

OLIVER WYMAN

Financial Services



## The Future of Private Banking: A Wealth of Opportunity?



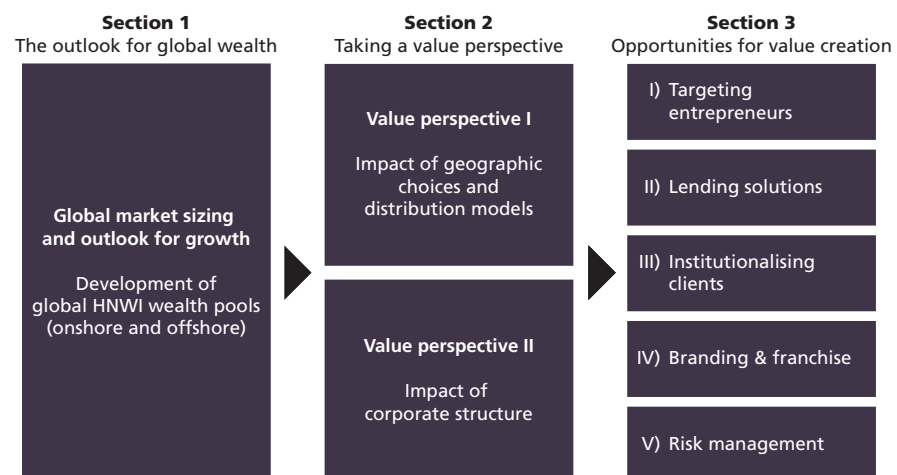
MARSH MERCER KROLL  
GUY CARPENTER OLIVER WYMAN

“Wealth unused  
may as well not exist”

## Executive summary

Fuelled by a bull run in stock markets and unprecedented wealth creation, the global Private Banking<sup>1</sup> industry has seen exceptional growth over the past five years. Throughout this period, Wealth Managers quite rightly have focused largely on expansion. The combination of increasing competition and more difficult market conditions, however, has marked the beginning of a more challenging era. For well-differentiated and increasingly global players, the changing environment will provide new opportunities to build a distinctive brand.

This report looks both at the strategic drivers of value in the industry and at the levers that Private Banks can pull to improve value creation in their businesses.



**Section 1** sets out our view on global wealth pools. We estimate High Net Worth Individual (HNWI) wealth to have reached some US\$50 TN in 2007, and expect it to rise to US\$75 TN by 2012<sup>2</sup>. This implies a slowdown in Compounded Annual Growth Rates (CAGRs) from 11% p.a. (2003-2007) to 9% p.a. (2008-2012). We expect growth rates to vary significantly by region, with the Middle East and Asia Pacific (except Japan) leading the pack. Offshore assets accounted for US\$8.0 TN, or 16% of total global HNWI wealth in 2007. Whilst we see a trend towards HNWIs keeping a larger portion of their assets onshore, we

<sup>1</sup> "Private Banking" is used interchangeably with the term "Wealth Management" in this report; it denominates the servicing of High Net Worth Individuals

<sup>2</sup> All HNWI wealth pool sizes and growth rates in this document, both historical and forward looking, were calculated using 2007 US\$ exchange rates

also see tax-transparent offshore offerings gaining momentum in light of increased cross-border cooperation on taxation. This new offshore model differs fundamentally from the old offshore offering and – with respect to client interaction – shares many similarities with onshore banking. Onshoring itself has been at the top of many Wealth Managers' agendas. Making a profitable onshore play involves a plethora of decisions, among them appropriate timing of market entry, the right business model, the operations strategy and the need for local partners.

Whilst growth of HNWI asset pools will slow down somewhat, Assets under Management (AuM) growth and industry economics will remain attractive. The industry will continue to benefit from the fact that there is significant untapped market potential: since the global percentage of wealth which is professionally managed or advised remains relatively low at around 50% of total HNWI assets. As a result, worldwide interest in Wealth Management will continue to raise levels of global competition and trigger a further influx of new players. This may leave the average player with a smaller market share, as competition for clients and scarce Relationship Managers (RMs) create a tougher environment. The Private Banking market remains highly attractive; but as competition intensifies, winning and extending a profitable position requires an in-depth understanding of the economics and a strategic approach.

**Section 2** deals with the implications of an increasingly competitive market. As the going gets tougher, some strategic decisions that have been unquestioned thus far will come under increasing scrutiny – decisions relating to banks' geographic footprint, the choice of distribution model and the choice of corporate structure:

- First, we show two ways in which choice of geography impacts Wealth Managers' potential for value creation. Accessibility of regional asset pools is one of the key strategic issues facing management, as accessible pool sizes generally tend to be overestimated – in the past, this was the case in Japan. Another key factor influencing the potential for turning accessible asset pools into shareholder value is the distribution model that is dominant in the region. Our analysis shows, for example, that the value of an average European onshore client (where the Advisory Model dominates) is some three to four times that of a US Broker/Dealer client. These discrepancies are due to differences in major value drivers, such as the share of revenue pocketed by the RM. As some of these drivers cannot easily be manipulated, Wealth Managers must have a clear view of both the status quo of the local distribution landscape and the anticipated shifts before entering a

new market. We expect long-term industry evolution towards the provision of independent and holistic advice characterising the Advisory Model. However, players betting on fast change will likely be disappointed.

- Second, we take a look at the value implications of corporate structures. We estimate the magnitude of synergies created between Wealth Management divisions and other Business Units (BUs), notably Investment Banking. We emphasise that in banks operating joint Wealth Management and Investment Banking divisions, synergies come at the cost of exposing the Private Bank to significant reputational risk and knock-on effects to the Wealth Management franchise. Overall, there is no clear evidence that the market deems integrated Private Banking Models superior to Pure Plays.

We conclude that Private Banks can extract synergies from an Investment Banking division but need to restrict potentially harmful activities, such as proprietary trading and leveraged finance, in order to safeguard against reputational spill-over effects. Moreover, incentive and coordination mechanisms must be improved to facilitate cooperation and synergy extraction between BUs. The latter is true not only for firms operating joint Investment and Private Banks, but also for Universal Banks aiming to leverage their – often significant – retail branch networks for generating Private Banking referrals.

**Section 3** explores how Wealth Managers can deepen their client relationships in order to capitalise on the wealth opportunity whilst facing off against an increasingly competitive market. We have identified a number of opportunities to capture the potential created by today's – and tomorrow's – market dynamics:

- **Segmentation** – Entrepreneurs constitute a significant and growing share of today's wealth market. Wealth Managers used to servicing “old money” will have to adjust their offering to tap this market, thinking in new ways about 1) tailoring segment service; 2) improving cooperation amongst BUs; 3) building relationships at an early stage; and 4) modifying the coverage model.
- **Product strategies** – Clients are increasingly demanding a comprehensive offering, covering both the asset and liability sides of their “balance sheets”. In this context, lending presents a vital opportunity, as it can increase Client Value by up to 30% through additional revenues and improved retention. However, it also adds complexity to the business and requires migration to more sophisticated risk management frameworks.

- Relationship management – Institutionalising the client relationship – tying clients to the bank rather than to RMs – has a significant impact on profitability. If institutionalisation in the Advisory Model were as low as it is for the Broker/Dealer Model, Client Lifetime Value would decrease by up to 40%. In light of market trends challenging historic institutionalisation, Wealth Managers should leverage coverage models, products, compensation structures and systematic retention management to create and secure institutionalisation.
- Brand – Private Banks operate in the luxury business as much as in the banking business. As a result, brand is instrumental in attracting and retaining the “right” clients. Wealth Managers first need to design a suitable message to be conveyed via brand imagery. The greater ongoing challenge is to ensure consistency between the promise given by their brand and the services delivered at all client touchpoints. Since a significant part of a Private Bank’s franchise value is locked up in its brand, the management of reputational risks is a key component of value management.
- Earnings and business risk management – Risk nowadays is taking a more prominent position in the minds of Wealth Managers. Rather than relying solely on conventional concepts of risk based on solvency and liquidity, best practice risk management for Wealth Managers must consider non-financial risk as well as P&L earnings risk management. For non-financial risks, emphasis should be placed on specific operational and reputational risks. For financial risks, earnings volatility modelling should lay the foundation for an improved understanding of the levers available to control risk-return.





## Key terminology used in this report

Since some of the key terms used in this report are understood in different ways in different regions, we have set out our definitions below:

**Advisory Model** – Wealth Management model that is characterised by a focus on the provision of holistic advice and financial planning, as well as discretionary or advisory portfolio management to individuals and families; typical of both offshore Private Banking and many European onshore markets (e.g. Germany, France, Italy, Switzerland)

**Broker/Dealer Model** – Wealth Management model in which players primarily trade securities for customers and for their own accounts. This style is characterised by a strong focus on transactions and frequent client contacts; typical of a significant part of the US private client business

**HNWIs** – High Net Worth Individuals (individuals with investable assets of US\$1 MM+)

**Private Banking (PB)** – Used interchangeably with the term “Wealth Management” in this report; denominates the servicing of High Net Worth Individuals and is not synonymous with the servicing of “Private Clients”, a term that is commonly used in the US to mean the servicing of clients with more than US\$150-200 K in investable assets

**UHNWIs** – Ultra High Net Worth Individuals (individuals with investable assets of US\$30 MM+)

**Wealth** – Refers to wealth pools; wealth pools are defined as financial assets of High Net Worth Individuals, excluding pension assets

**Wealth Management (WM)** – Used interchangeably with the term “Private Banking” in this report

# Contents

<b>1</b>	<b>The outlook for global wealth</b>	<b>9</b>
1.1	Steady growth, but search for sweet spots	9
1.2	Whither offshore?	10
1.3	Going onshore	12
<b>2</b>	<b>Size isn't everything – Taking a value perspective</b>	<b>15</b>
2.1	How accessible is the wealth?	15
2.2	Distribution rules	16
2.3	Corporate structures – Will break-ups create value?	24
<b>3</b>	<b>Opportunities for value creation</b>	<b>33</b>
3.1	Creating value in segmentation – Capturing entrepreneurs	33
3.2	Creating value through products – Lending	38
3.3	Creating value through client retention – Institutionalising client relationships	42
3.4	Creating value by branding – Differentiating and driving revenues	46
3.5	Creating value via risk management – Taking a seat at the decision-making table	50
<b>4</b>	<b>Your next steps?</b>	<b>55</b>
	<b>Terminology used in this report</b>	<b>57</b>
	<b>Appendix on market sizing methodology</b>	<b>59</b>



## The outlook for global wealth

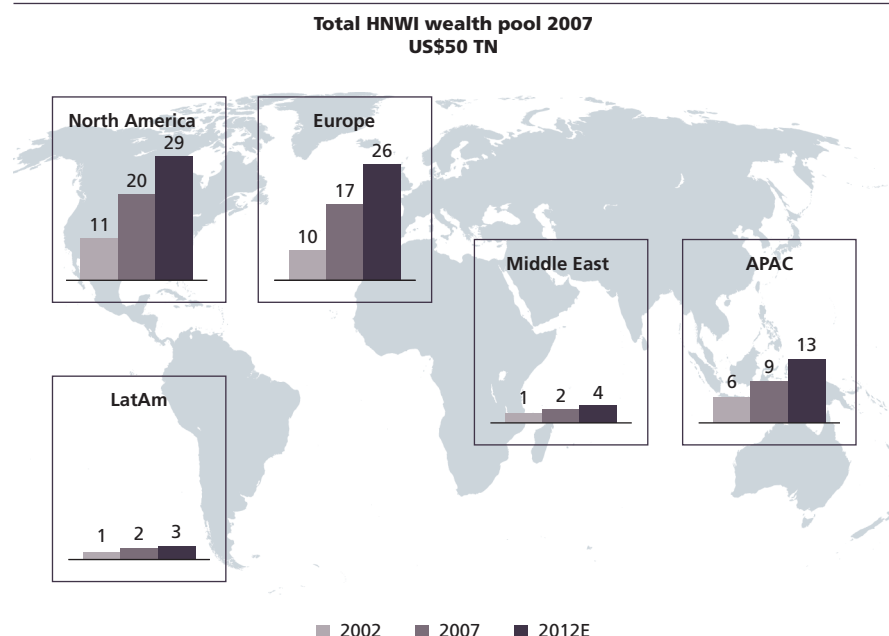
The global Private Banking industry can look back on five very prosperous years, having capitalised on both unprecedented growth in Assets under Management (AuM) and favourable business economics, such as stable revenue streams and low capital requirements. Despite the recent market turmoil, we believe that wealth pools will continue to expand across all regions, particularly in new markets such as Asia Pacific (APAC), the Middle East, and Latin America (LatAm). That said, the exceptional growth experienced during the past five years is not sustainable.

*Growth in global HNWI wealth is likely to moderate from 11% to 9% CAGR from 2008 to 2012*

### 1.1 Steady growth, but search for sweet spots

With more people becoming wealthy and wealth concentration increasing, the Private Banking industry has been soaring. The potential pool of investable HNWI assets grew by 11% annually over the past five years, reaching US\$50 TN in 2007 globally, as displayed in Exhibit 1. Given the underlying market dynamics, we expect growth to moderate over the next five years, with global wealth pools reaching US\$75 TN in 2012. This implies a CAGR of 9%.

**Exhibit 1: Global HNWI wealth pools, including onshore and offshore assets (2002-2012E, US\$TN using fixed 2007 exchange rates)**



Note: Wealth pools are defined as financial assets of HNWIs, excluding occupational pension assets  
Sources: OECD, IMF, UNECE, WFE, national banks and stock exchanges, Oliver Wyman Wealth Model

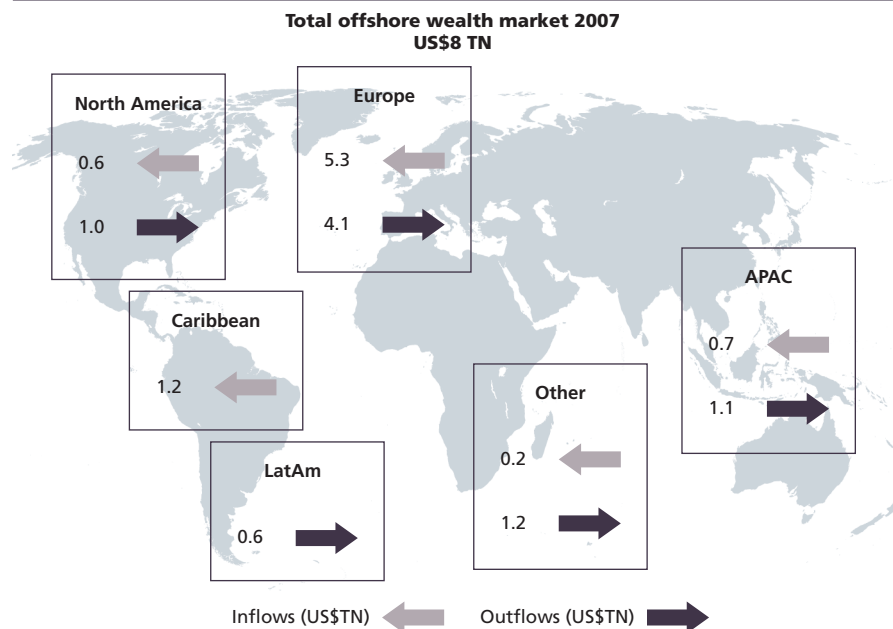
However, increases in AuM levels will be unevenly distributed. The pace of growth will remain high in APAC and the Middle East at 9% and 12% p.a., respectively, whilst the US is likely to experience a slowdown to 8% CAGR.

