SPEAR'S RUSSIA WHITE PAPER 2013/1

Does Financial Market Development Explain (or at Least Predict) the Demand for Wealth Management and Private Banking Services in Developing Markets?

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Abstract:

How should wealth managers and private bankers find and serve the wealthy – particularly in developing countries? Several banks and consulting firms provide market sizing estimates for the number of high net worth and ultra-high net worth individuals. However, it is still an open question whether financial management services actually create wealth (or increase the number of wealthy persons). How can financial advisors know if, on a macro-level, their service offerings grow their collective assets under management and increase their prospect numbers? In this paper, we find evidence that advanced wealth management and private banking services might help grow a wirehouse's book of business in developed, but not developing, markets. If wealth management and private banking follow general trends affecting the broader financial sector, their business also grows wealth in less advanced economies. Such evidence sheds light on the currently ambiguous role that financial development seems to play in creating affluent, high net worth and ultra-high net worth individuals.

JEL Codes: D31, E01, E21, O10 Keywords: wealth management, private banking, high net worth, wirehouse, HNWI

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Introduction

Wealth management and private banking have become, in the Post-Lehman era, one of the fastest growing segments of banking. In 2011, at a time of economic recession, the wealthy's holdings world-wide grew by 4.3% (BCG, 2011, p. 2). Developing countries account of much of this growth. In 2011, Middle East, Asia, Latin America grew by about 7%. Hiring in many of the international banks – at the time of this writing – has also focused on adding wealth managers and private bankers in developing markets. According to *eFinancialCareers*, roughly 2 jobs appeared in wealth management for each job in retail banking at the end of 2011. Do the financial institutions like *JP Morgan* and *HSBC* who offer these wealth management services help account global increases in wealth? In this paper, we assess the extent to which wealth managers and private bankers create wealth (assuming the affects of their services follow patterns related to the broader financial sector). We specifically look at the extent to which differences in financial sector institutions (and the wealth managers that work within them) help grow their own assets under management and prospective wealthy clients.

Our paper assesses the extent to which different financial sector institutions -- defined as financial institutions differing in returns on assets, costs, insurance premiums collected and so forth -- correlate with increases in wealth across countries and the number of affluent as well as high net worth individuals (particularly in developing economies). Because the large wirehouses and private banks abroad do not publish information about their books of business, we deduce that pattern affecting the broader financial sector also apply to the wealth management and private banking industries in these developing countries. We develop a model for explaining how wealth management firms and private banks can grow the wealth of their clients in developing countries and include mechanisms for increasing the numbers of affluent and high net worth clients through wealth management practices.

Our paper both supports and refutes the role of wealth management in generating wealth (and high net worth individuals). We find that such wealth management services probably serve to increase wealth (and the numbers of the wealthy) in the OECD member countries. However, in developing countries, we observe no or negative correlation between the differences in financial institutions and the growth of wealth and the numbers of wealthy. We also find that macroeconomic and institutional quality affect the extent of wealth creation far more than wealth managers and private bankers likely do. Our results remain extremely tentative – as only a detailed analysis of broker-dealers' client books can tell definitively if wealth management helps or hurts the affluent.

What Do We Know About Wealth and Banking Sector Development in the Developing World?

Recent trends in wealth

Wirehouses interested in acquiring new assets should ostensibly look to the developing world.¹ Figure 1 shows the value of such wealth in various countries (as proxied by wealth held by the top 10% of the adult population). Rich US households hold roughly \$50 trillion in wealth (depending on whose estimates you believe).² However, Brazilian, Russian, Indian and Chinese ultra-high net worth individuals, high net worth individuals and the affluent together also hold roughly \$50 trillion in wealth.³ For wirehouses looking to target wealth in Latin America, Argentina and Colombia provide wealth managers with the opportunity to collect between \$250 million and \$500 million. In the Middle East, the data show relatively deep pockets of wealth in Turkey. Saudi Arabia, and Egypt. Surprisingly, Iran and Pakistan also provide amble opportunities for wealth managers to accumulate client's assets in these markets. In Asia, India and Indonesia provide some of the largest opportunities (in absolute terms and outside of China and Japan) for aspiring wealth managers.



¹ The term wirehouse has come, increasingly in the specialised financial press, to represent international banks and broker-dealers operating in more than one branch or office. The term comes from the old days when they would send information by wire (or electronically). We use the term repeatedly as our paper focuses on implications for large wealth management firms and private banks operating in more than one jurisdiction.

² We discuss in the literature review section the various companies which produce "market sizing" estimates for wealth across countries.

³ We use the term ultra-high net worth individual to refer to persons with \$10 million or more in wealth, a high net worth individual has \$1 million in wealth, while an affluent person has \$100,000 or more in assets after subtracting out liabilities (and in current US dollar terms).

The developed economies – while producing wealth less quickly than the developing economies – tended to produce more of it (in absolute terms). Figure 2a shows the change in the absolute levels of wealth in the top 15 countries (ranked by levels of wealth). As shown, China produced the most wealth in 2010 (generating almost \$2 trillion for the top 10% of its wealth holders). The US came in second – generating a bit more than \$1.5 trillion. France, Italy and Australia filled-out the list. Yet, looking at the rates of growth, we see from the data that the old world clearly has not produced wealth at the same rate as in much of the developing world. Figure 2b shows these rates of change The OECD member countries generated wealth at roughly 4% per annum since 2000. The former Socialist economies in Eastern Europe and the Former Soviet Union produced wealth at roughly 15%.





