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Supporting an Effective Risk Culture in Private Banking/Wealth Management

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"Each customer is unique", starting from this perspective, the most recurring promise of the private banking/wealth management players becomes: "Each of our solutions is unique", which sounds good, but behind this promise there are a lot of risks. If everything is unique, then it is almost impossible and extremely expensive to keep the overall situation under control. While much less exciting, the most serious promise to the client should be: "We are able to keep your risks under control", and this promise becomes reliable, if the private bank/wealth management unit's risks are also under control.

That is why two of the biggest challenges in the private banking/wealth management area are related to the following:

1. How to combine risk management's need for standards and the private banking/wealth management promise of customization.

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2. How to comply with the rapidly evolving regulatory environment, which implies being able to invest in terms of risk culture, risk management and risk control, while maintaining an appropriate cost–income ratio. As a result of an increasingly prudential regulation, combined with the AML landscape, plus the input on product and customer suitability, the pressure on wealth managers is growing fast, as are IT and HR expenses.

In this chapter, our proposal is to adopt this double risk-based view, looking at the main trends in private banking/wealth management. In our view, the choice of business model is the strategic starting point, according to the ECB: "The key risk that stands out relates to banks' business models and profitability".

(ECB, Banking Supervision: SSM priorities 2016). In the following two paragraphs, first of all, the private banking/wealth management promise of customization is combined with the monitoring of risks, in a MiFID 2 perspective. Secondly, the private banking/wealth management business sustainability is placed under observation.

13.1 How to Combine Risk Management's Need for Standards and the Private Banking/Wealth Management Promise of Customization

In everyday language, the term "personalization" is frequently opposed to "standardization", adding a positive note to the former and a negative one to the latter. In reality, the identification of "standards" implies the existence of processes, in which quality parameters have been set and must be complied with and this is not a negative element. Higher levels of customization assume the impossibility to perform a series of checks. In the service delivery process, it is necessary to balance items that contain a strong "dose" of risk control, with the opportunity to build a unique and customized service for the client. This is not impossible, but the dichotomous view between standardized services and customized services must

be expanded, along with the acknowledgement that many different professional skills are involved, in providing the service, specifically in private banking/wealth management. Between the two extremes of "Pure Standardization" and "Pure Customization", there are at least three other strategies, with different customer and producer roles in the design, fabrication, assembly and distribution stages (Lampel and Mintzberg 1996).[1] What varies in the intermediate stages is the level of involvement of the customer and, consequently, the increasing difficulty of reviewing the final result on the part of the producer.

Rather than the creation of large-scale economies, linked to the production of a single product or service, typical of "Pure Standardization", in "Segmented Standardization", the producer makes a set of standard components, "available on the shelf", designed on the basis of needs, identified on different markets.

In "Customized Standardization", the customer is involved in the production phase of the service, participating in the assembly of a set of standard components.

In "Tailored Customization", the producer creates unique goods or services, based on a "prototype", proposed to the customer.

Finally, the "Pure Customization" is based on a partnership with the customer involved in the design phase of the product or service.

The quality control of the process has to be guaranteed to the client in each of the stages (in reality is a *continuum*), but the increasing difficulty of exercising control will have an influence on the price of the service provided.

Each operator, on the basis of their own market of reference, identifies the stage at which the exercise of quality control occurs at levels of adequate protection for the customer and, at the same time, of economic sustainability for the producer. On the other hand, the differentiation of the price for the customer should allow each customer to obtain the level of personalization/customization that he can support economically.

In this regard, in Europe, the MiFID framework emphasizes the centrality of the customer. The "*Know your customer*" principle is the categorical imperative, already affirmed by the MiFID 1 Directive and confirmed by the MiFID 2 Directive.[2]

Given the promise of customization in the field of private banking/wealth management, the operators cannot be positioned among low value-added services, for which the intermediary might exempt themselves from the client's suitability test. In line with the promise of personalization and the offer of high value-added services, the expectation of the private client is of maximum protection from the intermediary as requested in Article 25 *Assessment of suitability and appropriateness and reporting to clients* (2014/65/EU Directive).

In the configuration of the service, should be taken into account:

1. the nature of the services offered or provided to the client or potential client, with regard to the type, object, size and frequency of the transactions;
2. the nature of the products being offered or considered, including different types of financial instruments;
3. the retail or professional nature of the client or potential clients or (…) their classification as eligible counterparties.

