BCG

REPORT

Global Wealth 2009

Delivering on the Client Promise

The Boston Consulting Group

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Preface

This is our ninth Global Wealth report. Like the previous reports, it begins with a comprehensive review of wealth around the world. This review covers 62 markets representing about 98 percent of global wealth.

The report also includes a benchmarking study of 124 wealth-management institutions. The participants held a total of $5.9 trillion in assets under management at year-end 2008. To round out our analysis of the benchmarking results, we conducted about 40 in-depth interviews with wealth management experts from various regions and drew on the experience of about 45 BCG experts worldwide. Their views helped us understand the crisis-induced changes in client behavior, the challenges facing offshore banking centers, and the strategies and actions necessary for thriving in the postcrisis world. We are grateful to the benchmarking participants and interviewees for their invaluable insights.

We welcome your comments, and we hope you find the report both interesting and useful.

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Executive Summary

Global wealth declined for the first time since 2001. Measured in local currencies, global wealth fell by 11.7 percent in 2008 to $92.4 trillion. We believe that wealth will resume its growth trajectory in 2010, but the recovery will be gradual—we expect assets under management (AuM) to grow at an average annual rate of 3.8 percent from year-end 2008 through 2013.

Wealth became slightly less concentrated. AuM held by nonwealthy households—those with less than $100,000 in AuM—increased by 2 percent, while wealth in all other client segments declined. The number of millionaire households fell from 11 million to about 9 million in 2008. In both Europe and North America, the number of millionaire households fell by 22 percent. Singapore had the highest density of millionaire households at 8.5 percent.

An even more important change occurred in client behavior. Clients abandoned complex, arcane products in favor of simple, low-margin investment solutions focused on preserving wealth rather than growing it. The crisis also made clients acutely aware of the shortage of holistic advice. Even when their risk appetite returns, clients will continue to demand a far higher and more comprehensive level of service. This has major implications for wealth managers—and for the role of the relationship manager (RM) in particular.

Wealth managers were resilient. Wealth managers in our benchmarking study had a median pretax profit of 30.0 percent of revenues, and only a few incurred losses. Still, the pressures created by the crisis were visible in many performance measures. Cost-to-income ratios increased in most regions. The biggest jump was in Asia, where the median cost-to-income ratio rose from 62.9 percent to about 80 percent. Given the downward pressure on revenues—attributable to the decline and reallocation of assets, both of which will continue throughout 2009—most wealth managers will need to focus intently on lowering costs in order to improve this ratio.

The industry is being pulled in opposite directions. Revenues and profitability are sliding at a time when clients want more intensive service. As a result, wealth managers will have to do more with less. Reinventing the role of the RM to suit an advisory (rather than a product-push) model will provide a foundation for success, but wealth managers will also need to make changes throughout the business. RMs, for example, will require access to a large network of specialists such as portfolio managers, technical analysts, and external experts.

Pressure is mounting on offshore wealth. The amount of offshore wealth fell to $6.7 trillion in 2008, down from $7.3 trillion in 2007. The decline was relatively modest, considering the pressures facing offshore centers. The most overt threat comes from the increasing involvement and scrutiny of regulators, but offshore centers are also contending with a growing preference for onshore investments. They will need to have more than a one-dimensional offering to protect and grow their position in the offshore market—being inconspicuous and discreet is a tenuous value proposition in an era of increasing oversight. As in other markets, banks in offshore centers will need to provide comprehensive advice.

Wealth managers can take advantage of the flow of clients and assets. There is a window of opportunity to act while assets remain liquid and relationships remain fluid. Institutions that have gained ground because of the crisis need to cement their new relationships by showing that they are more than just temporary safe havens. Wealth managers that have lost clients and assets must redouble their efforts to improve their offerings and to demonstrate their commitment to building solid relationships. In general, wealth managers can deal with the pressures created during the crisis by taking four steps:

- *Recruit, train, and reward RMs who are focused on providing tailored, client-oriented advice, not pushing products.* Wealth managers will win or lose based on their RMs' ability to forge deep relationships and provide comprehensive advice. RMs, in turn, must be able to leverage a network of experts and specialists.

- *Revamp product and service strategies.* For the time being, clients want offerings that are simple and conservative, although some are already searching for solutions that will enable them to benefit from an upturn. Banks should concentrate on areas in which they have a competitive advantage or can add value for the client, and outsource or simply not offer undifferentiated products and services.

- *Focus intently on controlling costs.* Wealth managers must not confine their efforts to quick cuts but should also look for opportunities to fundamentally improve their cost position.

- *Develop new strategies for managing offshore wealth.* Wealth managers can deal with the challenges to offshore banking by moving abroad to capture onshore assets and by focusing on fully transparent and sustainable offshore AuM. In general, they should emphasize three attributes: their capabilities as wealth managers, their proximity to large or high-growth wealth markets, and their attractiveness as destinations in their own right.

It is a rare point of inflection for wealth managers. We fully expect assets to continue flowing largely within (not out of) this sector, particularly once a recovery takes hold. Because of this flow, well-prepared wealth managers will emerge from the crisis in a much stronger position, primed for sustained growth—but only if they invest now (ahead of the upturn) in a well-defined, clearly differentiated value proposition based on a set of core products and services.

Market Sizing

The Global Perspective

Global wealth, measured in local currencies, fell by 11.7 percent in 2008 to $92.4 trillion.[1] But this decline—the first since 2001—only hints at the transformative impact of the financial crisis and the ensuing economic downturn.

The share of global wealth held in equities decreased from 39 percent to 28 percent in 2008, driven mainly by significant losses in most capital markets. At the same time, investors—stung by these losses—changed how and where they invest. Many shifted their AuM from equities to more conservative investments.[2]

The crisis has taken a heavy toll on wealthier households. The number of millionaire households declined by 17.8 percent to about 9 million in 2008. Still, global wealth remained highly concentrated. A mere 0.6 percent of households were millionaire households, and they owned 35.6 percent of all private wealth.

We expect global wealth to resume its growth in 2010, but the recovery will be gradual—we project AuM to grow at an average annual rate of 3.8 percent from year-end 2008 through 2013.

Global Overview

The effect of the crisis on wealth mirrored its broader impact on the world's economies. The damage was most pronounced in larger, more developed markets such as North America and Western Europe. Elsewhere, the effects ranged from slight to severe.

- Latin America's political and economic structures have evolved considerably, and most banks had limited exposure to the U.S. real-estate market. As a result, the region has avoided both a banking crisis and a credit crunch. Brazil's wealth market has been particularly resilient owing to a steady increase in onshore AuM.

- Eastern Europe has been severely affected by the credit crunch. Many of the region's banks are subsidiaries of foreign banking groups, some of which had trouble refinancing and had to cut funding for their noncore businesses. In addition, many loans were made in currencies such as the euro or the Swiss franc to take advantage of much lower interest rates in those currencies. When Eastern European currencies devalued at the end of 2008, credit default rates soared. Nevertheless, the region's financial system has remained intact, defying some forecasts that it would collapse.

- The crisis has had a moderate impact in the Middle East. Real estate markets dropped by 30 to 40 percent in 2008 before showing signs of a slight recovery in the second quarter of 2009. The region's economies are not expected to contract, but they have experienced a significant slowdown in GDP growth. Many wealthy families have been affected by the turmoil in Western markets.

1. Unless stated otherwise, growth rates are calculated in U.S. dollars and include AuM owned by all households (not just wealthy households). Numbers measured in local currencies use end-of-year 2008 exchange rates for all years to exclude the effects of exchange rate fluctuations.

2. AuM includes cash deposits, money market funds, listed securities held directly or indirectly through managed investments, and onshore and offshore assets. It excludes wealth attributed to investors' own businesses, residences, or luxury goods. Global wealth reflects total AuM across all households.

- Asia's equity and real estate markets have declined, but the region as a whole has been insulated from the worst effects of the crisis owing to its high levels of cash holdings and relatively strong economies. The impact of the turmoil has varied by country. Although Indonesia and China suffered sharp reductions in industrial production, they are still performing relatively well. The Chinese economy is expected to grow by almost 8 percent in 2009. In Malaysia, the national pension funds have fallen in value by 25 percent and GDP is contracting. Thailand's economy is also shrinking, but the country's challenges are more political than economic.

Europe nudged out North America as the wealthiest region at the end of 2008. Its AuM totaled $32.7 trillion measured in local currencies, while wealth in North America (defined in this report as the United States and Canada) totaled $29.3 trillion.[3] The levels of AuM were closely correlated with the revenue pools for wealth managers. (See the sidebar "Revenue Pools.")

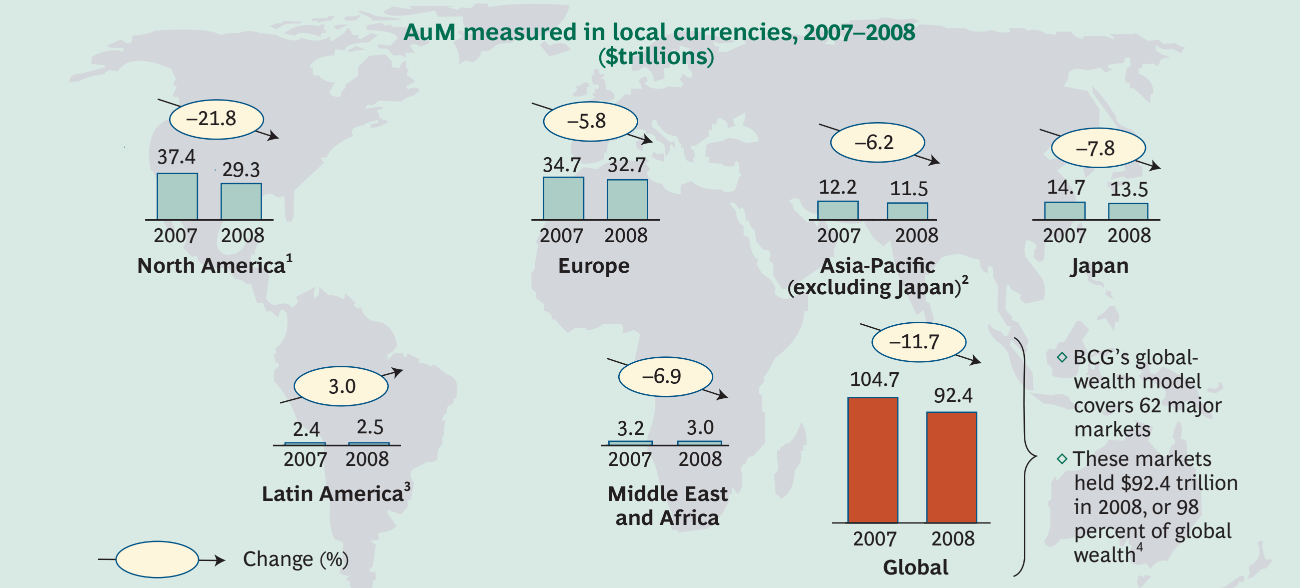
The United States remained by far the wealthiest country, with $27.1 trillion in AuM. Japan had the second-highest AuM at $13.5 trillion. Wealth in the remainder of the Asia-Pacific region totaled $11.5 trillion. The smallest regional markets were the Middle East and Africa, at $3.0 trillion, and Latin America, at $2.5 trillion.

Wealth declined in most regions. The growth of global wealth, measured in local currencies, fell from 6.2 percent in 2007 to –11.7 percent in 2008, mainly because of the steep losses in major stock markets. (See Exhibit 1.) Latin America was the only region where wealth increased; its AuM grew by 3 percent measured in local currencies.

The biggest wealth decline was in North America, where AuM fell by 21.8 percent. Japan had the next-highest de-

3. The level of AuM in North America was affected by our decision to exclude defined-benefit pensions from the definition of U.S. household wealth in 2008. These adjustments were made retroactively to our data from 2003 through 2007.

Exhibit 1. Wealth Declined in All Regions Except Latin America



Source: BCG Global Wealth Market-Sizing Database, 2009.
Note: Percentage changes and global totals of AuM are based on complete, not rounded, numbers. AuM levels for 2007 vary slightly from last year's report because of changes in the underlying macroeconomic data and the exclusion of defined-benefits pensions from U.S. household wealth. Global wealth is measured by AuM across all households; growth rates are measured in local currencies. AuM in 2007 was calculated using 2008 U.S. dollar exchange rates, so that growth rates exclude the effects of currency movements.
[1]United States and Canada.
[2]Includes Australia and New Zealand.
[3]South America, Central America, and Mexico.
[4]The remaining 2 percent of global wealth was spread across 119 markets.

Revenue Pools

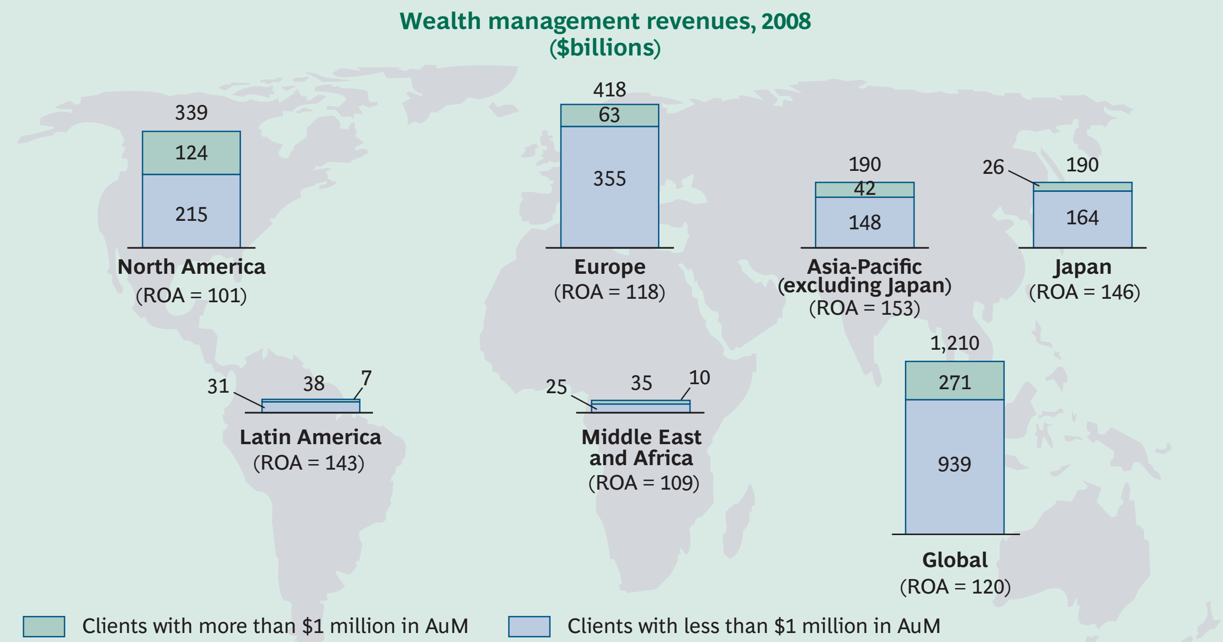
In 2008, the global revenue pool for wealth managers declined by only 2 percent to about $1.2 trillion. Good performance in the first half of the year helped offset much weaker performance in the second half.

Revenue pools are driven mainly by the total wealth in a market, but they can also be affected by pricing and price realization, as well as by changes in the asset and product mix—such as the recent shift to more conservative, lower-margin products. Accordingly, two markets that have similar levels of wealth could have significantly different revenue pools.

Europe had the largest revenue pool at about $418 billion, followed by North America at about $339 billion. (See the exhibit below.) Both Japan and the rest of Asia-Pacific had revenue pools of around $190 billion. The smallest revenue pools were in Latin America, at about $38 billion, and the Middle East and Africa, at about $35 billion.

Most revenues were derived from clients with less than $1 million in AuM. They accounted for $939 billion of the total revenue pool. Millionaire clients, by comparison, accounted for $271 billion in revenues.