The data in Figure 2b also show another trend of particular interest to the international wirehouses keen on building books of business in developing countries. In much of the developing world, ultra-high net worth individuals sent much of their wealth into the hands of foreign wealth managers. The Middle East (for example) has one of the highest proportions of the wealthy using foreign wealth managers – with roughly 70% of wealth

ending up in Switzerland, London, New York and other international banking centres. Such a pattern represents a large opportunity for large international wirehouses – who can take these funds from developing countries and use them in developed OECD member states. However, such a pattern poses both practical and analytical problems. Practically, asset managers do not use this wealth to invest in the markets where the wealth came from. Such wealth can not contribute to local businesses and grow an indigenous affluent class – complicating any analysis of the role of domestic financial advice on wealth creation. Analytically, wealth sent abroad can significantly distort any accounting of wealth in a particular country. Both national accounting (like household surveys) and international surveys (like BIS data) can serious under-report the extent of assets (and liabilities) held abroad. Such a pattern makes research on wealth that much the harder.

Despite these problems, we know that countries where the richest 1% of households possess significantly more wealth than the other top 10% saw slower growth in wealth in the last decade. Figure 3 shows the correlation between the annual growth rate of wealth and the proportion of wealth held by the top 1% (as a proportion of wealth held by the top 10%). The graph shows rates of change on the y-axis - so the negative correlation depicted in the graph means that countries with a less wealthy top 1% saw higher overall rates of growth in wealth. To the extent that the Credit Suisse data reflect reality, even a simple unweighted bivariate correlation very strongly suggests a relationship between wealth and inequality.⁴ However, the relationship differs across regions. In the East Asia and Pacific region, more concentrated wealth correlates with lower growth rates in overall levels of wealth (with a correlation coefficient of -0.26). Yet, in Sub-Saharan Africa and South Asia, highly concentrated wealth across countries correlates with increased growth in wealth. We can not say for sure what relationship the concentration of wealth has with the growth in overall levels of wealth. Yet, we can not ignore the intuition behind these numbers – that inequality relates in some way in the 2000s with wealth (for whatever reason).

⁴ We do not wish to over-interpret this finding. Thousands of papers provide theoretical and empirical arguments related to the relationship between the growth in incomes, household assets and economic inequality. We only seek to present the data "as is" in order to help the reader understand the data we use in our more complicated statistical analysis later.



The data also suggest that the proportion of affluent persons (with net assets of more than \$100,000) correlates with the proportion of national wealth held by the country's richest 10% of the population. The regional differences can startle. In East Asia and the Pacific, a correlation of 0.72 means that as the wealthiest accumulate assets, more adults become affluent – possible reflecting recent upward wide-spread economic mobility in several countries in the region. In Latin America, on the other hand, a negative relation exists. Such a relationship suggests that the wealthy either become very wealthy – or stay in the middle classes.



held by the top 1% (relative to the top 10%). We show the correlation coefficients next to the graph to give the reader a sense of correlations within groups. Data plotted on a logarithmic scale. Source: Credit Suisse (2010).

What explains wealth – and increases in the numbers of wealthy individuals? Macroeconomists explain the accumulation of wealth from four factors -- individuals can produce goods and services (and then trade them for financial assets like money), they can invest and receive returns from these investments, they can consume, and/or they can benefit from asset/wage bubbles (ε). This basic equation underpins the study of most wealth and we express this in equation 1. Wealth managers looking to expand their book of business traditionally have had to seek places where wages increased quickly, where stock markets and other investments boomed, where people chose to save rather than engage in copious consumption and/or where some mania or some "rush" (like a gold rush) had temporarily pushed up incomes and/or asset prices.⁵

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wealth = labour + returns to investment – consumption – \varepsilon (1)
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The data suggest that developing economies will likely provide the greatest opportunities for wealth managers. Figure 5 shows the likely evolution of wealth in a number of economies, using the basic wealth accounting we presented above. In this figure, we predict the extent to which the richest 1% of several advanced economies will likely remain important targets for aspiring private bankers. The figure shows the <u>wealth</u> shares held by the top 1% compared with <u>income</u> shares held by that same 1% for the most recent dates available (around the end of the 2000s). The wealth share of the richest Argentineans hovers at around 17%, yet they earned 23% of incomes toward the end of the 2000s. Such data suggest that their wealth should increase over time to reflect their increased income. Conversely, Australians at the top 1% hold roughly half of all wealth. However, they only earn 8% of incomes. We can therefore expect dissipation over time of their wealth (as the flows of wealth do not keep up with the levels or stocks of wealth they currently possess).

⁵ In practice, the relationship becomes more complicated because of debt. Debt simply postpones the effects of the long-term factors we cite in equation 1. For example, in the short-term, individuals or households may use debt to finance consumption (and repay such debt with funds they acquire as a result of their labour). An investor can also accumulate wealth from funding an investment through debt (which would comprise a simple investment return). In more complicated cases, the wealthy individual can simply defaulting on debt. In such a case, the wealth generated would analytically equal an abnormal return (ϵ)—the same as if he or she managed to gain from some distortion in asset or other markets.

