

# The future of Private Banking: leadership, talent and innovation

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## Preface

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Private Banking in Italy is a young sector that has established itself over the last twenty years, reaching a maturity that puts it at the highest level in the international scenario. Even before the outbreak of the Covid-19 pandemic, though reaching considerable successes, first and foremost the growth of market share compared to other distribution channels, the need for rapid adjustments to the service model was already perceived; an evolution dictated by various factors linked to social and behavioral changes in customers, technological evolution, the European regulatory framework, the forecast of an economic and financial scenario with very low or negative bond interest rates and the growing importance of sustainability issues in investment choices.

The advent of the Covid-19 pandemic has accelerated some of these processes and it has also introduced changes, probably structural, on the way of thinking and organizing work and customer relationships. These changes are even more relevant for sectors such as Private Banking, which have a founding and identity factor in consulting.

The reaction of the Private Banking industry to the sudden change in the scenario appeared to be rapid, as demonstrated by the steady satisfaction of customers interviewed in the autumn months and by a rational behavior in investment choices proven by a composition of assets managed by Private Banking that has seen, in a quarter, the return from an abnormal growth of the weight of liquidity on the total to a composition more favorable to asset management and insurance industry. The clients who have relied on advising have been rewarded, they have seen their assets return to the levels of the end of 2019.

The end of 2020 still sees us at the mercy of the uncertainty about when and how we will come out of the emergency, but one result is certain: the centrality of savings and of their use for the recovery of the country. In a framework in which the savings of Italians are destined to grow, at the expense of consumption, and in which their rational and efficient use will depend on part of the success of the economy in coming out of the emergency, the strategic role of the Private Banking sector is clear. The target of Private Banking has always been the protection and growth of the assets of its clients and today this function cannot ignore the growth of the economic system in which the sector lies.

If Private Banking wants to remain competitive on a national and international level, it can only do so in an economy that keeps growing while remaining competitive.

To this condition is added the need to speed up those modernization processes that had started before Covid-19 and that concern a more intense use of technology, attention to the new needs and to the financial education of the customer, a growing awareness of the role played not only at the micro but also macro level on the economy.

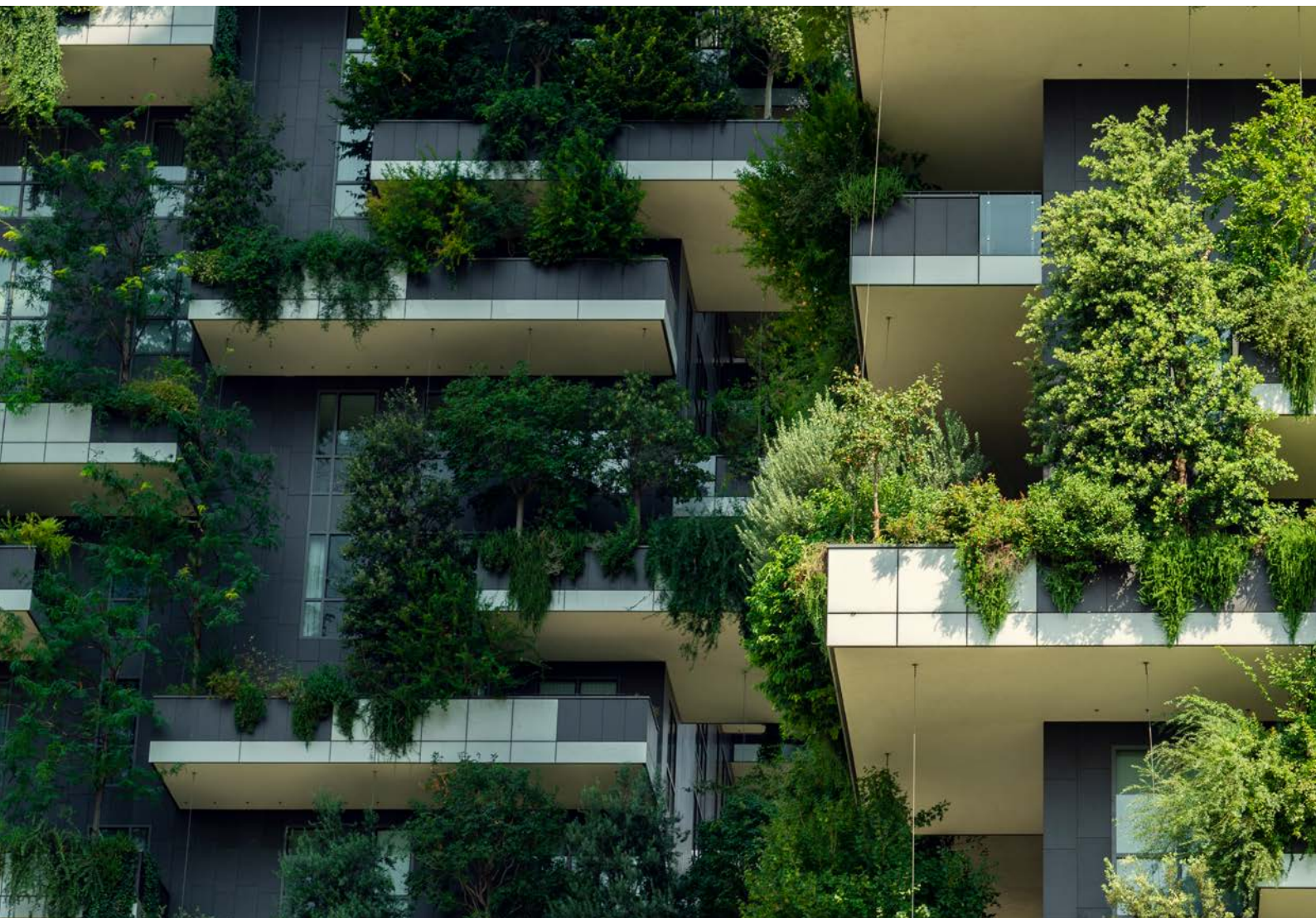
The study that follows, which is the result of the collaboration between Strategy& and the AIPB Studies Office, makes the avenues open to Private Banking more explicit by focusing on the evolution of consulting and the supporting role of technology, the need to lengthen the time horizon in client portfolios, the growing offer of investment processes based on sustainability and financing of the real economy, the central and essential role of professional updating and the various possible choices to support the growth of the sector.



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The Private Banking industry has all the characteristics to establish itself within the financial sector, it is central to the development of the country by connecting private savings and productive investments, it has been profitable without absorbing capital, it has shown flexibility in change, now it must prove itself capable of confirming these successes and be able to attract capital for the necessary investments and attract the best talents to be able to use them to the best advantage of its customers and the country.