## 1.2 Whither offshore?

*Global offshore assets account for some 16% of total (U)HNWI wealth*

Offshore assets – including tax-transparent offshore – accounted for US\$8 TN in 2007, or 16% of total global HNWI wealth<sup>3</sup> (see Exhibits 2 and 3). Europe, led by Switzerland and the Channel Islands, remains the most significant destination for non-resident assets, followed by the Caribbean, particularly the Cayman Islands and the Bahamas. Although the Asian financial centres of Singapore and Hong Kong have been growing fast, they rank only third in terms of offshore assets, marginally ahead of the US.

**Exhibit 2: Global offshore assets by source and booking location (2007, US\$TN using fixed 2007 exchange rates)**



Sources: SNB, Swiss Bankers Association, Oliver Wyman Wealth Model

Offshore flows historically have been driven by demand for privacy and discretion, financial stability, favourable legal and tax systems, as well as professional servicing – with different regions offering their own distinct advantages.

<sup>3</sup> Estimates for offshore pools, such as for the US, are based on statistical extrapolation supported by a variety of both publicly available data points and figures derived from Oliver Wyman's project experience

*Onshore Wealth Management services remain a key priority for many Private Banks...*

Whilst offshore service will remain relevant so long as international capital flows remain substantial, we are seeing a trend towards HNWIs keeping their assets onshore. One reason is increasing sophistication of emerging wealth markets and the availability of local investment opportunities, particularly the booming domestic equity markets.

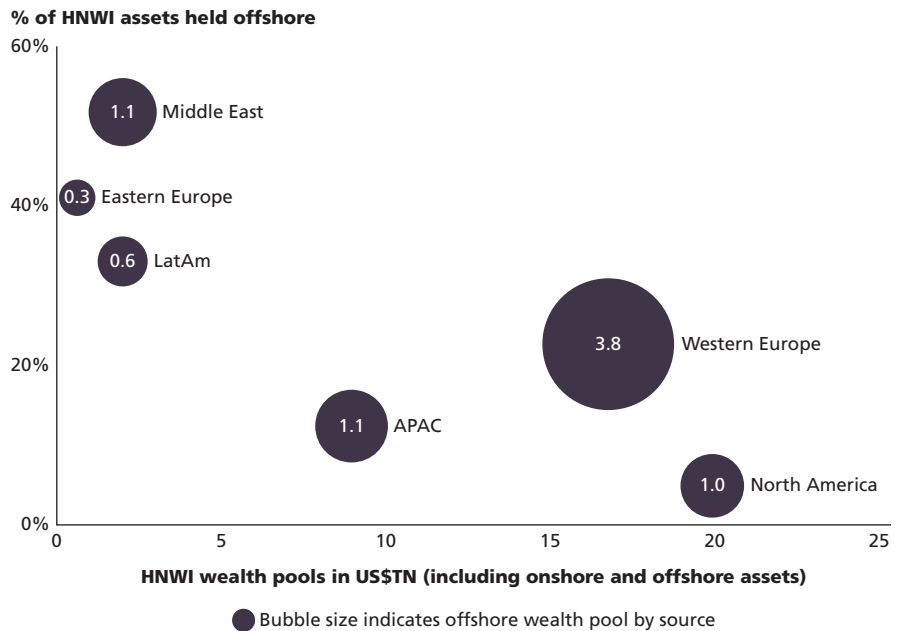
Another reason is rising regulatory pressure, due to the increased focus on transparency, as well as anti-money-laundering and counter-terrorism financing concerns. In addition, increased cross-border cooperation on taxation is contributing to a repatriation of offshore funds, particularly in Europe. For example, recent events around assets placed with Wealth Managers in Liechtenstein attest to the authorities' increasingly tough stance on tax evasion. This trend is likely to extend to other European offshore centres in the future, notably to Switzerland, Luxembourg and the Channel Islands. In the meantime, non-resident assets are still pouring into Asian financial centres, and we expect that offshore flows into Singapore and Hong Kong will retain momentum so long as these locations remain competitive relative to other offshore booking locations. Tax authorities and regulators need to consider that competition among offshore centres is ultimately global, and so they must be careful not to drive away assets from more transparent offshore centres to less transparent ones.

In nearly all geographies, regulators could actively speed up the trend towards onshoring by providing a more "Wealth Management-friendly" business environment, rather than imposing penalties on global capital transactions. Today, local regulation in numerous markets still presents barriers to Wealth Management services, such as provisions regarding the offering of investment advice by banks in Turkey, limitations on alternative investments in Germany or restrictions on investment in equities in China.

*...and in light of regulatory pressures, major international offshore centres will be forced to rethink their raison d'être*

In any case, the traditional competitive advantages of offshore centres are steadily eroding, particularly in more economically developed parts of the world. Consequently, we see the *raison d'être* of offshore increasingly shifting towards the provision of tax-transparent services and expertise through an advantageous concentration of skill and talent, which in many ways resembles the onshore model. In order to succeed, offshore centres will need to reinvent themselves and leverage competitive advantages, such as political and economic stability, excellent infrastructure, quality of life, as well as favourable and effective legal and regulatory environments.

**Exhibit 3: Offshore assets relative to HNWI wealth, by source (2007, % and US\$TN using fixed 2007 exchange rates)**



Sources: SNB, Swiss Bankers Association, OECD, IMF, UNECE, WFE, national banks and stock exchanges, Oliver Wyman Wealth Model

### 1.3 Going onshore

Onshoring – by which we mean accessing emerging wealth markets through local operations – in markets that have traditionally been served offshore is rising to the top of many Wealth Management executives’ agendas. Yet making a profitable onshore play involves difficult choices with respect to appropriate timing (first or second wave of entrants), the right business model and the need for a local partner. Across many markets, onshore Wealth Management is constrained by talent shortage and national regulations, and still has a rather “affluent touch” to it when compared with offshore Private Banking. This is particularly the case for many Asian as well as some European markets. To succeed in the HNWI sphere, Wealth Managers therefore will need to pay close attention to managing the transition – developing both the right Private Banking capabilities and an attractive value proposition for that market.

*Onshore expansion adds to the complexity of a Private Bank’s operations and technology platform, and requires meticulous planning*

Furthermore, Wealth Managers will have to manage operations and technology implications effectively when going onshore. Running a multitude of local operating models is potentially very costly and can be an impediment to scaling capabilities across markets. We suggest a staged approach, ramping up common systems early (such as vanilla

transaction support), and later adding customised solutions (such as special reporting and tax accounting). Customised services can be on local platforms if there is sufficient variation to justify this.

### Food for thought

- How reliant are we on offshore-based business? Should we rethink our offering in light of rising regulatory pressure and increased cross-border cooperation on taxation?
- How do we manage the risks stemming from our offshore business, such as potential breaches of confidentiality?
- What is the right time to enter emerging Private Banking markets? Do we have a thorough understanding of local market dynamics and client needs?
- What is the right entry strategy: organic expansion or acquisition?
- Do we have an overarching IT strategy to prevent a multitude of local operating models and island solutions?

## Size isn't everything – Taking a value perspective

*A considerable portion of global HNWI wealth is not available for management by Private Banks due to...*

Asset pool sizes and regional growth rates are only part of the story. Ultimately, what really matters is the ability to access those pools and extract sufficient value. To this end, having the right distribution model – and optimising it – is paramount.

### 2.1 How accessible is the wealth?

In most parts of the world, only a fraction of the estimated total HNWI asset pool is effectively available for management. How big that fraction is varies by region. Factors that impact availability include:

*...illiquid asset positions...*

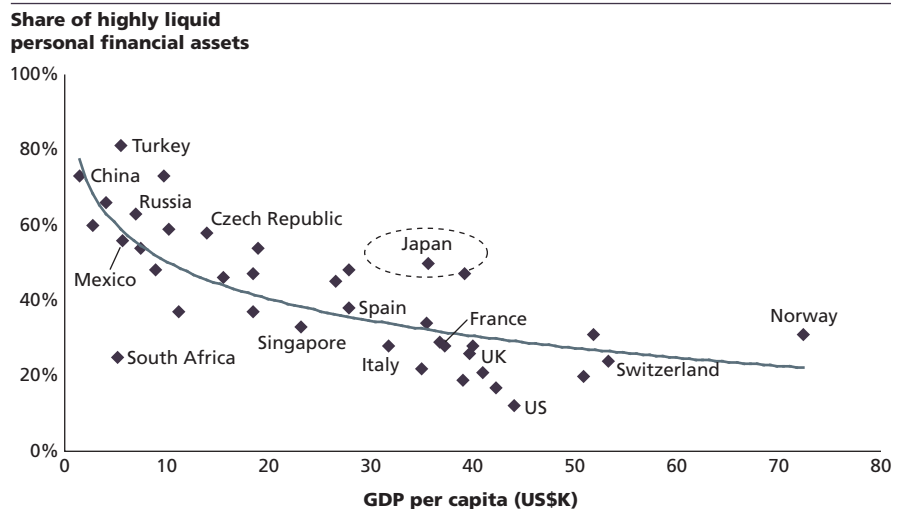
- Investable share of HNWI assets – Whilst common market size estimates are based on financial assets, a portion of these is locked up in Private Equity investments, concentrated stock positions or investors' own businesses – and is therefore unavailable for management by Private Banks. This is especially true in the Ultra High Net Worth (UHNW) space.

*...cultural preferences...*

The propensity of HNWIs to make use of Wealth Management services – Wealthy individuals' willingness to entrust external parties with the management of their money is partly dependent on factors such as culture, trust and financial literacy, and consequently varies from region to region. We find that, on average, the inclination to make use of Wealth Management services tends to be higher amongst investors in more developed regions and correlates positively with the degree of investors' financial sophistication.

Sometimes, however, cultural factors work against Wealth Management services even in highly developed economies. Japan is a prime example: Thus far, Japan has proved resistant to Wealth Managers' efforts to capitalise on the world's second-largest pool of HNWI assets. Exhibit 4 depicts Japanese investors' preference for holding unusually large portions of their wealth in cash and savings accounts. This propensity has likely been exacerbated by the post-1989-bubble drop in equity indices and real estate values, and the ensuing low growth environment, with negative real interest rates.

**Exhibit 4: Share of personal financial assets held in cash, deposits and savings accounts (2006, %)**



Sources: IMF World Economic Outlook Database, OECD

*...and the scarcity of talented Wealth Management staff*

- Wealth Managers' access to sufficient distribution capacity – The scarcity of skilled RMs is a challenge in many parts of the world, notably in Asia and the Middle East, but also in certain European onshore markets, such as Germany. Asia, in particular, where strong economic growth has caused demand for skilled workers to outpace supply, is suffering from a general skills shortage affecting not only the financial services industry, but also the broader economy. This phenomenon is particularly acute for the middle and senior management layer – and senior management access for clients is critical for success in Asia. We expect that it will curb attainable Wealth Management growth rates for the region in the short to medium term.

In an attempt to build a skilled force of RMs, some Wealth Management players have responded by setting up training facilities in the region. Creating a skilled RM, however, is as much about providing experience, preferably a minimum of three to four years, as it is about education. As a consequence, we believe the fight for talent in this region will continue to drive high compensation ratios and high RM turnover for years to come, thereby restricting the creation of shareholder value.

## 2.2 Distribution rules

*The economic attractiveness of different geographies is heavily impacted by the type of Wealth Management distribution model dominant in the region*

Insofar as different regions are dominated by local business models, the decision to enter a particular Wealth Management market inevitably implies the adoption of a distribution model prevalent in that region. In Private Banking, there are two distinct business models with very different economics. The Broker/Dealer Model and its sub-



variants dominate the US, Canada and large parts of APAC. They are characterised by a transaction-driven approach to client servicing and a close relationship between the RM and the client. The Advisory Model, prevalent in large parts of Europe and LatAm, places stronger emphasis on asset-based fees, discretionary portfolio management and financial planning. The prevalence of each model in different regions is indicated in Exhibit 5. As shown later in Exhibit 6, this has profound implications for realisable shareholder value and hence the economic appeal of different geographies.

**Exhibit 5: Prevalence of Wealth Management models by region**



Source: Oliver Wyman project experience

### What is the average Wealth Management client worth?

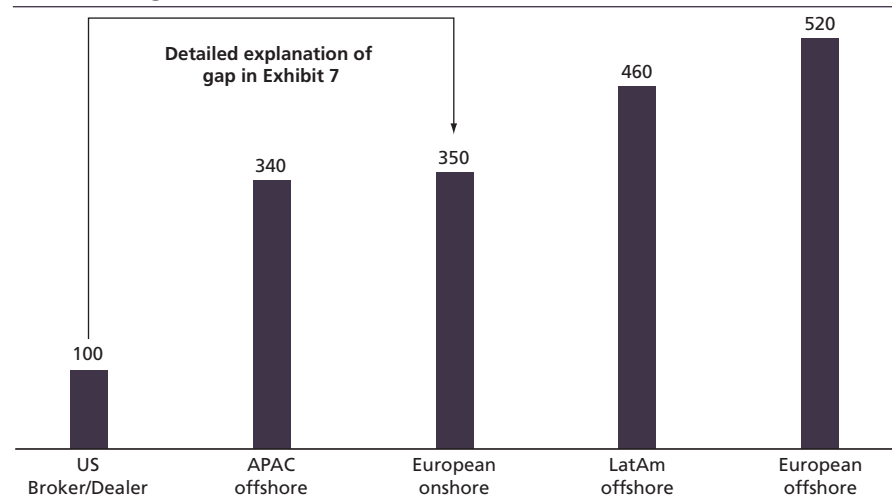
From a shareholder perspective, the Broker/Dealer Model is generally viewed as economically inferior to the European-style Advisory Model: Average gross margins tend to be lower, RM compensation ratios are higher, and the overall earnings stream is more volatile. Still, the real value implications for different regions are not so obvious.

To estimate the economic lifetime contribution value of the typical client to a Private Bank's shareholders, we have used a valuation model that takes into account key Client Value drivers. These include gross margin, gross new money rates, various measures of defection (RM and client defection as well as inter-generational attrition), RM loading, support staff ratios, compensation costs and business risk. We specifically refer to this figure as "contribution" value as we have decided not to factor middle- and back-office costs into our analysis. First, whilst we believe that scale has an impact on overall Wealth Management economics, it is not a differentiating feature of the distribution models in which we are primarily interested. In fact, solutions to outsourcing non-front-office parts of the value chain

- thus variabilising what otherwise tend to be largely fixed costs
  - have become much more refined and commonplace in recent years.
- Second, if we did not normalise our analysis for scale, the comparison of different-sized players would be distorted.

