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Rich Pumped for Fees in Private Banking ‘Conflict of Interest’
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By Warren Giles

March 24 (Bloomberg) -- After Steffen Binder and his partners sold a Frankfurt-based Internet research firm for $15 million in September 2000, he invested his share of the windfall with private banks. As the dot-com bubble burst, his holdings shrank faster and then rose more slowly than the market.

Binder discovered that fees were eating into his returns by pushing the annual cost of his accounts to more than twice the management fee of 0.8 percent to 1.2 percent of assets charged by a majority of wealth managers, he says, declining to identify his banks.

“Ninety percent of wealth-management clients are not aware of the costs they pay indirectly,” said Binder, 43, who in 2008 co-founded MyPrivateBanking.com, a Kreuzlingen, Switzerland- based firm that provides research and analysis on the private- banking industry. “If they invest in relatively expensive alternative products it can be a huge amount.”

The financial crisis cut assets at wealth managers by 17 percent to $14.5 trillion in 2008, according to London-based Scorpio Partnership in a study last year of 248 institutions worldwide, including the biggest: Charlotte, North Carolina- based Bank of America Corp., UBS AG of Zurich and New York-based Citigroup Inc. As a result, some clients are pushing back by hiring former bankers to chisel away at their fees.

William Drake, the co-founder of Lord North Street Ltd., a London-based firm that negotiates lower fees, said the rich often pay too much because banks push their own funds and trade more than necessary to boost commissions.

‘Conflict of Interest’

Higher fees erode returns over time. A private banking client with $10 million invested, for example, who earns annual returns of 7 percent a year and pays 2.3 percent in fees, will hand $3.4 million to his bankers over the course of a decade.
With fees of 0.9 percent, that client would pay $1.3 million.

“Most wealth managers and banks have a stumping conflict of interest because their riskier products earn them more fees,” says Drake, who worked at London-based Kleinwort Benson and Granville Plc for more than 20 years. “If your adviser is getting three times more for hedge funds and private equity than government bonds, you’re asking for trouble.”

Gregoire Bordier, chief executive officer of 166-year-old Bordier & Cie., says the bank’s fees represent a fair return for the service it provides. While clients ask more questions during difficult economic times, the Geneva-based bank is reluctant to negotiate on fees, he says.

Competence, Quality

“We’re rather of the idea that we have a competence, a quality, that comes at a certain price and there’s no real reason to start varying that from one person to the next,” says Bordier, whose bank manages about 10 billion Swiss francs ($9.5 billion). “You can’t have an institution that doesn’t earn money.”

Yves Mirabaud, a partner at Mirabaud & Cie., the 191-year- old Geneva-based private bank that manages 23 billion francs, said the crucial thing is to avoid “double charging.” For example, clients don’t pay a standard management fee of 0.8 percent on money invested in one of Mirabaud’s funds, though they do pay fees linked to the fund itself, he said.

Mirabaud’s Miralt Sicav Europe Fund, a 210 million-euro fund of hedge funds, can charge clients as much as 3 percent to initially subscribe, a 2 percent management fee and a 2 percent fee to exit, according to its prospectus.

A survey of 20 European wealth managers with offices in Switzerland by Binder’s MyPrivateBanking last year, including UBS, Credit Suisse Group AG, Julius Baer Group Ltd. and Spain’s Banco Santander SA, identified the three with the most transparent fees.

Most Transparent

Sal. Oppenheim Group, now a unit of Frankfurt-based Deutsche Bank AG, Geneva-based partnership Lombard Odier and Union Bancaire Privée of the same city scored highest on “acceptable flat fees and low hidden costs,” which added up to about 1.1 percent, including transactions, the survey found.

The addition of mutual funds, hedge funds and structured products to a portfolio of stocks and bonds added an average of between 1 percent and 2.5 percent annually to total fees, the study found, excluding some performance fees.

UBS, Switzerland’s biggest wealth manager, declined to comment on typical costs when asked by Bloomberg, saying they vary depending on the size of the account and investment strategy, according to spokeswoman Dominique Scheiwiller.

Additional Charges

The bank’s gross margin from business with international wealthy clients dropped to 0.86 percentage points last year. UBS plans to “rebuild” that figure to more than 1 percentage point with new products and trading ideas to shift customers out of their cash investments, Juerg Zeltner, who co-heads the wealth management and Swiss bank division, said in November.

Credit Suisse, the second-largest Swiss wealth manager, generates an average gross margin of 1.31 percentage points from wealth management clients, excluding any additional fees for third-party funds or products sold by other departments at the bank that may add to a client’s total costs.

Charges at wealth managers may include performance fees, transaction expenses, commissions, foreign currency and counterparty costs, as well as tax advisory fees, according to Drake, who said he’s counted at least 17 ways for wealth managers to charge clients.