North America and Europe Had the Largest Revenue Pools

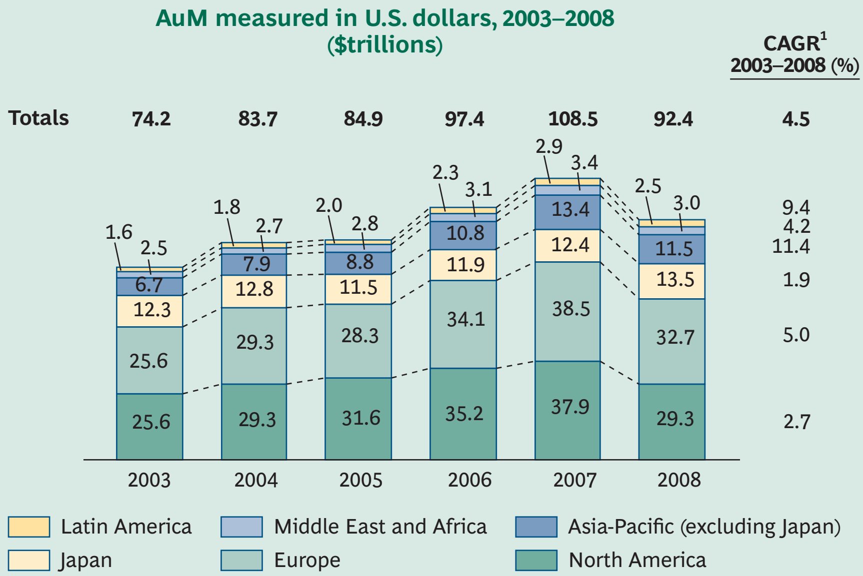


Source: BCG Global Wealth Market-Sizing Database, 2009.
Note: Revenue pools were based on average yearly AuM in 2008 and exclude revenues from lending businesses. ROA is an average (in basis points) in 2008; it is calculated as revenues divided by yearly average assets and liabilities.

cline at 7.8 percent, followed by the Middle East and Africa with a decline of 6.9 percent, Asia-Pacific (excluding Japan) with a decline of 6.2 percent, and Europe at a 5.8 percent decline. These changes were measured in local currencies to exclude the effects of fluctuating exchange rates.

Measured in U.S. dollars, global wealth shrank by 14.8 percent, with all major currencies—apart from the Japanese yen—losing value relative to the dollar. (See Exhibit 2.) European wealth declined by 15.2 percent measured in U.S. dollars. In Latin America—where wealth experienced positive growth measured in local currencies—AuM declined by 14.7 percent. In Japan, however, the strong yen turned a decline of 7.8 percent (measured in local currencies) into a gain of 9.4 percent (measured in U.S. dollars).

Exhibit 2. A Strong U.S. Dollar Magnified Losses in Many Regions



CAGR[1] 2003–2008 (%)	Change (in U.S. dollars) 2007–2008 (%)	Change (in local currencies) 2007–2008 (%)
4.5	–14.8	–11.7
9.4	–14.7	3.0
4.2	–11.6	–6.9
11.4	–14.3	–6.2
1.9	9.4	–7.8
5.0	–15.2	–5.8
2.7	–22.9	–21.8

Source: BCG Global Wealth Market-Sizing Database, 2009.
Note: Percentages are based on complete, not rounded, numbers. AuM levels for 2003 through 2008 vary slightly from last year's report because of changes in the underlying macroeconomic data and the exclusion of defined-benefits pensions from U.S. household wealth.
[1]Compound annual growth rate.

Losses were driven primarily by falling stock markets. Stock market losses accounted for about –13.5 percentage points of the –14.8 percent change in global AuM (measured in U.S. dollars). The rest of the change resulted from the net effect of savings, which contributed 2.2 percentage points to the growth of wealth, and the currency effect, which accounted for –3.6 percentage points.

The impact of these three factors varied widely. In North America, for example, stock market losses accounted for –22.0 percentage points of the total change in AuM of –22.9 percent (measured in U.S. dollars). In Latin America, the currency effect turned a gain of 3 percent (measured in local currencies) into a total decline of –14.7 percent (measured in U.S. dollars).

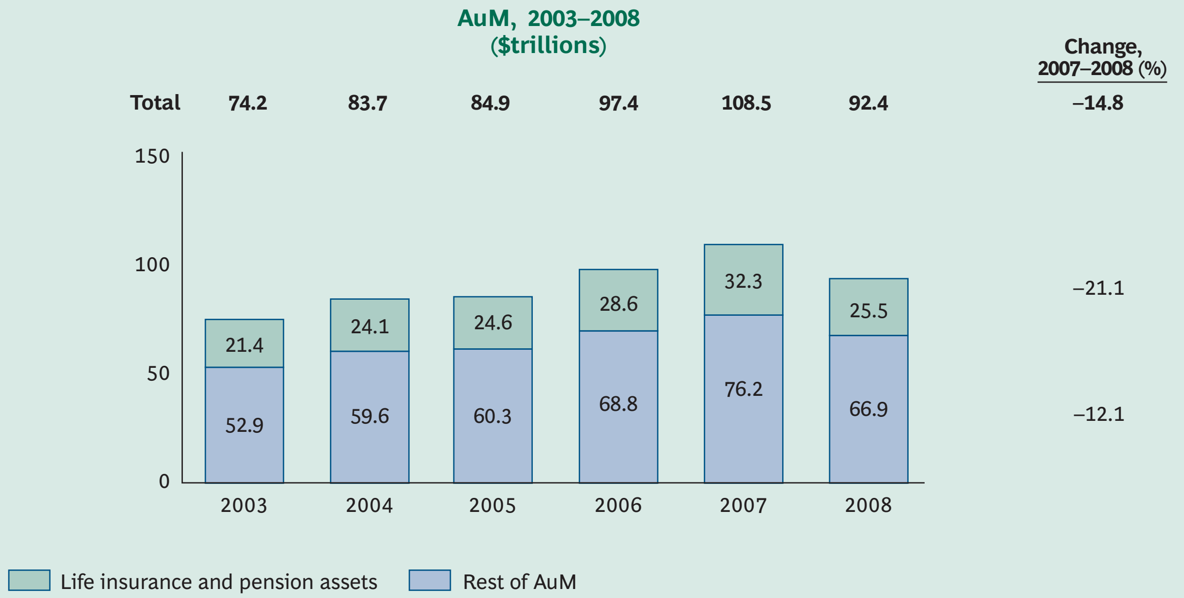
Life insurance and pension products were particularly vulnerable to the crisis. (See Exhibit 3.) Global AuM, excluding these products, declined by 12.1 percent, while assets held in life insurance and pensions shrank by 21.1 percent. These products accounted for slightly more than a quarter of total AuM. European households held 34.5 percent of their wealth in these investments, followed by Japanese households with 27.3 percent. In other regions, life insurance and pension products accounted for between 21 and 25 percent of household wealth—except in the Middle East and Africa, where they represented only 9.2 percent of total AuM.

Assets shifted away from equities. The share of global wealth invested in equities decreased from 39 percent to 28 percent in 2008, representing an absolute decline of $16.6 trillion. This was driven mainly by stock market losses, but client behavior also played a role as investors gravitated toward more conservative investments such as bonds or cash.

In North America, the share of wealth held in equities fell from 50 percent in 2007 to 38 percent in 2008—and yet the region still had the highest proportion of wealth held in equities. (See Exhibit 4.) Asia-Pacific (excluding Japan) had an equally steep decline in the share of AuM held in equities, at 12 percentage points.

Conservative investments were also affected by the crisis. Even though the *share* of wealth invested in conservative assets, such as bonds and cash, grew in all regions,

Exhibit 3. The Crisis Took a Heavy Toll on Life Insurance and Pension Assets



Source: BCG Global Wealth Market-Sizing Database, 2009.
Note: Percentages are based on complete, not rounded, numbers.

Exhibit 4. The Asset Mix Shifted Away from Equities

Source: BCG Global Wealth Market-Sizing Database, 2009.
Note: Percentages are based on complete, not rounded, numbers.

in some regions the *amount* of AuM held in these assets declined in absolute terms. In North America, wealth invested in bonds and cash fell by 6.4 percent and 4.9 percent, respectively. In Latin America, investments in bonds and cash were down by 7.5 percent and 4.8 percent, respectively. In Europe, cash investments fell by 3.5 percent. In the Middle East and Africa, they were down by 2.8 percent.

The crisis not only limited the flow of new wealth into these asset classes, it also triggered outflows. Some investors needed to use their assets to pay down debt. Others transformed their financial assets into more tangible investments, such as real estate or gold.

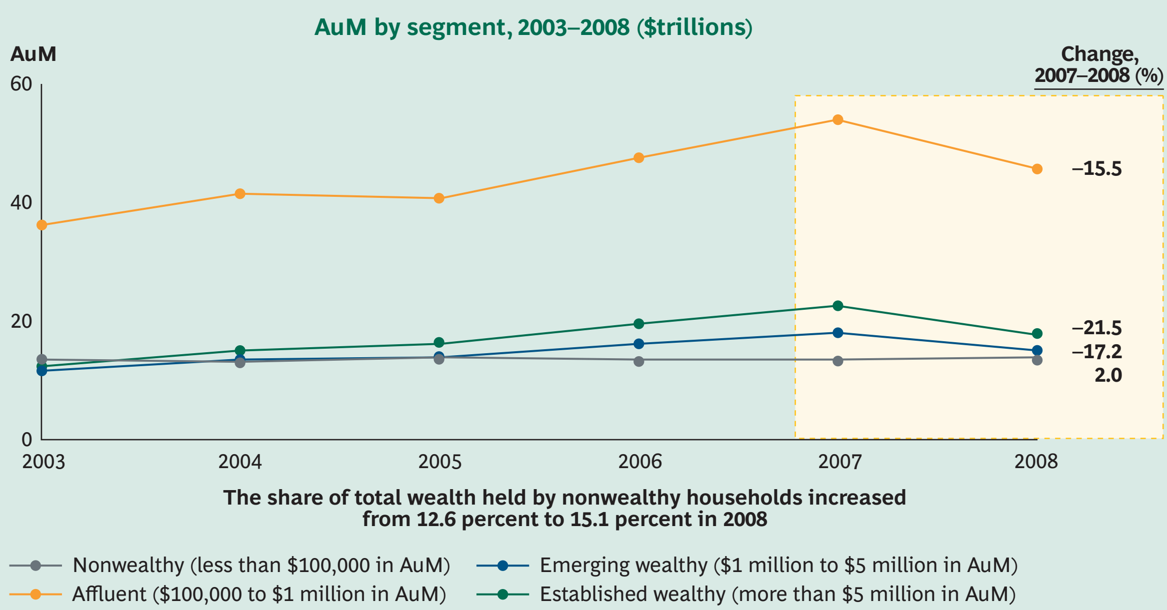
In contrast to other regions, Asia-Pacific (including Japan) saw positive growth in cash and bonds, at 10.6 percent and 9.2 percent, respectively. This underscored the shift to more conservative investment strategies in the region, particularly in Japan, where cash investments grew by 18.2 percent.

Wealth remained highly concentrated. Our study divided households into two categories: nonwealthy households, which own less than $100,000 in AuM, and wealthy households. We stratified wealthy households into three groups: the affluent, with $100,000 to $1 million in AuM; the emerging wealthy, with $1 million to $5 million in AuM; and the established wealthy, with more than $5 million in AuM.

Wealth was highly concentrated among a small group of households. In 2008, 15 percent of all households were wealthy (with more than $100,000 in AuM), but they owned 85 percent of global wealth. (See Exhibit 5.) At the same time, however, the gap between nonwealthy and wealthy households narrowed, albeit slightly. Nonwealthy households increased their AuM by 2 percent while many wealthy households saw their AuM fall sharply. The established wealthy were the most affected, given their high exposure to equity investments. Their wealth decreased by about 22 percent from $22.6 trillion to $17.7 trillion.[4]

4. As noted earlier, our definition of AuM excludes nonbankable assets, which—for the wealthiest households—can be substantial and typically include large residences, luxury goods, and other illiquid or less liquid assets, such as art.

Exhibit 5. Wealth Became Slightly Less Concentrated



Source: BCG Global Wealth Market-Sizing Database, 2009.
Note: Percentage changes are based on complete, not rounded, numbers.

The narrowing of the wealth gap owes much to a crisis-induced reclassification of households. The number of nonwealthy households increased by 4 percent last year, and the number of wealthy households decreased by 12 percent. Wealth was less concentrated in some large, industrialized nations. Nonwealthy households accounted for 85 percent of all households globally but only 47 percent of households in the G7 countries.[5] Globally, 0.6 percent of all households owned about 36 percent of all AuM, but in the G7 countries, 2.2 percent of all households owned 36 percent of AuM.

Millionaire Households

The number of millionaire households fell from 11 million to about 9 million in 2008. Europe and North America saw the biggest declines. In both regions, the number of millionaire households fell by 22 percent. Among the 62 markets in our study, the United Kingdom had the steepest decline in millionaire households at 47 percent.

At the end of 2008, the United States still had the largest number of millionaire households, followed by Japan, China, Germany, and the United Kingdom. (See Exhibit 6.)

But some small countries continued to have the highest concentrations of millionaire households. In Singapore, 8.5 percent of all households had at least $1 million in AuM. Switzerland had the highest concentration of millionaire households in Europe and the second-highest overall at 6.6 percent. Three of the six densest millionaire populations were in the Middle East—in Kuwait, the United Arab Emirates, and Qatar. Despite its larger population and direct exposure to the crisis, the United States nonetheless had the fifth-highest density of millionaire households at 3.5 percent.

Outlook

Wealth will begin a slow recovery in 2010 but may not reach its precrisis level until 2013. (See Exhibit 7.) From year-end 2008 through 2013, we expect AuM to grow at a compound annual growth rate (CAGR) of 3.8 percent and to reach $111.5 trillion. Several factors will impede a fast turnaround. Although many stock markets have shown signs of a recovery, broader economic indicators suggest

5. The G7 countries are Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

Exhibit 6. Despite the Crisis, the United States Still Had the Most Millionaires

Number of millionaire households

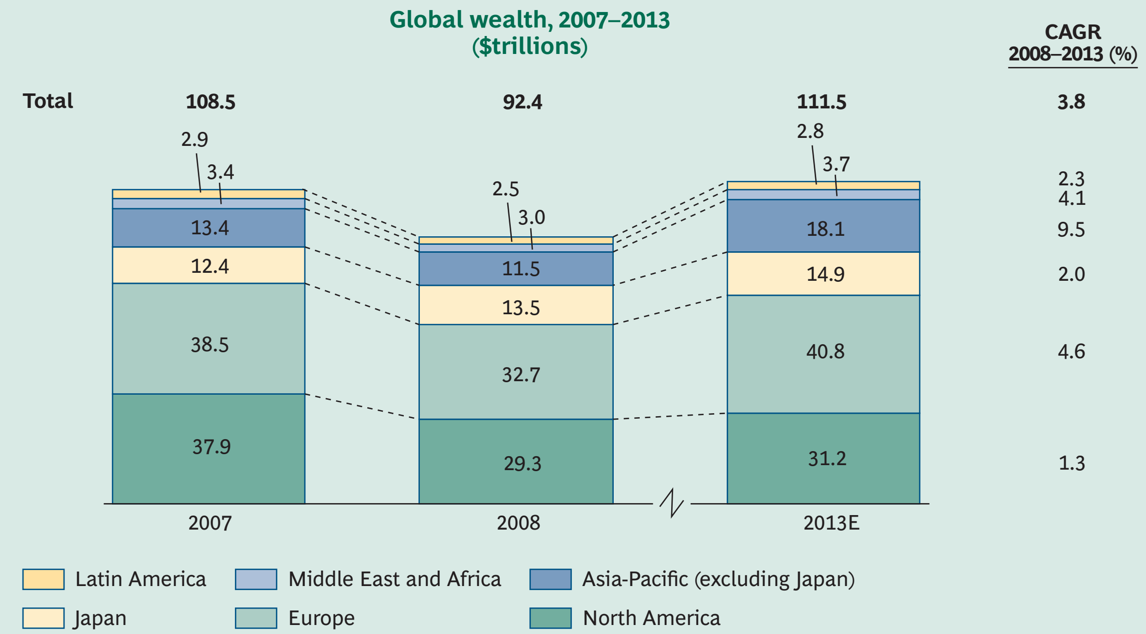
1.	United States (1)	3,980,560
2.	Japan (2)	1,085,584
3.	China (4)	417,155
4.	Germany (5)	373,565
5.	United Kingdom (3)	370,760
6.	Italy (6)	297,103
7.	France (7)	282,831
8.	Switzerland (8)	222,027
9.	Taiwan (9)	203,433
10.	Spain (12)	139,234

Millionaire households as a proportion of all households (%)

1.	Singapore (1)	8.5
2.	Switzerland (2)	6.6
3.	Kuwait (3)	5.1
4.	United Arab Emirates (4)	4.5
5.	United States (6)	3.5
6.	Qatar (5)	3.4
7.	Israel (7)	3.1
8.	Belgium (8)	2.8
9.	Taiwan (9)	2.7
10.	Japan (15)	2.2

Source: BCG Global Wealth Market-Sizing Database, 2009.
Note: Numbers in parentheses indicate rank in 2007.

