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HIGH NET WORTH INDIVIDUALS – THE CLIENTS OF PRIVATE BANKING

ABSTRACT

High Net Worth Individuals (HNWIs) are the clients of private banking. The category of HNWIs is not clearly defined. Generally, it is thought to refer to the clients with more than \$1 million in financial assets.

The paper describes the category of High Net Worth Individuals. It presents the market size and its growth from regional and global point of view. Moreover, the paper illustrates the structure of the segment of HNWIs and the implications for private banks. First of all, the source of the wealth of the clients is varying. The changes in the structure of the clients of private banking cause necessity for banks to serve HNWIs in different ways and with various instruments. Secondly, we can distinguish clients by the types of the services they need. As a consequence, private banks should adjust their attitude towards different types of High Net Worth Individuals and properly satisfy their needs.

Keywords: Private banking, Wealth Management, High Net Worth Individuals, Wealth preserving, Wealth maximizing, “old money” and “new money” clients, e-private banking.

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INTRODUCTION

Private banking is an individualised and complex system of financial services offered by the bank to the wealthy customers, i.e. High Net Worth Individuals (HNWIs) (Dziawgo, 2003 p. 14). High Net Worth Individuals are the clients of private banking. The category of HNWIs is not clearly defined. Generally, it is thought to refer to the clients with more than \$1 million in financial assets. However, we can find different classifications of the clients of banks in this respect.¹

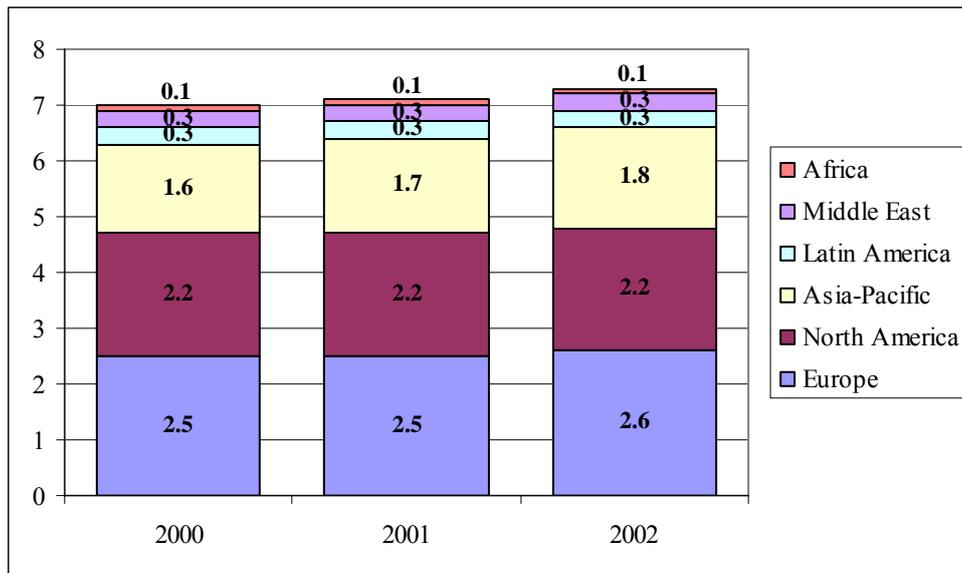
The group of the wealthiest clients of the banks is changing rapidly. First of all, we can notice that lucrative business activities and unprecedented economic expansion of the past decade have created many “new money” High Net Worth Clients. This segment of HNWIs requires more diversified products and services than the segment with inherited wealth. Other changes in the category of High Net Worth clients concern the risk propensity of the clients. A few last years of poor economic conditions caused that HNWIs, even these from the segment of “new money”, are less eager to take high risk of investments, and are more concentrated on preserving their wealth, than on creating it. Thus, there is a change in the way HNWIs want to invest their assets. Unlike earlier, they are deeply interested in financial advice of the customer relationship managers instead of making self-directed investments. The asset allocation of wealthy clients is also changing. In connection with high volatility of stock indices HNWI increased fixed income investments and alternative investments, such as hedge funds and real estate investments trusts.

