Innovate Software Consulting Inc

AMERICAN ACADEMY OF FINANCIAL MANAGEMENT

Indian Financial Sector: Wealth Management Opportunities & Challenges

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INTERNATIONAL BOARD OF STANDARDS

Table of Contents

Introduction

Worldwide, private banking and wealth management are business models that continue to be attractive to financial institutions, despite a temporary setback during the global financial crisis of 2008-2009.

These services are relatively 'low risk' when compared to other activities such as investment banking and extending credit to businesses and consumers. Growth in incomes all across the globe are resulting into emergence of wealthy individuals and families who tend to grow their wealth by employing professional wealth management services. The scope of wealth management includes Wealth Creation, Wealth Management, Wealth Preservation and Wealth Transfer.

It involves provision of facilities such as asset management, banking and related advisory services to the High Net worth Individuals [HNWIs]. Wealth managers are indeed skilled fund managers who deal in a more complex mix of assets than any other asset manager. The success of the wealth management business depends to a large extent on the ability in acquiring clients and establishing strong and long-lasting relationship. Therefore, Wealth management firms should have both fund managers who have the capability to manage funds efficiently and relationship managers who have the capability to explain confidently and persuasively to clients about investments, asset allocation, diversification and portfolio returns and risk.

As per the set standards, High Net worth Individuals (HNWIs) has at least US $1 million in investible assets excluding primary residence, collectibles, consumables and consumer durables. Ultra-High Net worth Individuals (Ultra-HNWIs) holds at least US $30 million in investible assets, excluding primary residence, collectibles, consumables and consumer durables. Further, those with $100,000 or more in their accounts but less than a million are termed as affluent, or mass affluent. Family offices are the small banks performing services for one or more wealthy families. These are often seen as a separate client segment, typically managing anything between $100 million and $1 billion. Assets of HNWIs that a bank manages for its clients are called as Assets under Management [AUM], a widely used term in the industry. These AUMs increase or decrease along with equity markets but also rise through fresh client money [net new money inflows]. Income in wealth management for the banks is usually generated as a fixed percentage of assets under management and can also depend on asset prices.

Global Wealth Landscape

Wealth Management market structure consists mainly of bigger players like; UBS, Citigroup, Merrill Lynch, Credit Suisse, Morgan Stanley, HSBC, JP Morgan, Wachovia Corporation, Bank of America and Deutsche Bank. The Wealth Management industry serviced $33.3 trillion in global wealth during the year 2008. The number is predicted to accelerate approximately by 6 percent each year to reach $44.6 trillion by 2010. According to Bear Stearns research report this could create a fee jar of $211 billion roughly three times the size of that in investment banking. UBS is considered the world's biggest wealth manager with about $1.7 trillion of assets under its wealth management units. According to Bear Sterns research, UBS is even way ahead in its private banking income as a percentage of overall revenues. The ratio stands at around 37 percent, making UBS the biggest player in the market. Credit Suisse with 35 percent comes next to UBS.

Wealth management across the globe is an extremely fragmented market. While the leader UBS has a market share of 3.5 percent, the top 10 banks jointly share 18 percent. It is interesting to note that in Switzerland alone, hundreds of small private banks operate which are mostly privately owned and therefore not exposed to shareholder pressure for high returns. Indeed, Switzerland is the hotbed for private banking. Being conventionally a secretive business it is luring wealthy clients from across the globe abroad to benefit from the country's banking secrecy laws, its strong currency and its stable political climate. Since centuries, this has made Switzerland the biggest destination for wealth.

However, its enviable position is now being increasingly challenged by other off-shore centers such as Hong-Kong, Singapore, and Dubai, which largely gratify the wealthy clients in emerging economies and those that have made their fortunes from selling oil. Further, the long-established business model is also under change, since the regulations are making it harder to evade taxes in Europe, as the increasing political stability across the globe has diminished the need for safe-haven banks abroad. This indeed has forced UBS and Credit Suisse, the two leading wealth managers (from Switzerland) to set up so-called on-shore branch networks across Europe to lure clients in their own countries. Similarly, HSBC, Citigroup and Barclays are also stepping in by improving their retail networks to attract wealthy clients.