Finally, I would like sincerely thank PwC Strategy& which shared its analysis with AIPB with generosity and transparency, in a dialectic and profitable exchange, making possible a further step forward in the knowledge of our sector.





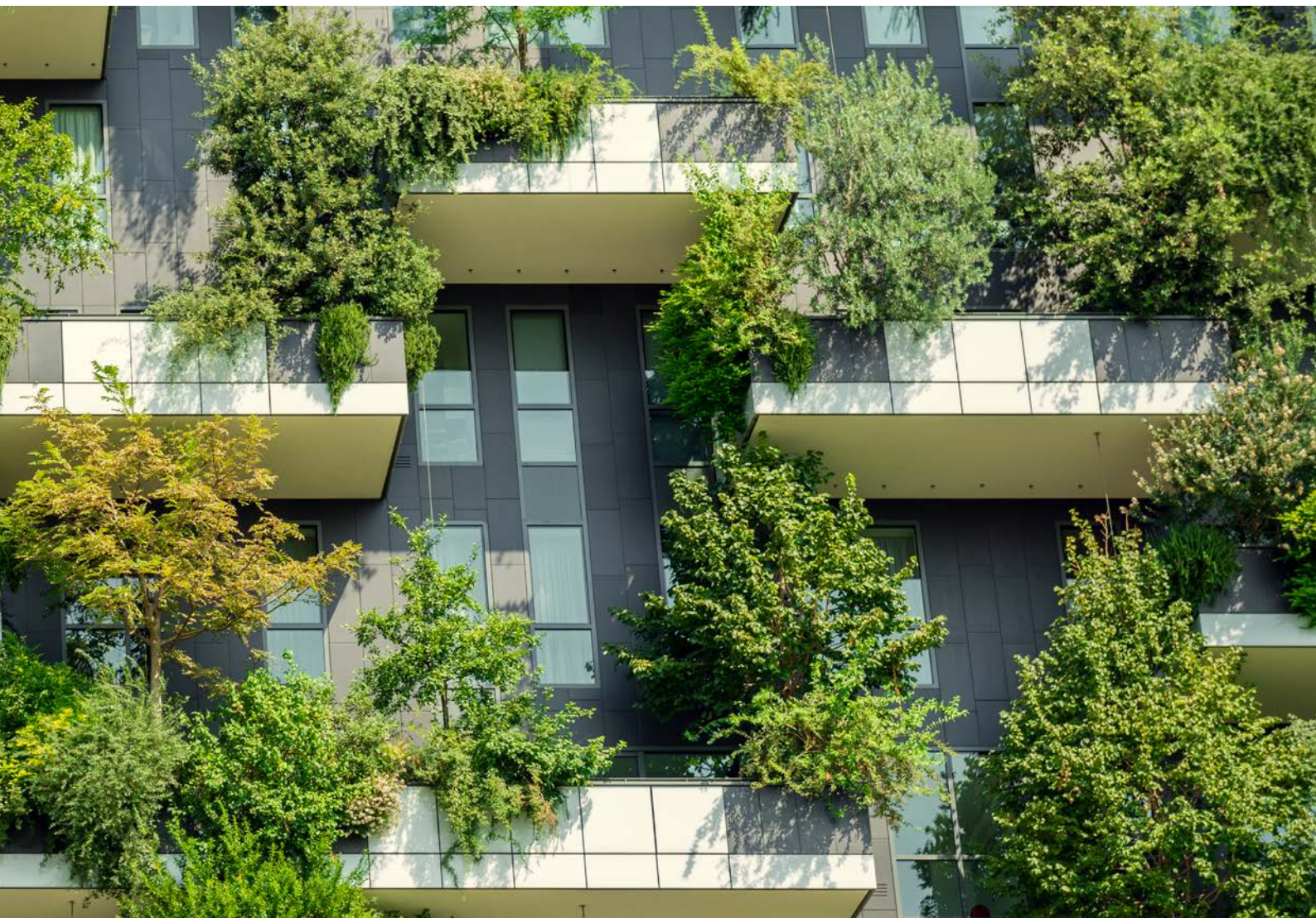
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## Introduction

Private Banking is the leading sector in Financial Services landscape in terms of profitability. In this paper, we describe the current trends, the main challenges and investment priorities, primarily talents and innovation, on which the industry leaders will have to focus in the near future.

This paper has been organized into three sections. The first one introduces the Italian Private Banking industry within the broader European context and it identifies its peculiarities. The second section analyzes the repercussions of the COVID-19 pandemic and the main contingent and structural effects that players will face.

Finally, the third section focuses on the high priority decisions that leaders will have to make in order to shape the future of the industry.







## Is Private Banking (still) an attractive market?



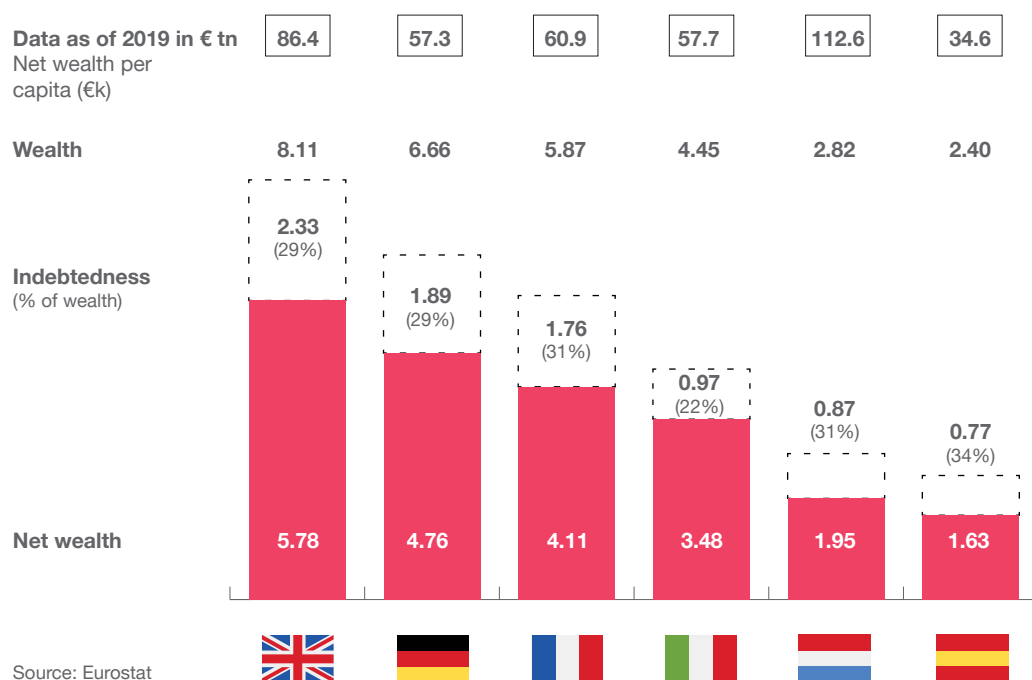
*The Republic encourages and protects savings in all its forms; ... it promotes to citizens the access, through their savings, ... to direct and indirect investment in the equity of the major production complexes of the Country.*

As Article 47 of the Constitution reminds us, the savings of Italian households are a precious asset.