THE SIZE OF THE MARKET

Merrill Lynch/Cap Gemini Ernst & Young World Wealth Report estimates that in 2002 there were 7.3 millions of High Net Worth Individuals worldwide. In comparison with the previous year, the number of HNWIs has increased by 2.1% from 7.1 million clients (see graph 1). The highest number of HNWIs lives in Europe (2.6 million), in USA live 2.2 million of HNWIs, and in countries of Asia and Pacific live 1.8 million of the wealthiest clients of the banks (Merrill Lynch/Cap Gemini Ernst & Young, 2003 p. 3).

¹ According to PricewaterhouseCoopers “Global Private Banking/Wealth Management Survey 2003” High Net Worth Individual is a client with at least 500,000 USD in financial assets.

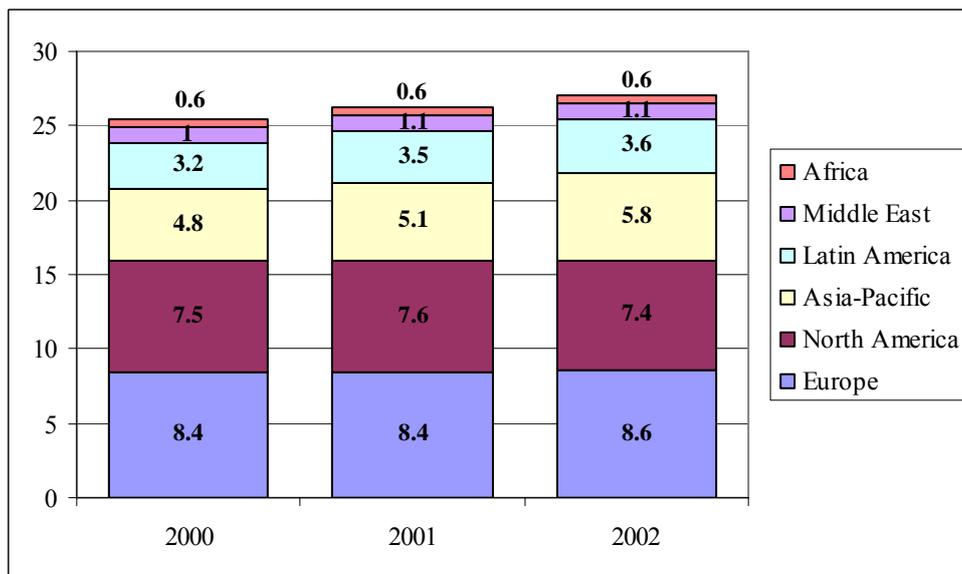
Graph 1: Number of HNWI's by region, in 2000-2002 (in millions)



Source: Merrill Lynch/Cap Gemini Ernst & Young, (2003 p. 3.)

The financial assets of HNWI's amounted to 27.2 billion USD in year 2002. In relation to year 2001 there was growth by 3.6%. Again, the leader is Europe. High Net Worth Individuals from Europe possessed 8.6 billion USD, while American HNWI's had 7.4 billion USD in financial assets. Clients of private banking from countries of Asia and Pacific were the owners of 5.8 billion USD in financial assets (see graph 2).