Taking the US Broker/Dealer Model as a baseline value, the results for different regional models are displayed in Exhibit 6.

**Exhibit 6: Lifetime contribution value of average private client<sup>1</sup> for different regional distribution models (indexed: US = 100)**



<sup>1</sup> Excluding middle-office and back-office costs; US Broker/Dealer figures exclude the Mass Affluent client base

Sources: Annual reports and IR presentations, Oliver Wyman project experience and Oliver Wyman Private Client Model

*The average European onshore client is worth some three to four times more to shareholders than the average Broker/Dealer client in the US*

With the Advisory Models predominating in Europe, the average European onshore client is worth some three to four times more to shareholders than the average Broker/Dealer client in the US. The European Offshore Model is even more extreme, commanding a multiple of some five times the US Broker/Dealer Model.

As a result, it is imperative for Wealth Management CEOs to make some key decisions:

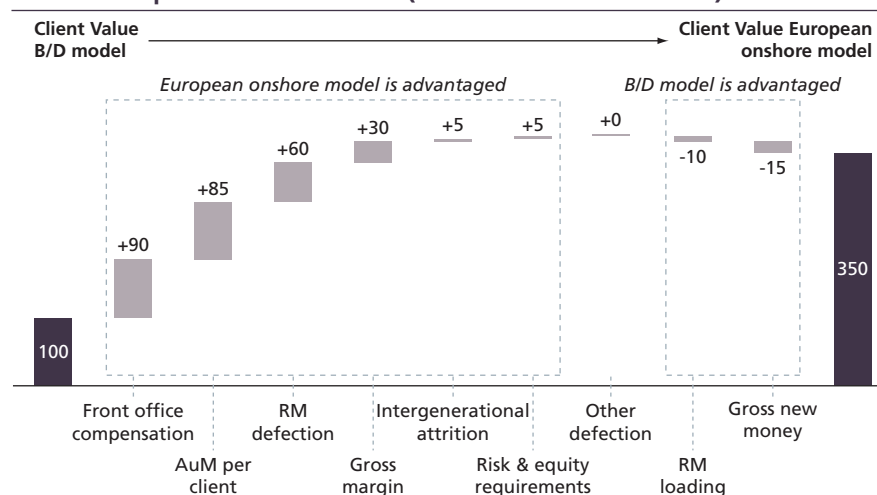
- In their current business model, where do the most significant differences in Client Value stem from, and which value levers can be used to narrow their gap to peers/best practices?
- Will the distribution landscape in our region stay unchallenged, or should we expect a shift to or an emergence of alternative models?

We address each question in turn.

## Mind the (value) gap

Using our Private Client Model, we can decompose the value gap between a typical US Broker/Dealer client and the average client of the onshore Advisory Model typical of Europe. The result is portrayed in Exhibit 7.

**Exhibit 7: Decomposition of the Client Value gap: Broker/Dealer Model vs. the European onshore model (indexed: B/D client = 100)**



Source: Oliver Wyman Private Client Model

From the perspective of a Broker/Dealer, the biggest gaps, even though partly structurally driven, present the most promising levers for value improvement:

- **Front-office compensation** (accounting for ~35% of the net gap) – The high level of RM compensation in the Broker/Dealer Model reflects the combined impact of two important aspects. First, it is due to the high proportion of variable compensation in the Broker/Dealer Model. Such compensation ratios significantly diminish economies of scale and the leverage from taking on additional clients. Second, it is indicative of the power of the individual RM vs. his or her employer. Whilst clients in the Advisory Model generally are loyal to their banking institution, the typical Broker/Dealer client tends to follow his or her RM to another bank. At about 70%, we estimate “follower rates” (percent of clients loyal to their RM) to be almost five times as high in the Broker/Dealer Model as in the Advisory Model. Hence, Broker/Dealers should focus on creating value by institutionalising the client relationship and distancing it from the individual RM.
- **AuM per client** (accounting for ~35% of the net gap) – The average AuM per Broker/Dealer client tends to be lower than the corresponding figure for the European onshore model, even when the Mass Affluent segment is excluded. This is a result both of

the Broker/Dealer Model attracting somewhat less wealthy clients overall and a stronger tendency of Broker/Dealer clients to divide their wealth amongst various players. Incenting RMs to focus on higher-value clients and more strictly enforcing AuM thresholds might improve the situation for Broker/Dealers.

- Client defections/attrition (together accounting for ~25% of the net gap) – The higher level of client/attrition in the Broker/Dealer Model is largely due to a higher percentage of clients following their RMs, coupled with higher RM-turnover rates or with RMs setting up their own shop – a recent trend. Broker/Dealers should pursue a two-pronged approach. First, increasing the degree of institutionalisation will help reduce both RM- and client-related defections. Second, investing in a retention process built on predictive analytics and data-mining techniques, such as logistic regression or discriminant analysis, will help reduce client defection that results from dissatisfaction.

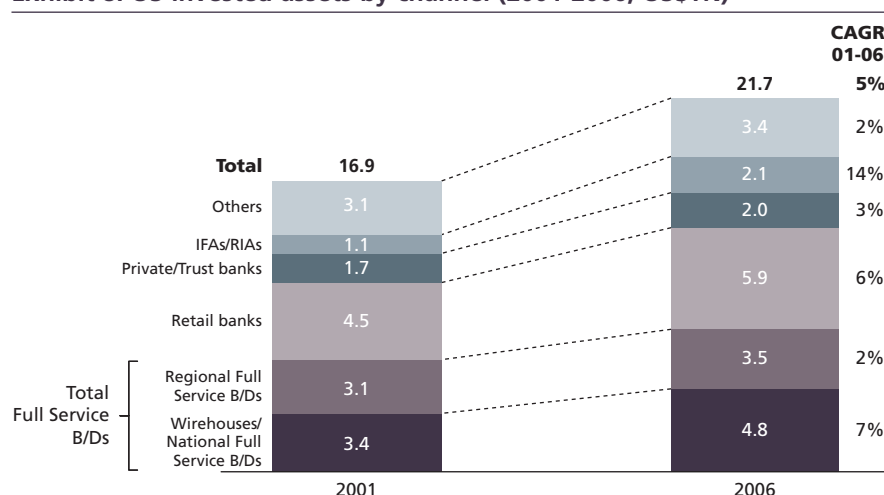
*We see a shift towards the Advisory Model but with an increased focus on transparency*

### Business models in flux

Both client pull and provider push factors are contributing to the increasing relevance of the Advisory Model in markets traditionally dominated by Broker/Dealer Models. The model emerging in those markets, however, differs slightly from the traditional European concept. Whilst borrowing from the European model in emphasising holistic advice, this version of the Advisory Model puts more stress on independent advice executed through a more open architecture.

Looking at the US, a highly fragmented market dominated by the Broker/Dealer Model, we observe a series of trends that indicate a shift away from the traditional “good call on stocks” culture towards a more holistic advice offering that emphasises transparency and independence. First, we witness Broker/Dealers seeking to offer more banking products and banks buying out Brokers. Second, we see that Registered Investment Advisors (RIAs) are a small but very fast growing segment of the market (Exhibit 8). From a client perspective, Independent Financial Advisors (IFAs) and RIAs in the US are by and large operating under a more transparent version of the Advisory Model; yet, their compensation structure is similar to the Broker/Dealer Model, in which most of the distribution profit is kept by the advisor. The trend towards higher AuM participation by IFAs is also evident in other markets, including Italy and Switzerland (“externe Vermögensverwalter”).

**Exhibit 8: US invested assets by channel (2001-2006, US\$TN)**



Note: "Others" includes Insurance Broker/Dealers, Independent Broker/Dealers, online discount brokerage and mutual fund brokerage; "IFA" is "Independent Financial Advisor" and "RIA" refers to "Registered Investment Advisor"

Sources: Bear Stearns, Trust and Estates, Investment Company Institute, analyst interviews, Schwab Institutional RIA survey, Oliver Wyman Wealth Model and analysis

### Client pull factors

We believe that a fundamental change in the underlying demand structure is driving this shift towards the more holistic Advisory Model. Today, about 70% of wealth is self-created rather than inherited. These emerging HNWI's often are overwhelmed by their new wealth, and have neither the financial experience nor the network of contacts to call upon. Another contributing factor is that in a world of defined contribution plans, investors are more aware of how critical building the proverbial "nest egg" is to ensuring a comfortable retirement. Thus, they are looking for customised and comprehensive solutions rather than just products. In addition, as products become more complex and investors more wary due to sudden market shifts, the demand for personalised service and independent advice continues to rise. In this context, open architecture plays an increasingly important role, particularly with the more sophisticated and often wealthier investor segment.

### Provider push factors

Provider push factors are also playing an integral role in this paradigm shift towards holistic advice. With higher net margins, more stable revenue streams and a higher degree of institutionalisation, the Advisory Model is economically advantaged. This is primarily a result of financial advisors capturing much of the value under the Broker/Dealer Model. It is also driven by lower client wealth and higher RM defection under the Broker/Dealer Model. In their battle to become more profitable, US broker-type Wealth Managers have been trying to push the traditional Advisory Model. Their efforts to capture more

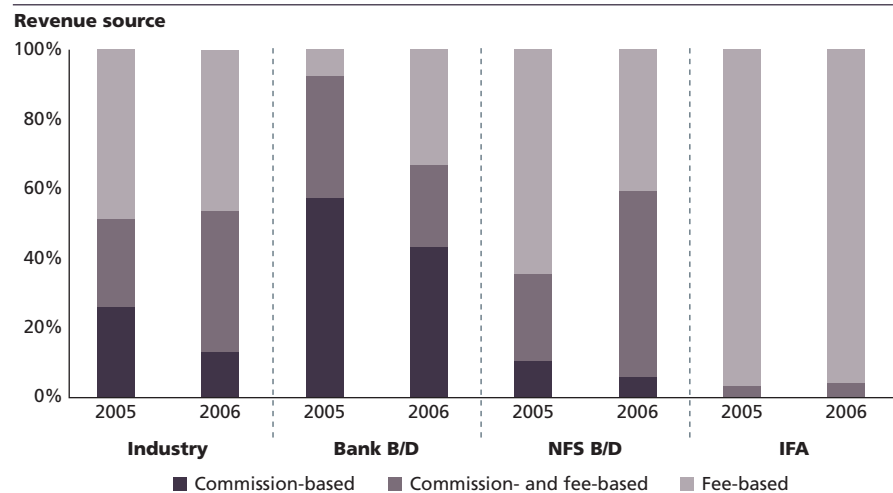
*The Advisory Model is economically advantaged*

value in this way have been somewhat thwarted by the departure of top-producing brokers who seek a higher revenue share. This highlights the reality that for a successful producer push, RM compensation models have to take centre-stage.

Broker/Dealers have attempted both to improve the economics of the Broker/Dealer Model and to slow down the departure of top-producing brokers by introducing the annuity-like revenue stream of the fee-based brokerage account. Fee-based brokerage grew substantially when the Securities and Exchange Commission (SEC) issued the so-called “Merrill Rule” rule in 2005 stating such accounts were not subject to fiduciary standards (see Exhibit 9). But the US courts overturned the rule in 2007, which will further drive a clear demarcation between the Broker/Dealer Model and the Advisory Model, with most fee-based brokerage accounts being either commission-based or full advisory fee-based accounts.

The combined result of these push and pull factors is a steady transition of the revenue mix from commission-based to more fee-based.

**Exhibit 9: Revenue source by advisor (2005-2006, %)**



Note: “Bank B/D” is “Bank Broker/Dealer”; “NFS B/D” is “National Full Service Broker/Dealer”

We believe that the Advisory Model, in the modified version outlined above, will continue to take market share from the Broker/Dealer Model in coming years. That said, there are two eventualities that we do not perceive as real possibilities:

*Business models are in flux, but a convergence of the Broker/Dealer Model and the Advisory Model or an “endgame” in Wealth Management seems unlikely*

- Convergence of the Broker/Dealer Model and the Advisory Model – To us, this scenario seems highly unlikely, and examples abound of failed attempts to blend these models. The same stark differences in culture and business philosophy that prevent convergence also

lie at the heart of European players' uncertainty about how to tackle the US market. Whilst many have tried to enter the US market by acquiring Broker/Dealers, we believe that Trust Banks offer a better strategic fit and an interesting growth opportunity – although their product offerings need to be significantly upgraded.

- An “endgame” in Wealth Management – Although we note an increasing emphasis on holistic advice in the US, we do not expect the Broker/Dealer Model to disappear. On the contrary, we see the Broker/Dealer Model continuing to play a significant role in US Wealth Management, especially for lower wealth tiers. Moreover, the idea of the Advisory Model achieving dominance as the ultimate global “Über-Model” seems unrealistic.

### Food for thought

- Should we focus on deepening our existing footprint, or on expanding into new markets?
- What is the right timing for expansion in view of potential structural differences and only slow change? Is it really paramount to be amongst the first movers? Should we expand organically or via joint ventures and acquisitions?
- How can we hope to win the battle for talent in Asia and in other onshore markets without paying irrational compensation packages?
- Does it make as much sense for European players to pursue the average wealthy investor in the US as it makes for US players to enter the European market?
- Will the current mix of distribution models prevail, or will an evolution towards the holistic Advisory Model make economics in some regions more attractive than in others?
- What are the operations and technology implications of operating in the different business models? What changes do we need to make to compete effectively?
- Which value levers explain the differences in economics between our business and our peers/best practice? What steps can we take to narrow potential gaps?
- How should US players address the growing demand for holistic advice? Conversely, how should European players address the increasing relevance of open architecture and transparency?
- How can big players stem the tide of clients defecting to small-scale providers in the US? Can they better leverage their global reach or access to alternative products? Conversely, should small players establish networks in order to achieve critical buying power and grant their clients access to alternative investments?



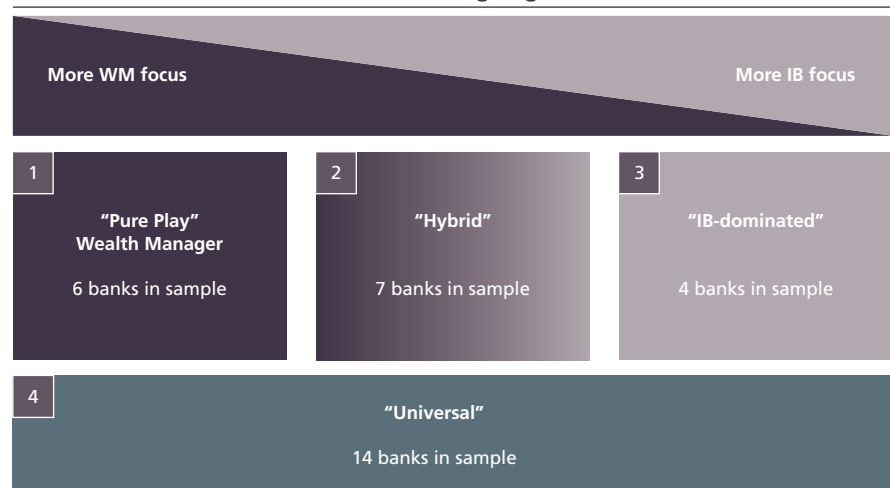
## 2.3 Corporate structures – Will break-ups create value?