Italy is the fourth largest country in Europe in terms of households' savings, with its 4.45 trillion euros in financial assets at the end of 2019, right behind the United Kingdom, Germany and France. These private financial assets amount to 195% of GDP, compared with lower values in France (169%) and Germany (138%), while the United Kingdom stands at 229%.

Moreover, the low level of private debt in our country (22% of the total households' financial assets compared with 29% in the United Kingdom and Germany) positions us substantially aligned with Germany and France with reference to per-capita net savings.

**Figure 1:** Comparison of the net and per capita wealth of the major European economies



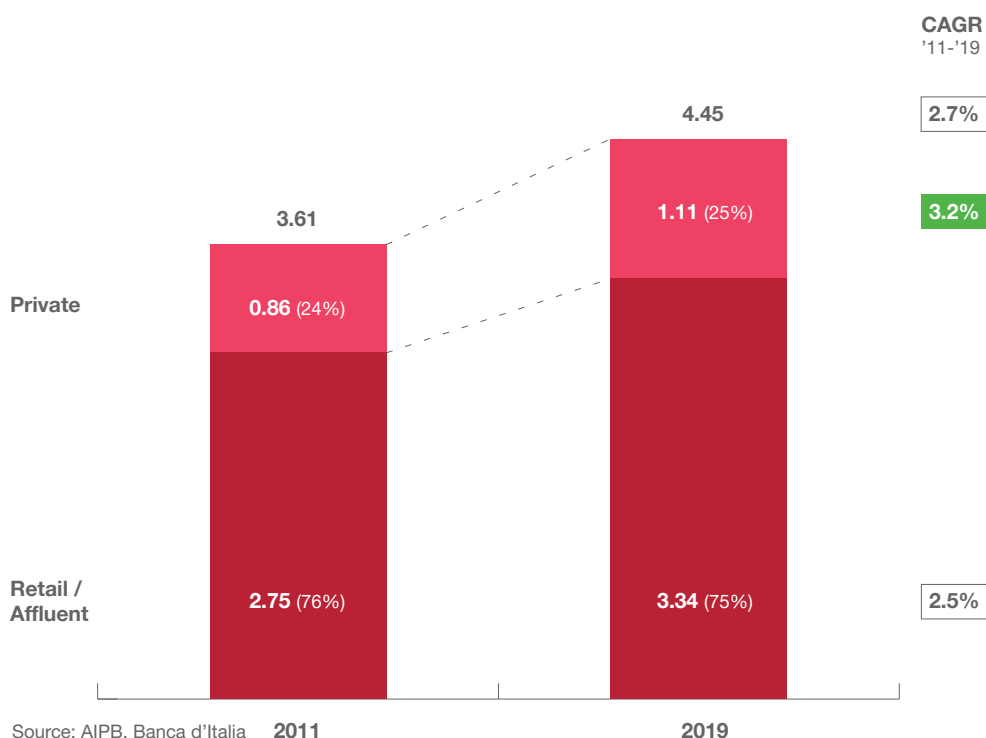
**Over the last 15 years, however, the Italian households' financial assets have grown at a lower pace** compared to the leading European economies. In our country, the financial assets have more deteriorated along with the 2006 and 2011 crises – and they have grown less during the 2011 – 2019 recovering span: as a result, **Italy has fallen from second to fourth place** in Europe in terms of households' financial assets<sup>1</sup>.

**Among the reasons for such delay** are the slower industrial production, the higher public debt, the increasing incidence of social benefits and pensions compared to labor income on GDP, the lower employment growth, the lower public and private investment and stagnation of salaries.

**The Private Banking segment** ("Private") – i.e. households with net financial assets over 500 thousand euros – **today accounts for about 25% of total Italian private savings** and it has shown better growth dynamics compared to the overall market.

The higher growth rate of the Private Banking's financial assets is directly connected to the work of the specialized players who manage them. In fact, over the last ten years, more than 40% of the market's growth has been driven by the Private segment, largely assisted by financial advisory services able to offer a broad diversification of investment solutions.

**Figure 2: Evolution of the Private vs. Retail/ Affluent wealth in Italy (€ trillion and %)**



1: Analysis by the Presidenza del Consiglio dei ministri, Dipartimento per la programmazione e il coordinamento della politica economica on OCSE, Eurostat, ISTAT, Banca d'Italia datasets.



From the **industry stand point**, the Private Banking sector is characterized by a high level of fragmentation, with the top 10 players holding 70% of the market share while the other 27 players share the remaining 30%.

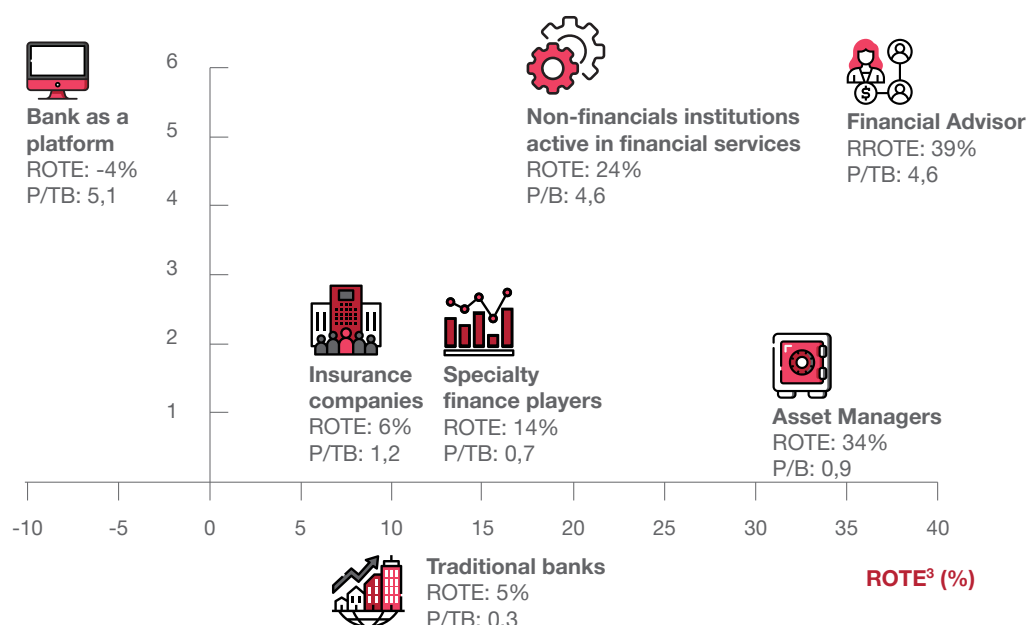
A first reason for such fragmentation lies in the high profitability of the sector, which has certainly attracted investments and new initiatives: the Private Banking industry is one of the most profitable in the Financial Services landscape with average ROTE levels of over 30%.