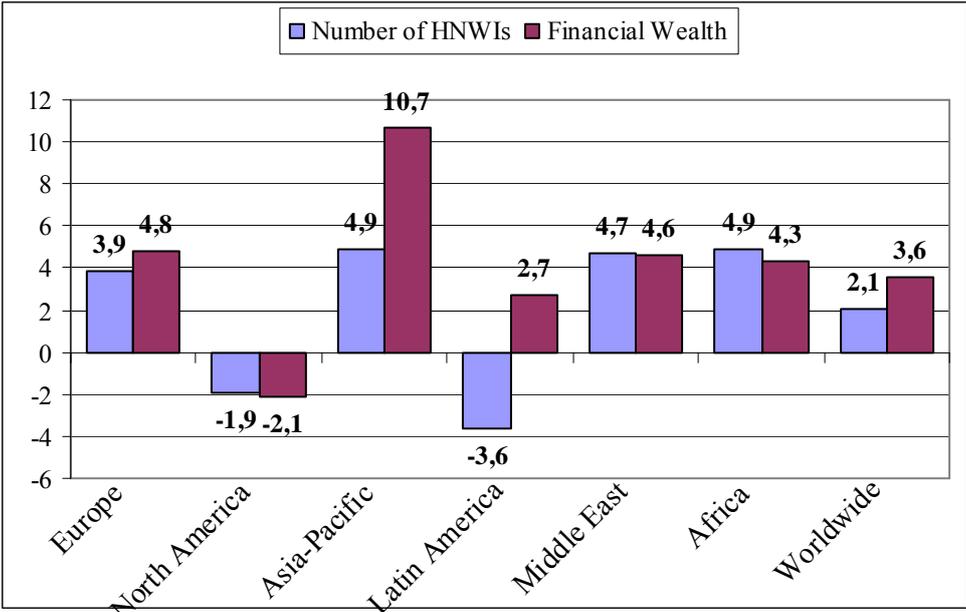
Graph 2: HNWI's financial wealth by region, in 2000-2002 (in trillions USD)



Source: Merrill Lynch/Cap Gemini Ernst & Young, (2003 p. 3.)

The growth of the number of HNWI's amounted to 2.1% and was the lowest since many years. HNWI's financial wealth increased by 3.6%. The reasons for such poor results were slow gross domestic product (GDP) growth and falling stock prices. European HNWI's wealth rose by 4.8% mainly as a result of appreciation of the euro and British sterling against the US dollar. American and Canadian HNWI wealth decreased by 2.1%. It was connected with continuing decline in equity market indices in the United States in 2002. Asia-Pacific HNWI wealth increased by 10.7% in spite of the Japan's economic stagnation. The growth was caused primarily by high saving rates and robust GDP growth in important regional economies, such as China, South Africa and Australia. Financial wealth of Latin America's HNWI rose by 2.7%. The main obstacles for higher growth in this region were economic and political disturbances in Argentina and Venezuela (see graph 3).

Graph 3: Annual changes from 2001 to 2002 in the number of HNWI's and their financial assets by region (in %)



Source: Own study on the basis of Merrill Lynch/Cap Gemini Ernst & Young, (2003)
World Wealth Report (2003, p. 3.)

CATEGORIES OF HIGH NET WORTH INDIVIDUALS

First of all, wealthy clients can be divided by the value of financial assets they possess (see table 1). About 83% of HNWI's in year 2000 were in the 1 million to 5 million USD assets band. The value of the wealth possessed by this group was 7.8 trillion USD (27% of the

total value). The band of Very High Net Worth Individuals amounted to 1.2 million people (16%), and assets being in their possession were worth 12 trillion USD (42%). The most affluent band of HNWI's (Ultra High Net Worth Individuals) had 52 thousand participants in year 2000, i.e. only 1% of all High Net Worth Individuals, but financial assets possessed by this group amounted to 30% of total wealth gathered by HNWI's (8.9 trillion USD) (Pietrzak, 2002 p. 5).

Table 1: Client bands according to the value of the financial assets of HNWI's, in 2000

Client band	Financial assets (mln USD)	Number of HNWI's (thousands)	% of clients	Value of the market (trillions USD)	% of total value
High Net Worth Individuals	1-5	6,225	83	7.8	27
Very High Net Worth Individuals	5-30	1,204	16	12.0	42
Ultra High Net Worth Individuals	> 30	52	1	8.9	31

Source: Pietrzak, J. (2002 p. 5).