Country	wealth*	incomes*	Index of	Expected
			Accumulate**	direction
Argentina	17%	23%	6%	Accumulation
Australia	49%	8%	1%	Dissipation
Canada	59%	13%	-4%	Dissipation
Finland	29%	6%	-4%	Dissipation
France	63%	9%	-2%	Dissipation
Germany	41%	11%	2%	Dissipation
India	0%	16%	4%	Accumulation
Ireland	50%	10.50%	-7%	Dissipation
Japan	50%	8%	-	Dissipation
Netherlands	40%	5.25%	-	Dissipation
New Zealand	39%	8%	-1%	Dissipation
Spain	27%	8%	-2%	Dissipation
Sweden	65%	5.50%	1%	Dissipation
Switzerland	38%	8%	-	Dissipation
United Kingdom	60%	13%	-2%	Dissipation
United States	54%	11%	-4%	Dissipation

Figure 5: The Uber-Rich are less likely to remain super-rich in the advanced economies in the upcoming years

* Wealth shares show the proportion of national wealth held by the 1% of the richest population and income shares show the percent of national income earned by the top 1% of the population.

** We construct the index by adding the growth rate of savings to the growth rate of GDP and subtracting the growth rate of consumption. We used GDP (constant 2000 US dollars), gross savings (as a % of GDP) and household final consumption expenditure (constant 2000 US\$) for our calculations. We did not want to turn this indicator into a complicated formula, so we provide this simple index rather than a true measure of changes in accumulation over time. By failing to weight the savings rate, we give changes in savings a greater weight. The index also provides a common sense check on the Credit Suisse data. Sources: Credit Suisse (2011) for wealth shares, Roine *et al.* (2009) for income shares, and World Bank (2012) for macroeconomic data.

Part of this change in wealth (and incomes) reflects financial flows from abroad (and particularly developing countries). We previously showed data about the off-shore holdings of the wealthy in several developing countries (in Figure 2b). Figure 6 shows bank assets and liabilities held abroad in several developed economies – providing further clarification about the extent to which wealth goes to (and comes from) relatively wealthy economies. As shown, the UK, Germany and the US represent the top 3 markets to which investors send their money abroad and foreign investors prefer to place their assets. These economies saw more than \$4 trillion either held abroad or held by foreigners. Much anecdotal evidence suggests that funds placed with managers – particularly from Middle Eastern, Africa and other developing countries – appear in the UK, Switzerland and the Netherlands. These data seem to confirm this trend. Wealth managers with firms like Bank of America, UBS, AXA thus have seemed to have found numerous rich clients abroad.



We also know from bank-level data that these OECD-based wealth managers (also known as financial advisors) are scooping up larger shares of high net worth and ultrahigh net worth investors. Figure 7 shows the top financial advisors as reported by various rankings. These ranking mostly cover the US – as the press reports on wealth management most vigorously in the US. The top 10 wealth management firms in the US control a fair amount of wealth. The largest wealth management firms – Bank of America, Morgan Stanley, UBS and Wells Fargo – manage roughly \$8 trillion in assets (or roughly a bit more than China's GDP). Such amounts clearly indicate that banking institutions serve as important intermediaries in managing wealth. We can not know how much of this wealth represents the financial holdings of high net worth individuals abroad. However, we do know that the US (and these financial institutions) represent prime wealth management service providers for many of the rich in the developing world.⁶ Financial institutions in rich countries (particularly in the OECD) seem to play a special role in wealth creation.

⁶ These data do not show the holdings of financial advisors based abroad – for example a Merrill Lynch advisor located in Argentina. In practice, US and foreign regulations pose obstacles for Argentine high net worth individuals seeking to wire funds to a US-based private banker. However, as the data show, these obstacles do not represent extremely serious deterrents.



total accounts for roughly 30% of total wealth in the US (as estimated by Boston Consulting Group in 2011). Source: Scorpio Partnership (2012).



Equity placements seem to benefit high net worth investors

A number of scholars argue that wealth inequality (particularly at the upper end of the scale) comes from equity investment (Favilukis, 2012). In this view, high net worth individuals acquire wealth simply as *rentiers*. Part of such increases in wealth simply reflects the geometric effects of compounding – as a billion dollars growing at 5% will earn more money (in absolute terms) than one thousand.⁷ Another part represents the fact that the rich can earn a higher rate of return because of preferential access to investments, lower commissions and so forth.

⁷ We ignore the relative productivity of capital and of course financial risk in this simple description.

The data seem to bear out the story that equity holders (on an aggregate national level) tend to have more wealth than those that don't. However, the data do not tell whether equity ownership has resulted in that wealth – or whether wealth has led to equity ownership. Figure 8 shows the cross-country correlation between wealth and stock market capitalisation (or the value of stock holdings on the national level). The data show what common sense already tells us – that countries with relatively high amounts of wealth per person also have relatively high levels of stock market capitalisation. At low levels of market capitalisations, the relationship with wealth is not very pronounced. At higher levels though, such a relationship becomes clearer.



The number (as well as value) of companies seems to have some relationship with wealth. If equity ownership affected wealth, then wide-spread securitisation of domestic commercial organisations should make their investors relatively wealthy. Figure 9 shows the number of publicly traded companies relative to the average level of wealth per person in economies world-wide. As shown, a weak (though positive) relationship exists in the data between the number of publicly-traded companies and the value of wealth per person. Naturally, increases in levels of wealth could explain increases in the number of public companies – rather than the other way around. However, the relationship does seem to exist.



The effect of stock market capitalisation also correlates with the number of affluent persons. Figure 10 shows the relationship between the proportion of affluent persons in an economy – and stock market capitalisation. We have divided the sample into OECD and non-OECD economies in order to see whether OECD economies' structural differences accounted for any difference in the way equity markets help create affluent persons. As shown, the relationship between the OECD and the rest of the world look very different. Equity participation and the proportion of affluent adults correlate far more strongly in the OECD than in the rest of world.