**Figure 3: Mapping Italian financial players by ROTE and P/TBV**

**Player profitability and market values by category**

Median values of the selected sample - data as of 06/30/2019

**Price to tangible book value<sup>2</sup>**



Source: Strategy& elaboration on public data

2. Ratio between market capitalization and equity excluding intangible assets.

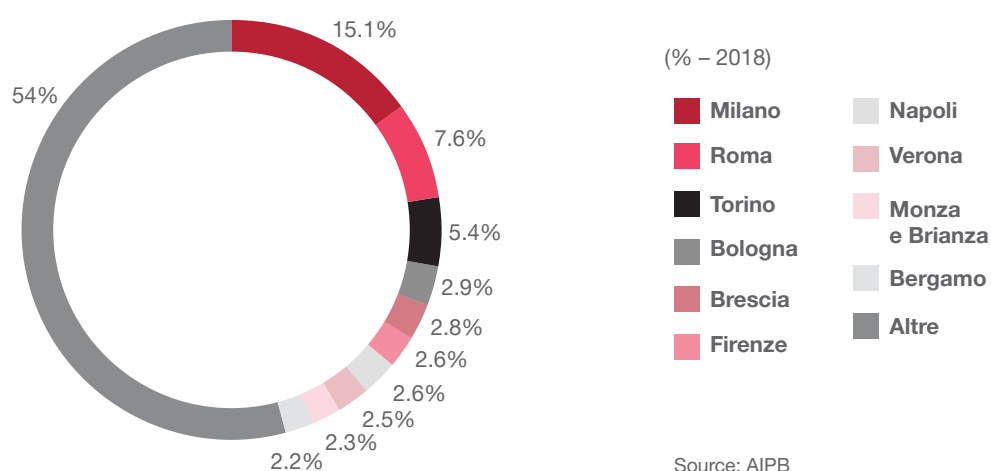
3. The "ROTE" (return on tangible equity) is an indicator that measures the operating profitability of a bank. The "ROTE" is calculated by dividing net income by tangible equity: that is, equity from which intangible assets (such as goodwill) are excluded.

Furthermore, two structural elements of the demand, one of a socio-demographic nature and the other connected to client preferences, have favored the fragmentation of the industry.

The first one refers to the **geographical dispersion of Private Banking wealth**, with the top ten Italian provinces accounting for only 46% of assets while over 54% is distributed among the remaining 97 provinces.

Given the traditional connotation of Private Banking as a “relationships and proximity business”, the geographical dispersion of the wealth has undoubtedly favored the resilience of players which, despite small in size, have a network of branches located in strategic areas.

**Figure 4: Geographical dispersion of the Private wealth among Italian provinces**



**The second element, regarding customer preferences**, can be traced back to the historical **bias** of Italian customers **towards banking relationship diversification** (multi-banking), deriving primarily from the desire to spread the risk of concentration towards a single player through the fragmentation and segregation of their assets.

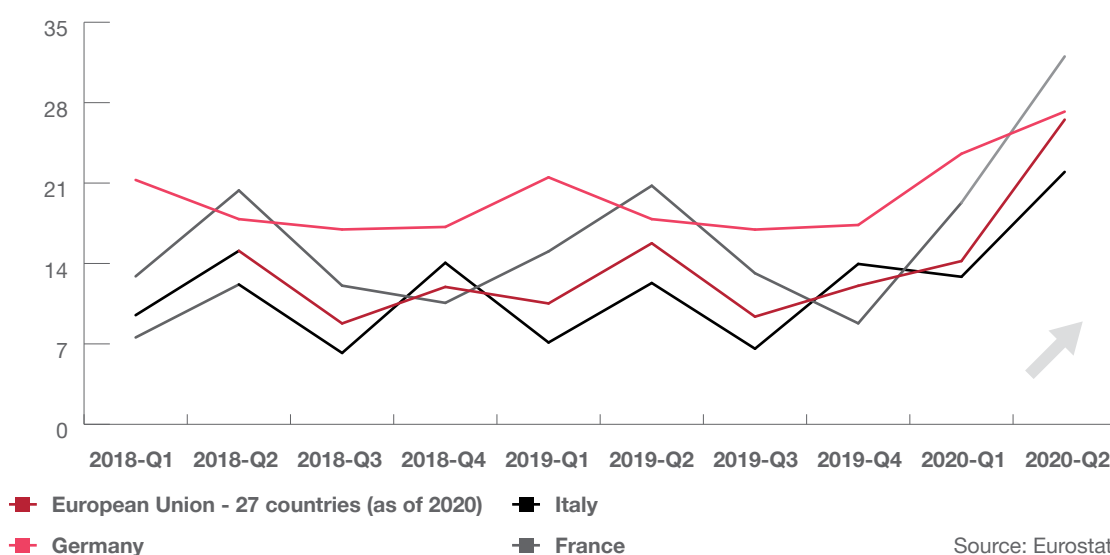
As a result of the phenomena described above, consolidation between players, typical of other European countries, has not yet been tangible in Italy.



