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ELECTRONIC BANKING AND PRIVATE BANKING

ABSTRACT

Private banking is growing every year by 3-8 per cent, rate of growth in case of electronic banking is much higher. These both services will have a great impact on the future of retail and investment banking. Internet banking, which is a main category of e-banking, has advantages and disadvantages. It allows banks to reduce the importance of the distance in customers relations with banks. High net worth individuals can use electronic services all over the world. In a field of private banking new-comers such as brokers, insurance companies, commercial banks, mutual fund companies and independent advisors have been recently introduced. All these institutions compete for prospective clients. This causes that electronic banking services are a crucial matter in a private wealth management. New technologies are cost effective and easily accessible to anyone. Traditional private banks had to adopt the same strategy as new competitors. Electronic private banking is also connected with risk because the most wealthy customers are the best potential fraud objects.

Keywords: Electronic banking, internet banking, private banking, wealth management, security, outsourcing, electronic platforms.

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INTRODUCTION

Internet banking is a comparatively new service. Its history started at the beginning of the nineties in the United States and Scandinavia, where http protocol was implemented to www pages (IDC, 2004 p.8)¹. First retail banks introduced basic operations through the Internet in 1992, later strictly virtual banks started their activity. Every year internet banking becomes more and more popular. New technologies have been implemented by retail customers, small and medium companies and even huge corporations, which defined levels of access and authorization to data with a Public Key Infrastructure. Electronic banking has wider definition because it includes internet banking, mobile banking, home banking, TV banking, access through ATM, PDA and call center with personal or automatic services. Evolution of electronic private banking has taken many years. Technology development caused that some electronic channels of communication and distribution were already used in banking in the eighties. Generally, they occurred in the form of basic home banking applications with different communication protocols, which later evolved to sophisticated software for companies and wealthy private customers.

CONVERGENCE OF ELECTRONIC BANKING AND PRIVATE BANKING

There are two main approaches to internet banking in case of private banking: technologies based on advanced home banking solutions and all kinds of transaction systems linked with internet browsers. The solutions based only on web browser have become more popular because they are accessible all over the world without any additional activity of a user, whereas home banking needs previous installation². Nowadays all techniques which make use of the idea of public key enable reliable identification, confidentiality and authorization in a log in process. Instead of core private banking, IT systems financial units have additional back and front side software. Clients can do all financial decisions by themselves, also there is a possibility to manage private banking customers funds by financial advisors and customers' relationship managers.

Private banking is almost as old as banking. It was exclusive service only for rich, affluent and famous individuals and families for a long time. Globalization and high growth rate in developing countries caused that more and more people can become clients of private

¹ Tim Berners-Lee, scientist at the CERN institute in Switzerland in 1990 developed a hypertext markup language (HTML) for sharing documents over the Internet that uses communications protocol (HTTP) for exchanging them and a browser for viewing and working with them.

²All users have to prepare operating system and other software for secure connection.

banking. Moreover, traditional marketing solutions were applied to private banking clients. Customers were divided into four segments: Ultra High Net Worth Individuals, Very High Net Worth Individuals, High Net Worth Individuals and Affluent Individuals or Mass Affluent Customers. The last two are lively interested in internet banking, especially customers from a group of new rich individuals. In case of Ultra, Very and High Net Worth Individuals electronic banking is also important, but relations are based on personal contact rather than on technology solutions. The newest security technology, if well applied by clients and banks, guarantees confidentiality. Private banking clients used to need personal contact once per quarter, now it has changed to at least once per month (Magrini, Thomas, 2001 p. 24). These trends suit electronic banking very well, because the electronic channels are accepted by young private clients as a necessary and integral part of the service. During last 20 years almost all financial markets shifted from not-automated transaction systems to electronic ones. Private banks' clients expect immediate reports and real-time information, which can be delivered only through electronic communication channels.

A lot of new trends and patterns in customers behaviour in financial institutions caused that there are many factors that have speeded up using of advanced technology in private banking. These factors are as follows (Magrini, Thomas, 2001 pp. 25-26):

- Many non-bank new-comers with innovative attitude have entered private banking target group,
- The Internet technology has generally reduced total costs,
- A geographic feature is naturally eliminated because of the new technologies,
- Software solutions enabled mass affluent clients to have access to wealth management services,
- Customers' demand for third party products results in the integration of all information in one centre,
- Customer Relationship Management systems raise satisfaction of the clients and the profitability of the private banks.