Ultra High Net Worth Individuals are the most sophisticated clients with the most complex needs. They are also the most profitable clients for private banks, hence the competition for the highest net worth clients is the greatest between banks. "Global Private Banking/Wealth Management Survey 2003" prepared by PricewaterhouseCoopers is the best proof of it. In the survey 49% of respondents (Private Banks and Wealth Managers) stated, that they expect to increase percentage of Ultra High Net Worth Clients in the near future (PWC, 2003 p.12). However it is not very probable that there will be sufficient number of super rich clients for all wealth managers to achieve their ambitions.

"NEW MONEY" VS. "OLD MONEY" CLIENTS

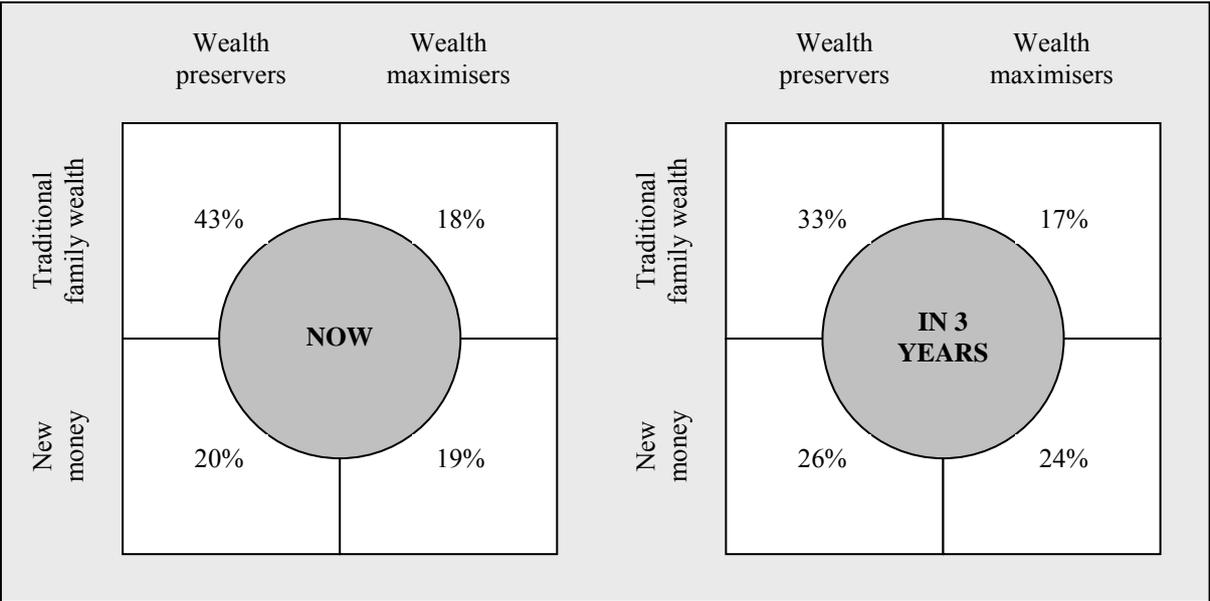
In the last few years interesting changes in the structure of the segment of High Net Worth Individuals have been noticed. There is an observable trend that the number of clients with traditional family wealth is decreasing (on average 61% of clients now, to approximately 50% in three years time), while the number of investors with new money is rising (PWC, 2003 p.14). The reasons for a such situation are primarily: lucrative business activities and unprecedented economic expansion of the past decade. The group of "new money" HNWI's consists mainly of managers, company owners and the representatives of the professions (such as lawyers, doctors, architects, etc.). Their wealth has been created by themselves in the first generation, whereas "old money" HNWI's did not have to generate their assets unaided,

because “old money” segment consists of the owners of the traditional inherited fortunes (see graph 4).

