INTRODUCTION

ITALIAN BANKS SEEK THIRD PARTY SALES SUCCESS

Customers of Italy's major savings institutions in recent years have favoured low added-value products such as bond or money market funds. But a recent trend to absolute returns and a cautious embrace of external funds has led to a newfound optimism, reports Elisa Trovato

Italian distributors, like their counterparts elsewhere in Europe, claim to be moving from a product push to an advisory approach to clients. While this marketing talk should be taken with more than a pinch of salt, professional advice for clients is gathering in importance, as branch networks try to integrate financial planning with asset allocation.

Having had their fingers burned in the previous decade, investors in the €655bn Italian fund market are now shy of risk. Consequently, the big banks offer them a plethora of low-value added vehicles, such as liquidity, short-term fixed income and insurance products. The predominantly Milan-based industry complains of a high degree of volatility of net inflows into equity funds, in strict correlation with historical market performance. More so than in any other market, Italian retail investors sell up immediately after shares have slumped, and buy up after a period of good performance. A lack of institutional fund flows, since initial mandates were given by foundations and pension funds after their creation in the late 1990s, means a lack of stabilising influence found in other markets, although the picture may look better after 2008, when legislation promises compulsory pension contributions.

"I BELIEVE THAT WE MUST ATTACH GREAT IMPORTANCE TO THE ADVISORY ACTIVITY AND CHARGE CLIENTS FOR IT"
NICOLA ROMITO, MONTE PASCHI

It is left to the industry players to manage investors' typically emotive buying and selling sprees, with funds perceived almost like individual securities.

"Market timing has destroyed and continues to destroy value in Italy," comments Nicola Romito, chief executive officer at Monte Paschi Asset Management, funds arm of the world's oldest bank in the world, which has conducted an in-depth study of investors' behaviour. "I believe that we must attach great importance to the advisory activity and charge clients for it. Building advisory models that enable consumers to clearly perceive the value of advice and asset allocation, rather than trading and market timing, is a necessary step to come out of this impasse."

Mr Romito talks of a major project, of an "advisory platform" that the €50bn Italian fund house is implementing within the group. The concept of wealth management, "which should not be identified with the management of private clients' wealth only," is central to Mr Romito's theory.

"Wealth management means building an advisory platform on which all clients will be served by employing different models and levels of services, according to clients' different levels of investible wealth," he says. The "engine" of the whole system is the asset management company, which designs the asset allocation and selects funds, while the bank is responsible for the selection of the other products, which are also included in the asset allocation.

The model mandates the bank and asset management company to monitor products and clients' risks positions, depending on the various levels of delegation given to the advisers. Those who have the highest level of delegation are, not surprisingly, private clients' advisers.

As the market becomes more open and distribution of third-party products increases, manufacturers are faced with a new challenge. Not only are they forced to be more competitive, but they also need to build their partnership with both captive and non captive networks, by providing asset allocation instruments, helping develop advisory

Lombardo: borrowing technology from the alternative world is good but some care is still needed

Bafunno: the advice process starts with understanding the client's true asset allocation

Romito: his 'advisory platform' is based on the findings of an in-depth study of investors' behaviour

services and specialising in selecting the best external managers.

This is the model inspiring Pioneer Investments, which as a result of the merger between parent group UniCredito and German bank HVB, will manage over €280bn globally, following the integration of HVB's asset management divisions. Fund selection, conducted through multi-manager GPFs activity, currently accounts for only €1.6bn of the total €109bn in total Italian assets managed by the group. Pioneer monitors 20 external managers, although the majority of GPF assets are channelled through 12-15 managers, explains Giordano Lombardo, deputy chief executive officer at the international company.

The innovative factor in the relationship between Pioneer Investments and its multiple channel distribution network has been the emergence of Xelion, the open-architecture bank of the UniCredito group, for which Pioneer Investments is the official adviser on asset allocation. It is also one of three managers providing discretionary multi-brand GPFs, alongside JP Morgan and Merrill Lynch.

Xelion manages €15bn in assets and distributes its products through a network of 2000 tied agents, or "promotori".

The bank has been providing a chargeable advisory service for the last few months to its target clients, who typically have investible assets of between €150,000 and €2.5m.

"In October 2005 we were the first to introduce advisory contracts to the market," says Vincenzo Bafunno, chief executive officer at Xelion. "We think it is very important to be able to help our clients select the best products on the market."

Viani: 'client financial planning' uses seven risk-return profiles to provide a point of reference

Xelion's analysis shows the importance of a multi-brand offering by comparing the different performance of funds employing the same investment style. For example, European funds distributed in Italy have returned a three-year cumulative average of just 9 per cent, while the worst ten funds lost 6 per cent, against a 34 per cent return of the best 10 funds.

The first step of Xelion's advice process is to understand what the real asset allocation of the client is. After mapping out all the investment products in the managed savings market, Xelion helps the client identify an asset allocation more coherent with their risk profile, as often the client is not on their efficient frontier, says Mr Bafunno. "We believe that strategic asset allocation explains most of the performance, on medium-long term horizons," he says.