The data show a relationship between equity participation and wealth as well as the number of affluent individuals in a population. Macro-level data can not determine whether wealth leads to greater equity participation – or visa versa. Macro-data also can not tell whether a third factor affects both equity participation as well as the level of

wealth (as well as its distribution among the population). However, these data do suggest that equity participation – particularly in the OECD -- warrants further analysis. The quality of financial institutions (particularly in the OECD) determines – in part – such shareholding. The quality of financial institutions could thus play an important role in wealth generation.

More and Better Banking Only Partially Explains Wealth Accumulation

What effect do financial institutions have on the generation of wealth? The ability to save, and earn interest, on monies should have some effect on wealth. The wealthy – or at least the affluent – should prefer to keep their money in banks. Yet, we fail to see these trends in the data. Figure 11 shows the extent to which individuals keep their money in banks and the proportion of affluent persons in a country. In theory, we would expect to see high net worth individuals keeping larger amounts of the country's domestic product in bank accounts. Yet, the data show an extremely weak relationship between the proportion of affluent persons in a population and funds deposited with banks.



Financial systems (in theory) should lead to larger, sustained accumulations of wealth. Banks and other financial institutions provide a store of value, channel savings to their most productive use and serve to compound financial assets (through interest). However, Figure 12 seems to show that the extent to which individuals hold their wealth in banks and other financial institutions does not lead to long-term sustained higher growth rates in wealth across countries. Among OECD countries in the 2000s, countries with higher levels of financial holdings tended to have lower rates of change of wealth. As for the rest of the world, no relation seems to exist (as indicated by the flat line).



As another hypothesis, imperfect competition in banking systems could cause differences in wealth accumulation. Whether concentrated (anti-competitive) or competitive banking best helps the wealthy accumulate assets remains an open question. Observing a pattern in cross-national data would suggest some kind of deeper relationship. Figure 13 shows the correlation between growth rates of wealth world-wide and changes in bank concentration (as defined by the assets held between the 3 largest banks). As shown across groups of countries, changes in bank concentration correlated with decreased growth rates of wealth in all major geographical groups. Such results suggest that the quality of financial institutions plays some role in wealth accumulation.



The data in the figure show each country's annual geometric grow th rate in w ealth compared with a similar geometric change in bank concentration (measured as the assets of the three largest banks as a percent of total bank assets). Source: Beck et al. (2011) and Credit Suisse (2012).

International financial flows can correlate with increased wealth either because capital flows into the country provide more funds to generate wealth – or increases in wealth seek higher returns outside the country. We have already showed that high and ultra net worth individuals in many developing countries most likely prefer to keep much of their wealth in OECD-based financial institutions. Yet, financial institutions engaged in cross-border activities probably have other roles to play in wealth management. Figure 14 shows the relationship between international debt issues (as a percent of GDP) and the growth of wealth in countries floating such debt. Loans from abroad correlate negative with the growth of wealth – suggesting that such debt tended to substitute rather than complement wealth creation. A number of reasons could explain such a correlation (including the capitalisation of growing but unprofitable firms with international debt or seeking foreign debt during times of recession). For our purposes, we only need to note that cross-border financial institutions (and their operations) play some role in influencing the evolution of wealth across countries.



Other data strongly suggest that differences in financial institutions play a role in predicting (and hopefully explaining) differences in wealth across countries. Figure 15 shows the average cost across countries of banking – expressed as the proportion of bank overhead costs to bank assets. As shown, Latin American and Sub-Saharan African banks have the highest costs – and banks in the East Asia and Pacific region have the lowest. Such anecdotal evidence seems to suggest that differences in financial institutions – and their cost structures – can influence the long-term evolution of wealth across countries.



Even the cursory evidence suggests that financial institutions – and the way they help generate wealth as well as increase the numbers of the wealth – differ in the OECD from other regions. Figure 16 shows a simple statistical test which compares various banking attributes across regions. The test assesses basically whether differences in costs, revenues, concentration, bank equity and risk-appetite correlate with proportions of wealth (and the number of affluent adults) across geographical regions. Summarising the figure crudely, banks' costs and incomes (in the form of interest) roughly help explain differences in wealth and the affluent in the OECD as opposed to other regions. We can not say from these tests how or why these OECD-based financial institutions help their clients become wealthy differently than in other regions. We only know a significant relationship exists in the data that bear further investigation.

Figure 16: The Structure and Efficiency of the Banking Sector Has Only Weak Influences on the Creation of Wealth (Except in the OECD)

Variable	Wealth to GDP	affluent per adults
Banks' overhead costs to total asset ratios	***	***
Banks' net interest margin		***
Bank concentration		
Banks' return on assets		
Bank's return on equity	***	
Banks' cost-to-income ratios		
Bank's "time to failure" (z-score)		***
Statistically significant geographical groups	OECD	OECD, SA
This table shows what is called a F-test of the similarity of grou	up means. In brief, the	e test finds out wheth
the mean net interest margin for banks from Latin America rou	ghly hovers at about	the same margins for

the mean net interest margin for banks from Latin America roughly hovers at about the same margins for banks in other regions. In more rigourous language, we test whether we can have a 95% confidence or higher than differences in net interest margins reflect real differences rather than random fluctuations.

Has Foreign Investment Led to the Rise of the Super-Rich?