1. First of all, the MiFID 2 framework requires the verification of the professional knowledge and experience of the investment firm, distinguishing between persons giving investment advice or giving information: "(1) *Member States shall require investment firms to ensure and demonstrate to competent authorities on request that natural persons giving investment advice or information about financial instruments, investment services or ancillary services to clients on behalf of the investment firm possess the necessary knowledge and competence to fulfil their obligations… Member States shall publish the criteria to be used for assessing such knowledge and competence*" (art. 25, 2014/65/EU Directive). Knowledge, competences and experience appropriate to the role were already the key characteristics required by MiFID 1. With respect to this regulatory framework, MiFID 2 provides for further evolution and imposes a change of pace. Article 25, in fact, requires that the European Securities and Markets Authority (ESMA) indicates guidelines capable of providing specific criteria for the investment company to assess the competences of its personnel that provide advisory services or provide information

to customers on behalf of the company on investment services and financial markets. Based on this request, and following its own policy, on 17 December 2015, ESMA approved the *Guidelines for the assessment of knowledge and competence*: *"The purpose of these guidelines is to specify the criteria for the assessment of knowledge and competence required under Article 25 of MiFID II, in accordance with Article 25 of the same Directive. ESMA expects these guidelines to promote greater convergence in the knowledge and competence of staff providing investment advice or information about financial instruments…. The level and intensity of knowledge and competence expected for those providing investment advice should be of a higher standard than those that only give information on investment products and services"*.[3] In this way is stronger the consequence that the risk culture must be "into the business" (Carretta 2016) inside a customer-oriented organization (Power et al. 2013).

Also with regard to the nature of the investment services offered, the investor protection standards are the highest in relation to investment advice and portfolio management services: "(2) *When providing investment advice or portfolio management the investment firm shall obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, that person's financial situation including his ability to bear losses, and his investment objectives including his risk tolerance so as to enable the investment firm to recommend to the client or potential client the investment services and financial instruments that are suitable for him and, in particular, are in accordance with his risk tolerance and ability to bear losses*" (art. 25, 2014/65/EU Directive). Without this kind of information, if the intermediary is not able to personalize the service and assess its suitability, it should refrain from providing it.

Providing low value-added investment services, the standard of conduct required becomes the *appropriateness*. Moreover, MiFID 2 underlines that: *"Information provided by investment firms to clients in relation to their execution policy often are generic and standard and do not allow clients to understand how an order will be executed and to verify firms' compliance with their obligation to execute orders on term most favourable to their clients. In order to enhance investor protection it is appropriate to specify the principles concerning the information given by investment firms to*

their clients on the execution policy and to require firms to make public, on an annual basis, for each class of financial instruments, the top five execution venues where they executed client orders in the preceding year and to take account of that information and information published by execution venues on execution quality in their policies on best execution" (2014/65/EU Directive).

2. Regarding the nature of the products being offered, the standpoint of MiFID 2 is highly innovative and emphasizes that the levels of protection in the "downstream" relationship with the customer are not sufficient. MiFID 2 imposes a prior "upstream" assessment, involving the top management and the control functions, in particular, the compliance function, which involves an activity of "product mapping", conducted by intermediaries, either producers or distributors, in order to evaluate the coherence between the product characteristics and the profile of the target.[4] The robust investor protection passes through the "*product governance*" regulations, which empower the role of top management and internal control systems, in the design phase of complex products and/or the decision to commercialize them. In the case of inadequate action on behalf of internal *product governance*, MiFID 2 strengthens the power of the ESMA and the national authorities, allowing them to intervene, following a "*product intervention*" *approach*.[5]

The change of the control framework leads to a reflection at the organizational level in the private banking/wealth management sector, driving providers to maintain high service standards, MiFID compliant, while maintaining the promise to customize the service offered to the client.

3. The modular nature of the investor protection concerns, not only, the nature of the service provided, but also the different types of target: *"One of the objectives of this Directive is to protect investors. Measures to protect investors should be adapted to the particularities of each category of investors (retail, professional and counterparties). However, in order to enhance the regulatory framework applicable to the provision of services irrespective of the categories of clients concerned, it is appropriate to make it clear that principles to act honestly, fairly and professionally and the obligation to be fair, clear and not misleading apply to the relationship with any clients"* (2014/65/EC Directive). Retail clients are entitled to receive the

highest level of protection required by regulations; only under certain subjective and objective customer conditions and only through a series of written communications, initiated by the customer on their own initiative, may private individual investors waive the protection provided for by the directive.[6] With regard to the characteristics of private banking/wealth management and the level of protection that the client expects in the relationship with the private bank or the financial advisory firm, this condition is totally anomalous, not so much in terms of the objective requirements, but in terms of (the presence of) subjective requirements (the client's knowledge, experience and competences).

