

Now is the time when many banks should reevaluate the future of their asset management units.

Proprietary Bank Funds: Time to Sell?

BY ALISTAIR JESSIMAN

As part of the banking industry push into investment products, most institutions say they have embraced “open architecture,” or the practice of providing multiple external brands through their distribution systems. But in practice, many mid-size regional banking companies still emphasize their own product lines, which offer higher margins.

Clinging to proprietary products has been a fairly easy decision to make in recent years, when valuations and investment inflows have soared. During the 12 months ended Sept. 30, 2007, for example, the Dow Jones Industrial Average rose by 19%, following a healthy 10.5% increase during the previous 12 months. Why mess with success?

But behind the scenes, a variety of troubling issues have continued to simmer for the proprietary asset management units of mid-sized banks, including marketing power, operating efficiency and investment performance. Mid-size players lack the brand strength and scale economies of the very largest bank investment units, for example, each of

which control from two to four times the amount of assets under management held by the average regional bank. And it's highly difficult to attract top investment managers into the banking industry, with its paralyzing bureaucracy and limited salary potential.

Then there are critical questions about customer preferences and expectations. In a market that is now flooded with investment options from a variety of readily-available sources, people don't want to be held captive in a particular product family, and they certainly don't want to settle for lagging investment returns. There's an erosion of product loyalty, in other words, and while the issue may have slept in the recent strong market, it promises to return with renewed vigor when the market slows — as seems increasingly likely going into next year.

The immediate implication is that now is the time when many banks should reevaluate the future of their asset management units. At a time when market values and purchase multiples are high, the environment is conducive to favorable sales transactions, for example. Alternatively, it may be possible to spin off the investment unit into a separate subsidiary, and build a culture and compensation structure that is more attractive to top investment managers. To be sure, both options are serious undertakings, but those who do nothing likely will face a shrinking set of possibilities.

Even more importantly, the bank's strategy for wealth management needs to be reoriented in many cases. Overlooked in discussions about prod-

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