OECD-based wirehouses (mostly from the US) have led the way in trying to increase the numbers of high and ultra-high net worth individuals in developing countries – as well as accumulate their assets. What does the data tell us about the way foreign financial institutions have interacted with the wealth of other nations in the past? Figure 17 shows that changes in foreign banking positions tend to correlate with changes in wealth. The wealthy open accounts abroad – or attract funds from abroad. We do not know why – but we do know that international banking must be responding to demand for foreign banking. We also know that demand for foreign banking services exists particularly strongly in the OECD countries (though we do not know by how much as BIS data for developing economies is remarkable sketchy).



Wealthy investors may also prefer to hold equity (in general) as opposed to debt. In figure 18, we show the correlation between the proportion of affluent investors in various countries and overall holdings of foreign debt and equity instruments. As shown, countries with higher proportions of affluent adults (and thus investors) tend to have much higher holdings of foreign equities than debt (as a share of the investors' country's GDP). These data suggest a role for financial institutions – and financial advisors – as equities require far more management than fixed income investments (bonds). Much of these investments will come from institutional investors. However, at the bottom of the financial food chain will lie individuals who give their income (in some way) to intermediate financial institutions and money managers.



What do these data tell us about the potential role for wirehouses looking to operate in the developing world? We know that foreign investment provides an important avenue for individuals to increase their wealth. Even from simple observation, we see the rich-and-famous involved in significant foreign investment. A crude look at the data show that the wealthy send significant proportions of wealth abroad. The data also show some correlation between such flows – and changes in the value of wealth and the number of wealthy persons in any economy. However, no where does foreign investment seem to play a role than insurance. Yet, in many markets, local insurance markets still remain underdeveloped.

Insurance Markets Protect the Wealth of High Net Worth Individuals

Most broker-dealers in recent years have increased their offering of insurance products (usually from third-party providers). High and ultra-high net worth individuals have a vested interest in maintaining their wealth through unforeseen problems – like illness, a death in the family and so forth. Insurance markets in many countries remain relatively small. Figure 19 shows the capitalisation of insurers in a number of countries. Only the US and UK have super-sized insurers (with market capitalisations over \$2 billion). These data suggest that insurance offerings should increase in a number of countries. They also suggest that wealthy persons in places like Ghana, Philippines, Oman and others may seek insurance services from abroad.



The data fail to show a very clear relationship between the depth of insurance markets and increases in wealth. Figure 20 shows the cross-country relationship between the payment of life insurance premiums (and non-life insurance premiums) and increases in wealth. Insurance provides a basis for the study accumulation of wealth – therefore we look at changes in wealth rather than levels. The relationship between the percent of affluent persons and life-insurance premium payments (as a percent of GDP) does not differ from zero. Yet, Figure 21 shows that the export of insurance products correlates with higher proportions of affluence. In contrast, the import of life insurance services does not correlate with increasing proportions of affluent adults. However, as usual, we can not know if increased affluence leads to the export of insurance services or visaversa. We also can not know why some countries with relatively high proportions of affluent adults do not import more insurance-related financial services from abroad. However, again, the data suggest some kind of relationship between the overall incidence of affluence in a population and the international trade in insurance-related services.



The data in the figure show the relationship between increases in wealth across countries from 2000 to 2010 and insurance premiums paid (as a percent of GDP) in 2010. Source: Beck et al. (XXXX) and Credit Suisse (2012).



Before conducting any complicated statistical analysis, the data appear to suggest a weak relationship between the offer of insurance and wealth. Given insurance's important role in wealth, we know that "feedback" (what economists call "endogeneity") befuddles the relationship between these two variables. Insurance also proves an important way to keep resources to transfer to future generations through bequests (wills and inheritances). Wealth management firms (and financial advisors working in developing countries) will want to know the extent to which developing insurance-related products helps grow wealth (and a wealthy class more generally).

Growing Markets for Bequests Mean Increasing Roles for Estate Management

Estate management services – namely financial planning for bequests – have served as a growing area of wealth management. Financial advisors (mostly in the US and Western

Europe) help provide advice and investment products aimed at helping clients keep and transfer wealth after their death. However, to what extent do such services help the wealth preserve their wealth – particularly across generations? Figure 22 shows that saving for retirement and leaving bequests seems a weak motive (and market) for wealth management. No reliable cross-country data exist on the extent to which the wealthy save in order to leave money to their heirs. However, we can deduce the strength of this motivation – particularly across countries – by observing actual savings behaviour. In the figure, we show the extent to which individuals in that country save at a higher rate than their earn income. For example, in Romania, households increased their savings by 3% more than they increased their earnings in the same period. We also looked at changes in life expectancy in the same period (2000 to 2010). Individuals in all age brackets interested in saving for their retirement and later leaving an estate to their heirs should increase their savings. We see the possible existence of such a bequest motive in the ECA region. As life expectancies increased, the extent of savings also increased. However, in other countries (EAP countries), such savings decreased. Despite what the lines on the graph indicate, the correlation between these two variables remains extremely weak. We thus can discern very little saving for retirement and/or bequest motive in these data.



In general, research aimed at retirement and the desire to bequeath money to future generations seems the Achilles heel of wealth research. Economists (despite over 40 years of intense research on the subject) still understand very poorly how people save for retirement and for leaving an planned inheritance after death. We present several findings -- during our literature review – of the kinds of data available. However, no reliance cross-country data yet exist that allow us (and thus wealth managers) to form opinions about the ways their services affect high net worth individuals *en masse*.