*Recent market turmoil has raised the question of whether Wealth Managers should be grouped together with other BUs*

Recent market turmoil has affected many banks that combine large Investment Banks and Wealth Managers under one roof. Whilst many Wealth Management divisions have posted record results for 2007, the credit market turmoil and resulting write-offs have raised the spectre of reputational knock-on effects on Private Banking franchises. This, in turn, begs the question of whether Private Banks and other BUs – first and foremost Investment Banks – should be grouped together in one entity, or whether a break-up would create value for shareholders.

Based on an analysis of some 30 banks active in Wealth Management, we have identified four core organisational models, which are shown in Exhibit 10.

**Exhibit 10: Overview of Private Banking organisational models**



Source: Oliver Wyman analysis

1. **"Pure Play"** – Wealth Management is viewed as the core business and dominates overall bank revenues. The conviction that a clear focus on asset-gathering best aligns the interests of clients and shareholders is at the heart of this model. Examples include Julius Bär, Sarasin and EFG International.
2. **"Hybrid"** – These institutions derive the lion's share of revenues from a combination of Wealth services and Investment Banking. Some players in this group are also active in Retail Banking, but normally are confined to their home market. This model rests on the view that significant synergies can be extracted from a well-orchestrated coordination of these lines of business. Examples include some of the world's largest Wealth Managers, such as UBS, Credit Suisse and Merrill Lynch.

3. **“IB-dominated”** – In this model, Private Banking usually acts as a somewhat peripheral add-on to the core Investment Banking business, which often acts as a UHNW client feeder. Examples include Goldman Sachs, Bear Stearns and Lehman Brothers. Given how IB-centric this model is, we will not elaborate further.
4. **“Universal”** – These companies are active in a wide array of financial services (of which Private Banking is just one), with a presence in numerous geographies. Similar to Hybrids, they aim to exploit synergies between Investment Banking and Private Banking. However, in most cases, Universals’ main asset is their extensive retail branch network, which – if adequately set up – serves as a significant client and AuM feeder to the Private Bank. They also tend to benefit from Corporate and Commercial Banking relationships that can be leveraged through their Private Banks. Examples include BNP Paribas, HSBC and RBS.

Pure Plays – almost by definition – can be considered the default organisational structure for Wealth Managers. The suitability and relative attractiveness of the other models boil down to two questions:

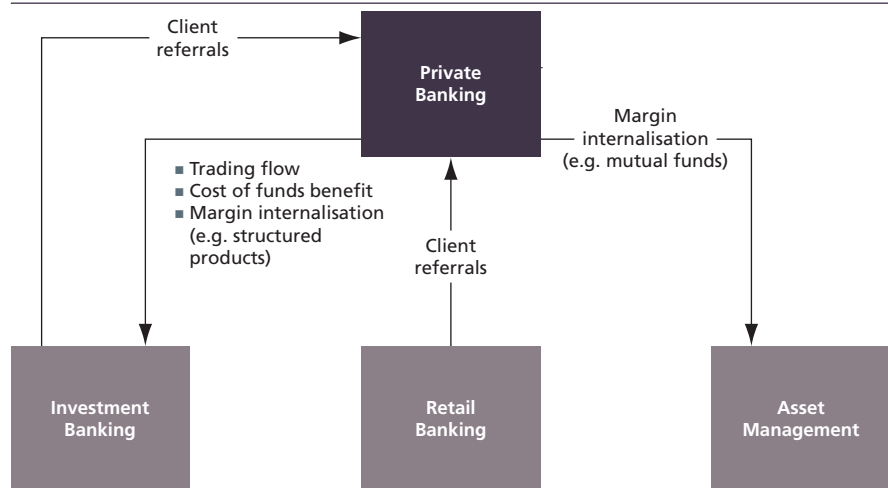
- What net synergies are created by grouping together Private and Investment Banking, or Private and Retail/Commercial Banking?
- What are the issues attached to these models, and do the benefits ultimately outweigh the drawbacks?

### Organisational synergies in Private Banking – They exist, but are elusive

There is no doubt about the existence of synergies between Wealth Management and other BUs. Whilst some are obvious, others are less intuitive and rather hard to quantify, such as the ability to offer Private Banking clients access to alternative investment products, like single manager hedge funds or co-investments. But even those synergies that lend themselves to quantification are difficult to measure, partly because banks themselves have only recently begun to systematically track them. Therefore, we focus our analysis on the four core synergies that we believe constitute the lion’s share of revenues (see Exhibit 11 for a graphical depiction of how they interrelate).

*Synergies between Private Banking and other Business Units exist, but in many cases are hard to grasp and quantify*

**Exhibit 11: Illustration of core inter-BU synergies**



Source: Oliver Wyman analysis

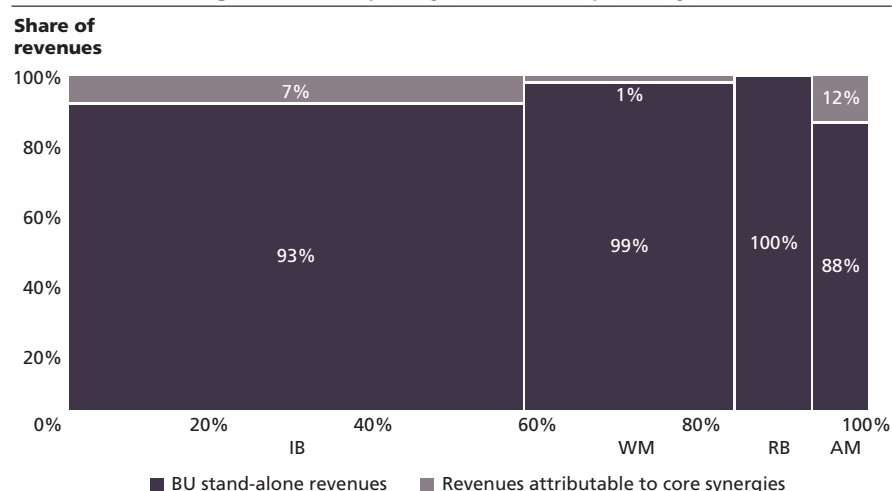
In order of descending magnitude, these four core synergies are as follows:

- **Cost of funds benefit** – As part of an integrated bank, the Investment Banking division is likely to enjoy a higher credit rating than it would as a stand-alone entity, due mainly to overall earnings volatility being smoothed by a steady Wealth Management revenue stream.
- **Wealth Management trading flow** – Trading flow provides an in-house Investment Bank with a revenue stream from both trading spread internalisation and commissions (providing best execution).
- **Margin internalisation** – The manufacturing part of the margin on structured products and investment funds, as well as on liability/structuring solutions, can be kept in-house by leveraging Wealth Management as a distribution platform for the group's Investment Banking and Asset Management products.
- **Client referrals** – Clients can be referred from Investment, Commercial and Retail Banking to the Private Banking division.

### The Investment Banking context

The question of whether Investment Banks and Private Banks make a good match is most relevant in the context of the Hybrid Model. Exhibit 12 shows the relative importance of synergies for different BUs in the European arena using 2006 actual figures. Area widths depict the relative average size of the BUs, whilst heights differentiate between stand-alone revenues and synergies.

**Exhibit 12: Average revenue split by BU for European Hybrids (2006, %)**



Sources: Company reports, Oliver Wyman project experience and analysis

*Investment Banks expose associated Wealth Managers to significant reputational risk*

Clearly, at an estimated average of 7% of BU revenues – corresponding to some 4% of total group income – Investment Banking-related synergies are by no means negligible. In fact, Investment Banking divisions turn out to be Hybrids’ biggest net recipient of inter-divisional synergies, the majority of which are derived from funding benefits and Wealth Management trading flow. In return, Investment Banks can refer wealthy clients to the associated Private Banks and provide the structuring and Corporate Finance capabilities that are key to attracting entrepreneur clients and demanding Ultra High Net Worth Individuals (UHNWIs).

However, these benefits come at a cost. First and foremost, certain Investment Banking activities, of which proprietary trading is only one example, not only present a risk of “first-order” losses and write-offs, but also expose a group’s Private Bank to considerable reputational risk. For example:

- Large trading losses might lead Private Banking clients to question the bank’s ability to manage their hard-earned money.
- An excessively flamboyant approach to risk taking does not bode well for a business in which fiduciary responsibility and care are paramount.
- Given the intense competition for skilled RMs, any erosion of trust in the brand could make it increasingly difficult to attract and retain employees as well as clients.
- Potentially worst of all, cases of fraud and breaches of confidentiality threaten to destroy Private Banking clients’ trust in their Wealth Manager.

All of these effects might collaborate to both diminish the inflow of new money and simultaneously cause higher AuM defections. The negative value impact on a business that is fundamentally annuity-based is significant.

Looking ahead, it is also doubtful if Hybrids will be able to increase the size of their synergy pools relative to total earnings. Whilst they might become more efficient at coordinating their Investment Banking and Wealth Management divisions, other trends are not working in their favour. First, the proliferation of open architecture in non-Anglo Saxon geographies will make the distribution of in-house products increasingly difficult. This will directly impact Investment Banking and Asset Management-related synergies. Second, regulation such as MiFID is likely to compress margins captured on trading flow going forward.

Overall, the net impact of Hybrid structures on market valuations is not entirely clear. Judging by analysts' Sum-of-the-Parts (SoP) valuations and banks' market capitalisation, it appears that Hybrids as a group have traded at a discount relative to Pure Plays in the past two to three years. In the wake of recent market turmoil, some analysts have even begun to apply explicit conglomerate discounts to Hybrid valuations<sup>4</sup>.

*The biggest challenge for Universals is to extract the Wealth Management synergies locked up in their Retail and Commercial Banking networks*

### The Retail and Commercial Banking context

Whilst reputational issues also arise in the Universal Model, the biggest challenge for this model is not, in our view, the management of reputational risk. Rather, it is the efficient extraction of the synergy potential locked up in the group's Retail, Commercial and Corporate Banking relationships. This is not trivial, and banks are at different stages of development when it comes to effectively exploiting their synergy potential. For instance, banks that have grown quickly via acquisitions without ensuring integration of systems, cultures and staff will generally have a hard time realising inter-BU revenue potential. Moreover, silo mentality and conflicting interests due to insufficiently aligned incentives result in lost opportunities and sometimes even in margin depression within existing business. The Wealth Management BU, for example, may end up competing with the Commercial BU for client business by lowering borrowing rates.

---

<sup>4</sup> For example, Deutsche Bank states in their recent report, "UBS – Q4 results review: the risks grow, the franchise shrinks" (February 2008), that they apply a 10% "conglomerate discount" across their European banks' coverage universe

Mechanisms that help to realise synergies in the Universal Model include:

- Organisational alignment of units – We find that placing different BUs under common leadership or even the same P&L simplifies cooperation and client referrals. In that case, BU-internal KPIs and performance targets help to align conflicting interests.
- Incentive schemes – Alignment of the interests of BUs running separate P&Ls can be facilitated by revenue-sharing agreements or even artificial, bank-internal currency units. Unfortunately, in the case of incentive schemes, better coordination and hence higher revenues come at the cost of additional complexity.
- Specialised relationship teams – Often operating as former Investment Bankers out of the Private Bank, these RMs mainly cater to the needs of entrepreneurs and business owners. In this way, they act as “cement” holding together the Private Bank, the Investment Bank and the Corporate Banking division.
- Systematic tracking of referrals and synergies – Effective management of synergies requires cross-BU Management Information Systems. However, many banks have only recently begun to quantify the success of their referral initiatives. In such cases, assessment of progress and identification of potential roadblocks are often based on educated guesswork rather than on hard data.

## Implications

*Non-Pure Plays must decide on which activity represents their core line of business and organise themselves accordingly*

How can Wealth Managers organise themselves in a way that is value enhancing? Whilst implications will differ for each player, we believe that all Wealth Managers, but particularly Hybrids, need to ask themselves two fundamental questions:

### **1. What business are we in, really?**

Trivial as it may seem to Pure Plays and IB-dominated players, this question could prove difficult for many Hybrids to answer. Given the fact Hybrids are – by definition – characterised by almost incompatible cultures, as well as profoundly different risk profiles and success factors – a clear commitment to one or the other BU may not appear to be politically feasible to these banks.

Still, without a solid answer to this question, there can be no clarity as to which BU is “in the lead” and whose business interests are paramount.

## **2. Given our core business, what organisational set-up is most likely to maximise the value of our bank?**

Given that the right organisational structure is one that supports rather than compromises the firm's core business, what does this mean for Hybrids and Universals?

We have shown that there are potential synergies between Wealth Management and other BUs. On the wholesale side, the question is which parts of the Investment Bank are actually complementary and which are potentially harmful to the Wealth Management business. Clearly, the ability to offer Private Investment Banking/Corporate Finance services is instrumental in gaining access to certain client segments, such as entrepreneurs or UHNWIs, whilst posing little risk to the Wealth Management business. Conversely, although Investment Banks gain a lot in terms of refinancing benefits and flow information, they also present a constant risk of damaging the Private Banking franchise.

Whilst these considerations cast doubt on the suitability of the standard Hybrid set-up, they do not necessarily imply this model is condemned to failure. First, inter BU-linkages make the break-up of a Hybrid difficult, and consequently a last resort. Second, the scaling down of Investment Banking activities to exclude high-risk proprietary trading and leveraged finance activities is a real alternative to break-up. The question is, in our view, whether management is willing to accept that a more focused Investment Bank is hardly compatible with global bulge-bracket ambitions.

On the Retail and Commercial side, the question is, what measures can be taken to optimise the respective BUs' coordination with the Wealth Management division?

### **Food for thought**

- Which business is at the core of our bank's expertise?
- Are our organisation's overall risk profile and the potential sources of synergies/dissynergies well understood? Specifically, does our current organisational structure's risk profile support or endanger the value of our core business? What are the risk-related interdependencies between Private Banking and our other BUs, particularly with respect to reputational and branding issues? Have we tried to quantify the value impact of relevant adverse scenarios?



- Do we have a thorough understanding of the extent to which potential synergies are being captured? Do we manage this process properly? Do we track it systematically?
- How can we better capture and realise dormant synergies? For instance, does our organisation make adequate use of incentive schemes? Are there structural measures, related to organisation and P&L, for example?

## Opportunities for value creation

With slowing markets and increasing competition, value management will come to the fore. In this section, we outline five opportunities for value creation, exploring how Wealth Managers can deepen their client relationships in order to capitalise on the potential created by market dynamics today – and in the future.