The division of High Net Worth Individuals into “new money” and “old money” clients entails specific consequences. The products, services, risk propensity, willingness to obtain advice, attitude towards their wealth (whether they just want to preserve it or also increase it) and the service required by HNWI depends, to some extent, on the origin of the fortunes of the private banking clients.

In general, traditional clients prefer simple, straightforward products. They tend to have discretionary portfolios in which investments decisions are principally in the hands of the private banks. Hence, these clients do not need to contact relationship managers to often. “Old money” HNWI require simply updates on the status of their accounts. On the other hand, “new money” clients ask for much more complex products, they want to participate actively in the investment decisions through advisory relationship. The requirements of the “new money” segment are totally different from those of the “old money” group. If these “new money” clients want to make the most appropriate decisions, they need continuous education and a great deal of information and research. Also fast and easy access to multiple channels of communication is needed. Such means as call centers and the Internet can facilitate contact between client and bank, and make it available on a 24x7 basis (ATKEARNEY, 2002 pp. 1-3).

Graph 4: Traditional and new money clients – changing profiles



Source: PWC (2003 p.14).

Another aspect of the private banking client behavior is his or her risk propensity and attitude towards wealth maximizing or preserving it. Generally, it is accepted that “new money” are willing to incur greater risk in order to earn more on higher yielding investments. So the group of “new money” HNWI is thought to be more interested in wealth maximizing. On the other hand, traditional HNWI concern more about preserving wealth rather than maximizing it. Nowadays 61% of all HNWI are the participants of the segment of the traditional family wealth. 70% of the clients from this group is more interested in preserving than generating wealth. The latter segment of HNWI (“new money” clients) represents 31% of all clients of private banks (PWC, 2003 p.14). Within this group, only approximately half of the HNWI is mainly interested in preserving wealth (see chart 4). So, it is reasonable to claim that “old money” clients are much more conservative towards investing their wealth.

WHY DO THE CLIENTS LEAVE PRIVATE BANKS?

Sometimes High Net Worth Individuals exchange one private bank to another. It is very important to identify the factors of such behavior. Especially private banks are deeply interested in recognizing the reasons. Big geographical differences are noticeable in that respect, however in most regions of the world private banks believe that clients leave primarily because of insufficient investment performance. The second most often listed reason was the lack of proactive advice. By contrast, a bit different factors are mentioned by the Asian private banks. 43% respondents of the survey conducted by PricewaterhouseCoopers and the Economic Intelligence Unit stated that HNWI leave banks when they are generally dissatisfied with the service or when they feel the lack of understanding of their needs. Another very important factor, which encourages the client to leave the bank is following key staff to other private banks. Gaps in the product range, too high prices and changes in personal circumstances seem to be less important reasons for leaving a bank (PWC, 2003 p.13).