A German private-banking client who requested anonymity said he invested 1 million euros at a bank in Zurich, which placed his money in more than 40 products. After less than two years he closed his account in mid-2007 and withdrew the remaining 850,000 euros. He declined to identify the bank and says he now keeps his money at a local bank in Germany.

Meeting Bankers

Private-banking clients with at least $1 million to invest are typically put in a range of funds and offered tax, inheritance and savings advice. Wealthier clients, with tens of millions, may get more personalized service, such as finding a specialist to value an art collection, booking a private jet, helping to create a family trust or pick philanthropic projects.

Raoul Hinder, a former investment banker and wealth manager at UBS and Credit Suisse, started Baar, Switzerland-based Goodvalues last year to negotiate fees as part of his portfolio consulting business, which selects managers and monitors client investments.

Negotiation services, such as those offered by Lord North Street and Goodvalues, evolved from advisory work for wealthy families. They tally how much a client is paying and then meet with the bankers to negotiate fees lower. While they don't manage money, they may make recommendations on where to find better returns.

Drake started Lord North Street with Adam Wethered, a former head of JPMorgan Chase & Co.'s European private bank, in 2001. Today, it represents investors with "several billion dollars," Drake says, declining to be more specific.

'Success Fee'

Goodvalues serves individuals and institutions with at least 5 million francs invested. At Lord North Street, the threshold is 25 million pounds ($39 million).

"If you can do it on your own, go ahead," says Hinder, who takes 38 percent of the first year's savings for helping clients negotiate lower fees. "This is a success fee that reduces costs. There are so many ways to hide costs through products and transactions that people know they need help."

In one case, Hinder negotiated on a client's behalf and managed to reduce the fees on a 45 million-franc portfolio to 0.8 percent annually from 2.1 percent, by eliminating all but "plain vanilla" investments, he said. Clients do need to understand, Hinder said, that they won't be able to invest in hedge and private-equity funds without paying higher fees.

'Price Doesn't Matter'

The financial crisis exposed "unsound incentive structures" that reward private bankers for pursuing their employers' interests rather than those of their clients, wealth management consultants Ole Heggtveit and David Clarkson wrote in a report published in December by Oliver Wyman, a unit of Marsh & McLennan Cos.

Potential conflicts include encouraging clients to buy higher-margin assets rather than lower-risk alternatives, pushing the bank's own products and third-party funds that pay commissions to the wealth manager as opposed to those that minimize costs, and promoting frequent trading over buy-and-hold strategies, according to the report titled, "Trust Me, I'm Your Private Banker."

"The message from the industry is that price doesn't matter as long as performance is right," Heggtveit says. "That might be true in bull markets when a client forgets the price he's paying, but in times like the last couple of years he starts looking at whether he's really getting value for money."

As a majority of wealth managers saw assets under management fall in 2008, only 13 percent said they cut fees, according to a survey of 238 firms published in July by PricewaterhouseCoopers.

Savvy Clients

Barclays Plc's wealth management unit has begun offering all-inclusive accounts, with a 1 percent fee that removes any incentive for managers to push the bank's products, says James Persse, managing director for Barclays Wealth's Geneva-based unit that serves clients in the U.K. and Ireland.

"These days, clients are savvy and I don't think they're prepared to put up with fees of 2 or 3 percent and are fed up with negotiating every five minutes," Persse says. The single fee "aligns the interests of both the client and the bank and isn't based on activity."

Banks may actually make more money with a single-fee model because transparency will attract new clients who have been reluctant to pay for investment advice, while helping wealth managers retain existing customers and increase a bank's share of their investments, according to Heggtveit.

'Don't Dare Ask'

Binder of MyPrivateBanking.com has taken things a step further. By managing most of his own money, employing just one rather than three private banks, buying low-cost products such as exchange-traded funds and using an online broker, Binder says he's cut his total costs to about 0.3 percent of assets annually from more than 2 percent.

He advises other investors to treat bankers like attorneys, paying them by the hour for research and investment proposals, with a commitment that they will rebate any kickbacks they receive from fund providers to ensure that there are no conflicts of interest.

"In the beginning we overpaid, a lot, and didn't understand the whole model of bankers receiving commissions on products," Binder says. "People are often aware that they're paying more than the basic management fee, but they don't dare ask how much."

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--With assistance from Elena Logutenkova in Zurich and Michael J. Moore in New York. Editors: Willy Morris, Dylan Griffiths

To contact the reporter on this story:
Warren Giles in Geneva at +41-22-317-92-02 or wgiles@bloomberg.net

To contact the editor responsible for this story:
Frank Connelly at +33-1-5365-5063 or
fconnelly@bloomberg.net