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PRIVATE BANKING & WEALTH MANAGEMENT MODERN PROBLEMS OF THE INDUSTRY. CUSTOMER REQUIREMENTS: IS THE INDUSTRY READY FOR A RESET.

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Abstract. According to the experts' assessment, the modern Private Banking & Wealth Management industry is stagnating. The financial crisis, COVID-19 pandemic, powerful geopolitical changes have influenced the profitability of the industry and revealed the shortcomings that need to get the most serious attention. Challenges include decreasing trust and customer satisfaction with the service and profitability. The world of on-line technologies and digital finance makes demands on both bank employees and customers. Tough requirements from the regulators on the control of financial flows and the introduction of many restrictions, the emergence of new young generations in the market with inherent socio-psychological attitudes and consumer preferences, all this requires assessment by the banking system and adequate proactive response. The research is an analysis of modern challenges and at the same time a search for possible solutions to overcome the stagnation of the Private Banking & Wealth Management industry

Key words: Private Banking, Wealth Management, Digital banking, customer experience, motivation program for private bankers, cybersecurity.

Introduction. In recent decades, the development of Private Banking & Wealth Management business can be characterized as a constant game of “catch-up”. It is obvious that the principles and traditions of work laid down over centuries, initially adequate and not sensible conservatism affected the work of the industry [1].

For a long time, traditionalism did not allow digital banking technologies to be introduced at the same pace and scale as retail. The ideology of human communication and privacy prevailed, and emphasis was placed on this very aspect. As a result, a significant gap was created, which was barely bridged by the end of 2020.

Practically the entire last decade, the private equity business has been shrinking its profitability, which has affected a number of aspects: cost cutting, which in turn has led to staff reductions, reduced client offerings and increased risk, and ultimately negatively impacted the level of service itself.

The emergence of new generations, their attitude towards business, staff another source of stress for the industry.

The COVID pandemic and its consequences affected the technology of Private Banking & Wealth Management business significantly.

The modern business model is stagnating. The adjustments brought in slow down this trend, but do not break the trend itself. Change is necessary for growth and development. Are there opportunities for resetting?

Basic theoretical and practical provision. The reaction of the owners of the large private capital to the current changes is interesting/ McKinsey conducted a fairly in-depth and detailed study of the factors that clients identified as fundamental to the performance of banks during the pandemic [2]:

1. At least 25% of customers were not satisfied with the bank's digital readiness;
2. Every fifth customer changed his bank during the pandemic (profitability and digitalization issues);

3. Clients have the most significant fear of digital fraudsters and are not prepared to transfer 100% of their decisions on-line only.

While the global banking industry withstood the peak load of the rapid, unprecedented in its scale, compressed by time transfer of business to the on-line mode, clients were not satisfactory with the level of support from banks in the issues of technical support and investment consulting. About a quarter of respondents noted that their banks and private bankers have not contacted them since the crisis began, a third of respondents were dissatisfied with the quality of investment consulting during the crisis and, as mentioned above, every fifth customer transferred their assets to another bank.

It is obvious that the reasons for dissatisfaction are digital equipment, banks' readiness, quality of service, and, of course, the level of professional support. At the same time, estimating the volume of issues that banks had to solve in an inconceivably short period of time, such as the increasing transaction activity, the issue of the equipment, the issue of communication channels, the operational readiness of specialists and the bank to conduct all transactions in a safe and organized mode, the situation still does not look catastrophic. In this case, the dissatisfaction of some clients is understandable and predictable. On the part of banks in the situation of crisis and peak load in all directions is acceptable.

The study shows that even within the historically most conservative customer segment, which always prefers live communication, the level of use of on-line solutions has reached 80%, with:

1) is still in favour of omnichannel (i.e., combining human and hardware communication) – 71%;
2) are in favour of a complete transition to on-line mode – 25%.

The risk brought by situations – digital fraud. Operational, information security. The growth in the use of digital technologies certainly means an increase in cybersecurity risks. The projected volume of losses associated with cybercrime in 2023 will amount to more than 8 trillion dollars. Experts emphasize that this is essentially the third “economy” in the world after the United States and China. The forecast for 2026 is already a figure of 20 trillion U.S. dollars [3].

One of the pressing issues of the present time is the transfer of Compliance & AML control processes and procedures into on-line and digital format. This is an undoubted stress for specialists of these professions and a challenge for IT specialists and of course for clients. The very implementation of technologies should take into account the possibility of live communication with the client (even in the elementary aspect – to explain the logic of certain documents) and at the same time systematic and efficient execution of the necessary procedures of analysis and control.