Exhibit 7. Global Wealth Will Not Reach Its Precrisis Level Before 2013



Sources: BCG Global Wealth Market-Sizing Database, 2009; BCG analysis.

that a downward correction of major stock markets is still possible. In addition, wealth has been flowing out of bankable assets into tangible investments such as real estate or gold, which are not included in our definition of AuM. Additionally, entrepreneurs in many markets have been forced to underwrite their ventures using their own wealth.[6] And with unemployment rising in many markets, a growing number of households—particularly in the lower wealth bands—will be forced to tap into their savings. Finally, the uncertain outlook for many economies is deterring new investments, thereby limiting the creation of wealth.

Asia-Pacific (excluding Japan) is expected to be the fastest-growing wealth market. From year-end 2008 through 2013, we expect AuM in the region to grow at an average annual rate of 9.5 percent, boosting its share of global wealth from 12 percent to 16 percent over the same period. Some countries in the region, such as China and India, have not been affected by a banking crisis. Their economies continue to grow, fueled by domestic demand and, in some cases, government intervention. China has launched a fiscal stimulus program and eased monetary policy to strengthen its economy and boost consumption.

6. These kinds of investments do not count toward AuM because they cannot be classified as bankable assets.

Changing Behavior

The Client's Perspective

The crisis has taken an emotional as well as a financial toll on investors, who have been left reeling from plunging stock markets, defaults on bonds and structured products, and scandals such as the Madoff scheme. As financial giants stumbled and words like "depression" and "meltdown" became part of the everyday vocabulary, worried investors began relying on their financial advisors more than ever, particularly during the second half of 2008.

At a time when they most needed to be in front of their clients with clear advice, however, financial advisors sometimes failed to deliver. Relationship managers did not keep their clients up to date on breaking events and the shifting financial landscape. Moreover, products were not always understood by the client—or even sometimes by the advisor—which meant that asset allocations were not transparent and risk was not aligned with the investor's profile. The result, in many cases, has been a loss of trust in both financial advisors and wealth management institutions.

A "New Normal" for Client Behavior

Unsettled by both the turmoil and the failure of their advisors to guide them through it, many clients have changed their investing behavior in ways that completely redefine their wealth-management needs. (See Exhibit 8.) These changes are directly linked to the turmoil, so they may not outlast the crisis. In many markets, however, the crisis has been so severe that some changes could become part of the "new normal" for wealth managers. The success of a wealth manager will therefore depend on the ability to adapt to the new behaviors exhibited by investors.

Investors are focused on preserving wealth. With their portfolios in free fall last year, investors became motivated more by fear than by any other factor. Assets poured out of high-risk investment vehicles, hedge funds, and real estate funds, and the market for structured products evaporated. Investors parked what was left of their holdings in liquid assets, money market funds, and gold.

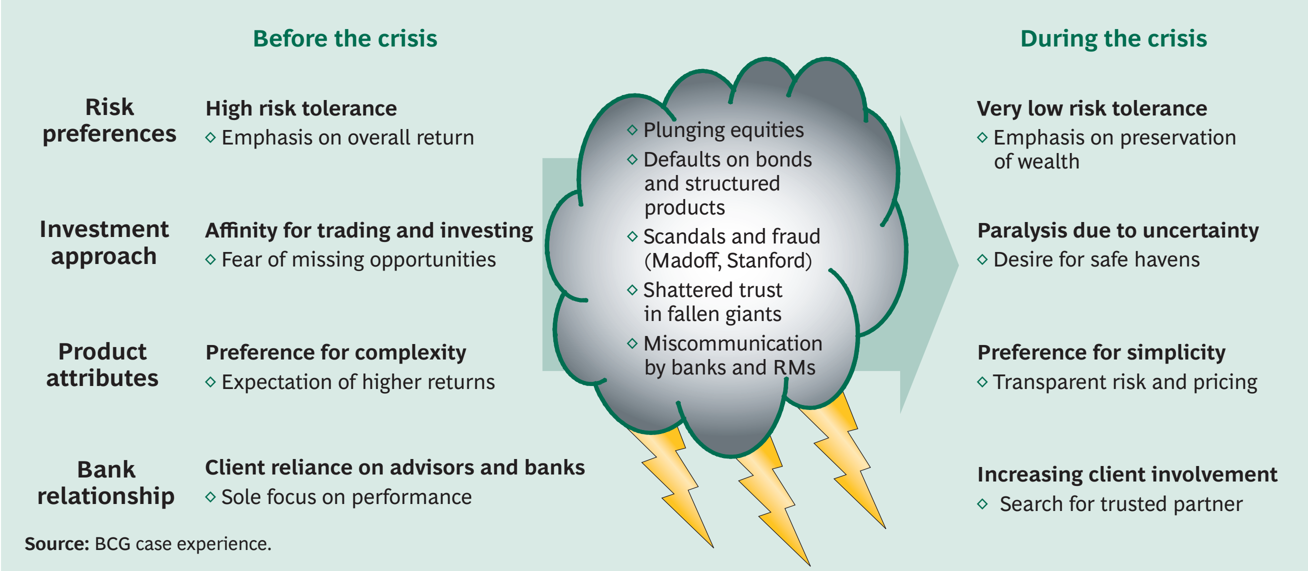
In some markets, such as the United Kingdom and the United States, the proportion of wealth held in equities peaked at about 60 percent before the crisis. By the end of 2008, the equity holdings in those two countries had fallen to 49 percent and 38 percent of AuM, respectively. It will take years for them to return to their precrisis levels.

But before they do, fear will have given way to opportunism. Investors will start looking for ways to take advantage of what they hope will be a transition to an upturn. In past crises, U.S. investors have generally proved to be impatient with bond yields and money market rates. As soon as they sense that equities have regained their footing, investors with a high risk appetite will go in search of higher returns.

For investors who are close to retirement—most notably the baby boomers—returning to the stock market might be too much of a gamble, however. Having lost a sizable proportion of their savings, many will need to rely on steady, if unspectacular, yields to finance their daily expenditures.

Even bold investors are paralyzed by uncertainty. Not every investor is risk averse, of course. The first half of 2009 saw a surge of activity in the equity markets as investors converged on what they hoped would be a sus-

Exhibit 8. Clients Have Grown Far More Guarded and Skeptical



Source: BCG case experience.

tained rally. At the same time, the value of emerging-market currencies increased, which suggests that investors were anticipating opportunities in these countries.

Still, many clients who are willing to tolerate risk are unclear about where to invest. An uneasy sense of caution prevails as questions linger about the state of the real economy and the timing of a recovery. In Germany, for example, investors remain concerned about the economic outlook—exports have declined sharply—and they continue to hoard liquidity. In Asia, trading activity is expected to remain low until there are clear signs that the market has stabilized. (Signs have already begun to emerge in some markets, such as China). In North America, many investors remain on the sidelines.

Some of this behavior is the result of fear, but it is also driven by a lack of conviction and clarity about the right investment strategy. This state of paralysis is likely to persist until there are definitive signs that the downturn is starting to give way to an upturn. A stock market rally can be ephemeral—investors need to see clear proof of fundamental economic improvement. And financial markets need to stop fluctuating long enough for people to feel confident about setting a new investment strategy.

Simplicity rules. Sophisticated products have suffered some of the biggest losses during the crisis. Structured products were undone by counterparty failure and the resulting loss of confidence in these vehicles. Products that had seemingly low risk, like absolute return funds or certificates written by reputable counterparties such as Lehman Brothers, were bought by investors who did not fully understand them. In some cases, financial advisors failed to adequately explain the terms and conditions of these and other products, in part because of their own lack of knowledge but also because their banks had rewarded them for pushing higher-margin products.

Clients want to revert to simple solutions for two reasons. First, they want to understand their investments. Dazzling complexity is no longer seen as a desirable attribute (if it ever really was). Advisors must be able to explain investment products in detail and give a clear picture of embedded risks. Second, clients feel—understandably—that the returns on sophisticated products did not justify their price.

Clients are changing their banking relationships. Wealth managers will be dealing with the repercussions of shattered trust and compromised relationships for some time. Clients will continue asking difficult questions and demanding thorough explanations. Those who have lost a large share of their wealth are likely to resent high fees for mediocre service and lackluster performance. Some clients are even seeking compensation for losses incurred as a result of the crisis.

The effects of strained relationships vary. In some markets, clients are diversifying their relationships to avoid becoming dependent on one advisor or institution. In other markets, clients are shedding banks in order to concentrate on the one organization they trust the most. In both cases, clients are locking on to trusted brands—although in the wake of the crisis, even the most venerable names have been tarnished.

Institutions that have a history of providing advice that is conservative—even sober—stand to strengthen their existing relationships and make significant inroads into new markets. In the Middle East, where clients have traditionally had deep and lasting relationships with their wealth managers, major brands have suffered considerably. Investors may be more willing to start a new relationship in order to diversify their holdings. Some may even consider replacing their primary wealth manager.

The Impact of the Crisis on Different Client Segments

The changes in client behavior are linked more to risk profiles than to net worth. Still, it is interesting to see where these changes do and do not vary among different client segments or wealth bands.

The ultra-high-net-worth (UHNW) segment was generally more active in complex investments such as structured products, private equity, and hedge funds.[7] Many of these investors have lost extraordinary amounts of wealth and might therefore be inclined to make dramatic changes to their investing behavior and asset allocation. But most private-banking experts we interviewed said that the majority of UHNW clients, despite having lost large amounts of wealth, have not been forced to alter their lifestyles. As a result, they have felt less pressure to change their investment strategies. In fact, in some places—such as Asia and Russia—many UHNW clients are eager to win back what they lost and have not sought shelter in more conservative investments.

Within the UHNW segment, wealth is often derived from family inheritances and is managed more conservatively. These owners of "old money" have been more disconcerted by the crisis and are likely to make a long-lasting shift to safer investment strategies. Such old-money tendencies are less common in Asia, however, where IPOs have minted many UHNW clients.

The affluent and high-net-worth (HNW) segments have made the most significant changes to their investment behavior.[8] There is an undercurrent of skepticism among many of these investors. They feel let down by their wealth managers and are being extremely cautious. Efforts to push products rather than provide advice will trigger a backlash from these clients.

Many HNW clients have had to alter their lifestyles because of the crisis and are facing the prospect of a markedly lower standard of living after they retire. Such changes in behavior are likely to persist—but because HNW clients will be reluctant to stray too far from their precrisis way of life, they will eventually search for higher returns. This desire to restore equilibrium could do as much to increase their risk appetite as an economic upturn would.

Some of these changes in client behavior will last only as long as the downturn. But regardless of how long it is before a recovery takes hold, it is clear that the relationship between advisors and clients has been affected in a profound and lasting way. Trust has been compromised and can be reestablished only by changing the way RMs service and advise their clients.

The Changing Role of the Relationship Manager

The relationship between wealth managers and their clients is not what it used to be. Public opinion of the financial sector, as a whole, has become sharply critical—people are outraged by the inability of the industry, with its legions of highly paid employees, to presage either the looming crisis or various financial scandals. Clients became far less trusting and increasingly likely to jump to another wealth manager. But the relationship between RMs and their clients actually began to change well before the onset of the current crisis.

The Precrisis Rise of the Product-Push Model. At many wealth-management institutions, particularly the larger ones, the continuity of client relationships has—over time—been disrupted by organizational changes and the shuffling of client portfolios among RMs. In

7. In most institutions, the lower threshold for the UHNW segment is $25 million in AuM.

8. The threshold between the affluent and HNW segments is typically $1 million.

some cases, the goal was to bind the client more to the institution than to an individual advisor. In other cases, however, the institution itself simply could not maintain a consistent service model.

In parallel, investors became more interested in diversifying their wealth across institutions. And as information about financial products became more accessible, some investors became self-directed. They tended to be less interested in holistic planning and more interested in specific types of support or investment recommendations.

The role of the RM also changed. Since the beginning of the decade, the RM has become less of a confidant and more of a salesperson. This shift was most apparent in the brokerage model, where RMs began providing targeted product recommendations rather than trying to understand a client's *overall* needs and priorities. This model became prevalent in North America and Asia and was taking hold in Europe before the crisis. The move to a product-push model was particularly pronounced in institutions with centralized asset-management departments that not only designed the products but decided which ones an RM should sell.

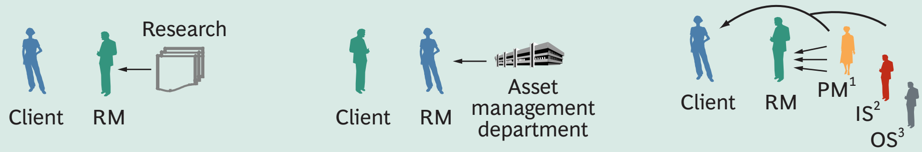
The product-push model diverged from a focus on client relationships in three fundamental ways. First, investment strategies were not necessarily tailored to the client's holistic needs. Second, RMs did not always fully understand the products they were selling, particularly as investments grew more complex. Third, relationships became far more superficial and far less personal. In times of growth, in particular, social events and a sense of exclusivity took on more importance than a deep understanding of a client's situation.

Continuity, Competence, and Commitment. Clients are again looking for trusted advisors—knowledgeable RMs who understand client priorities, are committed to the success of an investment strategy, and are able to explain their recommendations in clear, unambiguous terms. And in another break from the recent past, most clients are now eager for continuity and insist on seeing evidence of their wealth manager's competence and commitment. RMs must prove that they are focused on the client's interests rather than the institution's. (See Exhibit 9.)

To this end, RMs will have to provide more comprehensive advice. A client might ask an RM how to structure his or her finances or might consult with the RM on general

Exhibit 9. RMs Must Get Back to Being Trusted Advisors

	Past	Present	Future
	Old-style private banker	**Relationship-based product pusher**	**Trusted advisor**
Characteristics of a successful RM	◇ Profound financial know-how ◇ Undiluted focus on client's needs ◇ Close confidant	◇ People skills ◇ Sales skills ◇ Ability to identify investment (and sales) opportunities	◇ People skills ◇ Communication skills ◇ Basic financial know-how ◇ Ability to provide holistic solutions
Service and asset management model	◇ Individual selection of investments based on in-house and third-party research ◇ Portfolio management often done by RMs for "their" clients	◇ Advice based on a list of (in-house) products ◇ Portfolio management guided by the bank's priorities	◇ Teaming together with in-house portfolio manager and investment specialists ◇ Portfolio management determined by bankwide guidelines



Source: BCG case experience.
[1]Portfolio manager.
[2]Investment specialist.
[3]Other specialist.

financial matters. Other clients might be looking for a more substantial basis for generating wealth—something less one-dimensional than a simple focus on seizing market gains. (See the sidebar "Ethical Wealth: An Interview with Prof. Dr. Thomas Druyen.") And with clients having grown more sophisticated about investments and more wary of uninformed advice, RMs will have to be capable and knowledgeable—a lack of know-how will not pass unnoticed, nor will it be tolerated. Communication skills will be critical for rebuilding trust, not only at a specific wealth-management institution but also in the industry as a whole. Being close to the customer will be essential.

To provide clients with advice on the full range of wealth management issues, RMs will require access to a large network of specialists such as portfolio managers, technical analysts, and external experts. Increasingly, clients want to meet with such experts to learn more about their portfolios as well as any potential opportunities. It is critical that a wealth manager's asset-management experts work closely with the front-office staff, regardless of whether the institution pairs experts from a central asset-management department with frontline staff or develops decentralized asset-management capabilities.

RMs will need to adhere to a tightly defined investment framework that includes an approved list of investments in equities, bonds, and currencies. Gone are the days when advisors independently decided on the allocation and composition of "their" clients' portfolios. Responsibility for managing portfolios will shift from the RM to the institution because the latter is ultimately liable for the products and investments being recommended.

Compensation will play an important role in building the credibility of the advisor. Short-term incentives will give way to long-term performance goals, which will ensure that RMs focus on the client's overall wealth-management objectives. Over time, a relationship built on trust will lead to stronger and more sustainable revenue growth compared with that of a product-push model.

Finally, wealth managers must have the right RMs (and specialists) to support a model geared to providing holistic advice. Advisors will require both excellent people skills and deep technical knowledge. It is not good enough for RMs to understand the products—they need to be able to explain them to their clients. This combination of skills is not always easy to find. Wealth managers should take advantage of this period of low growth to recruit new talent—people who fit the mold of a traditional advisor. They should also develop and enforce principles for managing RM performance in a way that emphasizes the primacy of advice and the quality of relationships.