## The tumultuous period we are witnessing

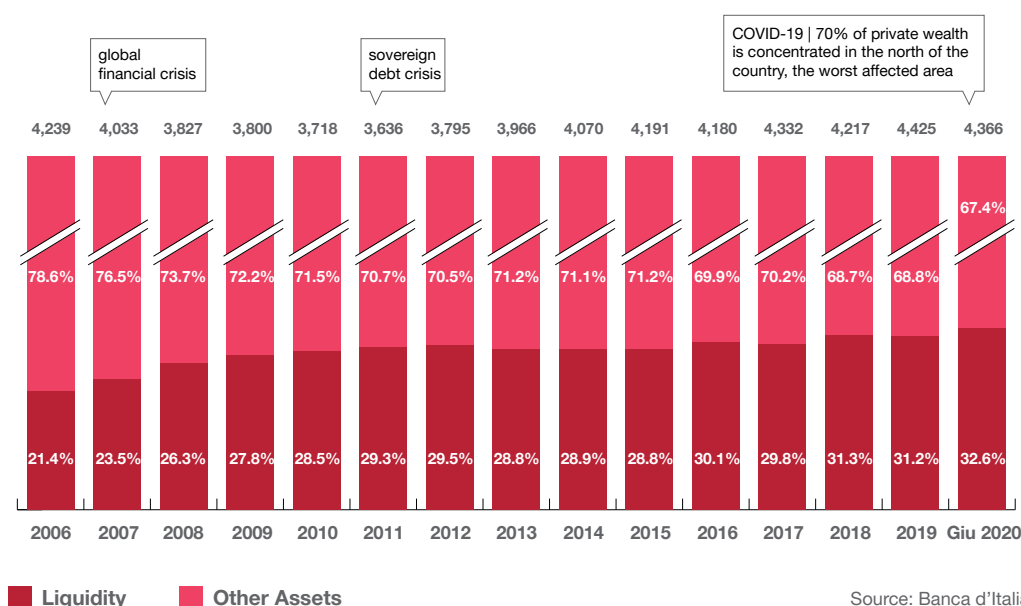
The COVID-19 pandemic has reduced consumptions, generating a **significant increase in the savings rate of Italian households** to almost double the 2019 values and in line with the main Eurozone economies.

**Figure 5:** Dynamics of the gross savings rate in Italy vs. main Eurozone economies (% of disposable income)



While this phenomena, on the one hand, provides **further impetus to organic growth expectations**, it is clear, on the other hand, that in the current phase the growth of savings has been accompanied by a strong aversion to risk and therefore by an impressive accumulation of liquidity.

**Figure 6:** Evolution of liquidity with respect to the total financial assets of Italian households

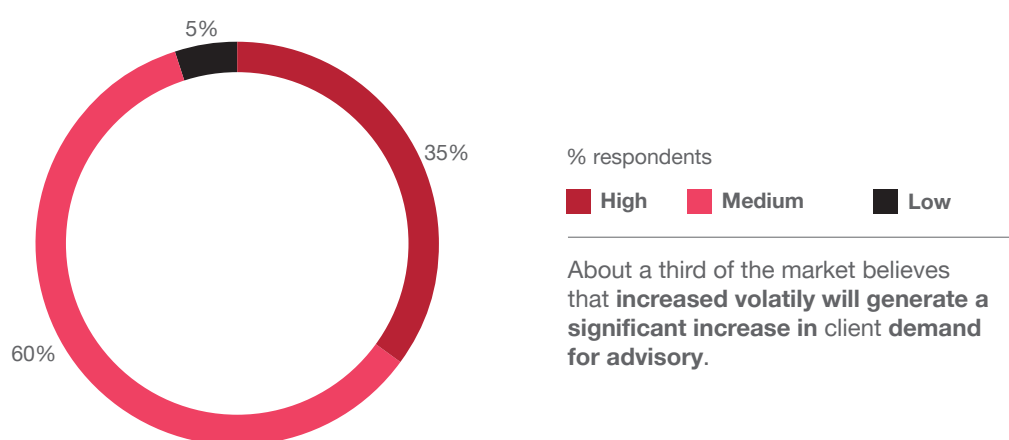


At times of great uncertainty such as the one we are currently experiencing, the reaction of investors is certainly understandable: for families there is a need to be accompanied in their investment choices and for financial intermediaries the opportunity to further consolidate their guiding role in assets protection.

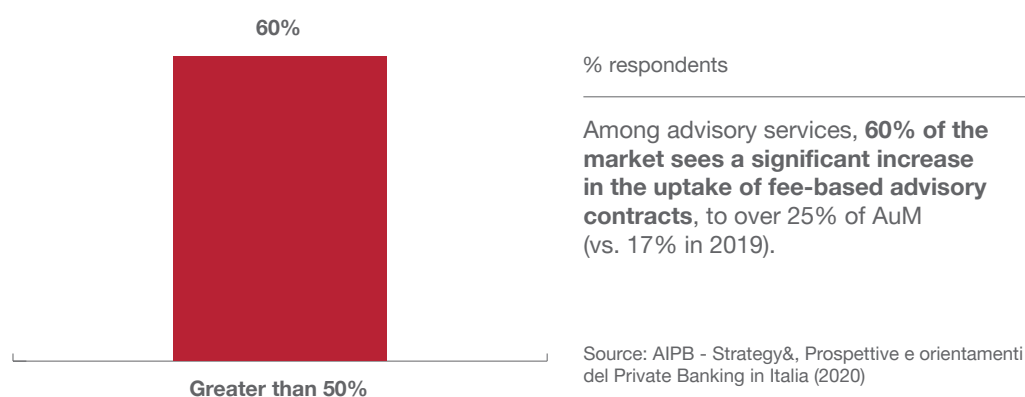
The magnitude of this opportunity is well known to industry leaders and is reflected in the perception of an increasing demand from clients for advisory, with a focus on fee-based high value-added advisory.

**Figure 7: 2020 AIPB Survey – Perception of the role of advisory**

Perception of increased demand for client advisory



Expected increase in the uptake of fee-based advisory



The loss of purchasing power, particularly of the huge liquid component of portfolios, is among the main risks offered by the current scenario.

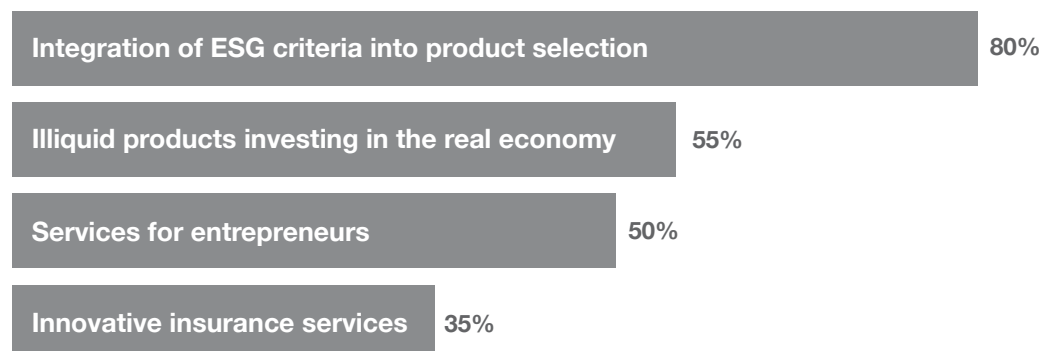
Keeping a medium-long term view will be key for defending clients' assets: investments in the real economy may represent an important opportunity for portfolio diversification. The industry leaders are certainly aware of it and they have set as key priorities, in terms of product development, the integration of ESG criteria and the development of illiquid products investing in the real economy.