Problems with measuring wealth

Measuring wealth remains – despite what the various market sizing exercises suggest – a dodgy task at best. Of the seven wealth reports available publicly, several use proprietary and confidential models – making them unreliable at best (and suspicious at worst). We do not want to discuss the problems with measuring household wealth which other authors have done exceedingly well (Cowell *et al.*, 2012). Estimates of household wealth can vary by trillions of US dollars between sources. We use the rigorous set of estimates available "as is" – without much critical evaluation or attempt to change them. The reader should thus exercise extreme caution when using our analysis.

The way that most market sizings deal with debt though suggest that much more work needs to be done in order to produce reliable estimates. The existing methodologies (including our own accounting shown in equation 1) subtract our debt as a liability on a household's balance sheet. Figure 23 shows the debt-to-wealth ratios in a number of potentially lucrative markets for international wealth management firms. According to the Credit Suisse data, Brazil, India, and Russia have extremely low debt levels (around 4%). The authors attribute these low debt levels to financial market under-development. Yet, comparing these estimates with other data suggests that wealth in these economies might be much less than the Credit Suisse data let on. According to the McKinsey Global Institute, household debt levels in China rest at a far more believable 25%. Even in Russia (with its truly under-developed banking sector), the McKinsey data show twice the amount of private debt as the Credit Suisse.

Figure 23: The Wealth Estimates We Used Probably Over-estimate True Lucre for Wealth Managers in these Markets

<u>Country</u>	CS Debt to wealth ratios	MGI Household debt	MGI Non- financial corporate debt	WB Private credit by money banks	WN Private bond market	WB loans from non- resident banks
Developing V	World					
China	<1%	25%	101%	-	19%	3%
Brazil	5%	15%	35%	58%	22%	7%
India	3%	9%	43%	53%	6%	8%
Russia	4%	8%	40%	47%	-	11%
Developed V	Vorld					
UK	13%	98%	109%	207%	17%	205%
Canada	16%	90%	54%	130%	33%	30%
USA	15%	85%	75%	66%	135%	34%
Spain	14%	82%	135%	214%	120%	43%
S. Korea	18%	81%	107%	116%	69%	24%
Japan	15%	68%	98%	93%	37%	12%
Germany	19%	59%	45%	98%	38%	36%
France	19%	54%	112%	115%	67%	72%
Italy	6%	46%	82%	109%	64%	43%

(all ratios compared with GDP except debt-to-wealth)

Note: Estimates may be approximate due to rounding.

Sources: World Bank (2012), McKinsey (2012), Suisse Credit (2011).

These data also suggest that the debt estimates for the advanced economies probably grossly under-estimate the true level of wealth – adjusting for part of that wealth that millionaires must return to their creditors. The Credit Suisse data show a debt-to-wealth ratio of 13%. However, all the other indicators show much higher likely debt levels. The McKinsey data show household debt of about 100% and private credit of roughly 200%. At the time of this writing, the advanced economies had drastically reduced their debt levels. However, these discrepancies suggest that we should deeply discount the Credit Suisse wealth estimates in the longer-run.⁸ We do not discount these data though – as current assets drive the wealth management industry.

A more serious issue relates to a tragic (though necessary) flaw in the way all these market sizing estimates treat household debt. Forty years of economic theory and practice clearly show that debt serves as a way to generate wealth (particularly in developing countries). Debt helps provide finance for good ideas, helps provide finance during market shocks, and even provides a way for bankers to contribute their ideas and risk management practices. Debt creates wealth. However, taking such effects into account will require far more work than economic viable for most broker-dealer research departments.

Literature Review

Economists have studied the poor for almost 100 years – but not the rich. Since the early 20th century, economists have developed models describing the relation between poverty, economic inequality – and recently – the role that financial intermediation plays in increasing the wealth of nations. Recent surveys of high and ultra net worth individuals have helped us to understand how – and why – the rich become richer (Taylor *et al*, 2008). An entire publishing industry revolves around selling books to readers interested in learning how the rich became rich -- and how to gain such wealth themselves. Some of the many such advisors include rappers (Lionel "Luciano Illuminati" White), pundits (T.J. Rohleder, the "blue jeans millionaire") and anti-gurus like MJ DeMarco. In the same vein, a number of studies show potential wealth managers and private bankers how to build multi-million dollar books of business (Evensky, 1997; Burgstaller and Cocca, 2011). Yet, academic economists have devoted little attention to the concentration of wealth or the role that the burgeoning wealth management and private banking industry play in such concentration. An *EconLit* search yields no substantive results for "high net worth" or "wealth management." A rapidly blossoming practitioner literature has developed in places like the Journal of Wealth Management. However, these articles tend to focus on the very narrow interests of daily wealth management – like running a more efficient wealth management operation. None of these article describe how develop these customers in developing countries from an institutional (wirehouse level) and macroeconomic perspective.

⁸ In the short-run, wealth managers would not care how debt translates into wealth. Debt produces cash which ultra-high net worth individuals can hand over to financial advisors. Financial advisors will still receive their asset management fees (based partly on cash coming from loans). However, in the longer-run, clients which wipe-out in a blaze of debt-induced liquidations pose litigation and other risks to wealth advisors.