Therefore, the standards of conduct of the intermediary are those required, when dealing with retail customers.

Underlying the promise of personalization and high quality, the implicit promise in private banking is keeping the risk for the customer under control; this is an ambitious goal, which is affordable if the client is fully aware of the risks involved. To achieve this condition, the private client requires the highest level of protection and transparency, which the law reserves to retail clients.

It is useful to note that the centrality of the principle of "*know your client*" and the recurring use of the term "standard" in the MiFID 2 directive (157 instances) are not conflicting, but rather complementary, because the latter is an assurance of quality, not only technical, referring to objective parameters, but also relational, referring to the characteristics of the client.

13.2 How to Comply with the Regulatory Framework Keeping the Cost–Income Ratio Under Control: A Magnificent Obsession

In connection with what has been presented in the previous paragraph, the promise of personalization in wealth management services must be compatible with strong risk control safeguards for the customer, a promise on which depends, not only the intermediary's ability to remain on the market, but also his reputation. The extensive personalization of the service, not allowing the "serial" control of risk, requires a dedicated

monitoring of risk, the cost of which is sustainable, only in the case of substantial projects. In industrial sectors, where risk perception on the part of end users is high, the absence of serial-based controls, would alarm the customer (for example, in the automotive industry, the lack of serial controls on the ABS system would put at risk the reputation first of all of the carmaker). In the same way, in the financial sector, the term "serial", associated with risk management on behalf of clients, should be attributed to the rigor and methodological robustness of the measurements was carried out. The uniqueness of the control process is justified, just in the case of projects, capable of supporting such a cost.

Having made these observations, regarding the range of services and their sustainable level of customization, it is understandable that competitors are heterogeneous in terms of size, vocation and positioning.

Among these, some competitors are performing in private banking/wealth management with an integrated and broad range of services; others may choose to cover a specific activity in the area of investment needs, for example, by concentrating their activities on portfolio management services, while others opt to conduct independent investment advisory. There are no compulsory choices.

With regard to investment services, from a strategic point of view, the MiFID framework, along with MiFID 2, permits a wide range of possibilities. For instance, looking at the high value-added services, investment advice and investment management, in both cases, the business model choice is not unique. Offering investment management services, the different strategic option could be to provide a variety of asset management solutions "in house" or the adoption of an open architecture model, partially or fully open, more or less "guided". Also offering investment advisory services, the variety of business models depends on that the intermediary may choose to offer independent advisory or non-independent advisory.

The implications, depending on the business model adopted, are in terms of the way the service is remunerated: the independent advisory service is incompatible with the perception of inducement, the remuneration for the intermediary must be entirely derived from the customer and the wide range of solutions, made available to customers.[7]

Furthermore, the choice of the degree of open architecture becomes a strategic decision, because opening the business structure entails the reduction of the margin and the increase of the assumption of operational risks.

It is increasingly apparent that there are multiple business models in the private banking/wealth management area: in recent years, "the industry has reinvented itself", in terms of the content of the services, the target audience and the professional roles involved, to the point of feeling the need to "change the lexicon", using the expression "wealth management", to emphasize the sector's transformation. A multitude of heterogeneous competitors face off against each other, with very different business models from each other.[8]

The uncertainty of the boundaries in private banking spreads and infects the lexicon: the amplitude of the sector leads to the term "wealth management", being used in some cases to emphasize the desire of the intermediary to manage the entire assets of the client, in others, to indicate the higher end of the private market or the methodology of overall financial planning, adopted to support the client's service.

Therefore, in its broadest sense, the activity of private banking/wealth management could include the provision, not only of investment services, but also of liability optimization, insurance and retirement planning, tax planning, estate planning and art advisory: in this way, the range of services can extend to cover any other type of service, capable of providing added value to the activity of the protection and transmission of family wealth (Musile Tanzi 2004; Evensky et al. 2011; Cassis and Cottrell 2015; Capgemini 2016).