Ethical Wealth

An Interview with Prof. Dr. Thomas Druyen

Prof. Dr. Thomas Druyen is chair of the Department of the Science of Ethical Wealth at Sigmund Freud University in Vienna, and director of the Forum for Wealth Research at Münster University. Dr. Druyen recently spoke with The Boston Consulting Group about the psychology and import of wealth.

What is the "science of ethical wealth"?

We study the world's wealthiest individuals, comparing their biographical, cultural, and religious backgrounds as well as their philanthropic activity. The group is sprawling and elite at the same time—the tier of millionaire households is 9 million strong, and they have $33 trillion in wealth. Our aim is to understand how wealthy individuals perceive their unique responsibility. What does it mean to be part of a small slice of the world's population that controls an outsize portion of its wealth?

Apart from diminishing their wealth, how has the economic crisis affected the wealthy?

It has made them far more vigilant. Compared with other investors, the wealthy were more likely to be entwined in sophisticated investments. They ended up losing large sums of money in ways that, even in retrospect, are difficult to grasp. For now, performance actually matters less to them than transparency and traceability. They are looking for reassurance on a grand scale. Banks must have sustainable business policies, regulators must have a clear field of vision, and rating agencies must be completely objective.

Is this sense of caution the most profound change in their behavior?

It is the most overt and immediate change, but our interviews have uncovered something much deeper—people

Ethical Wealth (continued)

have experienced a revelation about how wealth is created. Over the past ten years, there has been a fundamental shift from a real economy to a speculative one. Before this shift, wealth was driven by entrepreneurial principles. People built businesses, pursued growth, and invested in innovation, guided by a blueprint for creating value—usually over the long term. At some stage, this mentality gave way to a one-dimensional drive to maximize profit. Wealth grew at phenomenal rates in some places, but much of it was based on a thin—and far less stable—foundation.

Why is the focus on speculative wealth creation an ethical issue?

I think some people have recognized the consequences of accumulating vast amounts of wealth on top of such a shallow base. In some cases, wealth was created for the sake of wealth, rather than as a payoff from a sustainable, meaningful venture. In a sense, wealth was valuable, but it lacked a certain kind of intrinsic value. This raises ethical issues as much as it raises concerns about the stability of wealth. Given the systemic risks arising from the "phantom" creation of wealth, this is a global issue—it affects everyone, not just those who engage in speculative investments.

Will the global financial crisis spell the end of the speculative economy?

It has been put on hold, although it will probably reemerge, barring a concerted, global effort to curtail speculative practices. This requires a major shift in the balance of power. Can the interests of the financial system—and of society—take precedence over the interests of the individual? A vital sense of self-interest—which is just a polite term for greed—is often cited as the oil that keeps markets running smoothly. Can we preserve self-interest while ensuring that profits are achieved within a far more stable, fundamentally sound system of finance? It seems like an impossible balance, but this crisis is the perfect example of why we need to strive for a new order in the world of finance.

Is it realistic to think that we can achieve a new financial order?

We may soon realize that this epic crisis can open more doors than it has closed. This is a moment of change. But we need role models, and not just among the world's leading politicians or its financial giants. The world's wealthiest individuals can influence markets, companies, and politicians. They can argue for a system that does not necessarily limit growth or profits but has mechanisms in place to ensure that wealth is created within the bounds of acceptable—and transparent—risk.

Are wealthy individuals receptive to this kind of change?

Many are. They are not oblivious to their special position in society to change the way things are done. We have coined a name for our new branch of research: "Vermögenskultur." It does not have an equivalent in English, but it conflates the quantitative meaning of wealth with the qualitative dimension of will, experience, and competence. In Aristotle's view of the world, only a person who used his or her wealth could really own it. This perspective is coming back in vogue. People are increasingly conscious of the responsibility that comes from being part of an elite group.

What does this sense of responsibility mean for wealth managers?

Wealthy individuals possess the independence and ability to have an impact on global problems. Banks play an important role in this game, and they must carry their share of the responsibility by making the appropriate investment solutions accessible to wealthy clients. Through such investments, clients can play a part in addressing societal problems, such as poverty or malnutrition, and be entrepreneurial at the same time. Investing is a language they understand.

How should wealth managers react to this renewed sense of the intrinsic value of wealth?

First and foremost, wealth managers need to understand the client in a truly holistic way. The sale of products and services must be based on this understanding. The relationship between the client and his advisor must be that of a close friendship, in which the friend is being paid for his or her true advice. Many banks make this promise to the client, yet not all fulfill it. And if clients are conscious of a sense of responsibility that comes with wealth, private banks must ensure that their relationship managers, in turn, understand this responsibility. Relationship managers should have some understanding of psychology, cultural sociology, and the historical import of wealth.

Performance Benchmarking

The Wealth Manager's Perspective

The wealth management industry has weathered the storm better than most other financial-services sectors, but it was hardly unscathed. According to our benchmarking data on 124 institutions representing $5.9 trillion in AuM at year-end 2008, the industry's profitability (measured by pretax profit margins) declined in almost all regions and across all business models. Latin America was the least affected region, while the median profitability of European offshore institutions and Asian wealth managers fell significantly—by about 10 percentage points and 20 percentage points, respectively.

Despite the crisis, the strongest wealth managers maintained high revenue margins. Top-quartile European offshore banks in the benchmarking sample achieved an average revenue margin—measured by return on assets (ROA), which divides revenues by client assets and liabilities (CAL)—of 115.6 basis points, while the global median for all 124 institutions was 89.1 basis points.[9]

In addition to affecting profitability and revenue margins, the crisis had a substantial impact on net new assets (NNA) at individual banks. As the turmoil deepened, the flow of AuM among institutions intensified.

Profitability by Region

Wealth management remained highly profitable in 2008. Participants in our benchmarking study had a median pretax profit margin of 30.0 percent and only a few incurred losses.[10] Still, it was clear that the crisis had left an imprint on industry profitability—in 2007, these wealth managers had achieved a median pretax profit margin of 36.4 percent. (For more on our methodology, see the sidebar "BCG's Wealth-Manager Benchmarking.")

For wealth managers as a whole, the impact of the crisis varied widely by region. (See Exhibit 10.)

- **European institutions experienced a drop in profitability.** The median profitability of onshore banks fell slightly from 39.9 percent in 2007 to 38.8 percent in 2008. The decline was steeper among offshore banks, whose median profitability fell from 43.8 percent to 33.1 percent.[11]

- **In North America, private banks outperformed brokers.** The median profitability of private banks (including private-banking units of universal banks) increased from 34.7 percent to 38.2 percent, while the median profitability of brokers fell from 14.9 percent to 11.6 percent. Among first-quartile brokers, the decline in profitability was stark—the average plummeted from 28.8 percent to 19.1 percent.

- **Performance was comparatively stable in Latin America.** Banks in Latin America avoided a direct hit from the crisis and their profitability held steady at about 40 percent. These banks had a relatively low ratio of costs to assets.

- **After years of strong growth, profitability in Asia fell.** A handful of participants in this region experienced significant declines in revenues, causing median profitability to plunge from 37.1 percent to 18.7 per-

9. CAL is a measure of fee-earning assets within an institution. It is calculated as the sum of clients' deposits, brokerage assets, managed funds, and outstanding loans; it excludes pure custody holdings.

10. Pretax profit margin is defined as revenues minus costs (before depreciation and taxes), divided by revenues.

11. For our analysis, offshore institutions derive more than 50 percent of their AuM from offshore investors.

BCG's Wealth-Manager Benchmarking

Our benchmarking survey included 124 participants that oversaw a combined $5.9 trillion in AuM and $0.6 trillion in client liabilities. The survey included 54 European and 30 North American institutions, as well as 22 in Latin America and 13 in Asia. Five participants were classified as global.

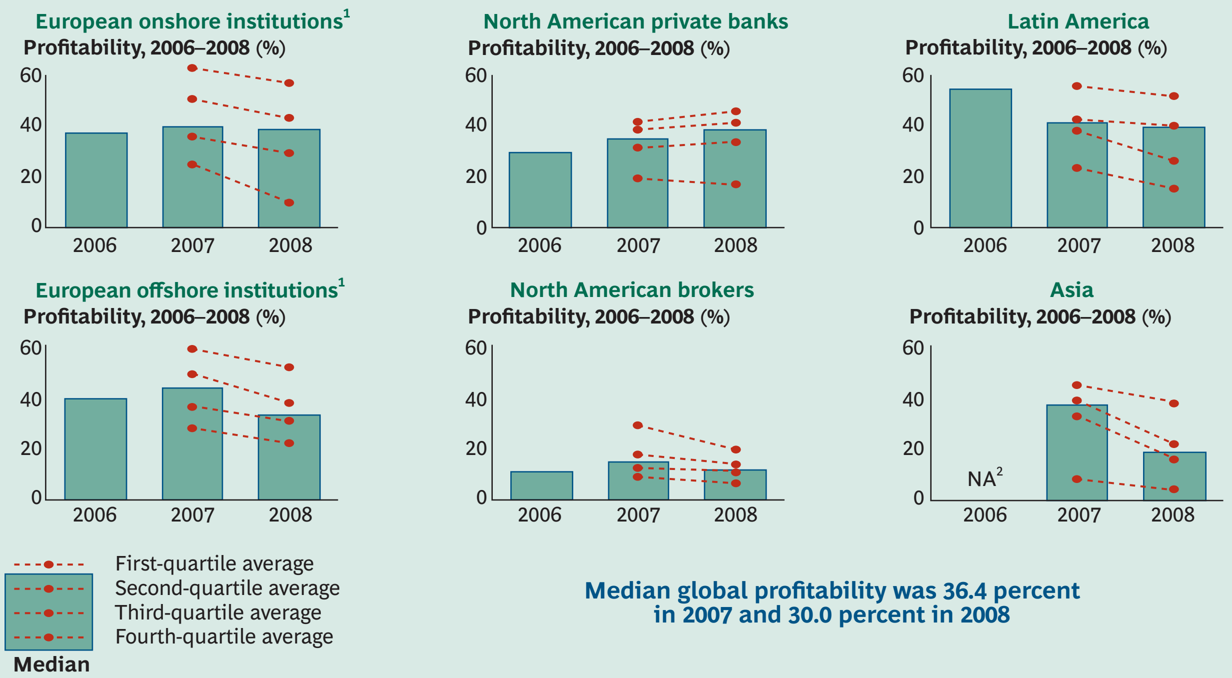
For the most part, analyses were based on client assets and liabilities (CAL), calculated as the sum of clients' deposits, brokerage assets, managed funds, and outstanding loans; it excludes pure custody holdings.

The participants were divided into six benchmarking groups: European onshore institutions, European offshore institutions (European institutions combined had $2.3 trillion in CAL), North American banks, North American brokers (North American institutions combined had $3.5 trillion in CAL), Asian institutions ($0.2 trillion in CAL), and Latin American institutions ($0.3 trillion in CAL). Offshore institutions derived more than 50 percent of their AuM from offshore investors.

Analyses of European onshore and offshore institutions were based, for the most part, on euros and Swiss francs, respectively. All other groups were benchmarked in U.S. dollars, taking into account exchange rate movements between 2007 and 2008, unless stated otherwise.

Figures referring to 2006 were based on a different benchmarking sample. The samples are comparable, however, because many participants were involved in both the 2006 and 2008 studies.

Exhibit 10. The Profitability of Private Banking in North America Increased in 2008



Source: BCG Wealth-Manager Performance Databases, 2007 and 2009.
Note: Median figures exclude outliers (more than 75 percent profitability). Profitability is defined as revenues minus costs before depreciation and taxes, divided by revenues. Quartile averages are weighted by client assets and liabilities. The benchmarking samples in 2007 and 2009 included many of the same participants but were not identical.
[1]Onshore institutions derived more than 50 percent of their AuM from onshore investors, and offshore institutions derived more than 50 percent of their AuM from offshore investors.
[2]Not available.

cent. This ended the region's strong run of increasing profitability.

To some extent, the wealth management industry defied the downturn. Although profitability was lower in 2008, it was still quite high. The losses incurred during the second half of 2008—when the crisis began to intensify, assets declined, and clients shifted more of their wealth to conservative investments—were cushioned by a relatively good first half.

Since mid-2008, however, it has been mostly downhill for markets, assets, and client sentiment. Many wealth managers have undertaken cost initiatives to counteract these negative forces, but they cannot fully offset the pressure on their margins. As a result, profitability will continue to fall throughout 2009.

Performance Levers

Our benchmarking analysis focused on a small number of critical performance levers, including asset growth, gross revenue margins, RM productivity, and costs.

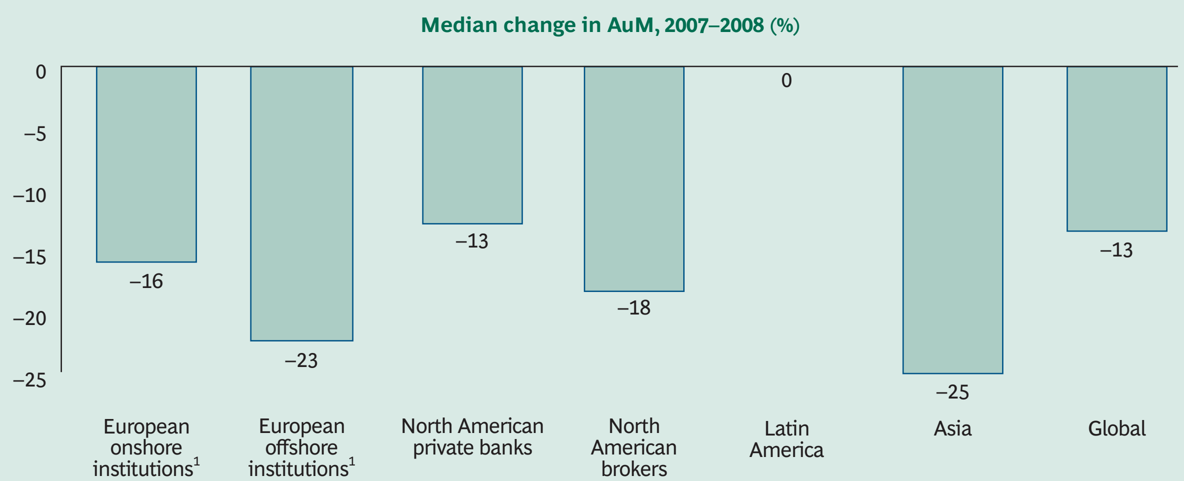
Assets decreased substantially. Among the 124 benchmarking participants, AuM contracted in all regions except Latin America. (See Exhibit 11.) The median changes in AuM ranged from –13 percent among North American private banks to –25 percent among Asian institutions. The median change in AuM overall was –13 percent, which created a considerable drag on profitability.

Revenue margins were resilient. In 2008, the median revenue margin was 89.1 basis points. The average margin of top-quartile wealth managers was 111.2 basis points, compared with 63.4 basis points for bottom-quartile wealth managers. European offshore institutions achieved the highest median margin at 95.5 basis points. (See Exhibit 12.) European onshore institutions had the lowest at 72.9 basis points.

Despite the financial crisis, revenue margins were still quite high in 2008, but the year comprised two distinct halves. The allocation of assets was not substantially affected in the first half of the year, which helped offset the effects of asset movements in the second half. We expect revenue margins to be lower in 2009, as clients continue to shift more of their assets to investments that are based on preserving wealth rather than growing it.

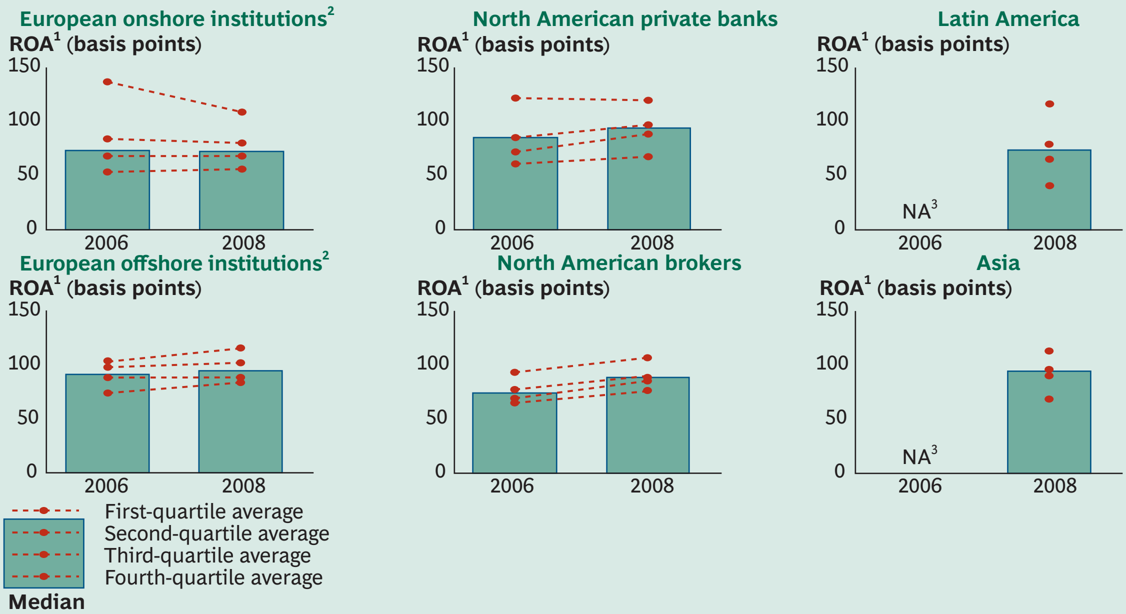
Net new assets reflected significant flows in assets. NNA measures the difference between inflows and out-

Exhibit 11. Most Wealth Managers Experienced Sharp Declines in AuM in 2008



Source: BCG Wealth-Manager Performance Database, 2009.
Note: This analysis was based on U.S. dollars, except for European onshore institutions (measured in euros) and European offshore institutions (measured in Swiss francs).
[1]Onshore institutions derived more than 50 percent of their AuM from onshore investors, and offshore institutions derived more than 50 percent of their AuM from offshore investors.

