



**ZURICH** — As the credit crisis drags on, not even the world's millionaire investors are immune from its effects, and the private banks that manage their money could be the next to feel the pain.

Rich investors are reducing leverage on their portfolios, depriving wealth managers of a lucrative income stream just as difficult financial markets cast a shadow over their results.

As the credit crisis eats away the value of their assets, millionaires are paying back cash they borrowed for investment purposes to reduce risk, private bankers say. "We've seen leverage vanish completely almost overnight from the beginning of November," said Nicolas Sarkis of Alphaone Partners.

The crisis has so far had little effect on the wealth management industry, which manages an estimated \$37.2 trillion in assets worldwide and which ranges from small firms to the private banking divisions of large wealth managers like UBS, Credit Suisse and Citigroup. UBS is among the most dependent of large banks on wealth management earnings, which accounted for roughly a third of its operating income in 2006.

Clients at Alphaone, based in London, previously borrowed money worth about 25 percent of their portfolio, typically putting the money into assets like hedge funds. But that number has gone down to zero, Sarkis said. "I think this is due to risk aversion spiking up and people paying off debts," he said.

Speaking on the condition of anonymity, a banker at a large wealth manager said he had seen loans' being reduced, a sign that the reduction in leveraging may be widespread.

The wealth managers' loss of income from loans would come just as stock markets enter a period of volatility. This could hurt their earnings, which depend largely on asset prices.

Leverage provides a double income stream for private banks. They charge a margin on the loan to clients, who typically reinvest the cash in products provided by the bank, again paying fees.

Wealth managers do not normally disclose how much clients leverage. Credit Suisse, Deutsche Bank, Julius Baer, HSBC and UBS all declined to comment on where leverage was heading in choppy markets.

Analysts' estimates of client leverage rank from single-digit levels to 50 percent or more, with clients in Asia generally known to be more willing to borrowing against their portfolio than those in Europe. "There are private banks where collateralized loans are a standard product to boost performance," said Bernard Coucke, who heads ING's private bank in Europe. "If a client is invested in leveraged products on top of that, he's seriously geared and I can well imagine that he will want to reduce leverage in turbulent times."

ING clients typically leverage about 20 percent of their portfolio, Coucke said. The bank has not seen that number go down, but that is probably just because leverage at that level is still "relatively conservative," he said. For some banks, reduced leveraging can show up on their financial accounts as money flows out. This happens when a bank adds the loan book to its assets under management, so money flows out once clients start paying back debt. The Swiss private bank EFG is an example of a bank that does this and UBS said in a research note that it was worried about EFG's weak third-quarter client money inflows, a closely watched determinant of future income. "We think this could be partly due to clients' deleveraging in a more difficult market environment," UBS said. "We think this trend will have persisted at least in the fourth quarter of 2007 or even well into 2008." A 10 percent reduction of loans in one quarter would almost halve money inflows at EFG, UBS estimated, causing outflows of around 800 million Swiss francs, or \$717.5 million. EFG said it added the loan book to client assets to more adequately represent the size of its business, and that leverage among its private banking clients was "fairly moderate." Leverage might also bring some unpleasant surprises for banking clients, said Coucke of ING. "There's a good number of private banking clients who are in a situation where they will either have to reduce market exposure, or bring down their loan volume," Coucke said. Investors might have received loans on the basis of a portfolio including leveraged products that have now lost much of their value, reducing not only the clients' money in the bank, but also their borrowing capacity, he said.

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