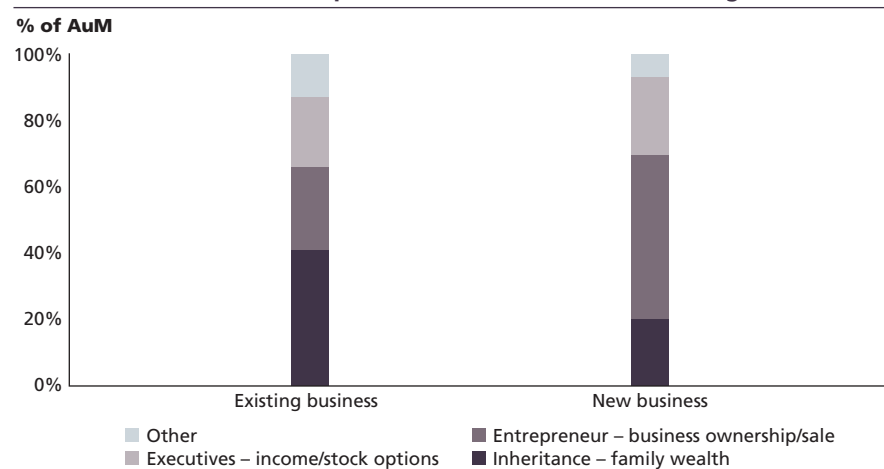
We discuss how targeting entrepreneurs, offering lending solutions, institutionalising client relationships, branding and risk management can substantially impact value capture for Wealth Managers. Whilst Operations and IT are not the focus of this report, it should be kept in mind that they are critical enablers and, if not sufficiently developed, will be obstacles to value creation and capture.

### 3.1 Creating value in segmentation – Capturing entrepreneurs

*Half of new business stems from entrepreneurs*

“Old money” was once the main source of wealth. This has changed. Today the rich are mostly self-made. In the developed markets, roughly half of new business stems from entrepreneurs and another fifth from executives (Exhibit 13). The situation is even starker in emerging wealth markets, where the typical Private Banking client is a middle-aged entrepreneur.

**Exhibit 13: Sources of European HNWI business (2006 average, %)**



Sources: Market interviews, Oliver Wyman analysis

Entrepreneurs are a distinct client segment with shared needs in relation to product range, risk appetite and interaction with the bank. Because their needs change over the life-cycle of their businesses, entrepreneurs require access to a more diverse set of products.

When capital initially is tied up in a growing business, entrepreneurs require Corporate and Investment Banking products and services such as lending, co-investments, business and market expertise, tax and succession planning. Tax and succession planning, in particular, have become key drivers of revenues and will retain momentum in light of significant business transfers in Germany, Spain, France and Italy in the years ahead.

Once entrepreneurs are beginning to reap the benefits of the business and have cash on hand, however, they become interested in more traditional Private Banking products and services such as asset allocation, investment ideas, consolidated monitoring and reporting, global custody and administration, tax and trust/estate planning. They also may look for advice on strategic stake investments or philanthropic options.

Entrepreneurs tend to be more willing than the general investor population to explore non-traditional investments, as evidenced in their higher allocations to structured products and alternative investments. They also prefer to be more involved in investment decisions.

### Key considerations when targeting entrepreneurs

For Wealth Managers to outperform their peers in the entrepreneur segment, they must focus on appropriate segmentation and effective cooperation amongst different BUs. They need to take a long-term view, ramping up the relationship over time, and they should consider modifying the coverage model. We will examine each strategy in turn.

#### **Refine segmentation beyond wealth buckets**

To date, only a few Private Banking players have explicitly addressed entrepreneurs in their segmentation practices and offered tailored services. Without special consideration, there is a risk that asset-rich/cash-poor entrepreneurs will be turned away, since they fail to meet minimum investable asset criteria. We recommend segmentation based first on their overall wealth, and second on the life-cycle of their business interest.

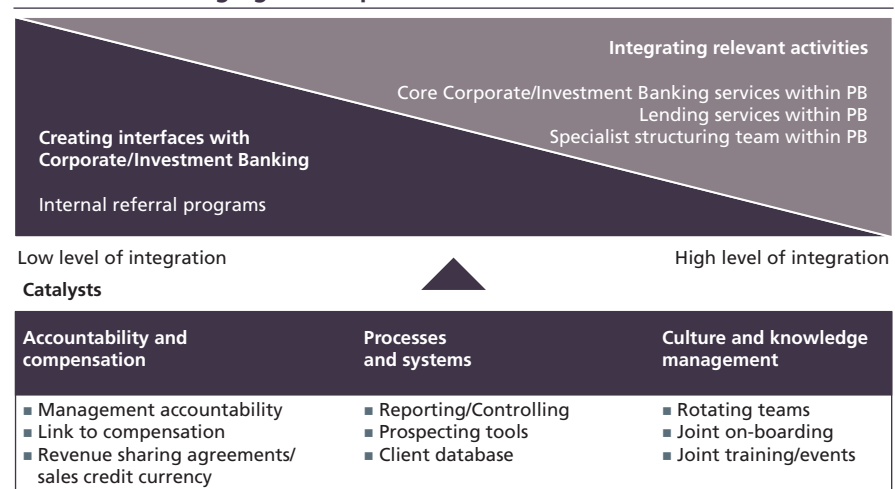
## Manage cooperation and coordination of BUs

More than your average investor, entrepreneurs need access to different services from different units of the bank at different times. Banks can gain competitive advantage by offering access to both Private and Corporate/Investment Banking services – either in-house or sourced from a third-party provider such as a Corporate Finance boutique. In practice, banks that attempt to meet these needs in a seamless fashion often run up against organisational and cultural clashes between different BUs, as well as compensation schemes that do not incent cross-referral business.

Successful players will focus on the careful management of interfaces amongst BUs, or will integrate the appropriate services into a single BU. These banks will recognise that whatever model they choose must be characterised by clear accountability, enabling processes and systems, a compensation system that supports the creation of a collaborative culture and a focus on knowledge management (Exhibit 14).

*Managing BU cooperation, either through effective interfaces or integrated teams, is critical to servicing entrepreneurs*

**Exhibit 14: Managing BU cooperation**



Source: Oliver Wyman

Some Wealth Managers have moved from a historically “siloesd” Private Bank to an integrated “Private Corporate Banking” offering, where a specialist structuring and advisory team sits within the Private Bank to support RMs that serve entrepreneurs. This positions the bank to successfully build out its mid-market coverage on the corporate side, increase the sale of Investment Bank derivative solutions, and participate in the IPO or sale of entrepreneurs’ businesses.

Others have focused on making the interface between BUs more effective. To this end, they have designed referral programs that are supported by explicit targets, management accountability, links to compensation schemes, and transparent reporting and controlling processes. To spot opportunities systematically, they have built prospecting/data mining tools. Some have created elaborate and at times cumbersome solutions such as internal currency models that span P&L silos.

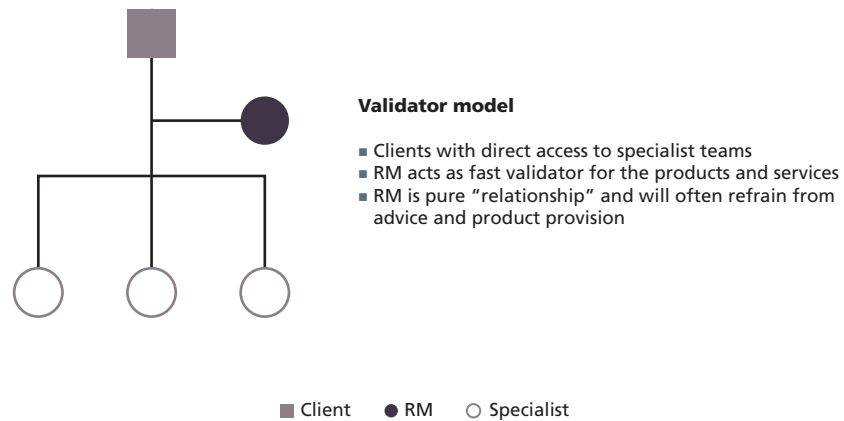
### **Carefully ramp up the relationship over time**

Business owners tend to be most profitable for Wealth Managers in the later stages of the life-cycle of their businesses. However, to establish trust and capture liquidity from a potential sale of the business, Wealth Managers have to invest in building client relationships at an earlier, potentially unprofitable stage. Invest too early and the client may be loss-making; invest too late and you may miss the opportunity to capture their broader financial services spend. Carefully graduating the intensity of the Private Banking relationship is therefore crucial to maximising the economics of the business. In addition to expert knowledge and experience, data analytics can assist this process by supporting the calculation of client profitability and profit probability, which can inform decisions on service delivery channels and service levels.

### **Introduce a coverage model with RMs acting as validators**

With business and personal needs frequently interlinked, the needs of the business-owner segment can be more complex than those of traditional clients and thus require special servicing. The traditional aggregator coverage model, or even the team-based approach that is prevalent in the HNWI segment, is not suitable for entrepreneurs. Given their diversity of needs, we see a “validator coverage model” as an effective strategy for serving the business owner segment. This coverage model is based on a multi-disciplinary team of specialists coordinated by an RM, the validator, who acts as an independent point of contact to help assist decision-making (Exhibit 15). In order to be effective, the validator coverage model needs supporting technologies that can provide consistent, integrated data to specialists, and that can capture all specialist interactions.

## Exhibit 15: Validator coverage model



Source: Oliver Wyman

When servicing the entrepreneur segment, the choice of the RM is paramount. Entrepreneurs want to talk to someone who knows what it means to be an entrepreneur, and many RMs simply do not have this understanding. To attract this market, RMs must be able to talk “entrepreneur to entrepreneur”. The success of independent family offices is often driven by their understanding of entrepreneurial aspects that go well beyond pure financial investments.

### Food for thought

- Do we understand the entrepreneur segment and know how to target it effectively?
- What is the optimal depth and breadth of products and services to offer entrepreneurs and their successors?
- Do we effectively manage cooperation with other contributing BUs? Is cross-referral business incented by explicit targets, management accountability, links to compensation schemes, reporting and controlling processes? What level of integration should we be targeting? Could we better serve this segment by having a specialised Corporate Finance team in our Private Bank? Have we established an optimal network of partners to source required services?
- Do we have a sound strategy for managing the relationship over time, building trust and maximising the value to all parties?
- Do we have the right people to serve entrepreneurs, and are they organised effectively?
- Do our information systems provide integrated access to the RM and all the specialists on the team? Are they updated on a regular basis so that the team has a clear picture of all client interactions with the bank?

### 3.2 Creating value through products – Lending

No Wealth Manager these days can afford to deny clients access to interesting products in the alternatives space. These products are equally popular with advisors, as a higher portion of AuM allocated to hedge funds, private equity vehicles or structured products translates directly into higher gross margins. We will not focus here on alternatives, as they are well understood in the industry.

*Considering both sides of the balance sheet is a largely untapped opportunity for Wealth Managers, and is key to servicing UHNWIs*

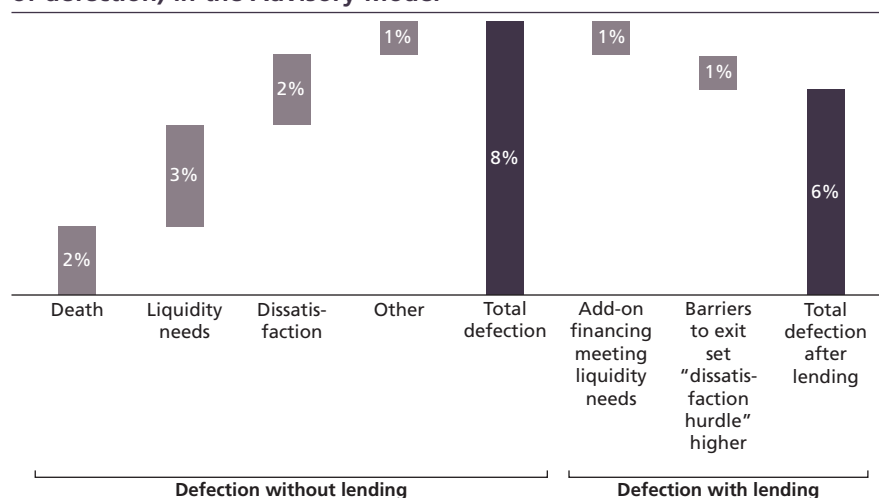
A largely untapped opportunity, especially in smaller banks, is to service the other side of the client's balance sheet by providing loans. This is especially true in emerging wealth markets such as UHNWI business in the Middle East, APAC and LatAm. Lending is a very versatile tool, with effects that extend beyond margin enhancement to strengthening client acquisition and retention. It also offers larger and specialised players opportunities to offer in-sourcing and white-labelling solutions.

Private Banks that provide solutions relating both to assets and liabilities are attractive partners, especially for asset-rich/cash-poor entrepreneurs, top management executives and UHNWIs with short-term liquidity needs who do not want to meddle with portfolios built on long-term objectives. The extent to which market participants now play in this space varies significantly. On average, Wealth Managers generate 12% of revenues from lending. The big banks typically are most willing to lend, leveraging their balance sheets, captive funding bases and risk management expertise. Pure Play Private Banks and Investment Banks tend to lend less and in some cases not at all.

We believe that these players should reconsider lending. Besides being a service that clients value, lending brings additional revenues from interest income, as well as incremental AuM from clients' interest in bundling assets for collateral purposes. Lending can successfully reduce asset defection from the typical Advisory Model average of 8% of AuM to 6% by limiting liquidity-induced AuM drain, and establishing natural barriers to exit (Exhibit 16). The fact that the asset portfolio is the collateral – and that the size, nature and diversification of the asset portfolio drive lending conditions – creates a significant inducement to stay. Lending establishes trust and a sense of partnership, potentially the single most important factor in client satisfaction.



**Exhibit 16: Lending impact on typical AuM defection rate (split by cause of defection) in the Advisory Model**

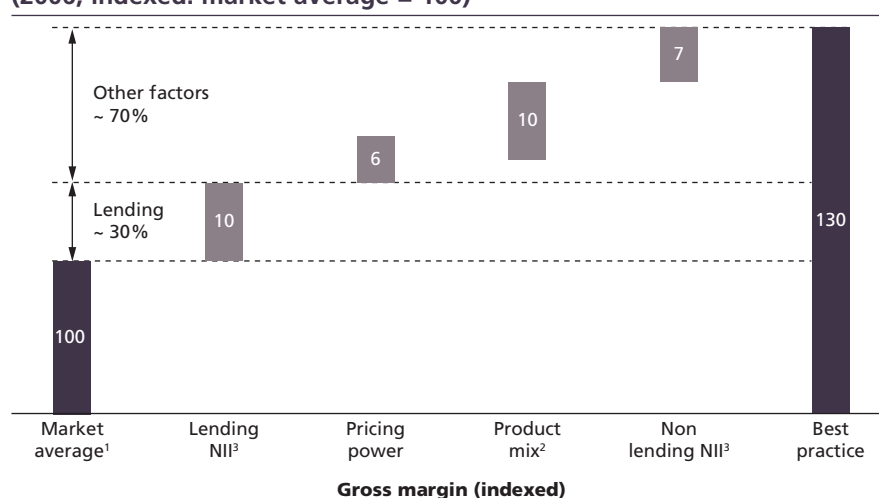


Source: Oliver Wyman analysis

In addition to improving the retention of current clients, having a compelling lending offering can be of help in poaching key clients from less sophisticated competitors. Finally, lending allows banks to get to know their clients better in the course of the credit due diligence.