Exhibit 12. Revenue Margins Remained High



Source: BCG Wealth-Manager Performance Databases, 2007 and 2009.

Note: The benchmarking samples in 2007 and 2009 included many of the same participants but were not identical. This analysis was based on U.S. dollars, except for European onshore institutions (measured in euros) and European offshore institutions (measured in Swiss francs).

[1]Revenues divided by yearly average assets and liabilities.

[2]Onshore institutions derived more than 50 percent of their AuM from onshore investors, and offshore institutions derived more than 50 percent of their AuM from offshore investors.

[3]Not available.

flows of assets. In 2008, there was a clear divide between the haves and the have-nots, particularly in Europe. (See Exhibit 13.) European institutions that had negative NNA suffered an average net outflow of 5.2 percent (weighted by the average amount of assets and liabilities managed in 2007 and 2008 at each bank). Those with positive NNA achieved an average net inflow of 7.3 percent (again, weighted by the amount of assets and liabilities managed at each bank). The winners tended to have either a proven commitment to a conservative, long-term investment strategy or the backing of a government.

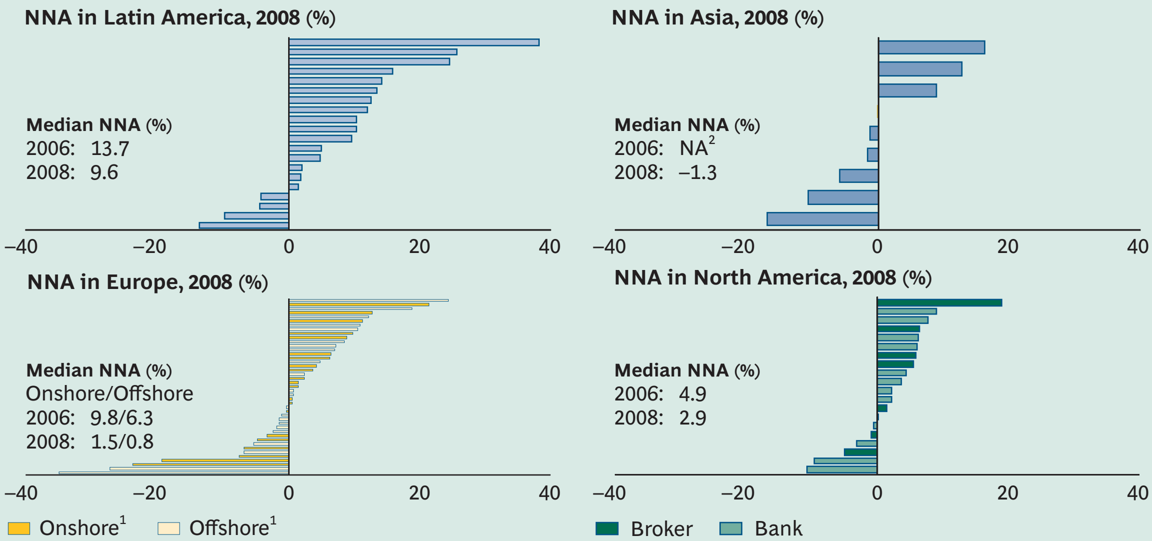
Interviews with banking experts suggest that these diverging NNA results stemmed from asset flows among wealth managers. In other words, most asset flows occurred within the wealth management industry. We believe that these shifts are temporary, for the most part, and we expect further asset flows in 2009.

RM productivity. Median revenue per RM fell to $1.2 million in 2008 from $1.3 million in 2007. It varied widely across regions and models. European offshore banks had the strongest median performance at $2.0 million per RM, while the region's onshore banks had a median of $1.0 million per RM. North American private banks had the second-highest median revenue per RM at $1.5 million.

In Asia, median revenues per RM dropped from $1.7 million to $1.3 million—a much bigger decline than the global median. Revenues in the region, which are largely brokerage driven, were pulled down by the collapse in volumes in the second half of 2008. North American brokers and Latin American wealth managers had the lowest median revenues per RM at $0.7 million and $0.6 million, respectively.

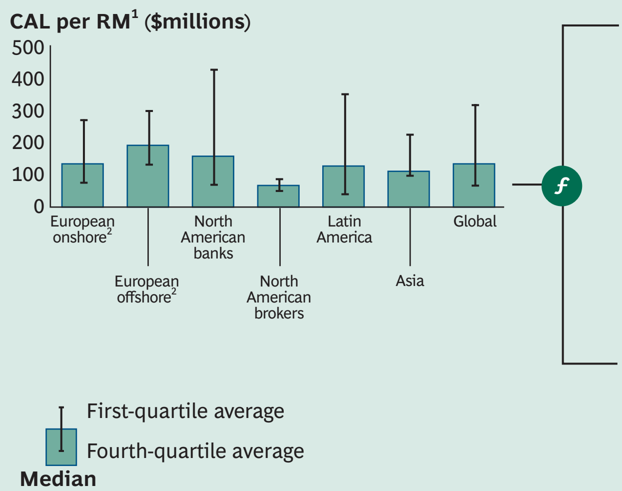
CAL per RM is another indicator of RM productivity. In general, a wealth manager's service model determines its CAL per RM—the measure is a function of client size and the number of clients per RM. The median client size varied significantly, from $2.1 million in Asia to $0.3 million among North American brokers. (See Exhibit 14.) Likewise, the median number of clients per RM ranged from

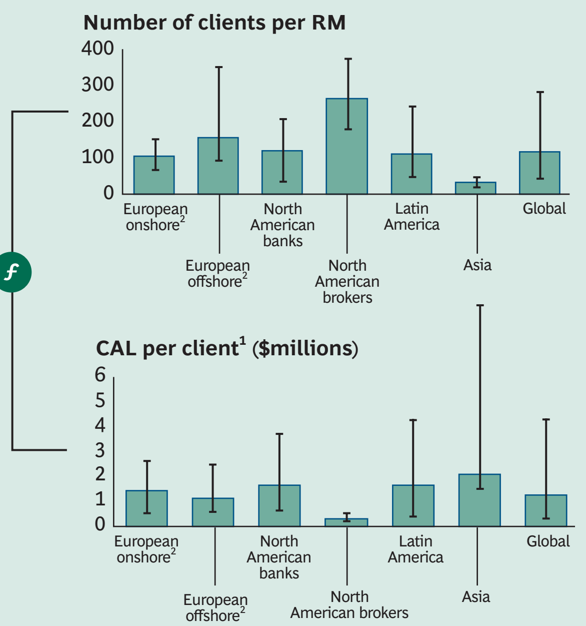
Exhibit 13. There Were Big Swings in Net New Assets



Source: BCG Wealth-Manager Performance Databases, 2007 and 2009.
Note: This analysis was based on U.S. dollars, except for European onshore institutions (measured in euros) and European offshore institutions (measured in Swiss francs). Of the 124 participants, 92 provided data for this analysis.
[1]Onshore institutions derived more than 50 percent of their AuM from onshore investors, and offshore institutions derived more than 50 percent of their AuM from offshore investors.
[2]Not available.

Exhibit 14. The Drivers of RM Productivity Varied by Region





Source: BCG Wealth-Manager Performance Database, 2009.
[1]CAL is client assets and liabilities.
[2]Onshore institutions derived more than 50 percent of their AuM from onshore investors, and offshore institutions derived more than 50 percent of their AuM from offshore investors.

34 at Asian institutions to 260 among North American brokers. Not surprisingly, then, our study found wide variations in CAL per RM. European offshore managers had the highest median CAL per RM at $191 million. North American brokers had the lowest at $66 million.

Cost-to-income ratios increased in most regions, often significantly. The biggest jump was in Asia, where the median cost-to-income ratio rocketed from 62.9 percent to about 80 percent. (See Exhibit 15.) Among European onshore and offshore institutions, the ratio grew from 60.1 percent to 61.2 percent and from 56.2 percent to 66.9 percent, respectively. Among North American brokers, whose cost-to-income ratios were already high, the median increased by about 4 percentage points to 88.4 percent. In Latin America, it stayed at about 60 percent.

In most regions, cost-to-income ratios increased mainly because of falling revenues rather than rising costs. Given that the downward pressure on revenues is likely to persist for some time, however, most wealth managers will need to focus intently on lowering costs in order to balance out this ratio.

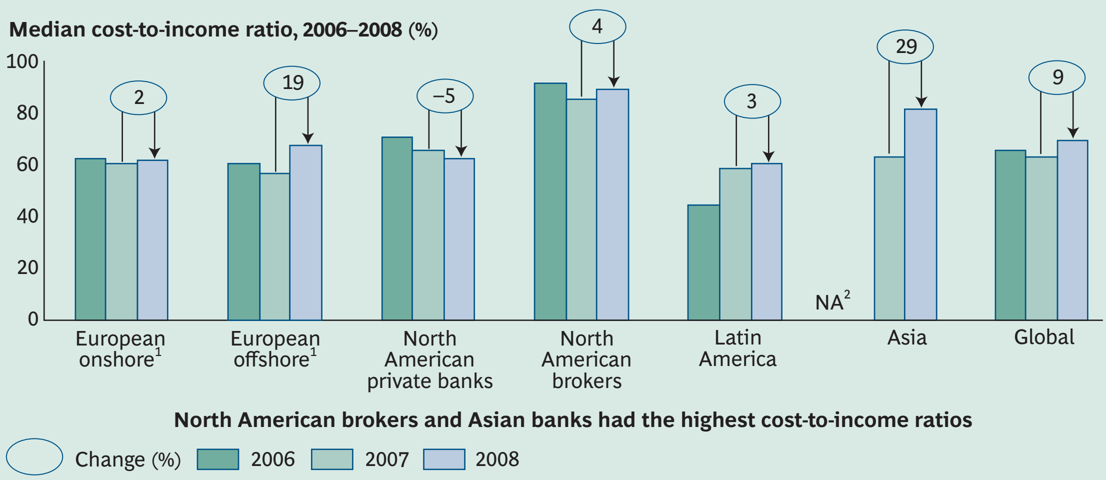
Bringing the cost-to-income ratio back to historical levels is not going to be easy, in light of the severity of the crisis. Some wealth managers may even exceed a cost-to-income ratio of 100 percent in 2009. For most wealth managers, cuts would have to be extreme to keep costs fully in line with falling revenues. Instead, wealth managers must focus on improving both sides of this ratio. Costs should be managed aggressively, but wealth managers must find ways to reverse the decline in revenues.

The Impact of Asset Reallocation on Revenues

A wealth manager's revenues are driven by two factors: its AuM and its average revenue margin. In most regions, AuM has deteriorated and will continue to decline this year. But we also expect revenue margins to remain under pressure for the next two to three years because of the reallocation of assets into lower-risk products.

The crisis has led to a flow of AuM into and out of different kinds of products and investment strategies. The changes include a shift to low-margin products—with a distinct outflow from alternative investments—and a move away from discretionary mandates. (For more on how wealth managers are dealing with the reallocation of assets, see the sidebar "Responding to the Reallocation of Assets: The Experience of Swiss Banks.")

Exhibit 15. Cost-to-Income Ratios Increased in Most Regions



North American brokers and Asian banks had the highest cost-to-income ratios

Source: BCG Wealth-Manager Performance Databases, 2007 and 2009.
Note: The cost-to-income ratio was calculated as total costs before depreciation and taxes, divided by revenues.
[1]Onshore institutions derived more than 50 percent of their AuM from onshore investors, and offshore institutions derived more than 50 percent of their AuM from offshore investors.
[2]Not available.

Assets have shifted to low-margin products. According to our benchmarking analysis, the proportion of assets held in cash and money market assets grew by 26 percent in 2008. This has undercut trading activity—and thus transaction fees—but it has had a far more consequential impact on margins. The margins on basic, low-risk investments are drastically lower than those on riskier investments such as equities, bonds, or alternative investments.

In comparison, alternative investments have waned. During the precrisis boom, they were the main growth engines for many wealth managers. The margins on alternative investments were nearly double those on direct equities and ten times those on cash or money market investments. Traumatic events such as the collapse of Lehman Brothers and the discovery of the Madoff scandal—not to mention the underlying performance of the investments themselves—have caused clients to make a distinct shift away from structured products, hedge funds, private equity, and commodities. (See Exhibit 16.)

The shift from alternative investments has also been driven by clients' risk aversion and their concerns about arcane products in general. Given the severity of the crisis, it will take time for these sentiments to change. Even after clients regain their appetite for risk, most will remain

Responding to the Reallocation of Assets

The Experience of Swiss Banks

The crisis has touched every corner of the banking world, including Switzerland's iconic private-banking industry. Far from immune to the turmoil, Swiss banks are dealing with many of the same challenges that are confronting their counterparts around the world. As in other markets, the reallocation of assets has posed challenges to private banks in Switzerland. The response of Swiss banks provides important lessons for institutions in other markets.

Clients have shifted their assets in an effort to preserve wealth. Investors have redirected their assets to well-capitalized banks that are backed by implicit or explicit state guarantees. Safety, not performance, is their overriding concern. Cantonal banks—banks that are owned by one of the cantons in Switzerland—have experienced strong asset inflows since the end of 2008. Clients have also steered their assets to traditional private banks that are known for their conservative profiles. Smaller banks, in particular, have benefited from this trend—some clients actually prefer private banks with no major credit business and no ties to a highly leveraged investment bank.

Money is parked, not permanently transferred. Wealth managers that have gained assets because of their stability should understand that these assets may be parked with them only until the turmoil subsides. Once clients' risk appetites return, they will search for private banks that offer more than just security. And the barriers to switching may be exceptionally low—many assets are now held in fairly liquid products.

Banks that have gained assets during the crisis should aim to build deep relationships with their new clients as quickly as possible. They have a window of opportunity to make a good impression—their competitive edge will be dulled once clients begin to feel more confident. Banks that have lost ground, meanwhile, can take heart that the transfer of assets is not permanent (at least, not yet). They will have an opportunity to win back assets, but they will need to spell out their value proposition in clear terms.

In interviews, some senior executives indicated that this opportunity is not far off. They expect clients to begin looking for the full complement of private-banking capabilities before the crisis has passed. To position themselves to capture the potential flow of assets, some private banks in Switzerland have been emphasizing the core elements of their offering:

- *Tailored Advice.* More than ever, private banks need to understand their clients and provide tailored advice. Clients will not respond well to being profiled and slotted into standard risk categories, which then lead to predefined investment strategies. Banks must ensure that they have the capabilities—and the capacity—to provide a meaningful level of customized service to their clients. They should consider paring down the client segments they serve rather than providing a thin level of service to multiple client segments.
- *Expertise.* Private banks have seen their image tarnished by the crisis. Some have even alienated their clients. But most investors still lack the time or the knowledge to manage their assets on their own. They want (and need) to delegate this task to an expert. Banks will be able to attract clients by demonstrating their expertise

Responding to the Reallocation of Assets (continued)

and capabilities in wealth management. Differentiating factors may include knowledgeable RMs, in-house fund managers, and competent research teams.

- *Additional Services.* Private banking involves more than investment advice. A comprehensive offering includes financial planning, fiduciary services, and specialist services such as tax consulting. Some banks may also have a network of affiliated specialists in areas as diverse as the law and the arts.