The expansion of the range of services is encouraged by the possibility of using external solutions, in the search for "best-in-class" solutions for the customer. However, the outsourcing solution requires the internal availability of highly skilled individuals to select the best suppliers, to control them and to "package" the best proposals to customers. This promise is the basis of the open architecture models in private banking/wealth management. Using third-party suppliers implies greater attention to the operational risk profile, linked to organizational procedures, the adequacy of the information system and the behaviour of the

staff involved in such processes. The open architecture information flows and procedures involve a multiplicity of actors outside the company perimeter, thus increasing the complexity of governing them, as they are not directly under control. The price paid, not only in terms of reputation, by those in private banking, who "opened their architecture" to a supplier, such as Madoff, has been high. The recourse to this aspect was already explicitly contained in the first European MiFID Directive on investment services (MiFID 1).

Therefore, in the present scenario, innovation in private banking/wealth management is supported by a number of important contextual elements that, on the one hand, help to modify expectations towards the service among end customers and, on the other hand, change the game plan among operators in the sector, particularly at the European level.

- In terms of the macroeconomic scenario, low-interest rates, high market volatility and low growth are a combination that raises the level of uncertainty for investors, increasing the importance of the ability to control risk on behalf of customers, the most serious promise made by the private banking/wealth management industry. This scenario affects the expectations of end investors, as well as the margins for banks deriving from various business areas. As the Global Financial Stability Report underlines in April 2016: "*Difficulties in business model transitions and legal costs have led to extraordinarily weak earnings results at several large European banks, while market turbulence has also affected other revenue streams, especially trading revenues and even wealth management*" (IMF 2016).
- In terms of banking regulation and financial services, the vectors of change are sufficient to redesign the business models of the operators, in particular, the following:

    1. the implementation of the CRD IV Directive highlights the contribution in terms of stability and limited capital absorption by the private banking/wealth management sector, in comparison with others, but at the same time requires the raising of standards of governance, in prudential terms, for all operators in the sector: the control of risk by the intermediary becomes the crucial element upon which to build the strategy of the operators;

2. the implementation of the MiFID II Directive, from January 2018, obliges a review of the design of processes at the level of the distribution of investment services, requiring a rethink. As underlined in the previous paragraph, the raising of standards in processes, along with greater transparency in pricing, will require a careful assessment of the sustainability of some activities, in particular, investment advisory services, since higher levels of personalized service in all economic sectors correspond with higher levels of cost to the producer and a higher price for the final customer.

- The macro-trend of taxation and anti-money laundering regulation has increased the sensitivity of operators in the sector to avoid sanctions, the amount of which, in the case of niche players, could endanger their very existence.
- In terms of information technology, innovation is relentless and has become an integral component of the business model, in terms of impact on the range of services, distribution choices, IT risk and operational risk.

Faced with these regulatory and market drivers, the need to strengthen the internal control systems increases structural costs and also compliance costs, which in terms of the development of the sector, must be capable of being seen as investments. That could be possible only if the risk culture is in the company's DNA, but "*Board must understand the risk culture of their organization in conjunction with their business model and not take it for granted*" (Carretta and Bianchi 2016).

In this perspective, the most serious issue and consequence in this field is not related to the bank capitalization, but to the heavy cost structure: selecting a sample of 40 European specialized banks and investment companies, focused on private banking,[9] the cost–income ratio was on average almost 80% and at least 50% of them had a cost–income higher than 82% at the end of 2015 (see Table 13.1). As a result of this, the private banking/wealth management profitability is low.

Based on what has been observed, private banking/wealth management services can be seen as a knowledge-based business area, for which the incidence of staff remuneration policies on the cost structure of the

Table 13.1 European private banking specialized players: selected sample, Year 2015, ranking by net fees and commissions value

Bank name	Country	Return On Avg Equity (ROAE) %	Cost to income ratio %	Total capital ratio %	Tier 1 ratio %	Net fees and commissions mil EUR	A/B %	Net fees and commissions mil EUR A	Operating income mil EUR B
Fideuram-Intesa Sanpaolo Private Banking Spa	IT	38.48	36.80	16.70	16.70	1.135	86	1.135	1.326
Compagnie Odier SCA	CH	13.85	85.54	25.70	25.70	820	82	820	996
Banque Pictet & Cie SA	CH	6.76	85.14	16.10	20.70	736	78	736	940
Union Bancaire Privée - UBP	CH	1.33	92.08	24.40	24.30	466	67	466	694
HSBC Trinkaus & Burkhardt AG	DE	7.88	70.91	12.60	10.30	441	59	441	748
Edmond de Rothschild (Suisse) S.A	CH	4.39	88.33	31.10	n.a.	430	73	430	587
Bank J. Safra Sarasin AG	CH	6.95	73.30	n.a.	n.a.	427	59	427	718
BSI AG-BSI SA	CH	6.49	78.19	22.78	21.91	421	55	421	770
Rothschild et Compagnie Banque SCS	FR	45.44	62.58	12.58	n.a.	351	96	351	367