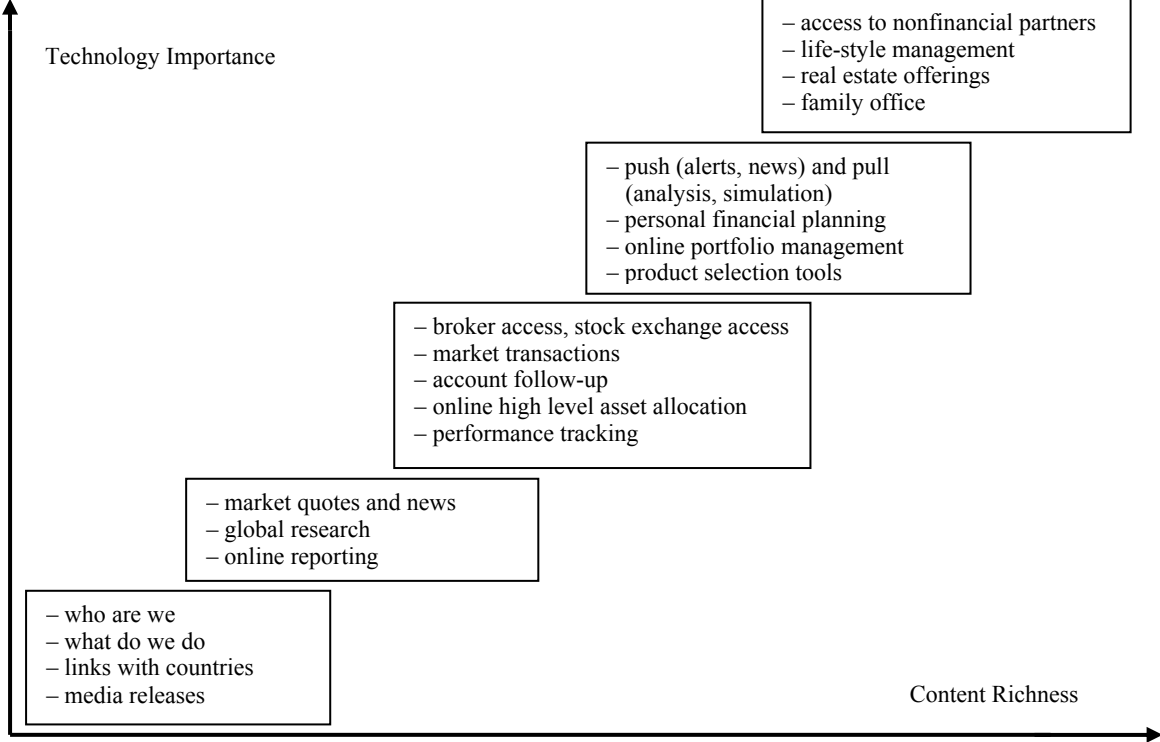
MODELS OF THE INTERNET APPLIANCE IN PRIVATE BANKING

Many models of using the Internet in private banking can be found. The bank's choice of the model depends primarily on the client of the private banking service. It is important to make an accurate division of the market. The identification of the clients' preferences about the way they want their assets to be managed seems to be the most vital. Three categories of High Net Worth Individuals (the clients of private banking) can be distinguished: the

delegators, who hand everything to the private banker; the validators, who make their own decisions but discuss them with the private banker before implementing them; and the last group – soloists, who do everything themselves (Magrini, Thomas, 2001 p. 28). The result of a study conducted by Booz Allen & Hamilton presented in “Wealth Management: the Challenge” shows that HNW group consists of about 50% of delegators, 35% of validators and approximately 15% of soloists (Booz Allen & Hamilton, 2001 pp. 2-3.). Depending on what kind of clients the bank has in majority, it needs to adjust appropriate model of using the Internet to the strategy of serving the private banking clients.

In order to satisfy delegators’ needs banks have to develop sites that provide information and electronic reporting. The majority of private banks are still at this stage, because they think that the Internet is not proper channel of communication with wealthy client. On the other hand, validators have higher requirements in the field of the contents of the web sites. To meet these requirements banks enabled doing payments, investing and getting advice about the most profitable investments through the Internet. Fulfilling the requirements of the third group – soloists – seems to be the most challenging. Banks try to provide them with individualized service, give them facilities, which will help to manage their assets unaided and as effectively as possible. Moreover, banks give the soloists possibility to make use of the most sophisticated own and third-party products (Magrini, Thomas, 2001 pp. 27-28).

Graph 1. Five steps of e-private banking web sites evolution



Source: Own studies on the basis Magrini, Thomas (2001 p. 28).