In addition to increasing the duration of the relationship, lending is also critical in driving gross margins. In European onshore, we estimate that lending accounts for about one-third of the variation between market average and best practice margin (Exhibit 17).

**Exhibit 17: Gross margin decomposition for European onshore players (2006, indexed: market average = 100)**



<sup>1</sup> Comparable market focus

<sup>2</sup> Share of equities, alternative investments, structured products etc.

<sup>3</sup> NII = Net Interest Income

Source: Oliver Wyman project experience and analysis

*Lending accounts for up to one-third of gross margin variation*

Additional revenues from lending increase the Client Value by 15%, whilst lower defection results in an estimated 16% increase in Client Value, according to the Oliver Wyman Private Client Model. Between higher gross margins and lower asset defection, lending can therefore boost Client Value by ~30% (Exhibit 18).

**Exhibit 18: Lending impact on lifetime Client Value (indexed: pre-lending = 100)**

*Lending increases Client Value through higher revenues and improved retention*



Source: Oliver Wyman Private Client Model

### Key considerations when offering lending

Whilst clearly attractive from the perspective of Client Value returns, lending in Wealth Management requires scalable and solid risk processes:

#### Automate lending in the traditional space

As lending volumes grow and clients demand faster turn-around times, Wealth Managers must think about how to automate lending processes – today largely manual – and make them more efficient. For traditional lending products, Wealth Managers can leverage retail credit processes to a certain extent, especially for lower wealth bands. Moreover, lending creates a requirement for a higher level of information sharing and inter-BU coordination (e.g. to avoid lending channel arbitrage, or manage implications from simultaneous Corporate and Private Banking lending relationships) that needs to be effectively supported by technology.

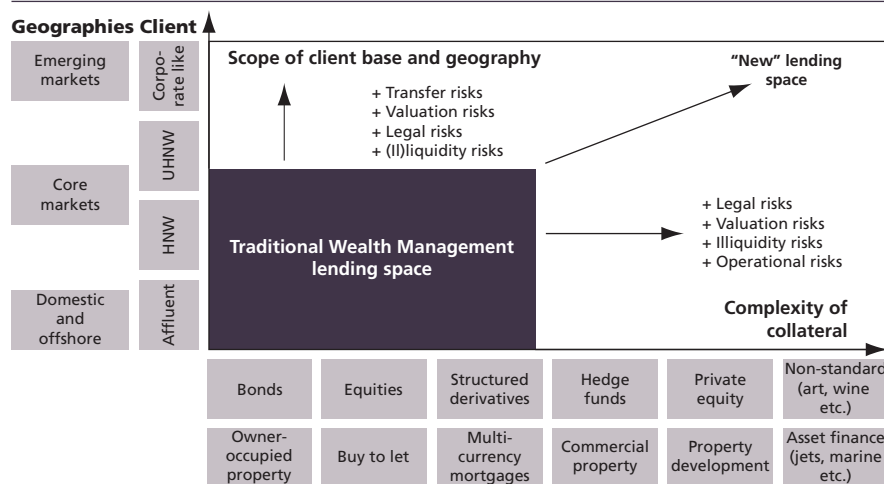
A specific loan-to-value calculation approach, and an engine whose output is used for credit decisions and ongoing monitoring, are mandatory for a sound Lombard lending business – as is the willingness of the organisation to actually put through margin calls and close-outs with the customer.

*The ability to manage non-standard collateral is critical to profitable Wealth Management lending*

### Review risk procedures in the “new lending” space

As client portfolios become increasingly diverse (e.g. structured products and alternative investments), adequately leveraging and managing non-standard types of collateral are becoming critical. Growing scale and reach of the business, as well as scope and complexity of collaterals, will increase valuation, liquidity and operational risks (Exhibit 19). These risks also carry the potential for knock-on reputation impact. A sound monitoring and risk mitigation approach which – unlike the more standard credit risk methodologies – takes into account the nature of this risk will be critical.

### Exhibit 19: Increasing complexity in Wealth Management lending



Source: Oliver Wyman

### Food for thought

- Do we adequately leverage the upside of lending in relation to client acquisition, increased share of wallet and improved retention management?
- To whom do we target lending solutions? What are the product implications?
- Is our lending process efficient, and are our RMs trained to market lending products, as well as to deal with margin calls in an adverse environment?
- Can our collateral management system track and value atypical assets such as shares in private companies, art or high-end property like boats and planes?
- As a smaller player, should we team up with an external partner to offer lending solutions? How do we select such a partner?
- As a larger player with lending expertise, should we leverage our balance sheet and risk management capabilities and offer white-labelling for smaller providers?

### 3.3 Creating value through client retention – Institutionalising client relationships

*Institutionalisation is key to protecting the economics of the business*

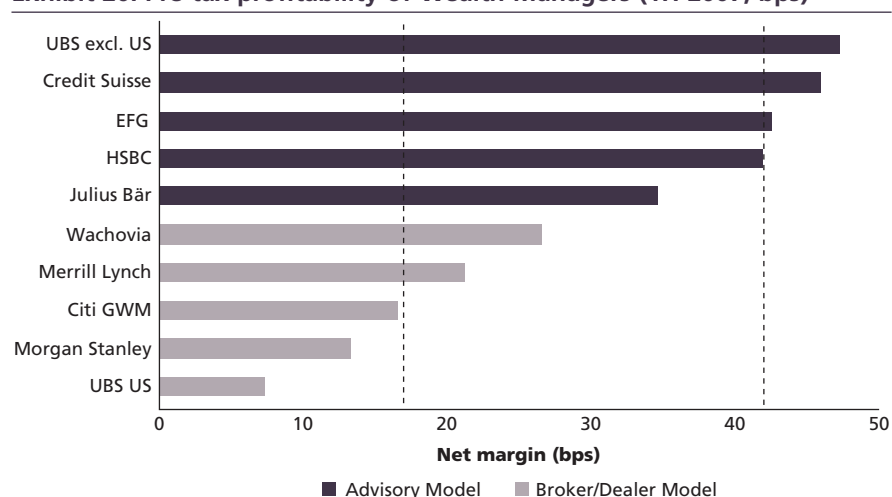
Institutionalisation of client relationships – tying them to the franchise rather than to their RM – has become an imperative for Wealth Managers seeking to protect the profitability of their businesses. The battle for talent, open architecture, operational outsourcing and entrepreneurial compensation strengthen the mobility of RMs, who, as witnessed earlier, often tend to take clients with them as they move. The challenge for banks is to prove that some degree of institutionalisation can both benefit clients and provide a sufficiently attractive proposition to RMs.

As we noted earlier, the Advisory Model is characterised by an inherently higher level of institutionalisation than the Broker/Dealer Model, and Private Banks operating on this model are more profitable – since the institution captures a greater share of the value (Exhibit 20). The very nature of discretionary management and the higher share of offshore business allow for a greater degree of institutionalisation. Conversely, under the Broker/Dealer Model, exclusive bilateral relationships between advisors and clients, nurtured by a more transaction-based culture, make clients more loyal to their RM than to their bank.

*Low institutionalisation is the main cause behind the unattractive economics of the Broker/Dealer Model*

The impacts are two-fold. First, RMs under the Broker/Dealer Model are in a strong position to dictate compensation terms and claim a significantly higher share of revenues than their peers in the Advisory Model. To a large extent, this helps to explain the lower profitability of the Broker/Dealer Model, where compensation-to-revenue ratios are almost twice as high as under the Advisory Model. Second, these banks' economics are further challenged by higher client defection rates, induced by increased RM turnover: Up to 70% of clients follow their advisors under the Broker/Dealer Model, compared to an average of 15% under the Advisory Model.

**Exhibit 20: Pre-tax profitability of Wealth Managers (1H 2007, bps)**



Sources: Company data, Oliver Wyman analysis

### Key considerations in creating and securing institutionalisation

*Market dynamics also challenge the institutionalisation under the Advisory Model*

We expect that factors such as the shortage of RMs, open architecture, operational outsourcing and entrepreneurial compensation eventually will impact the institutionalisation level of the Advisory Model as well. Assuming slightly higher compensation-to-revenue ratios (+50%) and similar RM-induced client defection rates (i.e. rates that are closer to those in the Broker/Dealer Model), we anticipate that Client Value in the Advisory Model could decrease by 40%.

Wealth Managers can no longer count on the strength of their brand and the quality of their infrastructure to keep the loyalty of their clients. To protect the economics of their businesses, Wealth Managers must create explicit strategies to institutionalise relationships and reduce RM-induced client defection.

Beyond any doubt, trust is an important factor in this equation. Whilst that may seem a somewhat slippery and abstract concept, in fact there are real operational levers with the potential to build and maintain client trust: the coverage model, product offering, RM compensation and systematic retention management. We will examine each in turn.

### Introduce team-based coverage models

Traditionally, the industry emphasised exclusive bilateral relationships between clients and their designated RM. In a bid to institutionalise client relationships, Wealth Managers today increasingly operate team-based coverage models. Team-based approaches allow RMs to become more specialised and better

serve clients with expert knowledge. They also prevent the client relationship from being monopolised by a single RM. In making this shift, however, there are potential issues that need to be effectively managed. First, to prevent disruptive departures, Wealth Managers must carefully consider RMs' reservations towards sharing client relationships. Second, to maintain client trust and credibility, the team structure must not be changed too often. Finally, as noted earlier, the team-based coverage model needs supporting technologies to provide consistent, integrated data to the individual team members.

### **Institutionalise client relationships through sticky products**

Increasing the share of wallet and expanding the offering of sticky products (i.e. products which establish a long-term relationship between the client and the institution) have proved to be successful strategies for creating and maintaining institutionalisation. Clients with transaction accounts, credit cards, loan commitments and less liquid longer-term investments – typically alternatives, insurance products, tax and trust/estate planning – prove to be more loyal to their bank than do others. This approach may be particularly relevant for emerging markets such as Asia, where Private Banking is even more relationship-based than in other parts of the world, and where there is a natural tendency for HNW clients to be more attached to their RMs than to the institution.

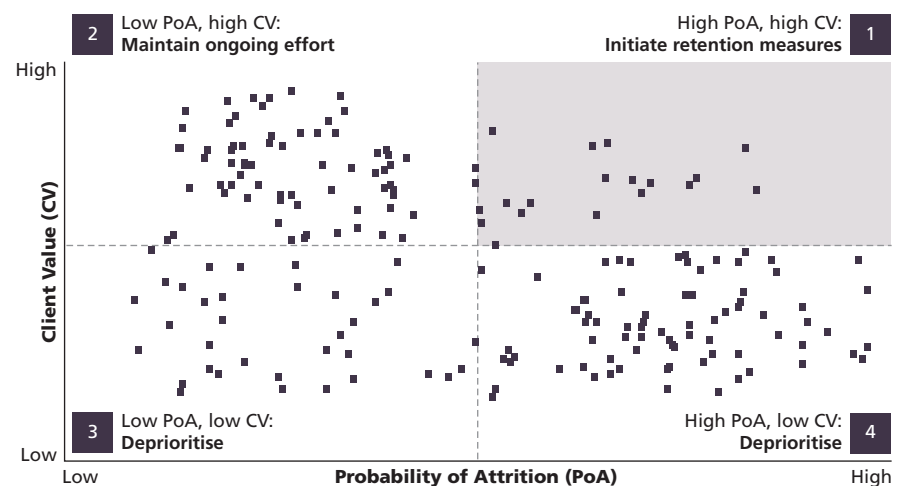
### **Set incentives for improving and securing institutionalisation**

RM compensation structures should take into consideration the need to institutionalise client relationships and limit RM turnover. This could mean tying compensation to benchmarks such as cross-sell ratios and length of client relationship, in addition to increasing the weighting of sticky products and the involvement of colleagues. Compensation mechanics are only one way to address turnover; many RMs are equally interested in career and development opportunities. Wealth Managers must be creative in order to retain their best RMs, because clients strongly dislike frequent change in coverage.

### **Implement a comprehensive relationship and client retention management process**

Comprehensive relationship and retention management processes are crucial to a sustainable improvement in client retention – yet very few Wealth Managers have them in place. Value at risk and probability of attrition (PoA) should be calculated systematically for each relationship in order to prioritise client retention management actions (Exhibit 21). Clients with high Client Value and high PoA should be subject to extensive client retention management measures.

**Exhibit 21: Retention management prioritisation framework (illustrative)**



Source: Oliver Wyman

### Food for thought

- What is our current level of institutionalisation?
- What has contributed to or undermined institutionalisation in our institution?
- What are the most effective levers we can deploy across products, coverage model, compensation and retention management to increase institutionalisation?
- What variations of the above do we need to make in order to prevent potential disruption in our organisation?
- How can we ensure continuity for our clients, whilst at the same time offering development opportunities to our RM base?



*Brand has a major impact on the client's choice of their Private Banking provider*

### 3.4 Creating value by branding – Differentiating and driving revenues<sup>5</sup>

Brands are even more important in Private Banking than they are in other areas of financial services. Research for several banks has shown that the correlation between brand reputation and choice of Private Bank is higher than is the correlation between brand reputation and choice of Retail Bank, where branch location and short-term product features such as rates are relatively more important.

As Private Banking has become an increasingly global industry, prospective customers face a plethora of relationship options, and cannot easily consider them all. So they will, consciously or unconsciously, somehow select a subset to consider before making a more rational comparison of the options within that set. Brand reputation is critical to getting a positive answer when they first ask themselves, “Is this bank for me?” and create this initial shortlist. Given that, it is surprising how similar most Private Banking brands look.

#### Branding in Private Banking

There are essentially three main sets of Private Banking brands:

- Those that project themselves as the Private Banking arms of major international or national banks (e.g. Citigroup Private Bank, Credit Suisse Private Banking, HSBC Private Bank, RBS Private Banking, UBS Wealth Management).
- Those whose brands are named after their founders (e.g. Coutts, Julius Bär, Lombard Odier Darier Hentsch, Pictet, Sarasin & Cie Co.).
- The composite brands that combine both (e.g. RBS Coutts, ABN Delbrück Bethmann Maffei, HSBC Trinkhaus & Burkhardt).

The first set rely on their masterbrands to differentiate themselves, using the descriptor of “Private Bank” or “Private Banking” or “Wealth Management” to promote their professionalism and high levels of personal service. They typically have the advantage of relatively high awareness, particularly among groups of potential customers who are new to Private Banking. Those brands that operate a Hybrid model by combining substantial Investment Banking and Wealth Management divisions (e.g. UBS, Credit Suisse) tend to have some perceived strengths in capital markets-related businesses and Asset Management. However, those that are seen as Universal or Retail Banks (e.g. RBS, NatWest, BNP Paribas) have the perceptual disadvantage of their brands being associated with general banking services, so lack exclusivity.