The third step comprises the development of a financial plan, which gives Xelion's client access to 1200 funds selected from 25 different managers. Mr Bafunno explains that promotori are then given a very clear indication of the best funds, which are ranked by "information ratio", the relationship between performance and risk.

The percentage of third-party products distributed by Xelion is 48 per cent of total assets, against 11 per cent for

the top 10 promotori networks in Italy, according to research from Assoreti, the national association of the promotori networks.

Other distributors are also moving into the area of advisory or client profiling, in an attempt to stabilise inflows. “We employ an approach to investments called CFP – client financial planning,” says Giovanni Viani, head of retail and private banking at Sanpaolo IMI. Last year they started profiling their 5.5m clients. Through an interview, investors state their investment objective and the risk they are willing to sustain. The relationship between risk and returns also implies a time horizon over which to monitor investments. “We have profiled 80 per cent of our private clients, around 70 per cent of affluent clients, and 30-40 per cent of family clients,” says Mr Viani.

The bank’s approach to financial planning includes seven risk-return profiles. For each of these profiles, Sanpaolo Asset Management designs and maintains a portfolio of asset allocation, which is the bank’s reference portfolio.

The Turin-based bank – Italy’s largest – is also moving towards open architecture. As recently agreed with Eurizon, the holding company for the asset management arm and its sister company AIP (Assicurazioni Internazionali di Previdenza), as well as Banca Fideuram, Sanpaolo IMI will have the possibility to distribute third-party funds up to 23 per cent of its assets under management over nine years, to be reached gradually. The bank has only distributed in-house funds to date through its branches. Mr Viani predicts

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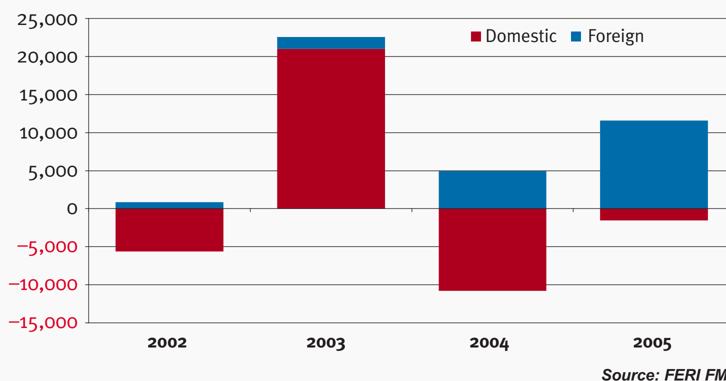
GIOVANNI VIANI, SANPAOLO IMI

that open architecture will start with a limited number of houses, which will be selected by the bank itself, probably with the help of an adviser. “An excessive number of external fund houses reduces the value of an open architecture offering, which lies in manager selection,” he says. This summer, Sanpaolo IMI will expand its multi-manager product range, which is today made of GPFs only, by offering a new multi-manager fund of funds, which will be managed by Sanpaolo AM. A new multi-manager insurance product managed by Sanpaolo Life Ireland has just been launched and will be included in the bank’s product offering too, reveals Mr Viani.

There is a current school of thought in the market that sees simplicity of the value proposition as a winning card.

Figure one: Foreign vs Domestic Sales in Italy 2002-2005 €m



Source: FERI FMI

“Eighty per cent of clients seek secure returns. On one hand they want to earn more than the government bonds, without incurring in higher risks. On the other hand they chase indexes that have gone up,” says Mr Viani.

To meet client demand, the Italian financial heavyweight has designed ABS Attivo and ABS Prudente, two Ucits III compliant flexible funds. The funds, which launched in October 2005 and started to sell in January, have gathered over €3.5bn. The funds are managed by employing an absolute return approach, which aims to generate government bond (BOT) returns +140 basis points and +60 basis points, on time horizons of 24 and 18 months, respectively.

Although to the more demanding investor this might seem like quite a modest target, Mr Viani says “clients like this sort of simple, clear message. We try to outperform government bonds, regardless of the market.”

Other fund houses have also joined the fray. Pioneer Investments has launched two absolute return funds, one more conservative and the other one more aggressive. “Total return products are one of the few areas of true innovation that we have seen in the last 20 years in the managed savings market,” says Mr Lombardo at Pioneer Investments, stating that the new Ucits III legislation, allowing a wider range of derivative instruments, has contributed to their popularity. But he also warns against the risks of managing these instruments.

“Derivatives are not something you can manage easily, you have to be equipped with appropriate technology structures and risk management procedures,” says Mr Lombardo. He explains that the derivatives they employ in their funds are used mainly to hedge away risk. “We are very careful not to use them as instruments of additional risk. We have this quite prudent approach.”

He explains that, having an alternative investment capability in-house (Pioneer Alternative Investments), they have been able to borrow so-called “risk budgeting” technology from the alternative world. “We have exported this technology into the long-only environment,” says Mr Lombardo. “We have not invented it, but the way of implementing it is completely proprietary. To do this, a significant investment in technology is necessary. This is why asset management companies have to have scale,” he says.