What solution and what can contribute to strengthening the position of classical banks – a system of work with clients, which can be seen as training. Explanation of aspects and causes of fraud, explanation of the logic of work and implementation of certain technologies. The challenge is not only in spending money and time on the development and implementation of new technologies. The challenge is to keep the client, his trust in the bank and the employee and the same trust in the new technologies offered.

In addition, the tightening of financial monitoring requirements, the growing volume of new instructions all this affects the time of execution of operations and at the same time narrows the possibilities of the bank in terms of offers to the client. The bank is forced to refuse part of the client's offer, as interaction with individual states or financial and non-financial instruments makes it necessary to pay more attention to legal aspects and control issues. This already affects the profitability of the bank, an issue that will be discussed separately later in this article.

Returning to technology issues, it should be noted that clients expect further development of on-line solutions. This includes security requirements and new technologies such as asset management through specialized artificial intelligence.

In addition, clients have an established demand for operations with digital finance: CBDC, NFT, cryptocurrency. Professional operators have several tasks in this case: to introduce these technologies into the bank's working offer and to train clients to work with these tools. Including explanation of the essence of these instruments and their inherent risks. If this issue is not so acute for younger generations, it is more than urgent for older generations.

One of the possible solutions to transform the service system of a classic Private Bank is the use of digital technologies, but tied to a more emotional interaction. McKinsey recommends personalizing content and recommendations to clients by using Big Data: information in social networks, demographic data, behavioural characteristics, i.e. applying personalization everywhere: from investment advice to the lifestyle component. The accumulation of information, elements of the so-called Internet of Things makes this possible. The challenge for marketers and customer experience specialists: the offer through digital solutions should provide new experiences, emotions and of course through the former and the latter generate interest.

An important point that comes through in the research and deserves the attention of banking professionals: clients in Europe continue to take social responsibility and social investing very seriously as part of their strategy choices. This is important: even in times of crisis, geopolitical turbulence, and falling incomes, clients are firm on these issues. Millennials and Generation Z have simply changed the structure of the banks' offer and the thinking of banking professionals with their pressure [4].

The task of banking professionals is not only to form a portfolio offer, but also to take into account the aspects of ESG, the United Nations responsible development (responsible environmental, social and corporate governance). What is important, bank professionals are also responsible for controlling compliance with ESG principles of certain issuers, as well as for controlling profitability. At the same time, ESG indexes still have no unambiguous and unified methodology, which may cause confusion and the question of profitability of such investments is not always obvious. Experts agree that such ratings will have to repeat the history similar to the credit ratings of the world's leading agencies. It took more than a decade to reach a consensus on methodology and ratings recognized by the market. In addition, the very focus of investors on responsible business is increasingly leading all companies in the market to seek actively meeting formal requirements. This leads to a greenwashing effect – cosmetic corrections to a company's activities and additional costs for communicating commitment to ESG principles. In reality, the company and its business do not change significantly. The task of control is also entrusted to the bank's analysts.

Sure, there is the eternal issue of profitability. It should be noted here that this problem is a perennial one, and it becomes acute in times of crisis. Taking into consideration that we’ve been living in a permanent crisis mode for the last decade, the banking industry is feverishly looking for new solutions and new opportunities. This is not to say that it is working out well. For example, McKinsey experts note that as a result of the 2008 crisis, global GDP fell by 1.7% and it took 10 years for the banking sector recovery. In general, the industry in Europe has shown a negative trend since 2018: profitability fell from the figure of 13.5 billion euros to the level of 13.3 billion euros in 2019 and the summary of 2020 will not show the best result. Post-pandemic situation of 2021were expected to show 3.5% drop in global GDP – for the banking industry this would mean a significant decrease in profitability. And of course the “black swan” of 2022 – war in the centre of Europe – was not taken into account. The very process of declining profitability has a constant moral (at the level of management and selling specialists) pressure, which affects the behaviour of banks.

That is why the initial reaction of the banking sector was quite traditional: staff cuts, reduction of administrative costs, etc.

Possible solutions proposed by McKinsey experts and largely already actively used by banks in the EU and Eastern European countries include reducing the number of physical offices of banks.

All this in turn leads to an increased burden on private bankers, fewer opportunities to communicate with the client and, as a consequence, a reduction in the quality of service. Banks and employees are feverishly searching for a solution, the answer is often a race for new clients, selling more risky clients, pressure on sales clients. The risks for the client are obvious: the desire for former comfort leads to sales in the interests of the bank and the client manager, but not the client [5].

