PRIVATE TRUST GROUP OF AMERICA

# Wealth Management Services

## Five Steps to Profitability

We recently wrote an article entitled "Wealth Management Services – An Opportunity for Community Banks" in which we presented the argument that the confluence of bank mergers and acquisitions with technological advances has created significant opportunities for capitalizing on the virtues of community-based banks and their ability to provide cost-effective, personalized services to high net worth individuals.

This article explores five critical steps that must be addressed if the enterprise is to be an economic success.

### Step 1: Understanding the Marketplace

Nearly any geographic location that will support general banking activities will justify offering some basic form of wealth management services. However, a careful study of the marketplace should be conducted in order to gain a better understanding of the types of services being sought by consumers, and to determine the bank's ability to provide the infrastructure to support such services. Two key areas to be considered are:

*Geographic Location* – Generally speaking, the bank's service area footprint defines the marketplace for the bank as a whole and will become the early recruiting grounds for suitable wealth management clients. Once a wealth management office has been established, services will usually expand outward to clients beyond the borders of that footprint through direct sales efforts and referrals from existing clients and their families. Therefore, it is important to look beyond the imaginary boundaries of the bank's current customer base to gain a perspective on possible expansion opportunities.

*Demographics* – A study of local demographics plays an essential role in determining the viability of a successful wealth management office. The study should encompass overall demographic statistics from independent sources such as state and local governments, local Chambers of Commerce and commercial organizations, as well as from the bank's current customer base.

An ideal demographic matrix should be constructed on a broad regional basis, which will help determine future growth opportunities. While local knowledge is certainly important in deciding the area of coverage, it should never be used at the exclusion of other reliable sources. A good rule of thumb is to extend the demographic coverage area outward from existing branches to include all adjacent population centers or counties.

Once the area of coverage has been determined, collect as much relevant data as possible with an emphasis on retirees, baby boomers and business owners. This can be accomplished rather inexpensively through a number of companies that sell lists including names, addresses and telephone numbers for households fitting user-defined criteria such as total household income, value of personal residences and aggregate value of financial assets within pre-determined ranges.

**Step 2: Defining Wealth Management**

Wealth management services means many different things to different people, which makes it necessary to clearly define the types of services being offered. It is often not necessary, and may indeed be counterproductive to offer the full range of financial products and services available in the burgeoning wealth management supermarket. Limited services, such as traditional trust administration and estate settlement, may be of far more value to the bank and its institutional identity than providing additional services for which the bank cannot or is unwilling to support.

A clearly defined, well articulated wealth management services program is essential to meeting the needs of customers and preserving the institutional integrity of the bank. It is better to do a few things well than many things poorly.

**Step 3: Building a Support Structure**

Wealth management, perhaps more than any other segment of banking, is built around institutional trust and personal relationships. First and foremost in the minds of wealthy individuals is to ensure the safety of their personal information and the security of their financial assets (institutional trust), followed closely by their sense of who best fits the role of understanding their intergenerational financial goals and objectives (personal relationships).

*Institutional Trust* – Unlike many large banks, brokerage houses, mutual funds and insurance companies that have been caught up in highly publicized scandals in recent years, community banks still enjoy a high degree of trust among their customers. In many cases, trust in smaller institutions is well founded and is, in reality, one of the primary reasons community banks continue to draw customers from their larger competitors.

Institutional trust is not a concept uniquely suited to high net worth individuals, but it is crucial to serving their needs. Internal safeguards to protect privacy and personal information must be constantly reviewed and steadfastly maintained to not only protect each customer, but to protect the bank's reputation as well.

Institutional trust at the community bank level provides customers with an attractive alternative to the whims of larger institutions where decisions are made by anonymous people in far away places. In a real sense, institutional trust defines the bank and gives the community a sense of pride and ownership.

*Personal Relationships* – Success in providing wealth management services, regardless of how that term is defined, is almost entirely dependent upon personal relationships. The institution offers a public identity and provides a sense of permanence, but it is the individual who molds the customer into a successful, long lasting relationship with the bank.

Central to the question of whether or not wealth management services should be an integral part of the bank's service offerings is the extent to which the Board of Directors and the Executive Committee recognize the importance of personal relationships to the success of the endeavor. The primary focus in building a successful and profitable wealth management group must be on hiring individuals who will project a positive image of the institution and who will gain the acceptance of each customer through a commitment to earning their confidence by being accessible, knowledgeable and trustworthy.

Recruiting good, qualified personnel with a clear interest in growing the business is of the highest priority. The costs of all other support services, including routine administration, operations and even investment management can be shared with competent service partners with fee structures designed on the basis of shared economic interests.

**Step 4: Pricing**

The inclusion of so many previously autonomous service groups (insurance, brokerage, estate planning, trust administration and financial planning, for example) under the umbrella of "wealth management services" has created some downward pressure on fees. With more regulatory oversight and greater consumer demand for additional services comes the need to be more open and flexible with respect to pricing individual products and services.

A careful examination of current fee schedules and other pricing models is necessary to secure a base level of revenue that properly reflects the value of services offered and the costs associated with them. It is not practical, for example, to unilaterally cap revenue under a traditional fixed fee schedule (whether it is based on a percentage of assets under management or otherwise) while expanding normal trust department activities to include other services. Since competitive pressures normally prevent an increase in the existing fee schedule, it is necessary to define the additional services and assign a value to them that can be justified to a customer and billed separately.

Adhering to a single pricing structure while demands for additional services continue to expand will increase customers' expectations and inevitably lead to declining profits. Pricing flexibility is the only sure way to guarantee that existing fee structures are not being diluted by covering services outside the scope of the original agreement.

**Step 5: Managing Costs**

With fee income under pressure from increased competition, the single greatest factor in successfully increasing profitability in the wealth management business is the ability of management to aggressively manage costs. Advances in technology and bank mergers have created a growth industry for businesses that support the main objective of wealth management organizations – growth of assets under management. Many new entries into the wealth management business are taking the approach that they want to manage customer relationships and move everything else to outside service providers.

The general rule of thumb for turning a traditional trust department into a breakeven proposition for a bank is to have $150 million under management, which would mean a customer base of approximately 200 to 250 accounts at an average account size of $600,000 to $750,000. Assuming an average fee of 85 basis points on the aggregate value of all assets under management results in gross fee income of approximately $1.1 million to cover the costs of operations, including physical infrastructure, support systems and services, staff and related overhead.

Today's technology has reduced the threshold of breakeven from $1.1 million to about $100,000, depending on the part of the country and the level of services offered, thus reducing the initial requirement for assets under management from $150 million in the previous example to just under $12 million. Therein lies the greatest source of competition, but also the greatest opportunity for existing trust or wealth management offices to regain control of their internal costs through new technology and strategic alliances with key service providers.

With proper service provider alliances, it is possible to substantially improve services, increase customer satisfaction and achieve a dramatic improvement in overall profitability. The market is moving rapidly toward a turnkey solution that allows trust officers to manage client relationships rather than the details of back office support operations. Managing costs and redirecting valuable resources now will turn today's loss leader into tomorrow's profit center.



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