**Figure 8: 2020 AIPB Survey. Priorities in the development of products and services for private clients**

**Results of the 2020 AIPB survey «Prospettive e orientamenti del Private Banking in Italia»**

% of «high priority» over the total responses of each category



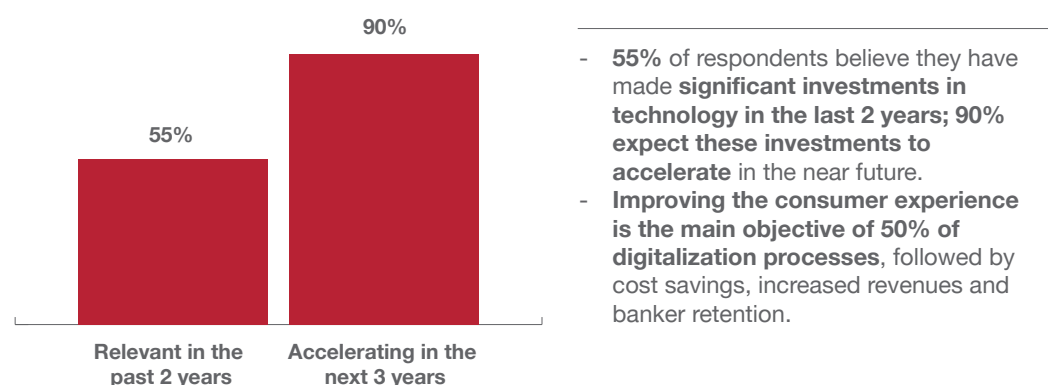
Source: AIPB - Strategy&, Prospettive e orientamenti del Private Banking in Italia (2020)

In addition to having an impact on the investment choices of Private Banking clients, the **COVID-19 pandemic will have significant structural impacts on the operating model of the industry players**, leading to an acceleration of certain trends, some of which are already ongoing:

- **Digitization: technology has not yet had a game-changing impact on the Private Banking industry, even though players now feel the need** to significantly increase investments in digital technology. The extent of these investments does not only affects the relationship between the private banker and the bank (“internal impact”), but also, and increasingly, it affects the interaction models with the customers (“external impact”), with increasing levels of sophistication ranging from the simplification of routine activities (e.g. digitization of processes and digital signatures) to the offer of new complex solutions resulting from the application of algorithms to the analysis of customer behavior.

**Figure 9: 2020 AIPB Survey. Significance of investments in digitalization**

% respondents



Source: AIPB - Strategy&, Prospettive e orientamenti del Private Banking in Italia (2020)

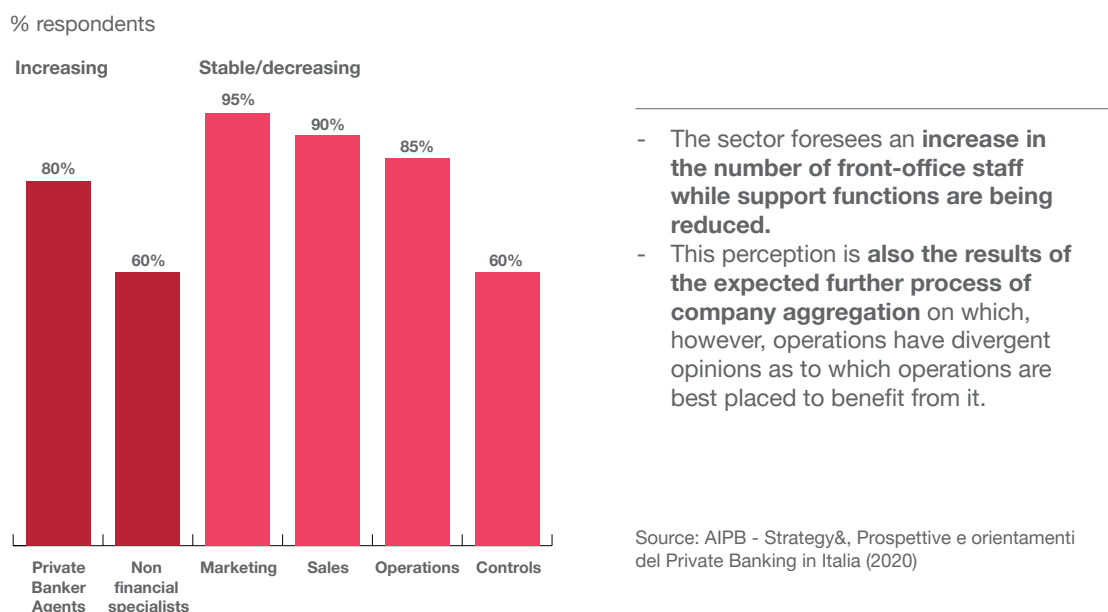
- **Development of new competencies:** the complexity of the economic scenario of the forthcoming years poses additional challenges for wealth managers, with regard to the management and protection of household's savings, and requires more articulated advisory processes.

For Private Banking, this represents an opportunity to further consolidate its role as a 360° advisor and guide for its clients. However, this will require greater expertise both in terms of understanding clients' needs and in identifying proper solutions.

The ability to attract and retain talents will become key to the future success of players. In this sense, we see an increasing attention of the industry to the strengthening of the advisory structures, through the inclusion of non-financial specialists, and of the investment center structures, through the onboarding of capabilities related to illiquid and alternative assets.

Players will have to react to this phase by embracing a medium long term vision of the industry. Only those players who will be able to evolve their business model by making significant investments, primarily in capabilities and technology, will play a leading role in the industry's further development.