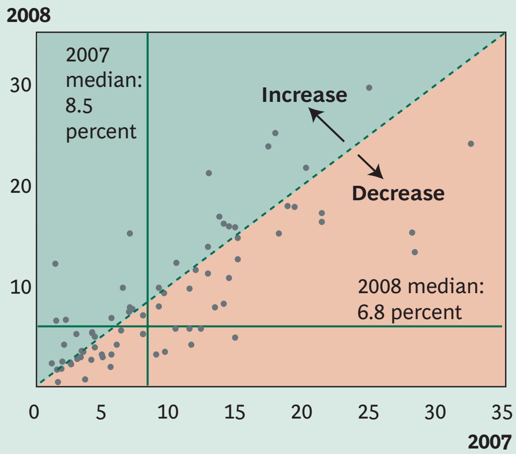
- *Products.* Although most investors will continue to shy away from products that seem overly complex, their needs will soon outgrow basic offerings. They will eventually begin searching for sophisticated products that provide capital protection along with access to different kinds of markets.

- *Prestige.* Clients have lost faith in some of the biggest names in wealth management, but the brands have not been completely devalued. Provided they can deliver the products and services that are relevant to clients in the postcrisis world, these banks will regain their prestige.

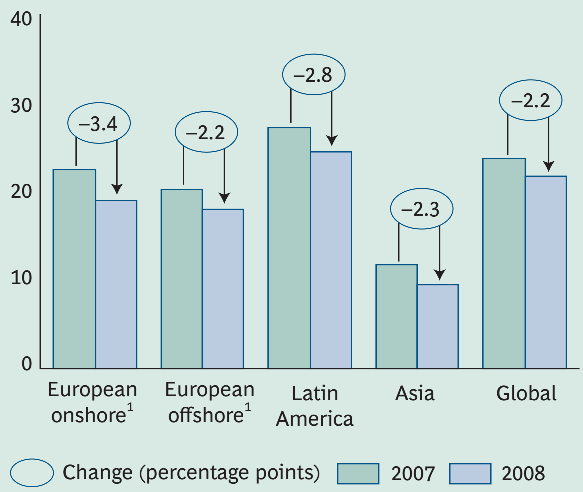
By emphasizing these strengths, wealth managers in Switzerland—particularly those that have venerable names and deep capabilities—should be able to win back many of the assets that were dislodged by the crisis. But they should also expect a fight from smaller competitors that have benefited from the turmoil. For smaller banks, the crisis presents a once-in-a-generation opportunity to gain ground by targeting dislocated clients, but only if they can offer more than just stability. Clients that have gravitated toward narrowly defined, conservative offerings are certain to grow restless as the turmoil begins to subside.

Exhibit 16. Assets Flowed out of Alternative Investments and Discretionary Mandates

AuM in alternative investments, 2007–2008 (%)



AuM managed through discretionary mandates, 2007–2008 (%)



Source: BCG Wealth-Manager Performance Database, 2009.
Note: Of the 124 participants, 74 provided data for alternative investments in 2007 and 2008; medians refer to participants with more than 0 percent and less than 35 percent of alternative investments. Alternative investments include hedge funds, structured products, and private equity. Percentages of AuM in alternative investments were based on end-of-year data. Discretionary-mandate averages were weighted by average client assets and liabilities in 2007 and 2008; analysis of discretionary mandates excluded North American institutions.
[1]Onshore institutions derived more than 50 percent of their AuM from onshore investors, and offshore institutions derived more than 50 percent of their AuM from offshore investors.

wary of opaque products. Wealth managers cannot count on a resurgence of high-margin products to pull them out of the downturn.

This does not mean that alternative investments are extinct. Our interviews with senior private bankers suggest that there will always be a need for complex products. In the wake of the crisis, however, investors will want a much more comprehensive understanding of the investments—the risks must be as apparent as the potential returns.

Wealth managers cannot count on a resurgence of high-margin products.

Passive products are becoming increasingly prevalent. The crisis has made investors acutely aware of a long-standing trend: most actively managed portfolios barely beat the market. Disappointed with the performance of these portfolios, many investors have gravitated toward passive products. In 2008, exchange-traded funds (ETFs) grew considerably, whereas mutual funds (excluding ETFs) experienced net outflows. The value proposition of ETFs is simple and clear: they are cost-efficient products that track market performance.

Traditionally, wealth managers have shied away from promoting these relatively low-margin products. Following the crisis, however, ETFs have emerged as a major source of growth for wealth managers. Their appeal is particularly strong among clients who have as much as about $2 million in assets. These clients can use ETFs to access portfolios with multiple asset classes that might otherwise be out of their reach owing to minimum investment thresholds or other restrictions.

Clients have moved away from discretionary mandates. Revenue margins also depend on a client's investment mandate. A discretionary mandate cedes control of the investment strategy to the wealth manager to act on behalf of the client according to a defined risk profile and an agreed investment strategy. Compared with an advisory mandate, whereby the wealth manager provides advice but the client makes the final decisions about where to invest, a discretionary mandate has considerably higher revenue margins—as high as 200 basis points, which is more than double the margin on advisory mandates. Discretionary mandates also have lower costs because the wealth manager meets less often with the client.

Our benchmarking study revealed that the proportion of AuM handled through discretionary mandates shrank by 9 percent in 2008. (See Exhibit 16.) The most affected regions were Asia, where AuM held in discretionary mandates—already a low amount—declined by 20 percent, and Europe, where onshore and offshore players saw their AuM under discretionary mandates fall by 15 percent and 11 percent, respectively.

The problem posed by discretionary mandates is that high margins come with high client expectations. Clients paying for discretionary mandates are usually not satisfied with good absolute returns. Moreover, most discretionary mandates tend to have balanced portfolios with a mix of low- and high-risk asset classes. Their aim is to beat a certain benchmark consistently, not extravagantly. By shooting for slightly better-than-average returns, however, this strategy is bound to disappoint some clients. In a bull market, the returns will not measure up to the performance of equity markets. In a downturn, the returns will compare unfavorably with the performance of bond markets. And in all markets, the cost of a balanced portfolio could appear unreasonably high given the proportion of assets held in money markets and bonds.

For these reasons, running a balanced portfolio strategy for a discretionary mandate can be a no-win situation. Wealth managers would be better off with discretionary strategies that are more closely aligned with a client's expectations: wealth preservation can be achieved using low-risk assets but the pricing of such a discretionary mandate should reflect the passive management style. Growth strategies, in contrast, should focus on high-risk asset classes that are positioned to exploit market opportunities.

Once trust in wealth management has been restored, the demand for discretionary mandates will increase. "There is the simple need for delegation," explained a banking expert. Trustworthy banks with a clear value proposition will again be able to capitalize on the client's desire to delegate. By offering discretionary mandates that are focused on clear objectives—something more strategic than simply matching average returns—wealth managers will be able to attract clients.

New Strategies for Offshore Banking

Offshore banking presents its own set of challenges. (Offshore wealth, in this report, is defined as assets booked in a country where the investor has no legal residence or tax domicile.) The amount of offshore wealth fell to $6.7 trillion in 2008, down from $7.3 trillion in 2007. (See Exhibit 17.) The decline was relatively modest considering the pressures facing offshore banks. About half of offshore wealth was held in Switzerland and the centers of the United Kingdom.

The most overt threat to offshore banking comes from the growing involvement of regulators, particularly in the United States and the other OECD nations. But offshore banking centers—especially in emerging markets—are also contending with a steady shift from offshore to onshore investments. These two developments will force wealth managers to change their offshore business models in order to remain relevant and competitive.

Regulatory and Competitive Threats

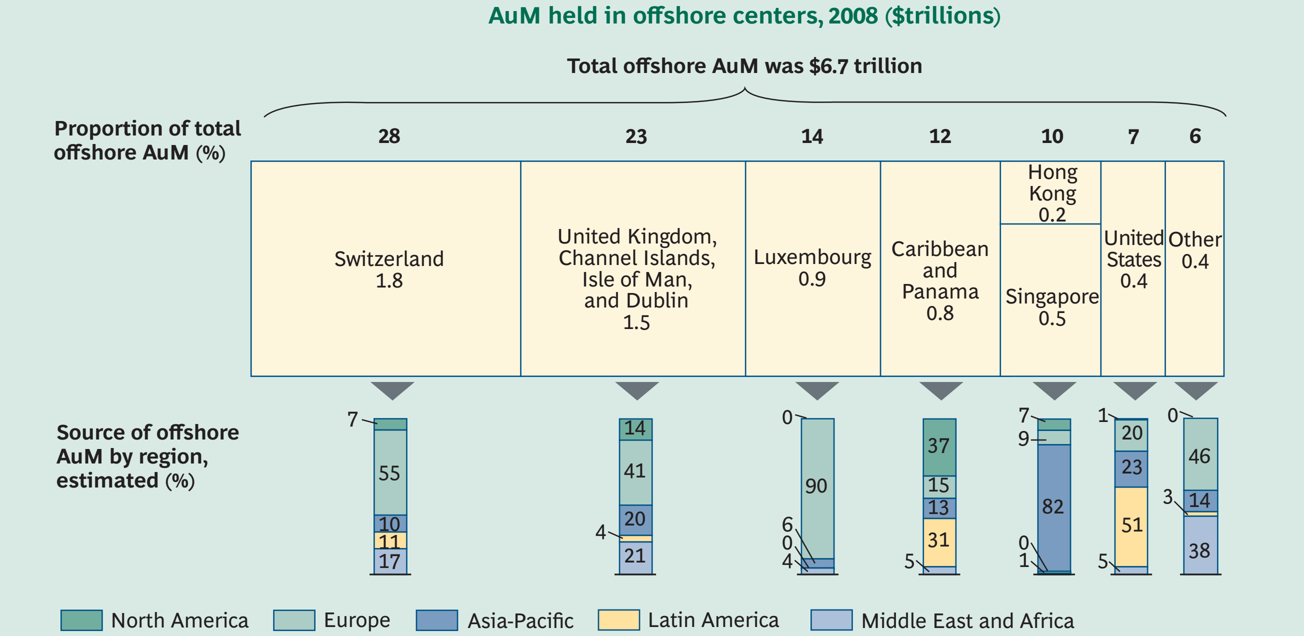
Political and financial instability are the traditional drivers of offshore banking. For decades, the quality and credentials of offshore centers such as Switzerland have provided peace of mind to investors looking for safety and stability. The reputations of these centers—along with their legal environments—carried a tremendous amount of weight and attracted substantial amounts of AuM. And their underlying capabilities as private bankers did even more to attract assets than did their standards for discretion.

Over the last 30 years, however, some investors began using offshore banks to hide assets. Offshore banking became virtually synonymous with tax avoidance—particularly in the media—although this was based on a false assumption. Undeclared assets account for a relatively small and steadily declining proportion of offshore AuM. In fact, a large share of offshore AuM comes from investors who have comparatively little reason to be concerned about taxes. Many investors from the Middle East, for example, do not pay taxes on income or capital in their home countries, and many Asian countries do not tax capital gains. Nonetheless, authorities regard offshore assets as dubious, even though most are already legitimate and the trend is toward increasing compliance.

Increased regulatory pressure has had a significant impact on offshore banking, although the effects vary among countries. For years, the United States has been enforcing strict measures to tax offshore assets. As a result, banks in traditional offshore centers have been turning away U.S. investors. In Germany, too, investors who hold offshore financial assets face increasing scrutiny. In many other regions, stricter regulations have been in effect for years. As a result, further pressure from foreign regulators may not have a significant impact on offshore centers (barring a general tax amnesty or an automatic data exchange). Most private banks in offshore centers have a neutral stance toward increased oversight.

A considerable threat to offshore banking stems from a less conspicuous but more fundamental change. In places such as Brazil, India, and China, investors continue to gain confidence in local banking systems and are becoming more receptive to onshore investments. In other markets, demand is shifting away from offshore investments for different reasons. In the Middle East, for example, a

Exhibit 17. Offshore Centers Drew Their AuM from Different Regions



Sources: BCG Global Wealth Market-Sizing Database, 2009; expert interviews.
Note: Region totals are based on complete, not rounded numbers; offshore AuM is AuM held in a country that is not the client's country of residence.

younger generation has assumed control of a larger proportion of the wealth. They find regional investments an interesting and attractive alternative to offshore banking. We expect the share of assets held offshore to decrease in Asia-Pacific (excluding Japan), Central and Eastern Europe, Latin America, and the Middle East and Africa, while remaining stable in the large industrialized countries. (See Exhibit 18.)

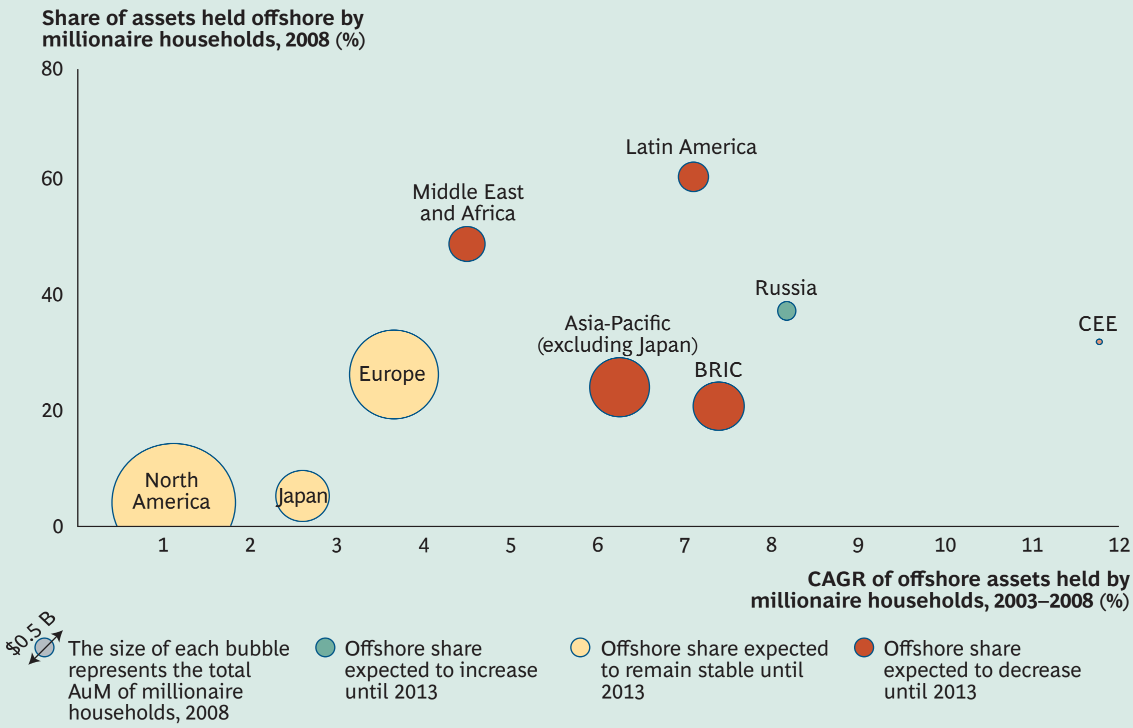
Although onshore investments are becoming more competitive in some markets, the need for offshore banking remains strong in many parts of the world. Concerns about political and financial instability will continue to be a consideration in markets such as Argentina and Russia, where trust in local banking systems has been compromised over the years (and where memories of recent crises remain vivid). And in some developed markets, the trend toward greater financial disclosure—and therefore toward less financial privacy—will continue to drive investors to offshore centers. The growing appeal of onshore investments is more likely to contribute to the incremental flow of new assets to offshore centers than to trigger a mass outflow of existing offshore assets.

Strategies for Bolstering Offshore Banking

Offshore banks are dealing with the threat of increased scrutiny and the growing appeal of onshore investments in two ways: moving abroad to capture onshore assets and focusing on fully transparent and sustainable offshore AuM.

Moving Abroad to Capture Onshore Assets. With many of their clients increasingly interested in onshore investments, some wealth managers might opt to establish or expand a foreign presence to capture additional assets. For smaller institutions, however, building a foreign presence can be prohibitively expensive, and the strategy itself carries significant challenges. Entrants sometimes underestimate the fierce competition from domestic wealth managers and have difficulty importing their brands and products, which leaves them with a smaller share of wallet, lower assets per client, and lower profitability. Lacking an existing network of clients, foreign wealth managers face an uphill battle in trying to gain referrals and build their brands through word-of-mouth advertising. An onshore business also tends to be

Exhibit 18. The Share of Wealth Held Offshore Is Expected to Decline in Most High-Growth Markets



Sources: BCG Global Wealth Market-Sizing Database, 2009; expert Interviews.
Note: CEE (Central and Eastern Europe) is also included in Europe; Brazil, Russia, India, and China (BRIC) are also included in their respective regions.

more costly because it generally requires more intensive service and greater proximity to the client.