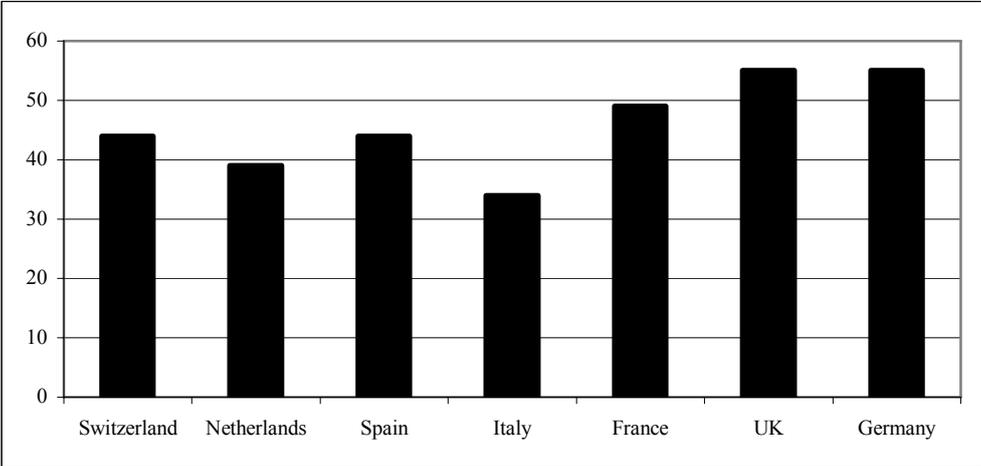
ELECTRONIC SERVICES FOR HNWI

Success in managing of funds of HNWI is connected with technology solutions used by private banks or specially dedicated to these services banks’ organizational units. Retail banks and investment banks were the first, that started to offer dedicated applications for wealth management as a standard. Later, traditional private banks with headquarters based in

and out of Switzerland followed this strategy. Software solutions usually work like aggregators of accounts in one or more banks with functions linked with banking, reporting, brokerage, insurance, loans, mortgages and credit cards services. Every year electronic way of communication is more acceptable by High Net Worth Individuals. It is interesting that the Internet penetration rate in the case of HNWI is about 10% higher than in group of Ultra HNWI. During three years between 1998 and 2002 the Internet penetration rate increased considerably, especially in the wealthier group, but still many wealthy customers do not have the internet connection at all. Relatively the lowest penetration rates have been noticed in Italy and the Netherlands. It could be a consequence of the structure of HNWI profile, since in these countries there is a domination of “old money” rich people. The highest level of the interest in the Internet was reached in Germany and the United Kingdom. It can suggest that “new money” HNWI are the majority of all HNWI there. It is assumed in the paper that in 2004 popularity of the computer wealth management solutions in all countries will steadily grow to 30-80% ratio depending on a country.

The Internet penetration rate implies the popularity of the software wealth management platforms and other technology solutions implemented in the private banks.

Graph 6. The Internet penetration rate in the group of HNWI and UHNWI in 2000 year



Source: Magrini, Thomas (2001, p. 26).

Market situation shows that despite this low interest in new technology more and more customers every year are changing their behaviors. European HNWI still prefer traditional bank branches for doing payments, investments and credit loans, this kind of answer declared 39 to 56% of European respondents. The survey shows that Internet is more preferred by

wealth customers than traditional mail, ATM or others channels that could be for example CRMs – Client Relationship Managers.

Tabela 2. Preferowane przez europejskich zamożnych klientów segmentu HNWI kanały dystrybucji w 2000 roku

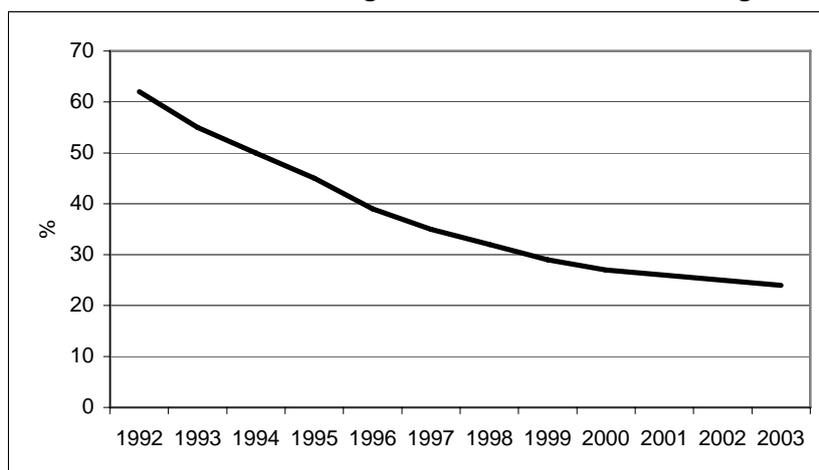
	Bank branches	Telephone	Internet	Mail	ATM	Other
Payments	39%	24%	14%	10%	7%	5%
Investments	46%	22%	13%	8%	4%	7%
Credit loans	56%	19%	9%	7%	1%	8%

Source: Magrini, Thomas (2001, p.27).