A wave of estimates attempt to provide a glimpse at this emerging market of high net worth and ultra high net worth individuals. Figure 24 shows some of the more popular estimates for wealth across countries. The differences in estimates between the sources can led to some scepticism about the validity of these estimates. For example, for 2010, the Boston Consulting Group (BCG) estimates wealth in North America at about \$14 trillion. In contrast, Cap-Gemini and Merrill Lynch estimate wealth at \$11.6 trillion in North America for 2010. Both high net worth and less affluent households held about \$38 trillion according to BCG. In contrast, Credit Suisse data show total household wealth for North America at about \$50 million. Given the enormous difficulties in estimating wealth (particularly wealth held at the upper end of the income distribution), such differences can be easily understood.

Publisher	Description	Link
Credit	The Credit Suisse Global Wealth Databook contains the most detailed	*
Suisse	estimates of world worth – often using data from the developed economies	
	and then using regression analysis to provide guesses for developing	
	markets. A leading scholar in the field guides their methodology and we	
	use the <i>Databook</i> for our own work.	
Cap-	Their World Wealth Report represents the practitioners' go-to guide for	*
Gemini-	understanding how wealth evolves around the world. Their less transparent	
Merrill	model makes their numbers less reliable for third-party purposes.	
Lynch		
Wealth-X	Authoritative and intelligently written. Provides data and analysis for	*
	understanding the ultra-high-net worth market.	
Forbes	Provides overview of ultra-high net worth individuals world-wide. The	*
Insights	study is based on the Forbes rich lists. Wealth-X remains more useful for	
(with	statistical analysis and in-depth analysis.	
Société		
Générale)		
Oliver	Provides a wealth of analysis and data. However, their non-transparent	*
Wyman	proprietary model and lack of specific numbers make their analysis	
	unusable by third-parties.	
Boston	Their Global Wealth Report focuses mostly on wealth managers. Their	*
Consulting	thoughtful analysis focuses mostly on the evolution of the wealth	
Group	management industry – with supporting numbers.	
Allianz	Just another publication, Allianz's Global Wealth Report 2011 provides	*
	mostly macro-level analysis. We use to illustrate the many kinds of reports	
	issued by banks and consulting companies.	
Knight-	Focuses on wealth – and what wealth means for property demand world-	*
Frank & Citi	wide. Uses non-transparent Citi model to estimate wealth.	

Figure	24:	Wealth	Estimates	from	Various	Practitioner	Sources
riguit	47.	vv caltin	Estimates	nom	v al lous	1 l'actitionei	Sources

Sources: see above. Links provide illustrations of the data available in these various reports. We may have used different versions (year of publication) for specific analysis contained in our paper. These reports represent the tip of the iceberg. For a compilation of reports from over 20 consulting, accounting and other advisory firms, see the <u>Privatebanker</u> website.

We use Credit Suisse numbers – provided as described by Davies *et al.* (2009) – because of their transparency and coverage.⁹ Davies represents one of the most important sources of estimates about the size of wealth held by millionaires and multi-millionaires (as well as their numbers). Unlike the other wealth sources cited in Figure 24, Credit Suisse provide detailed calculations and methods used in arriving at their wealth estimates. Davies (the lead consultant on the Credit Suisse market sizing project) also has published numerous papers academic, peer-reviewed papers showing his methods. These numbers thus provide the only reasonable source for academic use.

The Davies estimates come from a mix of household survey data and regression analysis. Davies studied household balance sheet and financial balance sheet sources from 45 countries (listed in his Table 1-2). For the other countries, he used regression analysis to estimate wealth levels (and the distribution of wealth) based on several predictors. Figure 25 shows the predictors used in order to estimate wealth levels (and subsequently the distribution of wealth) in many developing countries. These predictors included consumption, life expectancy, GDP growth, population growth, population density, market capitalisation, domestic credit, urban population, fixed landlines, and a couple of dummy variables. As shown (and as expected) consumption serves as the largest (yet positive) predictor for wealth.



None of these reports provide predictive factors which wealth management firms and private banks can use to position their offerings for the future. Broad factors like cultural change or policy changes do not help broker-dealers target particular markets – because these firms can not change such broad factors like national culture. For example, Saikat and Matti (2010) perform regression analysis of data from Australia, Canada, New Zealand, UK, and the US in order to determine what causes the top 1% of incomes to grow. They claim that asset bubbles largely explain increasing wealth among America's

⁹ Davies and his colleagues have worked on estimating wealth across countries for over a decade. The Credit Suisse Databook uses his research – packaging the research in a more approachable way than the *NBER* and other treatments.

high net worth individuals. They also find that financial development leads to ambiguous effects on the rich. Yet, these data provide very little guidance for policymakers – and especially wealth managers and private bankers seeking to help grow the incomes (and thus wealth) of these top 1%.

Do financial institutions help high net worth individuals to increase their wealth?

Financial sector (and institution) development plays an ambiguous role in creating wealth and new wealthy individuals. Figure 26 shows the effect that extending credit to various economic deciles has on economic growth in the US. In the top 3 deciles, extending credit has the largest effects on economic growth – as shown by "impact coefficients" above 3. However, these coefficients come close to similar impacts for credit extended to the lower middle class (the 4th income decile for example). These results point to a role played by financial institutions in helping the wealthy generate more wealth for themselves and for other income deciles. However, these impact coefficients do not differ very significantly from those in certain other decile groups. As such, there might be "more to the story" than financial institution credit simply helping the rich to create jobs and earn from investments.



