Improving Wealth Management Margins Requires HR Led Change

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By Peter Keuls
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Steady growth, high margins relative to other segments of financial services, and low capital requirements makes wealth management an attractive sector in a low growth, capital constrained post-Basel III world. However, the influx of investment has kept demand for Relationship Managers high and caused Relationship Manager pay to rise faster than productivity (*see Exhibit 1 below*). This has exacerbated the margin pressure caused by historically low spreads on banking revenue and weak equity markets. As a result, U.S. private bank margins have declined 25% since hitting a peak of 40% (pre-tax) in 2006. These lower margins have resisted dramatic improvement despite reduced loan loss provisioning in recent years.

Exhibit 1: 2011 Change in US Private Banker Productivity vs. Pay at Leading Banks

2011 Median % Change	
Productivity	***Compensation***
7.0%	8.5%

HR Strategies for Improving Profitability

The HR function, like never before, is strategically critical to improving growth and profitability at Wealth Management firms. Effective HR teams will take a leadership role by:

- Supporting integration of support functions across divisions, such as Asset and Wealth, to achieve cost savings
- Reengineering the client team model to improve sales effectiveness while controlling cost
- Strengthening the link between client team pay-and-performance and, so doing, maximizing the efficiency of the incentive pool

Support Function Integration

Wealth management firms have been centralizing global operations, technology, product management and other functions for several years. The more aggressive ones have consolidated these and other functions into central, corporate functions to achieve even greater economies of scale.

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For those firms which choose to retain all or some of these functions within the line of business, consolidating private banking with asset management will enable them to achieve many of the efficiency gains while retaining a large degree of control and linkage to the business. HR's challenge in both scenarios is to keep driving talent strategies that enable the wealth management business to differentiate itself from its competitors while achieving these sought after economies.

This means, for example, ensuring that marketing and product management staff create wealth management services that are well suited to the unique needs of the target wealth client and that operational staff and processes meet the globally responsive service requirements of High Net Worth Individuals. This requires identifying the key value proposition elements that truly distinguish the firm from its peers and assessing the related critical skills required to deliver that differentiated client experience. In other words, generic functions and economies of scale need to be balanced by what is essential for meeting client needs.

Re-engineering the Client Team Model

For too many years, the reaction to the need for revenue growth was to hire senior private bankers who could either bring a significant book of business or, at worst, had the skills to grow a new book. This competition for relationship management and sales talent has resulted in Relationship Manager pay levels that have risen faster than productivity every year for the last five years. The returns on this trade are declining as private bankers consume an ever increasing share of the profits. Private Banks need to review their client team staffing models to improve private banker productivity in a cost effective way. This could entail:

- Segmenting, or in many cases re-segmenting, the client base and adjusting the RM and specialist team to the needs and profitability of the client;
- Teaming senior bankers with less experienced bankers so senior bankers can focus on winning and developing relationships;
- Adding or redesigning client service roles to enable client service staff to take on higher value client functions and provide more leverage to senior bankers.

Individually or in combination, these changes can significantly reduce the compensation funding rate for the client team and improve margins without sacrificing growth and retention. In fact, these changes can create better career paths which in turn improve staff retention.

Better Linking Pay to Performance

With incentive pools severely constrained as private banks work to repair margins, private banks can't afford to overpay a single Relationship Manager. Understanding the market competitive pay at each performance level is critical to maximizing the

efficiency of the incentive pool. Private Banker performance varies greatly with a top decile banker managing 13 times as much revenue as a bottom decile banker. Yet, the typical firm pays its top decile only 3 times as much as a low decile performer despite the vast difference in performance. Pay differentiation varies greatly amongst leading private banks with a ratio of as little as 1.3:1 for the least differentiating firms.

Private Banks need to get serious about linking pay to performance and this requires:

1. Establishing and clearly communicating banker performance targets that are based on market performance standards and that reflect the firm's target client and strategy.
2. Understanding the market pay and performance relationship and then crafting a compensation strategy that achieves a target compensation positioning at each performance level.
3. Setting expectations for managers and bankers at the beginning of the performance year about this target relationship between performance and pay.
4. Reducing banker incentives and eliminating salary increases in a highly disciplined way for under-performing RMs and redirecting savings to shareholders and top performers.

Savings from this strategy can be significant, improving margins by 1%-2% at many firms. More importantly, improving performance and pay discipline creates a performance-driven culture that drives long-term revenue growth. We have found that re-engineering the incentive plan in this way can boost growth by 25% without increasing the cost of sales.

Private Banks are going to need all three HR strategies described above to remain competitive and improve margins. Each strategy requires a focus on performance to optimize organizational efficiency. HR in partnership with finance and the rest of the business should play a leadership role in implementing these changes.

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