WEALTH MANAGEMENT SYSTEMS IN PRIVATE BANKING

There are many private banking software solutions, some of them are dedicated directly to wealth management customers like Finaplex Wealth of Finaplex, Wealthview Banking of Fincentric, Lisa Wealth Management of Wealth Management Software, Sanchez Wealthware of Sanchez, HiWealth of DST International, x.eye Wealth Management of x.eye, OneWealth of Finantix³. The example of the wealth management system can comprise elements that are presented in table 1. Some platforms are more advanced because they consist of CRM, workstation designed for financial advisers and are highly compatible with core banking systems. Some CRM solutions are designed specifically for advisers and asset managers.

Table 1. The scheme architecture of TotalWorth Enterprise of Fincentric

<i>Customer View</i>	<i>Personal Wealth Management</i>		<i>Integrated Financial Services</i>
Consolidated Statement	Client View	Producer View	Insurance
Profitability	Market Data	Estate Planning	Trust
CRM	Life Goals and Financial Planning	Proposal Management	Mutual Funds
Analytics	Advise	Assets/Allocation Model	Mortgage
Data Warehouse	Profitability Analysis	Risk Profile	Brokerage
	Scenarios/Simulations	Equities, Bonds and Mutual Funds	Credit Cards
	Portfolio Management and Optimization	Producer Utilities	Core Banking

Source: Capgemini (2004 p. 3).

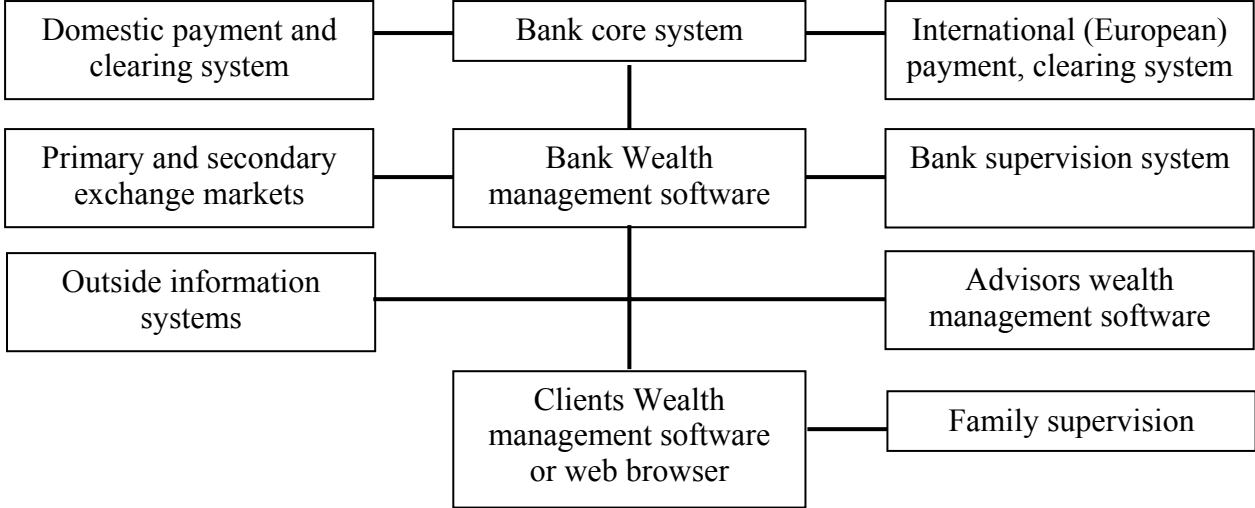
Companies providing wealth management and private banking solutions are usually different from vendors supplying core retail banking systems. The biggest world's retail producers sometimes provide software specially designed for private banking clients. Usually wealth management systems have to be integrated with advisors software, bank wealth management system, core banking solution, outside real-time information and transactions systems.

The accumulation of knowledge and specialization in a field of private banking caused that bankers prefer solutions of companies, which concentrate only on wealth management software. Demand for IT solution to the wealth management market is much more sensitive to quality, reliability, scalability and long term strategy than to prices. Banks try to avoid situation in which the IT system providers will go bankrupt or discontinue developing

³ Sanchez was acquired by Fidelity Information Services.

banking systems. However, despite such care of selection of banking systems this situation happens even to the biggest private banks, for example Schroders Private Banking Group.