---

<sup>5</sup> David Hensley, Senior Partner, Lippincott (part of Oliver Wyman Group).

The second group uses separate brands, usually the names of one or more founders, whether they are true independent private companies (e.g. Pictet, Lombard Odier Darier Hentsch) or separately branded subsidiaries of large international banks (e.g. Coutts, which is a subsidiary of RBS, or Sarasin & Cie., in which Rabobank has a substantial interest). These typically emphasise their heritage: The four names above were founded in 1805, 1796, 1692 and 1841, respectively. An impression of heritage may give some prospective clients a sense of prestige. The fact that heritage is often emphasised suggests that the older Private Banks believe this part of their brand image is important to their continued success in attracting and retaining clients.

A recent trend sees banks pursuing a third, composite branding strategy, trying to capitalise on the benefits of both approaches described above. This entails combining a masterbrand with a traditional Private Banking name, such as RBS Coutts (the non-UK brand for Coutts), ABN Delbrück Bethmann Maffei or HSBC Trinkhaus & Burkhardt. They have to balance the increased awareness that the masterbrand brings – and the possible advantage in cross-selling to existing customers of the parent bank – with the disadvantages of loss of perceived exclusivity and cachet. The heritage of the traditional name may still be visible, but “VW Bentley” would feel less exclusive than “Bentley”, to use an analogy from the automotive industry, and a “Ford Aston Martin” with the Ford blue oval on the front would undoubtedly lose some of its appeal. These composite brands also increase the reputational risk to their brand, as any reputational issues from other parts of the group (e.g. around sub-prime lending or rogue trader scandals) could impair a Private Banking reputation that has taken centuries to build.

### Brand imagery

*There is little variation among Wealth Managers' brand imagery...*

If you examine the brand communications done by Private Banks, it would appear most of them assume their Private Banking customers to be a pretty homogeneous group. They all use similar brand imagery: luxury goods – especially watches – well-dressed people, old buildings, classical music and exclusive sports such as yachting and polo. Where there is a Swiss heritage, this is also commonly featured. Typically, it is imagery that the advertising agencies have long associated with inherited wealth and Private Banking.

However, when you look at Private Banking customers, particularly those target clients who will be new to Wealth Management services, you find a much broader range of people and backgrounds and tastes: entrepreneurs who have built and sold businesses; executives who

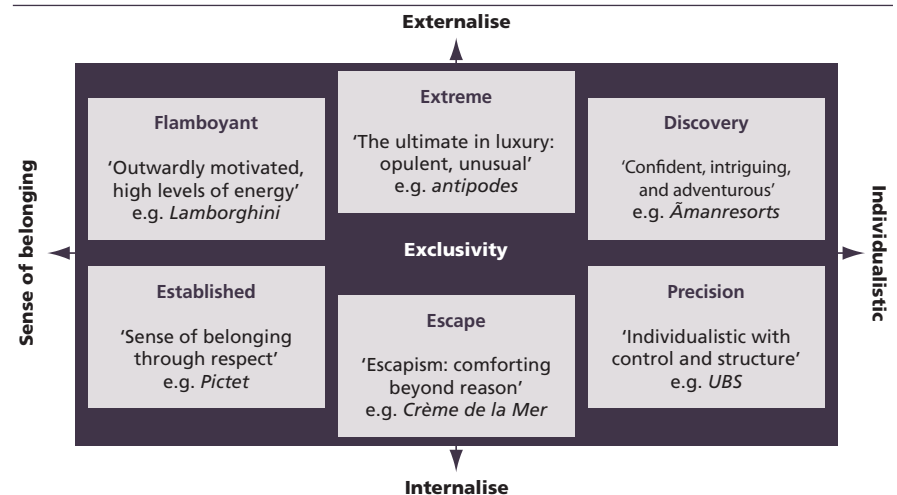
have reached the top of major organisations; sports and music stars. Whilst new money often tries to take up what it perceives to be the finest brands money can buy – drinking Roederer Cristal; wearing Chanel or Versace – it is likely that they also will gravitate to branded personal services that make them feel most comfortable.

*...leaving considerable scope for Private Banks to differentiate themselves more clearly from the competition*

This suggests that there is scope for Private Banking brands to differentiate themselves much more strongly into the different niche groups within HNWIs and UHNWIs. For example, some may want to see the accoutrements of worldly success, to reassure themselves that they have arrived. Others may want more subtlety and discretion, whilst still others may want a more functional sense of hard-nosed financial competence.

For many of the new clients, Private Banking brands are essentially luxury brands. As illustrated in Exhibit 22 below, we have analysed luxury brands across many categories and found that they essentially fall into six territories, all with a shared sense of exclusivity, but very different in the personalities that they project.

**Exhibit 22: Luxury brand territories across key dimensions**



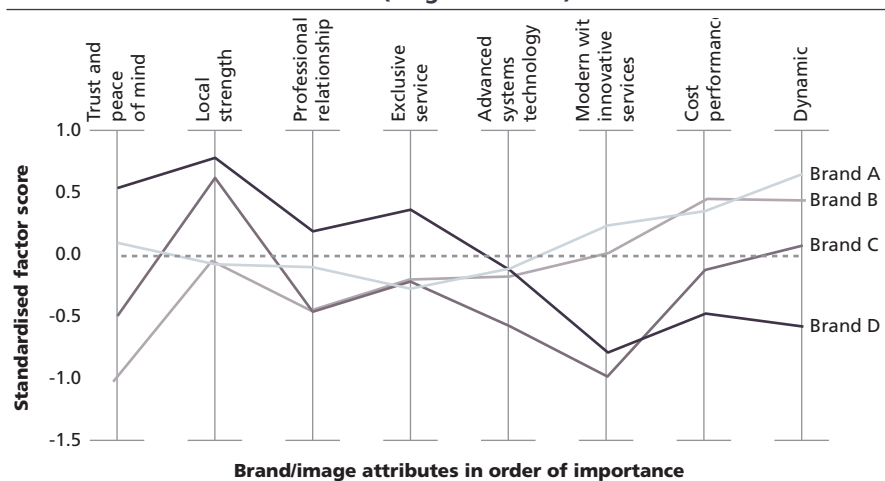
Source: Lippincott analysis

In this framework, the Private Bank brands nearly all fall into the “Established” territory (typically the smaller name brands) or the “Precision” territory (typically the Private Banking divisions of the international banks). This suggests that there are other brand positionings that could be taken by Private Banks brave enough to differentiate, which could allow them to dominate some different niches appealing to particular customer segments.

## Importance of brand attributes

Whilst Private Banks all pride themselves on the quality of their personal service, clients experience this only after they have made their choice. Therefore, prospective customers have to judge this on reputation and word-of-mouth. Although different customer segments have different preferences, Lippincott research has shown that they often consider similar sets of attributes in comparing Private Banking brands – and that the perceived strengths of the different brands vary significantly on these attributes, quite probably more than the actual operational differences between the brands, as highlighted in Exhibit 23.

**Exhibit 23: Brand perception amongst Private Banking clients against most relevant brand attributes (disguised data)**



Source: Lippincott analysis

For Private Banking brands to succeed, they need to identify the differences between themselves and their competitors, both actual and perceived, then work out how to build their brand reputations on the issues that matter. This will typically be a matter of managing their customer experience across all of the customer touchpoints, as well as refining their communications. It is not an easy task to get right, but the opportunity is significant. Put simply, it is a matter of answering the seven questions outlined below.

### Food for thought

- Who are our target clients, defined by geography, by assets, by behaviour, by source of wealth or simply by attitude?
- What are the attributes that cause them to select one Private Bank over another? (Not what they say is important to them, but what actually drives their decisions.)
- Which of these brand attributes do we want to differentiate our bank?
- Why should our target clients believe this claim?
- How will we deliver this proposition at each touchpoint with these potential clients, and with our existing clients – from whom they will seek advice? How will we develop and sustain this brand identity? How will we manage and avoid reputational risk?
- Where and when can we most effectively communicate this brand?

### 3.5 Creating value via risk management – Taking a seat at the decision-making table

*Inadequate risk management jeopardises the very foundation of Private Banks: their reputation*

Wealth Management is a franchise-driven annuity business, and inadequate risk management jeopardises its very foundation. We are only starting to see the impact (lower or negative Net New Money growth and high-profile RM departures) of recent industry events, including inappropriately managed sub-prime exposure, data management (data trading and data loss) and fraud; but already Wealth Managers have been painfully reminded of the paramount importance of sound risk management to protect their reputation and franchise for the long run.

Whilst these recent high-profile events have catapulted risk management into the spotlight, other more fundamental trends have continuously been moving risk management up on the agenda. These underlying trends have transformed Wealth Management from a historically low-volatility business, where risk management considerations have largely been confined to helping measure and manage clients' investment risks, into a higher-volatility business with increasing focus on shareholder and owner risk. Managing and mitigating these risks is particularly relevant for banks that are exposed to analyst scrutiny, since a lower valuation ratio translates directly into a very tangible decrease in shareholder value.

*Wealth Managers are experiencing higher revenue volatility, whilst at the same time are increasingly subject to analyst scrutiny*

### **Factors driving risk management needs for Wealth Managers**

First, trust is a critical requirement of a successful Wealth Management proposition – an ingredient that is strengthened by a reputation for sound risk management, and threatened if risk management is weak. It is also a factor that is coming under much closer scrutiny, as shown by recent industry events.

Second, new products come with new risks. Products such as lending and alternative investments, features such as principal protection and flexible redemption schedules, and new fund seed investments all introduce complexity, which asymmetrically impacts earnings risk. Moreover, such products can increase the potential for liquidity and solvency issues, as well as specific non-financial risk concentrations (e.g. pricing/model risk, legal risk, etc.). The increasing relevance of performance-based fees has also made earnings more volatile.

Third, the growing regulatory burden adds complexity and operational risk. We also expect the industry to see a spill-over from the rating agency focus on financial services (Moody's explicitly evaluates operational risk when assessing banks; S&P launched requirements for enterprise risk management in assessments of insurance businesses).

In the typical risk management frameworks used by Wealth Managers today, there are essentially two major shortcomings – the focus and the application:

- **Focus** – The tendency has been to attempt to import a banking-style approach that focuses on funding and solvency (focus on the latter increased with Basel II). The problem is that this approach is simply not that relevant for Wealth Management. Although economic capital could become a constraint for managers seeking to enter lending businesses, reputation, operational risk and earnings volatility management are far more appropriate issues on which to focus.
- **Application** – Even when the focus is right, risk management remains sitting in its own silo and is not properly embedded in day-to-day operations or finance processes. A proper risk strategy and articulation of risk appetite by the board and management should set the agenda for focusing resources and ensuring links to planning, product development, performance measurement and other key processes.

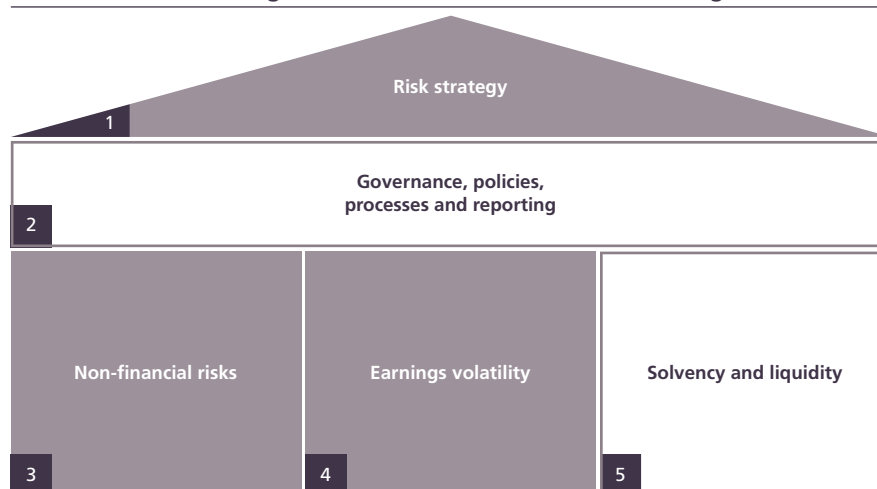
*Best practice risk management must focus on non-financial risks such as operational and reputational risks*

## Best practice risk management framework for Wealth Managers

In our view, a best practice risk management framework for Wealth Managers is based on five pillars: 1) overall risk strategy; 2) governance, policies, processes and reporting; 3) regular identification and prioritisation of non-financial risks; 4) identification and modelling of earnings volatility drivers; and 5) identification of major solvency- and liquidity-threatening scenarios (Exhibit 24).

We will focus here on the three pillars that, in our view, differ most from the standard approaches in play and that are most material to Wealth Management today: the overall risk strategy, the focus on non-financial risks, and earnings volatility.

**Exhibit 24: Risk management framework for Wealth Managers**



Source: Oliver Wyman

### Set the overall risk strategy

A Wealth Manager's risk appetite needs to be set in line with broader strategic objectives, and must reflect both shareholder and investor concerns. Risk appetite statements should articulate the amount of risk the entity is willing to accept. They should touch on constraints such as target debt rating, earnings volatility tolerance, target capital ratios, operational risk, franchise risk and strategic risk. The choice of the right risk appetite framework needs to then be operationalised through appropriate policies, risk limits, reporting and governance, and be embedded in the strategic planning process. Best practice reporting to the board is based on concise comparison of actual risk profiles vs. stated risk appetite and/or tolerance.



### **Non-financial risks – identify and prioritise non-financial risks**

Non-financial risks include operational and reputational risks, the key risks for Wealth Managers. Given the relatively narrow business model in Wealth Management, our experience suggests that as few as 10 specific risks account for the vast majority of major potential impacts to earnings and capitalisation through mismanaged operational processes or damaged reputation. Whilst these top risks vary by player, they typically include confidentiality breaches, data security, fraud, key people risk, regulatory risk including appropriateness and fiduciary responsibility, and spill-over reputational risk from other business operations. This top-down prioritisation is critical in our view and needs to happen first. Only then should the required detailed compliance and audit processes be created and implemented for the top risks identified. This kind of prioritisation process not only has proved very cost-effective, but also gives the board more comfort, knowing that the biggest operational and reputational risks are under control.

### **Financial risks – model earnings volatility**

For managing financial risks, the focus should be on earnings volatility (i.e. the deviation from forecast over a given time horizon), which captures the true drivers of risk in the core business. The main sources of earnings volatility are performance fees, equity exposure, fixed income, money market products and loan portfolios. The assessment of earnings volatility begins with the identification of the key value drivers across the individual businesses. These value drivers are then modelled to simulate the P&L under different scenarios. This approach gives a better understanding of “business as usual” risks (e.g. a drop in sales, redemptions, fund returns), both improving the ability to meet (analyst) earnings targets and providing better advice to management on how the portfolio of business can be optimised. Specific strategic initiatives to reduce earnings volatility include reviewing the fee structure (e.g. stabilising earnings through redemption fees), increasing the cost flexibility and diversifying across asset classes as well as grow in uncorrelated asset classes.