To avoid these problems, a wealth manager could pursue a niche onshore strategy—one that targets specific client segments, thus obviating the need for a real branch network. This "fly in, fly out" model works especially well in the Middle East, where the younger generation of clients prefers onshore investments but still has an affinity for banks, advisors, and investment experts from Switzerland or London.

Focusing on Fully Transparent and Sustainable Offshore AuM. With the amount of undeclared offshore assets expected to further diminish, wealth managers must develop a fully transparent and fully compliant offshore offering for each market that they want to actively target and serve. To this end, they should focus on clients who have little incentive to evade taxes (owing to favorable tax regimes in their domiciles), existing clients whose assets are already fully compliant, and new clients who are looking for high-quality banking services. Clients who pose a potential transparency issue should not be actively targeted and serviced—they should not be given investment advice, nor should they be advised about options for transferring their money into other structures.

To provide a fully transparent offering, wealth managers will need to deal with arcane tax-declaration procedures. Mastering these procedures could provide a competitive edge. Some institutions—especially smaller ones—may not be able to offer declarations that exceed a simple overview of assets and that meet the requirements of tax authorities in a client's domicile. Institutions in established offshore centers such as Switzerland will also need to accentuate the strengths of their home markets—and not simply as a destination for offshore AuM but as a center for high-quality wealth management backed by unwavering political and financial stability.

The Outlook for Key Offshore Centers

The allocation of assets among the major offshore centers has remained relatively stable, with Switzerland and the centers of the United Kingdom accounting for about half of all assets held offshore. But shifts in the regulatory landscape and the underlying demand for offshore banking are expected to usher in a period of change. Some centers will gain ground and others will become much less competitive.

Being discreet is a tenuous value proposition in an era of increasing oversight.

Switzerland has agreed to comply with OECD regulations governing the exchange of tax information. Bilateral negotiations are already underway, and banking secrecy may be softened by cooperation and disclosure agreements arising from investigations in certain countries. Although pressure is mounting and some reputations have been tarnished, Switzerland will not lose its status as a global financial center and will continue to draw offshore wealth. The capabilities of its banking system, together with its reputation for innovation and expertise, will continue to be important selling propositions, as will its proximity to European markets. In addition, clients will still be drawn to Switzerland by its highly educated, multilingual workforce as well as by its attractiveness as a destination in its own right.

Some nontraditional centers are poised for growth. In recent years, some centers outside Europe—namely Singapore and Hong Kong—have been growing faster than the traditional centers. If they were to avoid regulatory scrutiny for an extended period, a competitive imbalance would be created. Singapore, however, has announced plans to propose legislation this year that would bring its regulations into compliance with international tax standards.

The offshore centers of Singapore and Hong Kong will continue to benefit from their proximity to other Asian countries, where wealth is expected to grow at a strong pace over the long term. The growing quality and sophistication of Asian banks has convinced more clients to keep their offshore wealth in the region, especially because traditional offshore centers have lost some of their aura.

Singapore is particularly well placed to continue its ascent as an offshore center. Its strengths include the stability of its banking system and the qualifications of its employees. But even if it continues growing at an above-average rate, offshore AuM in Singapore (and other non-European centers) will still lag behind the offshore wealth held in traditional centers. We do not expect a significant outflow of assets from centers such as Switzerland or Luxembourg into Singapore or Hong Kong.

The outlook for other centers varies greatly. Offshore centers that have based their competitive advantage on tax avoidance are under extreme pressure. In countries that have little political capital, institutions will have few options but to agree to the regulations imposed on them. And once their tax and legal advantages evaporate, so too will their appeal—being inconspicuous or discreet is a tenuous value proposition in an era of increasing oversight. Clients will have little incentive to move new assets to these jurisdictions, especially if their banks cannot compete on the basis of service quality.

In other centers, the outlook depends very much on regulatory developments. The Channel Islands, Dublin, the Isle of Man, and London are, collectively, the second-largest offshore center in the world. Miami and New York are also among the leading offshore centers measured by AuM. The pressure on these centers has been less intense owing to the political power of their countries' governments, but the OECD expects to sign more tax-exchange agreements with their respective jurisdictions, perhaps before the end of the year.

Finally, Dubai has been growing as an offshore center. Although it is relatively small and its banking culture is still perceived as lacking the heritage and expertise of traditional centers, Dubai has built a strong position in and around the region, especially in the Indian subcontinent and central Asia. It will have to work hard to attract offshore wealth from further afield, however.

Thriving in a Challenging Environment

Wealth managers are dealing with a series of extreme events. Profitability and revenues have been affected by weaker investment performance, the erosion of AuM, and a shift in demand from complex to basic products. At the same time, clients have become increasingly conservative, insecure, and demanding. Many have lost their trust in their wealth managers.

To move forward in these challenging and uncertain times, wealth managers will have to change the way they do business. Their success will hinge on the relationship between client and advisor, and the role of the RM will become more critical in the transition from pushing products to providing advice.

In addition to redefining the role of the RM, wealth managers must make equally fundamental changes to their businesses. Some may even need to recast their business models. Three actions, in particular, will help position them to thrive in the postcrisis world:

- Redesign service and product strategies
- Improve the cost base by revisiting the business model
- Focus on core competencies and the fundamentals of wealth management

Redesign Service and Product Strategies

Few wealth managers would dispute the importance of providing clear advice and less arcane products. Trust and simplicity are words to live by in today's charged environment. But what exactly do these imperatives mean for a wealth manager's business? How should wealth managers revamp their service and product strategies to suit the postcrisis world?

Place advice at the heart of the service offering. Fewer clients are willing to delegate the management of their wealth in its entirety. The high-fee delegation option has been undermined by the loss of trust in wealth managers as well as by the weak performance of professionally managed investments.

Over the long term, the demand for delegation will be propped up by clients who are unable or unwilling to make their own investment decisions. To serve most clients, however, wealth managers will need to develop service models that are based on holistic advice. As discussed earlier, the continuity, competence, and commitment of RMs will provide the foundation for a client-centric approach. As clients embrace the advisory model, they will seek answers to complex questions about products and investment opportunities as well as about financial planning and structuring. Wealth managers will need to be prepared to address questions in several areas.

- *Succession planning* will become increasingly important given the surge of people nearing retirement in many countries. Many clients will be preoccupied with passing on their wealth or corporate structures to their children or successors. Wealth advisors could provide invaluable guidance about tax optimization or legal structures.
- *Retirement planning* will be essential, not only because of the vast numbers of people approaching retirement but also because the crisis has had such a significant

impact on wealth at a time when many people are prepared (or thought they were) to shift from earning income to living on their savings and investments.

- *Wealth structuring* will become more critical. Wealth managers are well positioned to provide advice on trusts, international fiduciary services, property solutions, and private-investment solutions. Institutions that lack this expertise should at least provide access to a carefully developed network of specialists.

- *Global custody and investment services* (such as global research and tailor-made investment solutions) will be sought by family offices or UHNW clients. The crisis could prompt these clients to search for more comprehensive ways to diversify risk. Some may be interested in a central custodian.

Despite its singular importance, advice is generally not a direct source of revenue. Clients expect advice to be part of their relationship with a wealth manager. Some institutions may be able to charge for specific advisory services that provide high value to the client and are clearly going beyond the purview of standard advice—but the pricing model must be fixed and transparent. In the United Kingdom and the United States, many independent advisors are charging fees for specific kinds of advice. Nevertheless, advisory services are geared mainly toward customer retention. Over time, of course, this should set the stage for stronger product sales.

In reviewing its service strategy, a wealth manager needs to be clear on where it can earn money. Client segmentation will be critical. Wealth managers should recognize that middle-tier clients can actually be more profitable than the wealthiest clients, who require more intensive service but often generate lower margins. Wealth managers must also be careful not to overlook the challenges and opportunities of serving lower-tier clients. (See the sidebar "Serving Affluent Clients Efficiently.")

Streamline the product portfolio. Complex financial products have bewildered clients and advisors alike. The universe of products and markets is impossible to grasp. To some extent, the challenge of reducing complexity has to do with a shift in mindset. Wealth managers must recognize that they can actually enhance the offering by narrowing their focus. To this end, they need to identify which of their products create value—for both the institution and the client—and which provide competitive advantage. They should question the need to provide all other products.

Wealth managers can actually enhance the offering by narrowing their focus.

This would mean that instead of offering a vast array of products, wealth managers can reduce their offering to a list of recommended products. The list should contain a set of core products supplemented by a small number of more innovative options. A "guided architecture" offering will reduce complexity while improving clarity and transparency—all of which will help wealth managers safeguard their revenues during the current crisis. True open architecture is virtually impossible to provide—there are simply too many options to research.

Small institutions have always had to rely on guided architecture, but many larger wealth managers have—up until just a few years ago—created offerings that were predominantly based on their own products. This model tended to foster a product-push mentality. It also lacked objectivity, provided a limited choice of products, and often left some client needs unfulfilled or inadequately addressed.

Offering third-party products will not necessarily hurt revenues. The client will most likely choose the in-house offering if it is competitive and the RM has established a good rapport. Moreover, a wealth manager can actually bolster its client relationships (and ultimately boost assets and revenues) by recommending third-party products—such recommendations underscore the commitment to the client's best interests. In addition, the direct competition from outside products could spur the institution to improve its own asset-management capabilities.

Reprice and recast the offering. Wealth managers are repricing products and improving their discounting practices. The aim is to increase revenues by identifying product categories for which prices could be raised—either directly or by reducing discounts—without jeopardizing client relationships. After a large universal bank discovered that it was offering discounts on 60 percent of its products, it identified lending products for which demand appeared to be price insensitive; it was able to raise its prices and increase revenues significantly in this category.

Serving Affluent Clients Efficiently

Affluent clients are commonly defined as having up to $1 million in AuM. Although this segment is both large and relatively profitable—on average, about 70 percent of the clients of our 124 benchmarking participants were affluent, and wealth managers (in principle) aim to serve them with standardized, scalable offerings—most institutions do not consider it part of the core business. As a result, they tend to overlook some of the traits and challenges that distinguish these clients.

Affluent clients generate substantial revenues. Affluent clients want more than commoditized products, but they are generally satisfied with a less intensive level of service and a more limited product selection. As a result, these clients generate higher revenue margins. Among our benchmarking participants, about 25 percent of AuM was held by affluent clients, but they generated from 30 to 40 percent of revenues.

Many wealth managers do not serve this segment efficiently. RMs are interested in maximizing the number of clients, irrespective of their wealth. They might not actively target affluent clients, but nor will they reject them—these clients contribute to the portfolio, and they also have the potential to move into wealthier segments and refer other clients. As a result, RMs often end up with a mixed book of affluent and HNW or UHNW clients. But because most wealth managers lack clearly defined service standards for this segment, RMs usually provide affluent clients with services that are more appropriate for wealthier clients, including tailored advice, comprehensive offerings, sophisticated portfolio management, and frequent meetings.

Wealth managers need a dedicated service model for affluent clients. Given the revenue pressures created by the crisis, a wealth manager cannot afford to have its RMs spending an inordinate amount of time on their less wealthy clients. It is not only inefficient but could also distract RMs from reinforcing relationships with wealthier clients, who require more intensive service. In fact, an RM who is focused entirely on the affluent segment can easily have up to 400 clients in his or her portfolio, whereas a book of HNW clients would not exceed 200 individuals. (In Asia, a typical book of HNW clients is even smaller.) At the same time, however, wealth managers cannot afford to miss out on the revenue margins that affluent clients provide.

To tap the full potential of affluent clients, wealth managers should design a service model specifically for this segment. Rather than having RMs with mixed books, an institution could designate a small number of RMs—or an entire desk—to focus on affluent clients. This would ensure that the segment receives a consistent and suitable level of service.

Wealth managers should also look for opportunities to provide a suite of products that offer the safety and simplicity clients demand. Examples include the following:

- *Plain-Vanilla Products.* These include quality funds, highly rated bonds, or simple call or put options. A Swiss private bank, for example, has set up funds focusing on conservative companies that have a high level of real assets. The funds serve as a hedge against inflation. In Brazil, banks have established conservative funds that have a low risk-return profile.

- *Passive Investments.* These are vehicles that are not actively managed, such as ETFs on stock indices or commodities. These instruments passively track the price movement of a certain market. They are highly liquid and their management fees are considerably lower than those for actively managed products.

- *Simple Capital-Protection Products.* These will prove invaluable to some clients. They allow clients to pay a fee for a form of insurance that acts as a ceiling for losses (particularly in the event of an extreme market scenario).

- *Risk-Sharing Products.* In some cases, a wealth manager can demonstrate its willingness to take on a certain share of the risk of a particular product. A U.S. bank has investment funds that are sold to the public only after a significant amount of money has been invested by its employees.

At the same time, wealth managers should offer a suite of products that provide greater opportunity and upside:

- *Short-Term, High-Interest-Rate Products.* These should be easy to understand and should be pitched to clients who are searching for higher returns but still need short-term liquidity. In Asia, for example, dual-currency deposits have become more popular.

- *Exclusive Offerings.* These allow clients to participate directly in deals, such as a joint investment in a real estate project.

- *Sector-Specific Products.* Products linked to recovering real-estate markets in the Middle East and Asia, for example, may become attractive.

The product portfolio should evolve to reflect the creation of new wealth. In China, for example, entrepreneurs may be able to seize opportunities created by fiscal stimulus programs and (potentially) an early economic recovery. Wealth managers should identify these potential clients and the products that appeal to them.

Improve the Cost Base by Revisiting the Business Model

Global wealth grew at an estimated annual rate of 9 percent from year-end 2001 through 2007.[12] Wealth management was an everlasting success story—or so it seemed. Wealth managers had limitless options to expand in regions such as Asia and the Middle East, and clients were relatively easy to satisfy. Absolute performance was mostly good, and the industry continued to produce a steady stream of increasingly sophisticated products.

In the run-up to the current crisis, most wealth managers were focused squarely on revenues and expansion. Cost efficiency and savings programs were seldom very high on the management agenda. The crisis has since put enormous pressure on revenues and forced institutions to adjust their cost positions to reflect lower asset bases, lower trading volumes, and different investment activities.

Many institutions have taken quick action to cut discretionary spending, but their initiatives tend to be more temporary than permanent in that they do not alter the cost structure—and the benefits could easily fade once the crisis subsides. Some wealth managers, however, are going beyond short-term measures by improving the business model and even changing how and where they compete. As a result, they are poised to emerge from the downturn in a stronger position.

Cut discretionary spending. A range of measures can be implemented in the short to medium term without disturbing the organizational structure or the business model. They are not likely to reduce costs substantially, but they do produce fast results, often with minimal effort.

De-layering provides an opportunity to place the best talent in the newly defined roles.

- Marketing, travel, and entertainment expenses are at the top of the list for most cost-reduction programs. Many institutions introduced cost initiatives in their overseas operations to reduce advertising and travel expenses, and the number and cost of client events have been reduced, especially for the affluent segment.

- Wealth managers in Asia and the Middle East have reduced salaries by 10 percent or more. Institutions in Europe and North America are cutting variable bonuses, owing in no small measure to public pressure. Institutions have also been able to reduce or outsource auxiliary positions—such as drivers, cleaners, and receptionists—without affecting the core business.

- Most institutions have raised awareness about the need for cost discipline with regard to furniture, decorations, and office supplies.

Improve or change the business model. Compared with efforts to cut near-term spending, this approach requires a much more focused and sustained effort, along with a willingness to change the organization. Wealth managers are pursuing a range of such initiatives:

- Many are reducing staff by de-layering hierarchies and cutting back overcapacities. Over time, wealth managers have ended up with too many organizational layers—and narrow spans of control. De-layering provides an opportunity not only to improve the structure but also to place the best talent in the newly defined roles. Several institutions have gone through such redesigns since the outbreak of the crisis, often reducing their staff levels by 15 to 20 percent.

12. This is an estimate; our methodology changed between 2001 and 2002.

- Wealth managers may need to revisit the value chain, thinking about which activities they need to perform themselves and which might be best left to third parties. It is crucial that an institution focus only on activities in which it is competitive; the rest could be outsourced or discontinued.

- Some are reviewing their IT strategies in an effort to postpone or reduce expenses. Such measures can impair an insitution's operational efficiency but they may be unavoidable given the severity of the crisis. At least one global universal bank has delayed plans to replace its legacy system because of the turmoil. Other banks, however, are modernizing their core systems in an effort to reduce costs over the long term.