According to the World Wealth Report 2009, the U.S., Japan and Germany together account for 54.0% of the world's HNWI population. China's HNWI population has gone beyond that of the U.K. to become the fourth largest in the world (364k HNWIs) while U.K., a mature economy, heavily dependent on financial services, clicked a HNI population figure of 362k. Brazil has surpassed Australia and Spain to reach 10th place among HNWI populations globally (131k HNWIs). India being an emerging economy, suffered declining global demand for its goods and services and a hefty drop in market capitalization (64.1%) in 2008. India's HNWI population shrank by 31.6% to 84k, the second largest decline in the world, after posting the fastest rate of growth (up 22.7%) in 2007.

Indian Wealth Landscape

Notwithstanding the slowdown due to global financial crisis, the growth in the Indian economy is projected to continue for several years. The progressing economy and an increase in income and purchasing power have turned many Indians wealthy. Disposable income in India is expected to grow from the current 2 per cent to 5 per cent in 2017. Indian financial sector currently shares about 7 percent of the total national disposable income. Further, it is also estimated that the share of the financial institutions would grow to 18 per cent by 2012. The growth is expected to be seen across all income levels.

While the lower-income segment would record the maximum growth in terms of volume, high net worth households would contribute the most in terms of wealth size. Thus, India is set to become a huge hunting ground for wealth managers with the number of prospective clients and size of manageable wealth both expected to grow four-times through 2012.

Wealth management industry which is currently registering a growth rate of 30 per cent-plus is expected to be of the size of $1 trillion by 2012. According to the report - 'Overview of the Wealth Management Market in India' published by Celent, a Boston-based financial research and consultancy firm, Indian wealth management market will have a target size of 42 million households by 2012 as against 13 million in 2007. The report states that the wealth management sector is poised to witness tremendous growth. India's economic growth is making larger sections of the population prospective customers of wealth management providers. The report states that client segmentation promises growth across all the six categories:

- ✓ Ultra-high net worth, or Ultra-HNW (in excess of US$30 million), will have a total population of 10,500 households by 2012.
- ✓ Super high net worth (between US$10 and $30 million) will have a total population of 42,000 households by 2012.
- ✓ High net worth (between US$1 million and $10 million) will have a total population of 320,000 by 2012.
- ✓ Super affluent (between US$125,000 and $1 million) will have a total population of 350,000 households by 2012.
- ✓ Mass affluent (between US$25,000 and $125,000) will have a total population of 1.8 million households by 2012.
- ✓ Mass market (between US$5,000 and $25,000) will have a total population of 39 million households by 2012

Indian wealth market is at present dominated by unorganized players, whose share is said to be 1.5 times that of the organized market. However, a structural change that is taking place would see organized players drawing clients away from the unorganized players. The revenues are expected to contribute 32-37% of the total revenue of full-service financial institutions by 2012. In India, mass market (Rs. 2-10 lakhs of disposable income) would be a key driver, accounting for 40% of the overall growth in the number of households. In view of this, a majority of wealth managers would target the mass market because of its youth-dominance. The ultra-high net worth households with wealth in excess of $30 million is expected to have a total population of 10,500 households by 2012, while the super high net worth households ($10-30 million) is expected to grow to 42,000.

The Indian wealth management industry has to gear up to meet the expanding market opportunities. According to the Celent research report, providers, products, channels, technology, regulation and clients are coming together in the wealth management space to capitalise on tremendous growth opportunity. The extent of the growth within India has resulted in a divergent population in terms of income and living standards. India has the second highest number of Ultra-HNWIs in Asia after Singapore and more than half the billionaires in Asia are Indians. On the contrary, only 38 percent of the wealth market is owned by those considered to be "high net worth". The rapid rate of growth seen in the Indian wealth market in recent years has given rise to numerous independent financial advisors and brokerage houses. The services offered by these segments are limited and also face stiff competition from insurers and private banks themselves. In view of the high incidence of mass affluent individuals in India it has also led to a continued reduction in the minimum liquid asset thresholds required to use wealth management services. The prominent among the wealth managers/banks in India include ABN Amro / RBS Coutts, Bank Of America, Barclays Wealth, BNP Paribas, Citigroup, DBS, DSP Merrill Lynch, HDFC Bank, HSBC, ICICI Bank, ING Vysya Bank (now Kotak Mahindra Bank), Kotak Mahindra Bank, Morgan Stanley, Société Générale, Standard Chartered Bank, UBS and Axis Bank.