**Figure 10: 2020 AIPB survey. Forecast of staffing trends in the main organizational units**







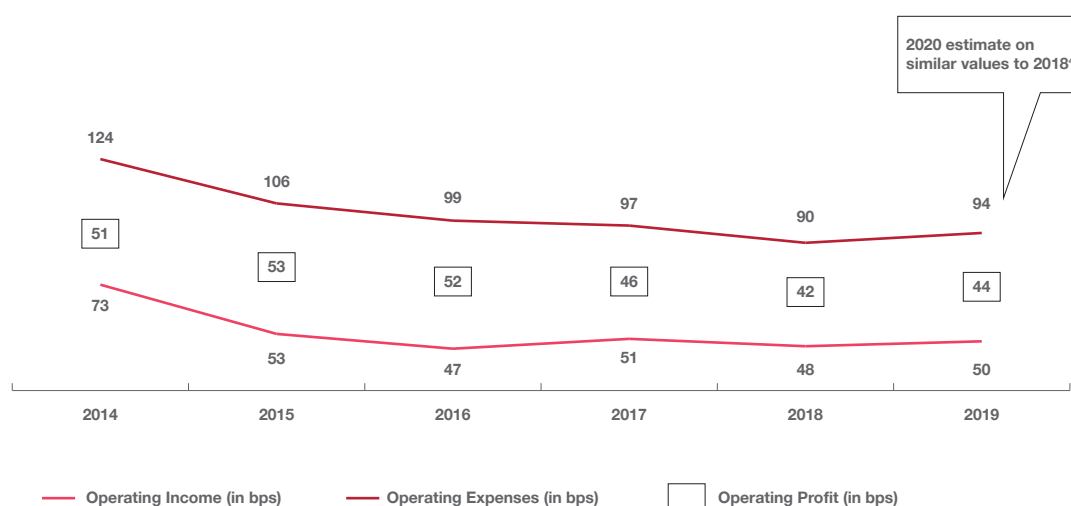
## Which implications for the industry players?

Between 2014 and 2017, the Private Banking **margins** fell by 10% with a 27 basis point contraction in profitability on assets under management driven by the well-known phenomena of competitive pressure, increased transparency and growth in passive instruments.

In the last two-three years, the contraction has slowed down and for 2020, despite the difficult situation, we can expect the industry's margins to be in line with that of 2018.

**Figure 11: Dynamics of margins and profitability of the Italian Private Banking sector**

Profitability in Italian Private Banking (bps)



Source: Strategy& Private Banks database

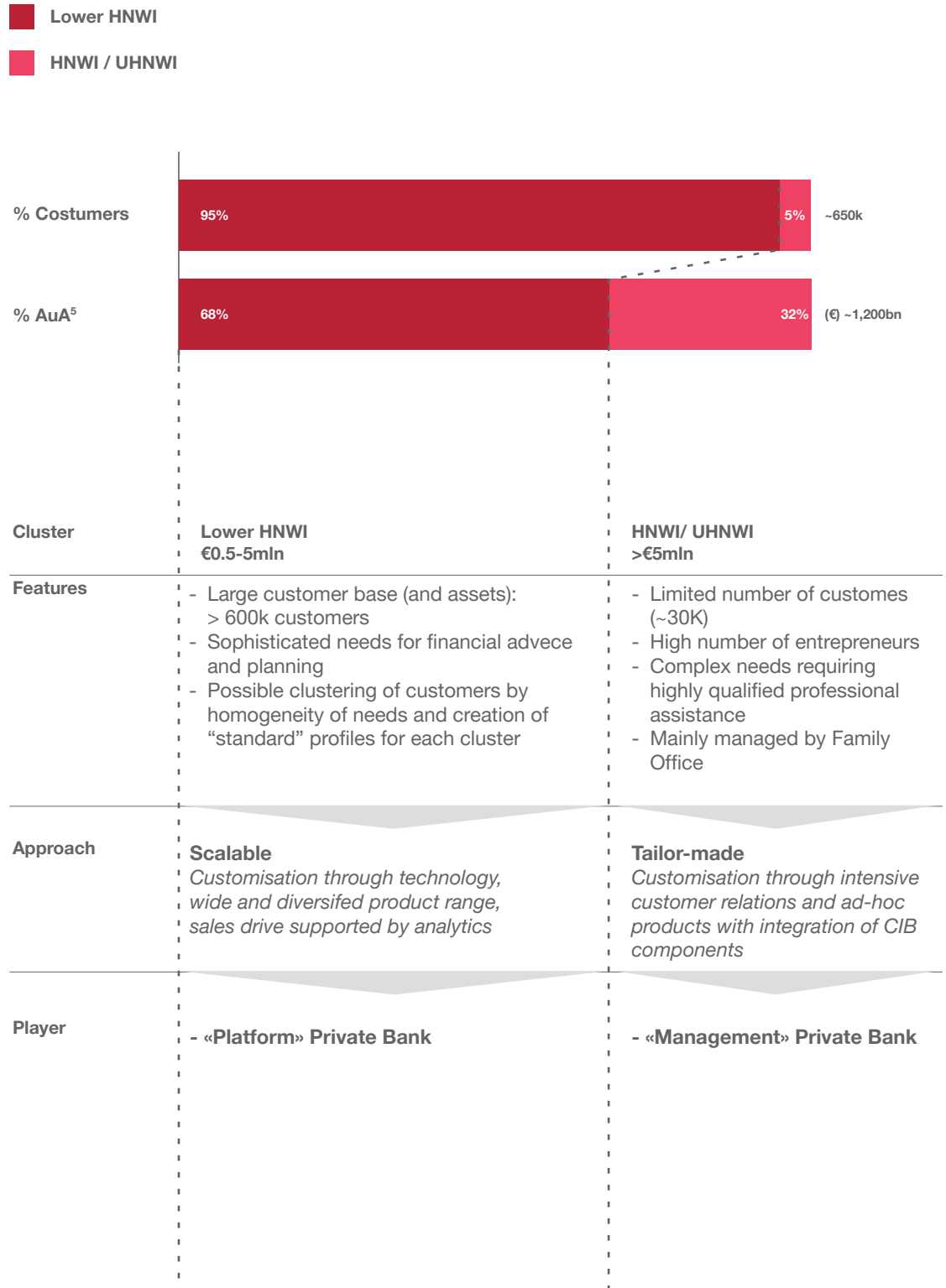
4: Estimate based on 1<sup>st</sup>H data from a significant sample of players

In the near future, however, we expect margins to come under further pressure, both on the cost side and on the revenue side.

From the **costs** point of view, the further increase will be generated by the aforementioned investments in **technology** (digitization of processes/ procedures as a driving element for a new interaction model between the financial advisors and the customers) and **human capital** (an element that remains fundamental, especially with reference to the provision of services with greater added value). From the **revenues** point of view, instead, we expect a trend in line with the last two years, with a slight drop in profitability.

Going into greater detail, it is worth highlighting how the Private Banking market can be segmented into at least two major customer clusters that require distinct business models with different investment priorities.

**Figure 12: Segmentation of the Italian private market**



Source: AIPB (2018)

5: Financial wealth of Italian households



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## (U)HNWI

This is the segment of **households with financial assets over 5 million euros**. It includes a limited number of wealthy families (5%, i.e. around 30 – 35 thousand households) with complex and articulated needs, who account for more than 30% of the market's assets under management.

This is the playing field of Boutiques and Family Offices, i.e. operators where the quality of human capital makes the difference in ensuring a tailor-made approach.