- By reorienting their strategic focus, wealth managers can reduce the number of teams and desks. "We used to have a guy for Mexico, one for Brazil, and one for Argentina," said an executive of a subsidiary of a U.S. bank. "Now, there is just one LatAm desk."

- Although changes to the product offering are largely demand driven—clients want simplicity, not sophistication—a streamlined offering can also help reduce costs. Wealth managers are lowering their asset-management costs by closing noncore funds and replacing their own products with third-party offerings.

- Several large institutions are pulling out of markets where they are subscale. And in places where they plan to retain a front office, they are taking steps to reduce back-office costs. A European bank with extensive operations in Asia is planning to move some of its back offices in Singapore out of the central business district as part of an effort to reduce the facility's operating costs—such as rent and insurance—by 20 percent.

The extent to which wealth managers have implemented these initiatives varies by region. In regions that have been relatively insulated from the crisis, such as Brazil, institutions have yet to pursue any cost initiatives as a result of the turmoil—although with the revenues of Brazilian banks now declining, those banks may need to reduce costs to improve or stabilize their cost-to-income ratios. Banks in the Middle East have avoided the worst effects of the crisis and are not pursuing major changes to their business models. Still, many reacted promptly to the crisis by laying off underperforming employees, especially in the front office. In Asia, most emerging economies are still growing, albeit at a slower pace, and markets bounced back during the first half of 2009. As a result, revenue growth has bumped cost reduction from the top of the agenda. Some of the region's banks, however, have made significant cuts using tail management for front-office staff.

Several large institutions are pulling out of markets where they are subscale.

Wealth managers in some of the most severely affected markets, on the other hand, seem to be almost overwhelmed by the problems they are facing. Many Russian banks responded quickly to the crisis, laying off as many as 15 percent of their staff and reducing salaries by 10 percent. But they are reluctant to transform their processes or business models. Having grown accustomed to sustained growth during the precrisis years, some of these banks have no experience in dealing with a significant downturn.

In contrast, some Swiss and U.S. banks appear to have made progress in fundamentally realigning their costs. They are aware that sustained cost reduction will require changes to processes and eventually to their business models. For example, banks in Switzerland that have been hit hard by the crisis have already implemented ambitious, organization-wide cost-cutting programs. Likewise, U.S. brokers, which felt the full impact of the crisis, reacted quickly with extensive layoffs. (For more on the U.S. wealth-management market, see the sidebar "Adapting to Change: U.S. Wealth Managers.") Most had already developed well-prepared plans for dealing with declining revenues and profits.

Focus on Core Competencies and the Fundamentals of Wealth Management

Wealth managers need to do more with less. Clients are demanding a higher, more attentive level of service, but revenues and profitability are feeling the strains of a significant shift (and loss) of assets. As a result, institutions must focus on the activities that they do best or that differentiate their brands in the market, while avoiding activities that do not add value. They simply cannot afford to offer everything to all clients. Most will only move forward by going back to basics—an unwavering commit-

Adapting to Change

U.S. Wealth Managers

In the United States, wealth managers are dealing not only with changing client behavior and declining assets but also with a massive transformation of the financial services landscape. Since the crisis began, two of the five major independent investment banks have collapsed, one has been taken over, and the remaining two have been converted to bank holding companies. The shifting ground has created even more uncertainty about which business models will succeed in the postcrisis world.

For decades, investors in the United States could choose from a variety of wealth management models, although three business models came to dominate the landscape: the full-service brokerage model, the private-bank or trust bank model, and the independent-advisor model.

- National full-service brokers offer a wide selection of investment products and advisory services, while regional and independent broker-dealers generally provide a smaller set of products along with specialized advice. Full-service brokers serve a range of clients, from mass-market investors to ultra-high-net-worth clients. Traditionally, they relied on transaction-driven commissions, but over the past ten years they have moved toward fee-based pricing. Decoupled from transaction activity and driven mainly by a client's AuM, fee-based revenue tends to provide a more stable income stream. In our benchmarking study, North American brokers derived an average of 41.9 percent of their revenues from fees.[1]

- Private banks and trust banks have focused on fee-based advisory services and products. They typically offer more comprehensive financial advice and products, including investments, cash management, lending, custody, trusts, and estate plans. They generally serve high-net-worth and ultra-high-net-worth clients and are often seen as being more conservative in their investment selections. According to our benchmarking data, fees generated an average of 61.3 percent of revenues at these institutions in 2008.[2]

- Independent advisors also provide fee-based advice but to a wider range of clients. They typically source their products and platforms from third parties. Some of these advisors derive all of their revenues from fees.

Full-service brokers, which are the single largest distribution channel in the U.S. wealth-management market, have been most affected by the crisis and have seen a steady outflow of assets over the last few quarters. Earlier this year, independent broker-dealers reported that the vast majority of their new clients had come from full-service brokers. Private banks and trust banks have also benefited from the crisis-induced flight to safety.

In response, full-service brokers have begun reinventing themselves. Some have engaged in M&A to remain at the forefront of the retail-brokerage industry. Others are adopting a more focused approach. One institution has decided to concentrate on a specific client segment and will sell 55 of its branches to a regional broker-dealer that is looking to expand. They are also continuing to broaden their advice and fee-based offerings and have been looking to retrain their advisors to deal with the "new normal."

We believe that full-service brokers will remain the largest wealth-management business model in the United States. Time after time, they have proved to be agile and entrepreneurial competitors, able to adapt their business models to suit changing market conditions. The growth of independent advisors, by contrast, is constrained by their lack of institutional resources for products, platforms, and branding. And private banks and trust banks continue to be perceived as the domain of the very rich and very conservative.

1. Broker wealth managers are firms that derive more than half of their revenues from commissions.
2. Bank wealth managers are firms that derive more than half of their revenues from fees and net interest.

ment to the client that is grounded in a thorough understanding of his or her overall investment needs and objectives.

Wealth managers are reconfiguring their business models based on a critical assessment of what they do best. Core competencies will vary from institution to institution. In Latin America, local banks have been able to accentuate their stability relative to international competitors. (See the sidebar "Latin America: Using Trust as a Competitive Advantage.") Institutions that want to be client-centric tend to invest in highly qualified RMs and networks of trustworthy affiliated specialists, such as lawyers and tax experts. Wealth managers with strong asset-management capabilities are revising their product portfolios to create unique offerings that resonate with

Latin America

Using Trust as a Competitive Advantage

Latin America's wealth-management market is unique. It includes several countries that have overcome numerous financial crises and some that have dealt with recurring hyperinflation and currency devaluation. Having weathered previous storms, institutions were prepared for this crisis, with solid capitalization, conservative leverage ratios, sufficient liquidity and solvency ratios, and sophisticated IT. And even though their markets have matured, they have still maintained a foundation of traditional products. In most countries in Latin America, wealth managers were focused on regional investments and had little incentive to push Wall Street's most innovative products, which, for the most part, were too complex for their clients. In addition, securitization constructs—such as collateralized debt obligations—were slow to evolve.

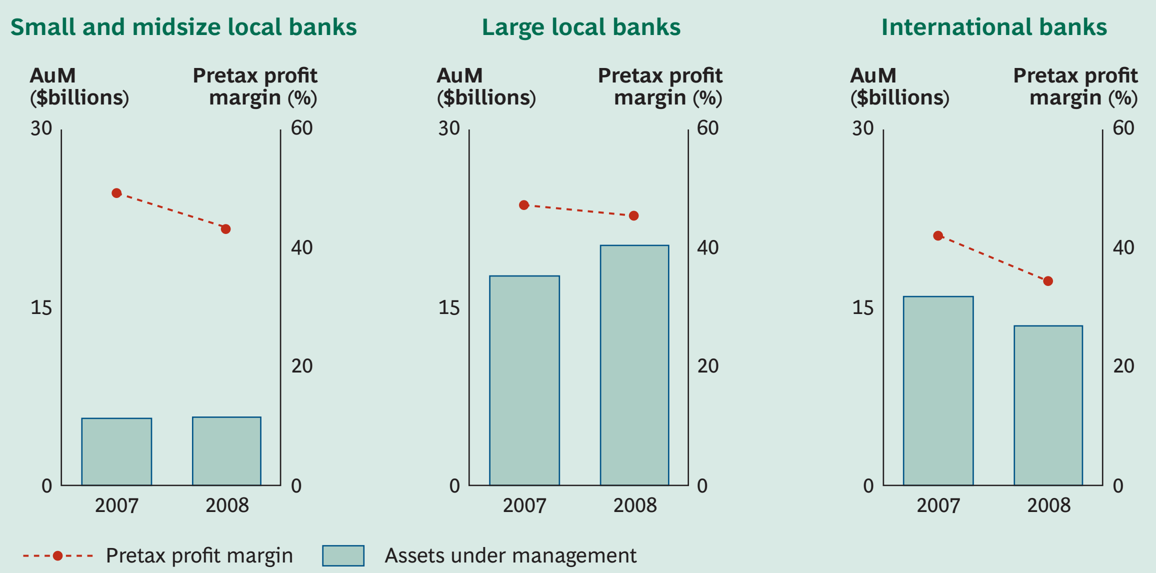
The region's wealth managers also benefited from their late—and somewhat guarded—embrace of global diversification. Rather than venturing overseas, they were more likely to grow by means of mergers and acquisitions closer to home. This experience with regional M&A made them more conscious of controlling costs and improving operations, which lent even more stability to their businesses. It also provided scale and boosted profitability.

As a result, local institutions now have a competitive advantage over their foreign competitors, most of which suffered massive losses in the crisis. (See the exhibit below.) This competitive edge stems from many of the factors described above, but perhaps the greatest differentiator boils down to one word: trust.

Varied Economic Performance. Although the region as a whole has fared well, economic performance—and along with it, the strength of wealth managers—varies from country to country.

- **Brazil** is the region's largest economy and one of the most robust. The Brazilian real remains strong, while high interest rates have attracted capital and diminished the appeal of offshore investments. Last year, Brazilian banks increased their AuM by 21 percent, while net new assets grew 10 percent. Strong banks, such as Itaú Unibanco (which, as of March 2009, was the elev-

Large Local Banks Have Fared Better Than International Banks



Source: BCG Wealth-Manager Performance Database, 2009.
Note: Large local banks were defined as having more than $14 billion in AuM; the pretax profit margin is revenues minus costs (before depreciation and taxes), divided by revenues.

enth-largest bank in the world measured by market value), still invest mainly in the region but might consider expanding overseas. The country is bullish about its economy. "We were the last in joining the crisis," said Brazil's president, Luiz Inácio Lula da Silva, "and we are going to be the first in getting out."

- **Mexico** is unique because of its proximity to and dependence on the U.S. market and the high penetration of international banks. The crisis was quick to hit the country, and the peso soon lost about 20 to 30 percent of its value. AuM fell by 1 percent, while net new assets increased by 2 percent. With support from the International Monetary Fund, the situation has since stabilized, providing room for a more flexible monetary policy. Most financial institutions have settled into what one banker described as "normal recession mode," although there are signs of an increasingly robust wealth-management sector. The gradual move from offshore to onshore investments has continued despite the devaluation of the peso. With more than 80 wealth managers now competing in Mexico, the industry will be pressured to develop higher-quality services and cultivate relationships based on trust.

- In **Argentina,** the government has taken steps to foster the development of the onshore market. It recently tried to repatriate some of the country's $160 billion in offshore assets through a tax amnesty program and stricter measures to police offshore investments. But the financial crisis, combined with political and macroeconomic uncertainty domestically, has undermined confidence in onshore opportunities. Argentina's wealth-management market continues to revolve around offshore investments.

- **Chile** has a sophisticated wealth-management market. Several local competitors—including boutique investment banks, domestic commercial banks, and asset managers—have taken advantage of the stable macroeconomic, political, and regulatory environment to develop a large and profitable onshore market.

- **Uruguay** and **Panama** are both offshore centers, and they face the same challenges confronting similar centers around the world. The OECD is pushing for greater transparency, and Uruguay recently signed an agreement to adhere to global transparency standards. The importance of these centers, however, is limited. Montevideo mainly serves Argentine clients, while Panama mainly serves clients from Mexico.

Changing Dynamics. The industry will evolve in different ways for different institutions. Some of the region's midsize banks are aggressively targeting the clients of their weakened foreign competitors. This will usher in a period of consolidation in the midsize market. Meanwhile, Latin America's biggest banks will continue to pursue M&A opportunities throughout the region (and perhaps abroad).

Brazilian banks are particularly well placed to take advantage of these changing dynamics, given their operational discipline—honed by past crises—and their trusted brands. But they need to act soon, while they still enjoy a competitive edge over foreign banks. They have emerged (some might say unexpectedly) as relatively stable alternatives to their international rivals, although the conditions that led to this advantage may not persist. Latin America, in general, remains vulnerable to currency devaluation, sustained inflation, and political instability. These risks aside, some of the clients that wealth managers have gained during the crisis may be inclined to leave once the turmoil subsides—the shift is certainly more temporary than permanent.

To avoid losing the gains they have made since the start of the crisis, wealth managers in Latin America should make a concerted effort to deepen new relationships. The flow of assets to conservative investments will likely be reversed as soon as markets recover, but clients will continue to seek trusted advisors that are committed to building relationships. As in other markets, the era of pushing products has given way to the advisory model.

clients. Universal banks might differentiate their wealth-management units by playing on the strengths of a global footprint and their other businesses, namely corporate and investment banking.

The first step for all wealth managers is to form clear opinions on general wealth-management topics such as trends in bond rates or currencies. Only institutions that manage to give the client this basic guidance will be perceived as trustworthy. In addition, wealth managers need to make a clear connection between their undiluted focus and their value proposition. Institutions that highlight their core competencies—while providing comprehensive advice within a framework of guided architecture—have a much better chance of emerging from the crisis as winners.

The industry's reputation may have been scarred, but its services remain vital.

A Call to Action

The wealth management industry is well placed to take advantage of the current turmoil and the eventual upturn. The industry's reputation may have been scarred, but its services remain vital. At the same time, however, wealth managers must recognize the challenges that they face. Profitability and revenue margins will continue to suffer from the decline and reallocation of assets, and client relationships remain tenuous.

Wealth managers can deal with the pressures created by the crisis by taking four steps:

- Recruit, train, and reward RMs who are focused on providing advice rather than pushing products. Wealth managers will win or lose on the basis of their RMs' ability to forge deep relationships and provide holistic advice. RMs, in turn, must be able to leverage a network of experts and specialists.

- Revamp product and service strategies. For the time being, clients need offerings that are simple and conservative because most are still preoccupied with preserving their wealth—although some are already searching for solutions that will enable them to benefit from an upturn. Wealth managers should concentrate on areas in which they have a competitive advantage or add value for the client, and outsource or simply not offer undifferentiated products and services.

- Focus intently on controlling costs. For many, this will mark a radical shift from the precrisis drive for growth. Wealth managers must look beyond the quick cuts for opportunities to fundamentally improve their cost position. The crisis can act as a powerful catalyst for change.

- Wealth managers also need to develop new strategies for managing offshore wealth. They can deal with the threat of increased scrutiny and the growing appeal of onshore investments in two ways: moving abroad to capture onshore assets and focusing on fully transparent and sustainable offshore AuM. In general, they should emphasize three attributes: their capabilities as wealth managers, their proximity to large or high-growth wealth markets, and their attractiveness as destinations in their own right.

By taking these steps, wealth managers will be able to stabilize their businesses while capitalizing on the dislocation of clients and assets. There is a window of opportunity to act while assets remain liquid and relationships remain fluid. Institutions that have gained ground because of the crisis—owing to their strong brands and conservative investments—must cement their new relationships by showing that they are more than temporary safe havens. Wealth managers that have lost clients and assets must redouble their efforts to improve their offerings and demonstrate their commitment to building deep relationships by delivering on the "client promise."

It is a rare point of inflection for wealth managers—as unprecedented as the crisis itself. We fully expect assets to continue flowing largely within (not out of) this sector, particularly once a recovery takes hold. Well-prepared wealth managers will emerge from the crisis in a much stronger position, primed for sustained growth—but only if they invest now (ahead of the upturn) in a well-defined, clearly differentiated value proposition based on a set of core products and services.

For Further Reading

The Boston Consulting Group publishes other reports and articles that may be of interest to senior financial executives. Recent examples include the following:

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A White Paper by The Boston Consulting Group, July 2009

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Collateral Damage, Part 7: Green Shoots, False Positives, and What Companies Can Learn from the Great Depression
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A Wealth of Opportunities in Turbulent Times: Global Wealth 2008
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The Return of the Strategist: Creating Value with M&A in Downturns
A report by The Boston Consulting Group, May 2008

Note to the Reader

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