(continued)

Table 13.1 (continued)

Bank name	Country	Return On Avg Equity (ROAE) %	Cost to income ratio %	Total capital ratio %	Tier 1 ratio %	Net fees and commissions mil EUR	A/B %	Net fees and commissions mil EUR A	Operating income mil EUR B
EFG Bank European Financial Group SA	CH	4.21	90.33	17.40	n.a.	347	54	347	645
Mirabaud SCA	CH	12.89	88.22	21.06	21.06	210	78	210	270
Banque de Neuflize OBC	FR	6.47	74.53	n.a.	n.a.	179	51	179	350
Financière Syz & Co	CH	–13.12	119.85	14.90	14.90	147	86	147	172
BNP Paribas Wealth Management SA	FR	–51.66	111.29	n.a.	n.a.	117	48	117	244
Notenstein La Roche Privatbank AG	CH	18.03	82.08	19.00	19.00	112	71	112	159
Banque Privée 1818 SA	FR	6.69	90.61	n.a.	n.a.	108	86	108	126
Banque Transatlantique SA	FR	21.80	58.14	n.a.	n.a.	88	62	88	142

(continued)

Table 13.1 (continued)

Bank name	Country	Return On Avg Equity (ROAE) %	Cost to income ratio %	Total capital ratio %	Tier 1 ratio %	Net fees and commissions mil EUR	A/B %	Net fees and commissions mil EUR A	Operating income mil EUR B
Dreyfus Söhne & Cie. AG Banquiers-Les Fils Dreyfus & Cie. SA Banquiers	CH	5.76	58.36	33.34	33.34	86	73	86	119
EFG Bank AG	CH	–1.67	95.67	18.40	18.40	78	28	78	276
HSBC Private Bank (UK) Ltd	GB	5.78	59.27	36.13	35.57	73	21	73	338
PKB Privatbank AG	CH	4.39	82.31	18.97	18.97	70	65	70	107
Finanza e Futuro Banca SpA	IT	46.54	57.04	10.73	n.a.	68	100	68	68
Banca Esperia SpA	IT	3.58	87.05	12.60	12.50	65	79	65	83
Falcon Private Bank Ltd	CH	15.79	86.74	19.00	19.00	64	50	64	127
IWBank Private Investment SpA	IT	–3.68	97.96	21.37	19.40	61	59	61	103
Banca Leonardo Spa	IT	2.59	68.84	26.94	26.74	51	47	51	109
Merck Finck & Co Privatbankiers	DE	0.28	107.68	23.50	n.a.	49	81	49	60

(continued)

Table 13.1 (continued)

Bank name	Country	Return On Avg Equity (ROAE) %	Cost to income ratio %	Total capital ratio %	Tier 1 ratio %	Net fees and commissions mil EUR	A/B %	Net fees and commissions mil EUR A	Operating income mil EUR B
Barclays Bank (Suisse) SA	CH	12.31	86.96	15.40	13.10	48	29	48	163
Bank J. Van Breda en Co NV	BE	8.29	55.60	15.92	14.49	45	33	45	134
Bantleon Bank AG	CH	6.46	63.31	36.87	36.87	42	136	42	31
EFG Private Bank Limited	GB	12.78	75.53	24.50	n.a.	42	37	42	115
BBVA (Suiza) SA	CH	4.93	72.89	n.a.	54.44	36	68	36	53
Banca Patrimoni Sella & C. SpA	IT	12.46	72.32	15.83	15.80	31	59	31	53
Banca Popolare di Sondrio (Suisse)	CH	4.51	78.52	n.a.	n.a.	31	36	31	84
Banca del Sempione	CH	5.41	77.72	n.a.	n.a.	27	76	27	36
Schroder & Co Bank AG	CH	11.16	90.50	25.40	25.40	26	39	26	67
Maerki Baumann & Co. AG	CH	1.71	97.21	17.00	17.00	26	78	26	33
Saxo Privatbank A/S	DK	9.72	69.84	14.30	n.a.	25	62	25	41