### **Food for thought**

- Is our risk management framework at best practice vs. peers? Is it sufficiently tailored to our specific product-client mix?
- Have we defined/communicated our overall risk appetite? Is it in line with broader strategic objectives and the constraints of stakeholders?

- Have we identified the major risk exposures and drivers which threaten breaches to risk tolerances and hence our reputation and franchise? Have we explored significant scenarios that would result in economic losses? Have we quantified the risk exposures and calculated risk budget utilisation?
- Have we the appropriate authority levels and governance in place for controlling/monitoring the risk profile in a forward-looking manner?
- Have we modelled the major drivers of earnings volatility and used this in target setting and strategic planning processes?
- Have we concisely defined our top 10 non-financial risks and clearly documented the relevant controls?
- Can our risk management systems handle the broad range of assets owned by our clients? Do our RMs understand the limitations and nuances of the risk systems? Are the proper procedures in place so that all BUs are equally aware of their risks? Have we dealt appropriately with data risk management (i.e. who has access to client data, who can edit/download data)?

## Your next steps?

In the course of the preceding pages, we have set out our views on Private Banking. In particular, we have touched on the challenges of an increasingly competitive environment, as well as on some of the levers that Private Banks can pull to better position themselves to win clients, to grow assets and to attract the best talent.

In light of this, what should your next steps be?

**In summary, the key questions you should strive to answer are:**

- Do we have a clear view of both our competitive positioning and the implications of anticipated changes in the global Wealth Management landscape? Under what circumstances does geographical expansion look like a viable strategy?
- Do we fully understand the impact of our main value drivers on our business economics and how do we take advantage of this knowledge to improve our position?
- Do our business decisions, our strategic positioning and our approach to managing risks reflect the long term annuity character of Private Banking, or are we short-term opportunistic and potentially risking the long-term prospects?

**In addition, if you are the CEO or Head of Private Banking of a larger player:**

- Are we clear about the relevance of Wealth Management to our organisation? And are we appropriately safeguarding against negative reputational spill-over from other BUs?
- Have we optimised the coordination between our various BUs or is there anything we can do to improve synergy extraction that will benefit the client?

**In addition, if you are the CEO or Head of Private Banking of a smaller player:**

- Have we occupied a niche – geographical, product or client-related – that will support attractive economics in the future?
- Have we taken steps to ensure client access to alternative investment products and specialised services? Do we have the right manufacturing model and have we assessed options for establishing networks with our peers?

Time is ripe for strategic thinking in private banking. This starts with an objective reflection of where you currently are, of what is happening in your immediate surroundings as well as what is happening in the wider realm of Private Banking. Given the long-term annuity nature of Private Banking, the view must take into account long-term trends. Overall, a tricky but important undertaking to realise the wealth of opportunity available.

March, 2008

Stefan Jaecklin

Marc Deuster

Ricarda Demarmels



## Terminology used in this report

**Advisory Model** – Wealth Management model that is characterised by a focus on the provision of advice and financial planning, as well as discretionary or advisory portfolio management to individuals and families; typical of both offshore Private Banking and many European onshore markets (e.g. France, Germany, Italy, Switzerland)

**APAC** – Asia Pacific

**AuM** – Assets under Management; denominates client assets placed with a Wealth Manager under a brokerage, advisory or discretionary mandate

**Broker/Dealer Model** – Wealth Management model in which players primarily trade securities for customers and for their own accounts. This style is characterised by a strong focus on transactions and frequent client contacts; typical of a significant part of the US private client business

**BU** – Business Unit

**CAGR** – Compounded Annual Growth Rate

**FSBD** – Full Service Broker/Dealer; Broker/Dealer that offers a variety of services to clients, such as research, tax planning, etc.

**GNM** – Gross New Money; gross (i.e. not accounting for defections) inflow of new client AuM over the course of a given time period

**HNWIs** – High Net Worth Individuals (individuals with investable assets of US\$1 MM+)

**Hybrid Model** – Organisational model that aims to achieve a close integration of asset-gathering businesses (Wealth Management and Asset Management) with Investment Banking. Major listed banks in this category include UBS, Credit Suisse and Merrill Lynch

**IB** – Investment Banking

**Institutionalisation** – In this report, refers to the process of tying client loyalty to an institution/franchise, rather than to an individual Relationship Manager

**LatAm** – Latin America

**NNM** – Net New Money; net inflows of new client AuM over the course of a given time period

**Offshore Wealth Management** – Private Banking business focused on the administration/management of non-resident clients' wealth

**Onshore Wealth Management** – Private Banking business focused on the administration/management of resident clients' wealth

**Private Banking** – Used interchangeably with the term “Wealth Management” in this report; denominates the servicing of High Net Worth Individuals and is not synonymous with the servicing of “Private Clients”, a term that is commonly used in the US to mean the servicing of clients with more than US\$150-200 K in investable assets

**Pure Play Wealth and Asset Manager (WAM)** – Organisational model that focuses entirely on asset-gathering businesses (Wealth Management and Asset Management). Major listed banks in this category include EFG International, Julius Bär and Sarasin

**RB** – Retail Banking

**RIA** – Registered Investment Advisor; firm or individual registered with the Securities and Exchange Commission, acting as advisor to private clients (often HNWIs)

**RM** – Relationship Manager

**RM loading** – Number of clients serviced by one Relationship Manager

**SoP** – Sum-of-the-Parts valuation; approach to valuing a financial institution by valuing its constituent businesses individually, adjusting for group-level issues (e.g. surplus capital), if required

**UHNWIs** – Ultra High Net Worth Individuals (individuals with investable assets of US\$30 MM+)

**Wealth** – Refers to Wealth pools; Wealth pools are defined as financial assets of High Net Worth Individuals, excluding pension assets. For the US, these are total financial assets, excluding all pension fund assets – except for IRAs and annuity reserves at life insurance companies, which are included

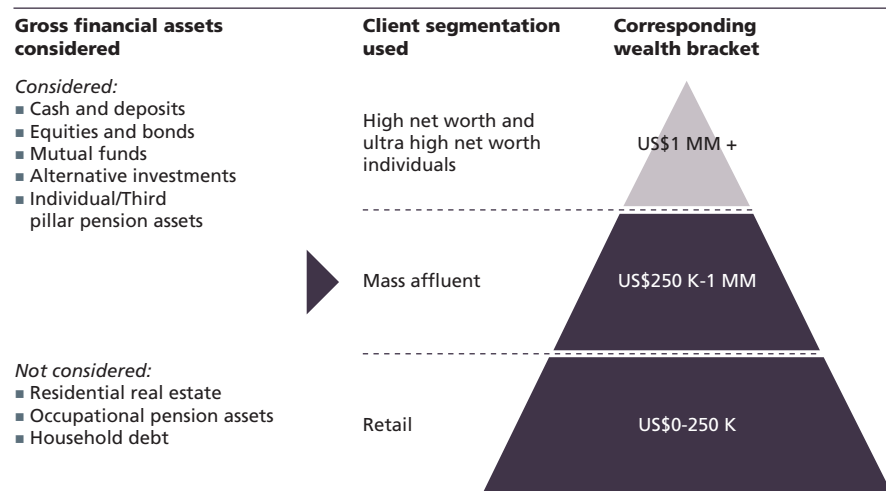
**Wealth Management** – Used interchangeably with the term “Private Banking” in this report

# Appendix on market sizing methodology

## Definitions

Regional wealth pool estimates presented in this report are the output of Oliver Wyman's proprietary Wealth Model. The definitions of "wealth" and "wealth brackets" used to create Exhibits 1-3 of this report are delineated in Exhibit 25 below.

**Exhibit 25: Wealth and segment definitions used in the Oliver Wyman Wealth Model**



Source: Oliver Wyman

## Methodology for estimating global HNWI asset pools

The Oliver Wyman Wealth Model is based on three fundamental building blocks:

- A. Estimation of total onshore financial assets** – For each country analysed, we estimate total household gross financial assets as defined above. Wherever possible, we rely on official records of households' balance sheets, as provided by national banks and the OECD. Where such data is not available, as is the case for many Latin America, Asian or Eastern European countries, we leverage empirical relationships among the state of economic development, geography, GDP and financial assets to determine the total asset pool for a specific base year.

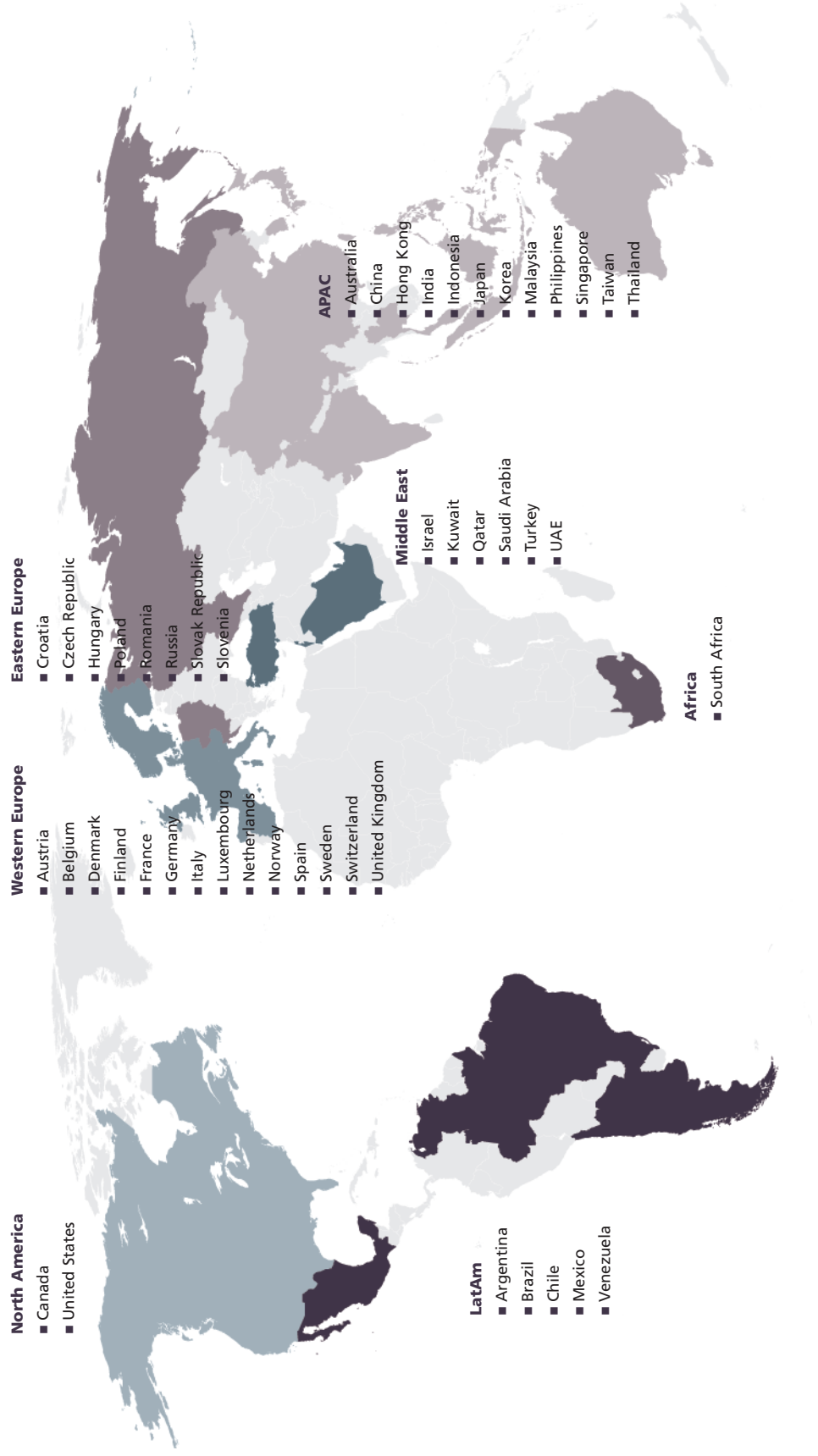


Forecasts and further estimations are then made by taking into account the wealth-generating effects of expected GDP growth, savings rates, regional asset allocations and expected performance of regional and global stock markets (based on the Capital Asset Pricing Model).

- B. Overlay of wealth distribution** – In a second step, we overlay each country's financial asset pool with a distribution describing regional wealth inequality. To this end, we employ a Lorenz curve-based methodology that relies both on publicly available wealth distribution data and generally accepted relationships between wealth distribution and a country's state of economic development.
- C. Estimation of offshore assets** – Finally, we complement onshore data by deriving estimates for wealth pools held offshore. Due to the nature of the business, information on offshore banking can only be described as patchy at best. Using a regression analysis, we extrapolate existing offshore data points on individual countries to a wider range of geographies. As explanatory variables, we rely on marginal tax rate figures and composite indices describing a country's degree of "economic openness". The latter is a composite including aspects such as a country's degree of fiscal freedom, property rights and freedom from corruption.

## Oliver Wyman Wealth Model

The Oliver Wyman Wealth Model explicitly analyses 48 countries grouped into seven major regions, covering some 95% of total world GDP.



# “The Future of Private Banking” – Regional contacts:

## Head of Wealth and Asset Management

Dr. Stefan Jaecklin      +41 44 553 34 02  
stefan.jaecklin@oliverwyman.com

## Europe

Dr. David Clarkson      +44 20 7852 7515  
david.clarkson@oliverwyman.com

Julia Hobart      +44 20 7852 7432  
julia.hobart@oliverwyman.com

Toby Pittaway      +44 20 7852 7564  
toby.pittaway@oliverwyman.com

## APAC

David Noble      +852 2506 0767  
david.noble@oliverwyman.com

John Sullivan      +61 2 8864 6561  
john.sullivan@oliverwyman.com

## North America

Denis Bastin      +1 646 364 8445  
denis.bastin@oliverwyman.com

Arjun Saxena      +1 646 364 8452  
arjun.saxena@oliverwyman.com

Anne Marie Schultz      +1 646 364 8521  
annemarie.schultz@oliverwyman.com

## Lippincott

David Hensley      +44 20 7915 9802  
david.hensley@lippincott.com



# OLIVER WYMAN

For more information please contact Dr. Stefan Jaecklin, Head of Wealth and Asset Management by phone on +41 44 553 34 02 or by email at [stefan.jaecklin@oliverwyman.com](mailto:stefan.jaecklin@oliverwyman.com), or contact the marketing department by email at [marketing.fs@oliverwyman.com](mailto:marketing.fs@oliverwyman.com) or by phone at one of the following locations

## EMEA

+44 20 7333 8333

## North America

+1 212 541 8100

## Asia Pacific

+65 6510 9700



MARSH MERCER KROLL  
GUY CARPENTER OLIVER WYMAN