Table: Investment Options under Wealth Management Activities

Investment Category	Investment Options
Banking	Bank Accounts and Deposits, Business Banking, Mortgages and Loans
Investment Products	Bonds, Structured Products, Derivatives, Equities, Commodities, Alternative Investments, Forex products, Discretionary PMS and others
Financial Planning	Tax Planning, Retirement planning, Succession planning, Estate Planning
Value Added Services	Gold, Art, Philanthropy and Antiques

Components of Wealth Management

Wealth management services involve fiduciary responsibilities in providing professional investment advice and investment management services to a wealthy client. Depending on the mandate given to the wealth manager, wealth management services could be packaged according to the requirements.

- ✓ **Advisory Services**

  In this aspect, wealth manger's role is limited to the extent of providing guidance / advice on investment / financial planning and tax advisory based on client profile. However, investment decisions are solely taken by the client, as per his /her own judgment.

- ✓ **Investment Processing**

  In this type of services which are primarily transaction oriented, the client assigns wealth manager to execute specific transaction or set of transactions related to his wealth management. However, investment planning, decision and further management remain vested with the client.

- ✓ **Custody, Safekeeping and Asset Servicing**

  In this type of services, client himself is responsible for investment planning, decision and execution. Wealth manager is only entrusted with management, administration and oversight of the process of investment.

- ✓ **End-To-End Investment Lifecycle Management**

  In this type of services, wealth manager is fully mandated by the client to undertake financial planning, implement investment decisions and manage the investment throughout its life. He is responsible for the gamut of investment planning, decision, execution and management.

Redefining the Success of Wealth Management

In the expanding the wealth management canvas, the key strategies for wealth management should be:

- **Delivery channels:** Anywhere and anytime through branch / call center / online / POS
- **Personalized services:** Advisory services, relationship managers and financial planning experts to manage accounts and plan financial goals
- **Investment tools:** Analyze portfolio, rebalance portfolio against model portfolio, portfolio simulation and "What-If" tools
- **Product types:** Traditional banking, traditional investment products and alternate investments
- **Straight Through Processing:** End-to-end transaction processing for investments
- **Tax planning:** Country-specific tax and social security
- **One-stop financial shop:** Interface with market data vendors, banks, depositories, clearing
- houses, custodians and brokerage houses
- **Concierge services:** Lifestyle related value-added services
- **Customized views and reports:** Portfolio specific or across portfolios
- **Strict adherence:** Financial regulation, compliance and other country-specific mandates
- **Secure and trusted environment:** Data storage

Regulatory Environment for Wealth Management in India

Reserve Bank of India (RBI) currently allows foreign banks to increase their cumulative network by between 18 and 20 branches per year. The figure is higher than the 12 that India is required to permit under the terms of its trade deals with the World Trade Organization but does not allow significant room for manoeuvres. Despite the surge of wealth and influx of private banking initiatives, the shadow of regulation still hangs heavy over the Indian wealth management market. Indian regulations currently limit overseas investment per individual at $200,000.

Further, banks cannot offer cross-currency products because of capital convertibility issues. Regulators need to provide the flexibility to develop new products to ensure that there is a greater depth of offering. Another sticking point in the industry is the absence of a level playing field for service providers. There are multiple regulators regulating the same industry. Non-bank financial institutions face fewer restrictions than banks. For example, as a commercial bank HSBC cannot advise its clients on any overseas investment while other players in the space can. There needs to be consistency in regulations to enable the banks to offer similar propositions. Hence, it is opined that certain regulatory changes need to take place for the wealth management market to flourish in the country.