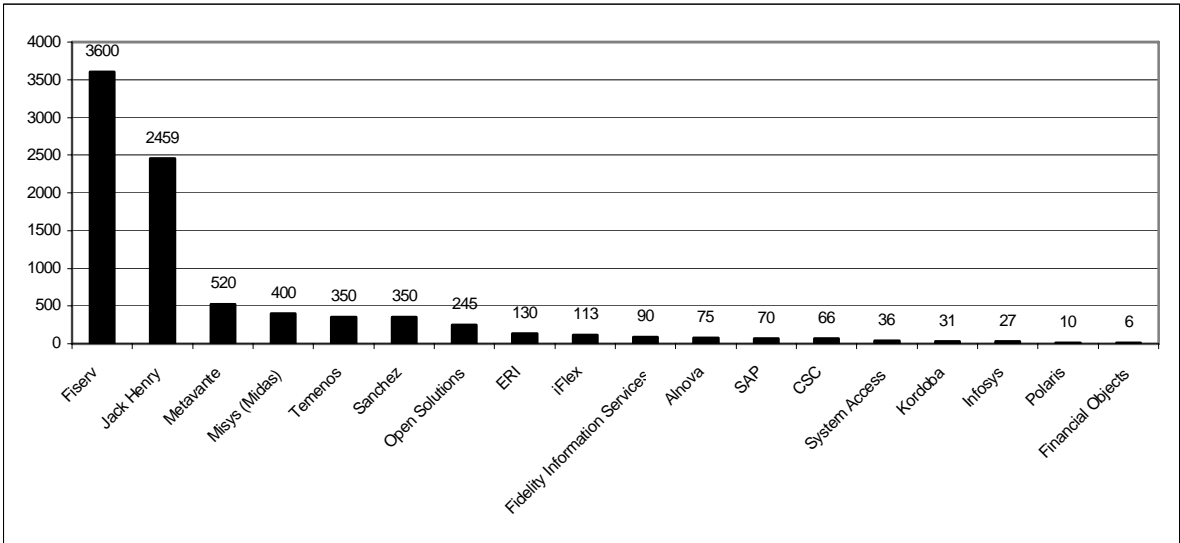
Graph 2. The scheme of wealth management relations in private banking



Source: Own studies.

The analysts state in reports that expenditures on core banking systems in the European banks are and will be bigger than in the US, due to the European integration and the use of euro. A lot of implementations of the banks solutions done by American Fiserv and Jack Henry are the results of the situation in the American banking system where there are many state orientated local banks. Private banks have recently changed they mission and now pay more attention to innovations and new technologies.

Graph 3. Number of banks running respective core banking systems



Source: (Barry 2003).

SWISS ELECTRONIC PRIVATE BANKING

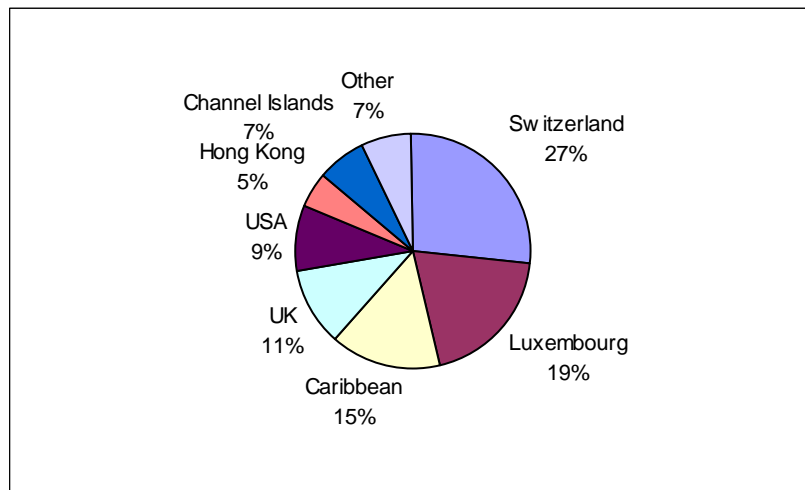
Switzerland is the centre of private banking services. Over 30% of total cross-border private assets managed worldwide have been invested from there, 60% of approximately 3400 billions CHF assets controlled by Swiss banks were of a foreign origin (Swiss Banking – a Programme for the Future, 2003 pp. 5-6). Temenos Systems with headquarters and origin in Switzerland is one of the leaders of the private banking core systems. It has launched customized Temenos Globus solutions and the new Temenos T24 which were implemented in such banks as Julius Baer and Julius Baer Securities, Standard Chartered Grindlays, Banque Edouard Constant, Schroders Private Banking Group (Temenos news I-III 2003-2004). The origin of Temenos system implies that it has introduced transaction systems to SWX Swiss Exchange and virt-x, the pan-European blue chips exchange, naturally. SWX is the fourth European financial market in terms of turnover, but the second one after London City in terms of internationality. SWX is also the second global market leader for bonds, foreign bonds and eurobonds denominated in euro, US dollar, Swiss franc and yen.

