Asian Private Wealth Management

In a previous article (Private Wealth Management) we explored the failings of the current model of wealth management in Asia. Now we look at possible solutions.

Regaining Investors' Trust:

For reasons of alignment of interest, the ideal model of an Asian wealth management business would always ultimately involve the deployment of the firm's own capital in the same or related investments as that offered to its clients recalling the merchant banking model of the 1980s. The level of mistrust of financial advisors in Asia resulting from the experiences during the financial crisis in 2008 require such alignment of interest in order to restore the trust between principal and agent. A more direct alignment between principal and agent can be achieved by requiring or encouraging staff to invest alongside clients. The bonus pool is a convenient pool of staff capital that can be deployed to this purpose.

Building Long Term Relationships:

Staff turnover in Asian private banks is acutely high and confounds the objective of building lasting relationships. Bankers retain their relationships instead of transferring them to the firm. The result is a constant rotation of clients through firms as their relationship managers rotate. An appropriate compensation scheme for talent acquisition and retention and alignment of interest would involve partial retention of bonuses which would be invested in the firm's products or services.

Winning Discretionary Mandates:

While there is a proliferation of private banks in Asia, most of them are in fact expensive retail brokerages with a small percentage of their revenues coming from traditional private banking services. Discretionary investment management mandates are difficult to win and grow as discretion requires more trust than clients are currently willing to bestow.

Discretionary mandates need to be won in stages. Asia’s wealthy families are mostly first or second generation wealth and continue to grow their operating businesses. This provides a strong pipeline both in the demand and supply of PE directs. This deal flow presents the opportunity for a wealth management firm to bootstrap its business with a placement and advisory business where it provides due diligence and cornerstone capital to transactions which are then syndicated to its clients. The client base itself as well as selected GP partners are a rich source of origination. The discretionary asset management business can be built upon the foundations of a successful placement and advisory business. It is important to differentiate this business from the low value-added, low margin discretionary portfolio management services offered by garden variety asset managers. There is a dearth of absolute return, long term, policy mandates designed for long term legacy management while controlling downside risks to avoid interrupting the compounding effect. Alternative investments are under-represented in garden variety discretionary portfolios. Anyone who has done an unconstrained optimization will obtain significant allocations to alternatives, allocations which are often suppressed in traditional portfolios for no other reason that the investment manager is patronizing and pandering to their expectations of client sophistication. This is counterproductive to client objectives and to the managers’ fee margins.

Difficult market conditions and negative past experience with private banks have driven up liquidity and control premia in Asia. Investors are acutely more willing to invest in very liquid investments, substituting this liquidity away only in investments where they have extraordinary transparency and control. Quarterly and monthly redemption hedge funds are notoriously difficult to raise capital for. So too are long duration blind pool PE funds. Investors tend to favor daily liquidity funds or if they invest in private equity, prefer directs to funds where they often seek some level of control. A positive experience needs to be built with investors before discretionary mandates can be won.

The Asian International Nexus:

Asian wealth management sits on a goldmine of investment opportunities which exceeds the regions ability to absorb them. Diversification also advises Asian investors to invest at least a portion of their assets elsewhere. European, US and LatAm investors, however, are seeking Asian investments, and often require help in due diligence and deal analysis to weed out unsuitable investments. The Asian wealth manager may seek to place Asian investments internationally, helping businesses to diversify their investor base.

Asian investors’ international experience is yet immature and a significant proportion of them do not plan to diversify internationally. The propensity to venture abroad comes with understanding. The Asian wealth manager should invest in the education of their investors to bridge this gap. In fact, investor education is an important component of any credible wealth management business, not merely to bridge immediately evident gaps, but to maintain the level of sophistication of the partnership.

Fear of the Road Less Travelled By:

Asian private banks have been active since the mid 1980s. Few have broken out of being a transactionally driven brokerage business with expensive products, services and staff. Management have taken the international private banking model and attempted to get there in a straight line. In doing so, and ignoring cultural factors, they have created their own impediments, which they now cannot recognize or address satisfactorily. A different approach needs to be taken which puts the client first in practice and theory, and not just in rhetoric. The path is easy to see, its just very difficult to take.