THE CONSULTING PARTNERSHIP

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Is the "sales culture" in Private Banking coming to an end?

Since the first publication of this article in 2016, little has been changed: the gap between falling revenues and rising costs is widening again and the banks depend on innovation and new sources of revenues. Coupled with slower organic growth, new pricing models come into focus.

Due to the increased regulatory requirements, banks are struggling with additional costs that cannot be rolled over to clients, on the basis of the current fee models. At the same time, an increase of the fees would be hardly acceptable, which deprives banks of the possibility to compensate the eroding margins. Nevertheless, we are convinced that private banking will be losing its special status as the industry with minimal price competition in the not too distant future, as new fee models are being rolled out.

„Traditional Fee Structures are no longer appropriate"

Since the outbreak of the financial crisis, client expectations have also changed: the passive private banking clients of the past have transformed into emancipated, cost-conscious and competitive clients: performance orientation and holistic advice in a low interest environment are increasingly replacing capital preservation as primary objectives of wealth management. This reflects not least the volatility in which many of the clients operate today. Actually a perfect moment to adjust their business model from a sales- to service driven approach and to align fee structures accordingly.

For decades, the fee models applied by most of the banks have remained unchanged: they are based on volume- and transaction-based commissions (safe custody- and investment management fees, brokerage fees, etc.). For the following reasons, this commission structure is no longer appropriate: banks generate a large part of their revenues on the sales side of client transactions, without participating in the success or failure of the investment performance resulting from their advice. On the other side, banks are offering a substantial range of value adding services "free of charge" without being compensated, in the anticipation of future transaction income. On the same line, client advisors are currently incentivized primarily on their acquisition success and sales results (Net New Money and generated commissions). Overall, this sales driven approach creates a direct conflict of interest between client and bank. This problem may be removed with a performance-oriented pricing approach.

Compared to quantitative transaction commissions, a performance-oriented fee model contains a qualitative element, which is determined by the investment success, against a predefined internal or external benchmark. With this approach, both bank and client are equally benefitting from successful advice and vice versa. At the same time, the fee model may be extended over the entire value chain of services provided by the bank to the client.

Both satisfaction and loyalty of clients strongly coincide with the positive investment performance in conjunction with the obtained quality of holistic advice. Satisfied, involved clients would most probably welcome qualitatively oriented fees in the sense of "risk sharing" as a fair practice, at the same time they are more open to accept additional fees relating to value adding services previously offered free of charge. Satisfied, loyal clients are profitable revenue producers for the bank. A bank which is prepared to position itself in such a competitive and performance-oriented way, is perceived by clients as a strong and trustworthy partner.

The level of client activity can be positively influenced

Besides of the qualitative service orientation, we anticipate that the creation of "all in" service packages is another element that may positively influence the level of interaction between client and bank. For example, special incentives may be offered to passive clients to motivate them towards a higher activity level. By offering service packages fitting the requirements of specific client segments, bundles may be created that already include an appropriate service level / volume (e.g. Robo-Advisor vs. tailor made).

Overall, a performance-based pricing strategy is a highly valuable differentiator, which provides added value to clients and at the same time opens the door for banks to generate additional revenues by integrating the entire value chain in their fee structure. At the same time, we recognize that performance based pricing is a complex and controversial topic, even more so we are looking forward to see the first bank jumping into the "cold water"!

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