Heads of Sarasin private bank, one of the biggest and the oldest private banks in the world with total assets under management amounted to around 49 billions CHF in 2003, say that Sarasin is *creating innovations by breaking down traditional patterns of behaviour* (Sarasin Annual Report, 2003 p.17).

Swiss banks still dominate in private wealth management but every year more assets are held by off-shore and Asian institutions. This long term change in the structure of the market can impact on IT behaviour of private banks. Significant part of private banking software is now created in Asia, for example an Indian core banking system I-Flex gained a big market share and won a lot of awards during 10 years of its real existence⁴. Sanchez launched banking system based on GNU/Linux platform as one of the first in the world. The systems created on the basis of the open source are at least as secure as the others, and what is the most important, they are much cheaper. However, changes in bankers' behaviours in making choices take a long time.

⁴ IMF is the user of this system.

Graph 4. World Market Shares of Wealth Management in 1997



Source: (*Swiss Banking – a Programme for the Future*, 2003 p. 6)

OUTSOURCING

Outsourcing is not very popular within wealth management institutions yet, but some banks have decided to move IT processing and basic advice services to India, China (especially to Hong Kong) or to Singapore. This trend is very popular in case of retail banks from the United States and Great Britain. Many outsourcing centres were established in Hyderabad and Bangalore in India, Guangzhou, Hong Kong and Shanghai in China, Singapore, and Kuala Lumpur in Malaysia (Jebson, 2003 p. 3)⁵. Citibank, Barclay's and HSBC are one of the about 20% banks from US and UK which commonly use outsourcing (Kelly, Nolle, 2003 p. 63). 5,7 billions of US dollars spent on outsourcing by US banks represents 19 percent of U.S. banks' IT total spending (Kelly, Nolle, 2003 p. 65). IT outsourcing has many disadvantages which can not be accepted by reputable private banks at all. The disadvantages of outsourcing are the results of problems in social, economic, and political instability of a country, legal conflicts created by foreign jurisdictional laws concerning the outsourced activities, and the most important, difficulty in ensuring security and confidentiality of banks' and customers' information (Kelly, Nolle, 2003 p. 63). Confidentiality of clients' information is a crucial characteristic of private banking. Security reports confirm that one of the main fraud sources comes from inside of the organization and common outsourcing could just multiply this effect. Outsourcing agreements could be a part of the IT strategy in a field of disaster recovery capabilities.

⁵ Wipro and Infosys are the biggest India based financial outsourcing companies.

THREATS TO ELECTRONIC PRIVATE BANKING

There are some dangers connected primarily with new technologies, e.g. someone can spy on transactions, get personal data, or – in the worst situation – someone can make a transfer of money when one of the elements of electronic banking systems fails. The threats on the side of the bank are almost eliminated, however, the biggest probability of making a mistake lies on the side of the client. It is connected, among other things, with unbelievable growth of viruses and the Nigerian spam spreading all over the world in millions of pieces per hour. The Trojans, unconsciously installed by new money High Net Worth Individuals, who are still under impression of the Internet phenomena, may enable frauds to intercept log-ins and passwords from private banking clients. Only supplementary technological protections connected with Public Key Infrastructure with electronic signature storage on microchip card can guarantee security. New threats are also linked with internet sociological techniques. The frauds try to gain personal data or access passwords through counterfeited and spurious e-mails (supposedly from bank employees) – this is so called Nigerian spam.

The total use of advanced technologies in private banking services can cause that instability of a crucial element may expose clients to losses. Hence, the alternative channels of communication, such as personal contact with relationship manager, are so important.

In spite of dangers, wealth management systems provide many opportunities. First of all, they enable clients to invest with limited, estimated and accepted level of risk. Moreover, electronic systems are necessary in connection with international standards and requirements, which especially in private banking should be applied. World's regulatory requirements, in particular Basel II and International Accounting Standards – IAS 32 and 39 introduced an obligation to create reports for capital adequacy for supervisor institutions and shareholders. Banks have to measure especially operational risk and this Basel II activity relies on accuracy transactional and financial statement data. All application and banking core systems used by customers should meet all these regulations.

SUMMARY

Private banking is changing its face. Competition from non-bank institutions, which use the Internet on a mass scale, caused enormous changes in attitude even of traditional Swiss banks. Electronic banking is a big chance for private banking. Banks will succeed, if they make use of it. So far, large commercial and investment banks have taken the advantage

of this situation. The questions are: whether the private banking market will move to other than long-established areas, such as Hong Kong or Singapore; how fast this deregulation and migration process will be; how the private banking services will look like within 20 years; is there any place for personal relations. These questions are still open.

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