(continued)

Table 13.1 (continued)

Bank name	**Country**	**Return On Avg Equity (ROAE) %**	**Cost to income ratio %**	**Total capital ratio %**	**Tier 1 ratio %**	**Net fees and commissions mil EUR**	**A/B %**	**Net fees and commissions mil EUR A**	**Operating income mil EUR B**
Semper Constantia Privatbank AG	AT	6.11	86.90	22.69	20.21	25	70	25	35
Bank CIC (Schweiz) AG-Bank CIC (Switzerland) Ltd	CH	2.81	82.16	n.a.	n.a.	22	21%	22	105
Average		7.87	79.96	20.75	22.23				
Median		6.47	82.12	19.00	19.40				
Standard Deviation		15.06	16.44	6.88	9.56				

Source Bankscope

company, which provides the services, is relevant. Furthermore, the private banking/wealth management business models are supported by complex ICT systems, in order to keep under control risks on behalf of clients and own risk (Janssen and Kramer 2015) and to comply with the internal and external, multiple authority-based regulations (Carretta et al. 2015).

Without a strong risk culture set by the Board, it is a kind of "*Mission Impossible*".

For this reason, the biggest worldwide wealth management global player, UBS Group AG in its Annual Report 2016 affirms: *"A strong and dynamic risk culture is a prerequisite for success in today's highly complex operating environment. We are focused on fostering and further strengthening our culture as a source of sustainable competitive advantage. By placing prudent and disciplined risk-taking at the center of every decision, we want to achieve our goals of delivering unrivaled client satisfaction, creating long-term value for stakeholders…*

Our risk appetite framework combines all the important elements of our risk culture, expressed in our Pillars, Principles and Behaviors, our Risk Management and Control Principles, our Code of Conduct and Ethics, and our Total Reward Principles. Together, these aim to align the decisions we make with the Group's strategy, principles and risk appetite. They help provide a solid foundation for promoting risk awareness, leading to appropriate risk taking and the establishment of robust risk management and control processes" (UBS Group AG 2016a).

Already in its Compensation Report 2015, UBS underlined: *"We strengthened our emphasis on values to support cultural change within the firm. Therefore, we not only take into account <u>what</u> was achieved, but also <u>how</u> the objectives were achieved*" (UBS Group AG 2015b).

13.3 Conclusions

The private banking/wealth management sector shows a lot of promises to its customers. The most serious promise is the ability to control risk on behalf of clients. This promise is unreliable, if the ability to keep its own risks under control, is not manifested by the private bank/wealth manager.

As argued in this chapter, the "*know your client*" principle and the "standard" requirements requested by the MiFID framework are not conflicting, but complementary and the second ones are a kind of assurance from the client point of view. A strong risk culture requests standard process that is fully compatible with a client-oriented organization.

The rapidly evolving regulatory environment implies for the wealth manager being able to invest in terms of risk management and risk control. The challenge is also how to keep under control the structure of cost–income ratio. In the recent years, the business for some wealth managers was close to the limit. In the current scenario, the income side is quite uncertain, with the only certainty of costs. This is why it is so important that the risk culture becomes effective and able to push all the organization to become more risk aware, without losing entrepreneurial spirit. The increasingly prudential regulation, the AML conduct regulation, the regulatory inputs on product and customer suitability put pressure on wealth managers' IT and HR expenses, as in each organization the individual accountability consists in transforming costs in incomes and "starting at the Top" (BIS 2005), to ensure a strong risk culture by the Boards.

Notes

1. "*Although pure aggregation and pure individualization are perceived as opposing logics, this influence has not led to the emergence of two distinct groups of strategies. Instead, we find a continuum of strategies, depending on which functions lean to standardization and which to customization… But the best solution is not necessarily a compromise. In just the operating processes, some firms tilt one way or the other because of the needs of the customers they choose to serve, while others favor intermediate positions. The latter reflect an organization's ability to customize partway back in its value chain, while retaining standardization for the rest. Since the cost of customization tends to increase in proportion to the number of product changes, it makes sense to customize the downstream functions first*" (Lampel and Mintzberg 1996).
2. The MiFID 1 framework (Markets in Financial Instruments Directive 2004/39/EU and 2006/73/EU) was revised in the light of regulatory

limitations identified following the financial crisis of 2008, when the European Commission approved the MiFID Review, or MiFID 2, also known as Directive (2014)/65/UE of the European Parliament and the Council of 15 May 2014 on markets in financial instruments. This amends Directive (2002)/92/EC and Directive (2011)/61/UE and the associated Regulation (UE) N. 600/2014 of the European Parliament and the Council of 15 May 2014 on markets in financial instruments and amends Regulation (UE) n. 648/2012. MiFID 2 comes into force on 3 January 2018.