In particular, in this segment we expect **investments in technology** to be primarily aimed at upgrading the customer experience and reducing operational activities with lower added value (e.g. digital management of documents, electronic signatures); however significant they may be, we believe they will not represent the main differentiating element of the value proposition, but rather a “must have” to survive on the market. **Competencies represent the true differential value of this segment** and investments will be concentrated in this area over the next few years, with emphasis on team-based management of customers, corporate finance, liquidity events management, asset advisory, corporate advisory and philanthropy.

We expect the magnitude of investments in the segment will, in the end, raise the break-even point; this will require a step-up in size that can be achieved through organic growth or consolidation actions. Smaller players could opt for more disruptive choices, such as getting rid of banking license and operating as family offices or unregulated advisory boutiques, focusing their business primarily on advisory services.

## Lower HNWI

This is the segment of households with financial assets of between 500 thousand euros and 5 million euros; it includes a significant number of customers (i.e. around 600 – 620 thousand households) and accounts for around 70% of market assets under management.

The needs of clients in this segment present several elements of sophistication, however, the ‘smaller’ size of their assets requires careful management of the cost of service.

In this segment, technology is a key element of the service model and investments in this area must be oriented towards ensuring differentiation. Competencies are no less important but must they always be supported by technology to make them scalable.

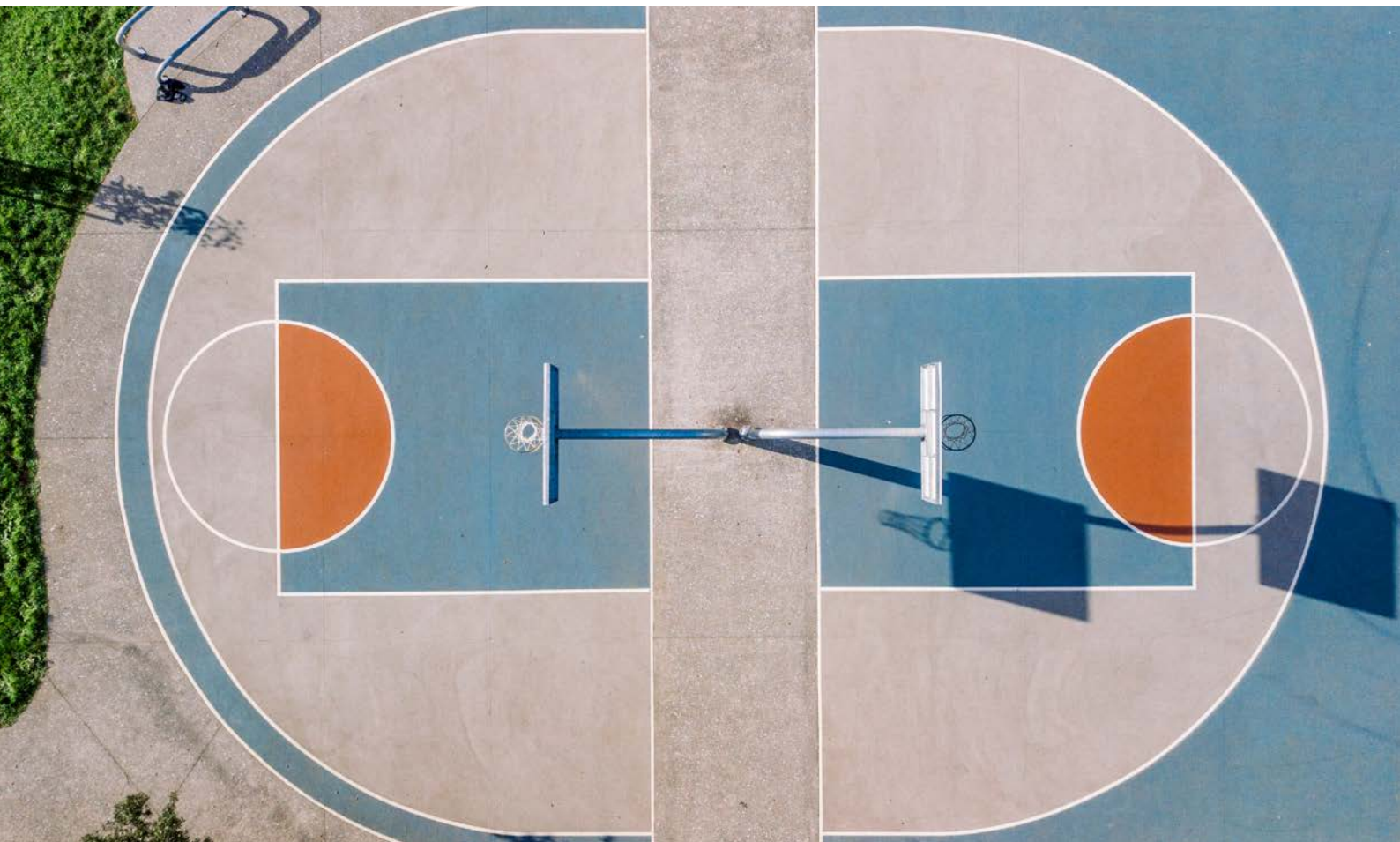
This is the playing field of Financial Advisors’ network and Commercial Banks where, given the significant investments in technology, the size will be increasingly important and where we expect consolidation activities to take place, in some cases led by the leading banking groups.

We believe that the different morphology of the players active in the two segments will become more pronounced in the future, leading to greater polarization and a rapid acceleration of the consolidation process; it will be crucial for players to clearly define their playing field and to be rigorous in applying the cornerstones of their business model so as to be able to better target their investment priorities.

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Within this transformed context there are five priority actions that will guide the strategic choices of players in the forthcoming years:

1. Invest in human capital, through training and the selective inclusion of specialist profiles able to provide a boost in terms of service capabilities and, particularly for the UHNWI segment, enable the study and proposal of articulated solutions tailored to the needs of each individual customer.
2. Engage on a digitalization process pursuing, for the Lower HNWI segment mainly, a real competitive advantage in terms of technology through a process that goes beyond the streamlining operations including the vis à vis interaction with the customer.
3. Deliver advanced, value added advisory by understanding evolving client needs and by defining consistent investment approaches.
4. Renovate the business model in an agile way to adapt to the continuous changes in the playing field.
5. Accelerate growth in order to reach a size that allows to maintain the current levels of profitability.



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AIPB - Italian Private Banking Association - was founded in 2004 and brings together the main national and international Private Banking operators, Universities, Research Centres, Service Companies, Sector Associations, Legal and Professional Studies. The purpose of AIPB is to promote and enhance, through constant institutional, research, cultural and educational activities, the Private Banking service in terms of competence, transparency and effectiveness towards the needs and requirements of individuals and families.

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