Opportunities for Indian Banks

A survey of Asia's leading wealth managers by investment banking firm Barclays Capital has revealed that India is still regarded as among the most attractive markets for wealth management in the region. Nearly one-fifth of the survey respondents have forecast revenue growth in India of over 15 per cent over the next two years. A similar sentiment has been expressed by London-based wealth management research firm, Ledbury Research. India represents one of the greatest opportunities to wealth managers over the coming decades, states Ledbury, adding: "Even in today's financial environment, the wealthy population in India is large and growing, yet the market is served by an underdeveloped wealth management industry". Ledbury estimates that India has the tenth highest number of dollar millionaires in the world and their rate of growth is higher than in any other country.

The Indian wealth market is delicately poised, and nowhere is that more apparent than in the competition between domestic and foreign players. The influx of foreign competitors has led to a domestic fight back, as banks, brokerage houses and new entrants develop their offerings. With its extensive local network and considerable knowledge of the local market, Indian banks have advantages in targeting the Mass Affluent in view of their importance of brand and reputation and also because of their association with the clients. In India, wealth management is evolving along with a positive regulatory environment, changing demographics and incomes. Another area that is witnessing increasing significance is the distribution of solutions as part of the overall wealth management value chain.

The most powerful offering for a bank offering wealth management services would be to offer integrated financial planning and monitoring. These scenarios call for an active participation of Indian banks in the wealth management business. In view of this, Indian Banks have tremendous business opportunity in view of their larger unparalleled reach through huge branch network, established brand and trust. Banks are well placed to extract value from their customer base because of their footprint and touch, product range and diversity, customer knowledge, distribution efficiency, unique and strong relationship, funds management expertise, distribution experience and wide geographical presence.

Challenges for Indian Banks

While immense business potentiality of this emerging sector is a driving point for most of the firms, they face many challenges in formulating winning services offering meeting the client needs. In the following section, I would briefly take a look on the key challenges in the present context.

Highly Personalized and Customized Services - Unlike other stream of financial services, mostly being transactional /commoditized in nature, wealth management services require client specific solution and service offering. No one solution exactly meets the needs of other client. In a situation of highly personalized and customized nature of service offering, developing any form of generic service model does not support growth of the business.

Personal relationship driving the business - To meet client expectation of personal attention, mode of communication in wealth management services tends to be highly personalized. Success of wealth management heavily draws on personal interaction with the dedicated relationship manager, who takes care of whole investment management lifecycle for bunch of clients on one-to-one basis.

Evolving Client Profile - The biggest challenge in providing wealth management service offering is to factor and reckon the evolving nature of client profile in terms of investment objective, time horizon, risk appetite and so on.

Intricate Knowledge of Cross-functional Domain - By very nature of wealth management, it not just involves matters of plain vanilla finance but has intricate relationship with many elements of domestic / international law, taxation and regulatory norms.

Technical Architecture and Technology Investment - As business architecture is still evolving, a proven basis of resilient technical architecture and framework to support the emerging business greatly remains missing. In absence of this framework, any investment commitment towards application development / system implementation would be fraught with severe risk.

Conclusion & Summary

The wealth management marketplace is evolving with the expansion of an affluent client pool and increased competition created through mergers, acquisitions and the introduction of non-traditional players. The considerations to create or strengthen a customer centric model are complex, but most firms have recognized that long-term success is determined by an organization's ability to deliver customer centric products and services.

Wealthy individuals have multiple and complex financial needs. Banks should be geared to meet their needs and build long-term relationships in which, advice along with products and transactions is the prime focus. Banks should establish multiple touch points with clients and typically benefit from enduring client loyalty and their predisposition towards referrals to prospective clients. The primary differentiators are advisory capabilities, product breadth, and facilitation of customer ease and convenience.

For banks to be profitable, their wealth management solution has to be comprehensive, scalable and customizable to the unique demands from multiple customer segments. Segmentation would be critical to deliver a unique value proposition and offer multiple service models through web-enabled access and personal advisory channels among others. The way forward for the banks in wealth management rides on their capacity to restore client trust and confidence.