3. Cfr. ESMA; Final report, *Guidelines for the assessment of knowledge and competence*", December 2015.
4. *"2. When providing investment advice or portfolio management the investment firm shall obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, that person's financial situation including his ability to bear losses, and his investment objectives including his risk tolerance so as to enable the investment firm to recommend to the client or potential client the investment services and financial instruments that are suitable for him and, in particular, are in accordance with his risk tolerance and ability to bear losses. 3. Member States shall ensure that where an investment firm provides investment advice recommending a package of services or products bundled (…) the overall bundled package is suitable. Member States shall ensure that investment firms (…) ask the client or potential client to provide information regarding that person's knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the investment firm to assess whether the investment service or product envisaged is appropriate for the client. Where a bundle of services or products is envisaged (…), the assessment shall consider whether the overall bundled package is appropriate. Where the investment firm considers, on the basis of the information received under the first subparagraph, that the product or service is not appropriate to the client or potential client, the investment firm shall warn the client or potential client. That warning may be provided in a standardised format. Where clients or potential clients do not provide the information referred to under the first subparagraph, or where they provide insufficient information regarding their knowledge and experience, the investment firm shall warn them that the investment firm is not in a position to determine whether the service or product envisaged is appropriate for them. That warning may be provided in a standardised format"* (2014/65/EC Directive).

5. ESMA had already published a survey in early 2013 on the subject of "*Retailization in EU*", warning against the fact that retail investors have neither the skills nor the experience to evaluate products that present a highly complex profile, and therefore run the risk of incurring unexpected losses. Faced with this situation, ESMA published an Opinion in February 2014 on the subject of "*MiFID practices for firms selling complex products*", underlining the fact that the design process should be demand-driven and not determined by the needs of the intermediary, and in March 2014 published a document focusing on *good practices* that intermediaries are called to follow when they produce and/or distribute structured products.
6. Annex 2 of 2014/65/EC Directive confirms the taxonomy already established by MiFID 1, and stipulates that *"Clients who may be treated as professionals on request": "… Investment firms shall therefore be allowed to treat any of those clients as professionals provided the relevant criteria and procedure mentioned below are fulfilled. Those clients shall not, however, be presumed to possess market knowledge and experience comparable to that of the categories listed in Section I.*

   Any such waiver of the protection afforded by the standard conduct of business regime shall be considered to be valid only if an adequate assessment of the expertise, experience and knowledge of the client, undertaken by the investment firm, gives reasonable assurance, in light of the nature of the transactions or services envisaged, that the client is capable of making investment decisions and understanding the risks involved. The fitness test applied to managers and directors of entities licensed under Directives in the financial field could be regarded as an example of the assessment of expertise and knowledge.

   In the case of small entities, the person subject to that assessment shall be the person authorised to carry out transactions on behalf of the entity.

   In the course of that assessment, as a minimum, two of the following criteria shall be satisfied:—

   the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters,—

   the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments exceeds EUR 500 000,—

the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.

Member States may adopt specific criteria for the assessment of the expertise and knowledge of municipalities and local public authorities requesting to be treated as professional clients. Those criteria can be alternative or additional to those listed in the fifth paragraph."

7. In UK, the Retail Distribution Review forced the adoption of clear business model, posing high standard for the independent financial advice, but *"One of the results of the RDR is that it has created an 'advice gap' for customers who are seeking to make investments but do not have access to advice for a variety of reasons such as cost, trust and knowledge. This issue has become so widely reported that the Government has announced the Financial Advice Market Review which will examine how financial advice, considered in its broadest sense, could work better for consumers",* Brewin Dolphin Annual Report 2015, see also Ring (2016).
   For a literature review on "Business model", see Zott et al. (2010).
8. For a literature review on "Business model", see Zott et al. (2010).
9. The sample has been selected, using the Bankscope database.

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