Deregulation of financial markets caused that nowadays private banks compete for HNWI with brokers, insurance companies, mutual fund companies, independent advisors and mainly with commercial and investment banks from all parts of the world. It used to be that professional and the best-in-class private banking was only from Switzerland. Currently many units registered off-shore e.g. Jersey, Gurnsey, Isle of Man, Bermuda, Cayman Islands or on-shore like Monaco, Luxemburg, Singapore, Hong Kong do strongly compete with the best known Swiss private banks like Sarasin or Pictet. This competition inducts flow of High Net Worth Clients and their assets from traditional private banks to commercial banks because the second ones were first who adopted the internet technologies on a mass scale. Advanced IT systems allowed to introduce whole range of the wealth management products for High Net Worth Clients. Standard core banking applications should be connected with insurance, trust, mutual funds, mortgages, loans, brokerage and credit cards financial services and retirement planning. Private wealth management services should provide HNWI with: market data from all financial markets, equity and fixed income trading services, tax advice, estate planning and insurance products which are the best-in-class.

The late introduction of advance internet transaction systems in the private banks caused that brokerage firms, e.g. Charles Schwab, E-Trade and Ameritrade dominate in selling products to Affluent or High Net Worth Customers in the USA. Bank-affiliated brokerage firms lost considerably market shares in the most profitable segment during last 10 years. Banks had only 24% of Ultra-High Net Worth Clients market compared with 60% served by brokerage companies. Brokerage firms have always been one step ahead of the banks, they launched high-tech products, implemented open architecture and hired skilled staff long time before most banks started considering it (Josephson, 2004).

Graph 7. Banks' shares of the Ultra-High Net Market in the brokerage services market



Source: Josephson (2004).

In the area of delivering of mutual funds and insurance services to HNWI's group domination of units not related with banks is incontestable. Private banks lost markets in these services forever.

Table 3. U.S. banks' market shares in services dedicated to High Net Worth Individuals in 2003.

	Brokerage services	Mutual funds services	Life Insurance services
U.S. Banks' affiliated units	24%	17%	1%

Source: Josephson (2004).

There are many wealth management platforms, some of them are dedicated directly to affluent customers like Fincentric, Sanchez and x.eye or High Net Worth Clients like Finaplex, SunGard x.eye and Finantix (Lee, 2002). Wealth management solutions allow banks to assess optimal ratio of client's care versus the cost of the relationship. HNWI's expect from the private banks to get aggregated real-time wealth positions across all channels; integration of client, market and product information with planning tool and transactional services; comprehensive financial adviser's daily, weekly or monthly recommendations; asset allocation, portfolio modeling strategies and tools; cross-selling opportunities; personalized advice and rule-based alerts; analyses and reports of client value performance and profitability (<http://www.finantix.com>; <http://www.xeye.com>).

SUMMARY

The world of private banking is changing, so do the clients. There are many new features of the present client of private banking. To recapitulate the main new characteristics of the segment of High Net Worth Individuals are as follows:

- Increasing involvement in investment decisions,
- Growing sophistication of customers,
- Changing preferences for receiving advice,
- Increasing delivery of investment advice and transaction capabilities across multiple channels,
- Growing demand for complex products,
- Increasing focus on investment performance,
- Growing access to best-in-class products, including third party products,
- Changing preferences to internet based channels of communication,
- Different approach to new technology wealth management solutions across countries.

High Net Worth Individuals are the most profitable and the most perspective group of clients for all kinds of financial institutions. The key to success in this very difficult market lies in perfect understanding of the needs and behaviors of these most sophisticated group of customers of the banks. If banks dealing with private banking want to serve High Net Worth Individuals profitably, they have to adjust their attitude towards different types of High Net Worth Individuals and properly satisfy their needs.

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