The pressure and growing level of conflict leads to high staff turnover, which in turn causes customer dissatisfaction. It would seem to be a vicious circle. The way out may be innovations that focus on an agile mix of digital solutions and personal communication. Reshaping the segmentation and generational model, while advanced technologies are offered to a greater extent to younger generations who are more predisposed to use them in banking. By doing so, there is an opportunity for more time for the classic generations in terms of their consumer characteristics. One of the recommendations here is to manage this time wisely using it for education and training in the use and control (cybersecurity) of certain digital innovations.

The crisis has forced both the banking system and the client to significantly reduce their expenses. This has led to increased demands from the latter and certain changes in the nature of relationships: a deep and focused approach (client demands that cannot be left unattended). McKinsey research participants noted that their strategy for the near future will be to evaluate their own portfolios and withdrawal from non-core assets and refusal to cooperate with inefficient professional market operators.

The negative thing is that, according to these studies, clients are so dissatisfied with the results and approaches of financial institutions that one of the most demanded services of recent times is the so-called "second opinion". A third-party expert's assessment of a portfolio and the effectiveness of its management. This indicates a significant decline in trust in banking professionals. Generally, profitability is a very cyclical value, it decreases during each financial crisis and grows while the market shows a positive trend. After the crisis of 2007–2009, experts attribute the restoration of trust in banks and managers to the complexity of the instruments offered by them and the dynamics of events taking place in the market, rather than to changes in the habits of the latter. The client simply does not have time to analyse information and make decisions, and the logic of some financial instruments does not understand at all without careful explanation from experts. This is forced trust. But such trust is not endless.

First, clients are increasingly paying attention to the fact that in case of risk events, as a rule, neither the operator (bank or asset management company) nor the manager directly bear virtually risks. Losing a client is probably the most crucial.

Second, clients are demanding greater transparency in charging. Capgemini's annual World Wealth Report 2020 survey indicates that more than 33% of clients who own large private capital (over USD 1 million and more) are dissatisfied with the level of fees [6]. They would prefer a fee structure based not on the amount of assets, but on investment results and overall service quality of both banks and asset management companies. These demands have been increasingly systemic in Capgemini's research since 2017: the client is willing to pay, but understanding *what for* and *how the fee structure is* formed. Clearly, the pandemic crisis has only sharpened these issues and client demands.

Clearly, solutions are needed where there is a partnership in risk sharing and commission principles based on the positive results of the financial partner responsible for managing the client's assets. The bank bears its own costs for building the infrastructure, part of the commission payment is due to this, but the majority of such commissions should be formed by the banking institution as a certain share of the income generated.

Solutions to improve the situation have been proposed for quite some time:

1) entering by the bank's own funds into the strategy offered to the client;

2) formation of dependence of professionals who have formed this strategy and work with it (analysts, managers, private bankers) on its result. Deferred bonus (in the amount of 30% or more of the annual bonus) invested in the strategy.

Such an approach will have the most significant impact on client confidence and the discipline of banking professionals. But how many of you know of such proposals in reality? It is very difficult to break habits and accepted rules.

One of the trends aimed at reducing the cost of commissions on the client side is a preference for brands that can provide services from the perspective of fully working with the client's portfolio of assets, the so-called holistic approach.

Conclusion. New challenges mean new demands on the one hand and new opportunities for transformation of the banking industry on the other: redesigning the operating model, creating cybersecurity systems, a new approach to service and customer experience. The reset will also affect such aspects as staff incentive programs, staff retraining (especially in digital banking and cybersecurity).

Changes in service management should be understood as changes in marketing, analysis of client preferences and positioning of large private wealth management services.

The main risks that will push the banking system to actively seek solutions and transformation are highlighted:

1) Increased workload on private bankers (downsizing) and lower quality of service; emergence of a new generation of customers. The way out: flexible combination of digital services and physical work with the client; change in functionalities and approaches taking into account consumer characteristics of different generations.

2) increasing requirements from the regulatory authorities in terms of Compliance, AML (reduction of the range of services, as it is impossible to take into account all aspects of rapidly changing legislation). The way out: maximum automatization of the process in terms of analysis and decision making, but retaining the option of dialog with the client in case of any clarifications, etc.

3) decreasing customer confidence (striving for transparency in tariffing issues); decreasing profitability of banks, combined with the struggle for personnel, this leads to the risk of sales in the interests of the bank and the manager, but not the customer. The way out: restructuring of the personnel motivation system; creation of a partnership approach in the formation of product offer to the client (profit and risk sharing).

4) growing demands for new competencies and knowledge among private bankers. Customers want personal communication and at the same time new knowledge and competencies. A lunch with a client and a dialog on secular topics are no longer enough. The way out: transformation of the training system, training program for clients and their families.

To summarize, we can say that the banking system simply has no choice, either a reset and work on mistakes will be carried out, or sooner or later banks will lose their dominant role as players in the market of servicing large private capital.

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