** to oversee transformation efforts, with the CIO as the lead or co-lead.

• **Transform in phases** by starting with small customer segments before embarking on a full roll-out.

• **Focus on a simplified and distinctive customer experience** rather than offering a hodgepodge of tools and platforms.

• **Learn from customer usage and seek their feedback regularly** to refine and offer tailored digital services.

Note: Code Halo™ is a pending trademark of Cognizant Technology Solutions.

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**Footnotes**


6. Retrocession fee is the amount paid by asset managers to the distributors, usually from the client’s money without notifying the client.


20 Ibid.


References