



The rush to protect what's left

The current financial crisis has had a dramatic effect on the risk tolerance levels of private clients. **Utpal Bhattacharya** finds out why aggressive investors have taken a U-turn and are now happy with principal protection and modest returns.

With investors everywhere having lost anywhere between 15 per cent and 50 per cent of their net worth on average, affluent banking has taken a hit. Bankers who were encouraging investors to leverage several months ago are now cautioning them against its use. The warning has come a little too late, though, especially at a time when no free money is available for personal investments. But lessons have been learnt, the pain of loss has been felt and promises have been made not to repeat the follies of excess leverage.

The mood is so sombre and the shock of loss is so deep that clients are no longer asking for return on their capital, but rather for return of their capital, says Stuart Crocker, HSBC Private Bank's CEO for the UAE and Oman. Private clients are no longer sure if redemption in certain products will bring them back any money at all – forget the invested capital or any return on it.

The hype around structured products has also died down. In fact, banks'

selling strategies have changed to accommodate the altered financial landscape. The whole "product approach" has become a thing of the past as bankers find themselves grappling to salvage what is left of their clients' portfolios. The new approach is one of advising clients to be prudent and shun leverage. Customers are being told to insure their lives, create trusts and save in a way that will allow their wealth to last through six generations.

What went wrong?

Despite such large losses, there aren't many blame games being played between clients and their advisors. It is obvious that both are equally to blame for indiscretion or for not adhering to some of the basic principles of investing while implementing asset allocation in their portfolios over the last few years. As investors try to cope with their new realities, they are also becoming extremely risk averse, according to bankers.

Jean-Claude Gracia, acting CEO of SG Private Banking in the Middle East, says that private clients were investing in equity markets, structured products, private equity and real estate until about six months ago. Most of them were also eager to accept risk in order to obtain better returns and were requesting leveraged solutions to maximise their returns, he notes.

Although there is no more credit left in the market, the word leverage still evokes bad memories for many. In fact, the leverage strategy has hit investors so badly that Crocker believes those who survive the present crisis will approach their leveraging strategies differently and will be much more conservative in the future.

The mistake many investors made with their leverage strategies was underestimating the asset bubble that had built up in the global market. For those in the region, the relentless northward march of the oil price

escalated their confidence levels to arrogant proportions. Many felt that nothing could go wrong, and even those who advised caution suggested leverage to make hay while the sun still shone. Of course, when the rug under its feet gave away and margin calls started coming, the futility of the leverage-based investing model lay exposed.

Investing and saving strategies are now coming back to the basics. Clients are, of course, doing more due diligence regarding the quality of wealth management providers, but the trend has moved towards favouring a return to simple strategies and ensuring a mix between cash deposits and investments in low-risk products such as sovereign bonds and fixed deposits. There is also a perceptible push towards buying physical gold as concern builds up about the likely inflationary pressure on economies in the near future as a result of the enormous quantum of stimulus packages.

But some clients are still ready to consider investment possibilities such as those offered by private equity. Structured products are also beginning to come back, especially when the protection level is simple, efficient and easily understood, says Gracia.

Now that the times of high returns are gone, Gracia feels that a safer investment that protects an investor's principal will find more takers today than it would have a year ago.

"In uncertain market conditions, structured products represent particularly effective financial instruments because of the capital protection or guarantee

that can be embedded. They are, for example, an excellent way to invest in the equity market, taking advantage of lower entry points in 2007 and 2008 while benefiting from a capital guarantee or protection," he says.

HSBC Private Bank also confirms that it is involved in private equity deals in which it is matching sellers and buyers using the group's investment banking arm. Crocker says that although high net worth clients have lost money, they still have enough left to invest in projects and properties.

End of the product approach

As growth in the region slows and the oil price remains low, investors' immediate concern will be more about wealth protection than about growing their wealth. As such, Crocker feels that the product approach needs to go. There will also be a shakeout among private banks. As investors shift to quality rather than to products, some private banks will not survive these market conditions, says Crocker.

"A product-driven approach can lead to inappropriate behaviour in a global investment portfolio, but if you take a need-based solution approach and offer clients global solutions to serve their needs, that works much better," he argues.

Crocker adds that it is time to go back to the basics and look at customers' needs, objectives and risk tolerance before advising them on products and solutions.

Gracia agrees. He feels that a long-term relationship between a private bank and its key customers will become the norm and that banks will be less interested in volumes compared to the intrinsic quality of their customers.

Strong banks are also going to benefit from the trend that is emerging, with many affluent and high net worth clients who had banked with a number of different banks now looking to consolidate their relationships.

"A number of our clients are now talking to us to amalgamate the relationships that they have with a number of banks into just a few. They have been asking us to help in this regard," Crocker discloses.

Gracia adds: "It is now expected that high



Jean-Claude Gracia

net worth individuals will want to retain the services of two or three private banks at the same time."

One of the other trends emerging, according to Gracia, is the multi-family concept and its impact on private banks. SG Private Banking formed an alliance with Rockefeller & Co. to serve its ultra high net worth individual clients with this concept in mind, he says.

Crocker also points to similar trends. He says that HSBC Private Bank is closely working with families to set up family holding companies and adopt best practices in family governance. There is also demand building up for setting up trusts and foundations to ensure that wealth is protected and available to all members of families.

"Setting up family offices is not a new thing, but it has not been done at a time like this. However, people are more receptive now than a few months ago to our recommendations about these concepts, mostly driven by a need for safety," says Crocker.

It is obvious that the focus of private banking has now turned to wealth protection. There is also an emphasis on product and services enhancement, with research being an important pillar. According to bankers, advisory is also going to become more important now that clients are eager to heed advice.

It will be interesting to see how quickly the banking industry adapts to the new realities and manages to come up with efficient investment solutions to keep clients interested. Those banks that come up with better ideas will stand out against their peers.



Stuart Crocker