Other data suggest that financial institutions help make high net worth and ultra-high net worth individuals even richer. Roine *et al.* (2009) look at the extent to which a number of factors explain changes in the top 10% and 1% of income distributions in various upperincome countries. They find – as shown in Figure 27 – a statistically significant role played by financial sector development, marginal tax rates, and the level of economic development. They find that bank crises probably affect ultra-high net worth individuals in the 13 relatively high-income countries they study. However, they find no statistically discernable effect for currency crises. In general, the authors seem relatively hesitant to attribute any specific effects to financial institutions in increasing (or decreasing) the holdings of the top 1% or top 10% of the population in the countries they study.

Figure 27: Wealth Management Likely to Have Uncertain Effects on Wealth at First Glance

Changes in	Change in Top 1%	Top 1% as proportion of top 10%	
Structural Variables			
GDP per capita	Х	Х	
Population			
Government spending			
Financial development	Х	Х	
Openness			
Marginal Tax rates	Х	Х	
Level of economic development	Х	n/a	
Situational variables			
Bank crisis	Х	n/a	
Currency crisis			
Financial sector variables			l
Bank deposits	?	?	
Market capitalisation	?	?	
Private credit	?	?	

An "X" signifies that the variable has a statistically significant correlation with the dependent variable listed at the head of the column at the 95% confidence level or better.

Source: Roine *et al.* (2009). We have reinterpreted their results for ease of reading. The reader should consult the original for exact variable definitions and results.

The Roine data teach us that we need to understand the role that banks and brokers play in wealth creation – particularly among high-net-worth individuals. The large wealth managers like *JP Morgan* can not determine the rate of population growth or government spending. However, they can affect the level of financial development in the jurisdictions they operate in through their choices of market entry, development and so forth. The Roine data provide a solidly ambiguous message on this level. On the one hand, they find statistically significant relationship for financial development. On the other hand, their specific regression coefficients related to bank deposits, market capitalisation and private credit remain relatively uncertain. Positive regression coefficients would suggest that providing banking services, encouraging investment in equities and extending more credit allows the wealthy to accumulate more wealth. However, the Roine and co-authors data do not allow us to make such a conclusion.

How might wealth management and private banking services help increase the number of high net worth individuals and the amount of their investable funds? Theory suggests a number of factors which may explain how wealth managers and private bankers can increase their clients' wealth (and thereby attract more clients themselves). Figure 28 shows several of these theoretical factors – taken from Demirguc-Kunt and Levine's literature review. They highlight the theoretical importance of three factors brought out in the Roine *et al.* results – the effect of savings, access to equity, and access credit for investment. However, others theoretical factors important for wealth accumulation and enfranchisement include human capital, tolerance for risk, financial literacy and other factors.

Figure 28: Why Might Wealth Management Lead the Production of More Wealth? (at least among the affluent)

Factor and example	Description	Wealth Management Angle	
authors			
Human capital	Differences in wages account for much of	Education planning and	
Galor and Tsiddon	the persistent differences in wealth across	borrowing allow for greater	
(1997a,b)	time.	family earning power	
Investment	Wealthy investors may have access to	Wealth managers can offer	
opportunities	particular high-return investments due to	premium clients higher return	
(McKenzie and	lack of liquidity constraints, indiv-	investments.	
Woodruff, 2006)	isibilities of large projects and so forth.		
Preferable risks	Wealthy investors may have less absolute	Wealthy clients can take larger	
(Bowles and Gintis, 2000	and/or relative risk aversion.	risks that yield higher risk-	
		adjusted returns.	
Generates snowballing	Banks allow for the store and transfer of	Large role for retirement savings	
savings	wealth.	and estate planning	
(Levine, 2005).			
Insurance	Wealthy can purchase insurance (unlike	Large role for life, health and	
(Demirguc-Kunt and	poorer cousins) to protect wealth.	disability insurance.	
Levine, 2009)			
Cross-finance between	Wealthy families can use private banking	Offer of small and medium	
personal and	returns and/or services for family	business accounts to complement	
professional banking	business.	affluent accounts.	
Bequests and	Financial institutions play pivotal role in	Prospecting of wealthy families	
inheritances	transferring money across generations (as	increases portfolio and client size.	
(Townsend and Ueda,	money under beds no longer counts as		
2006)	viable inheritance mechanism).		

We show the major theoretical factors explaining how financial sector development can explain rising levels of wealth and increased numbers of wealthy adults. The original source describes the role of financial sector development on income inequality and economic growth generally. We reinterpret the original in light of our focus on wealth management and private banking. Source: based on Demirguc-Kunt and Levine (2009).

Wealth managers and private bankers (in theory) differ from ordinary financial advisors in that they help provide advice and services related to many of the different factors identified in Figure 27. Wealth managers offer their clients regular courses on financerelated topics and they can help arrange financing for future education (and the education of their children). Wealth managers provide access to investment opportunities not available to retail investors (such as access to star fund-managers who have relatively high account minimums). They also offer products which help their clients to save for retirement, obtain credit by collateralizing their securities portfolio, and access special tax-advantaged funds for use in bequeathing money to children and other relatives.

What does economic theory tell us about the role played by wealth management more generally? The basic Gaytan and Ranciere model (shown in Figure 28a) illustrates how financial management (in general) helps expand wealth in general. We spend a bit of time on their model as the model we use in this paper extends on their theoretical framework. Bank accounts serve as a way to "pull" money from the past into the future (as we save what we earned yesterday in order to invest in something tomorrow). The blue and red

lines basically tell us that we must earn a bit more tomorrow in order to put yesterday's earnings into a bank account. Financial advisors – from basic passbook tellers to highly trained family office advisors -- simply help their clients to save and invest. Such financial intermediation – as shown in the figure – basically helps these clients earn a bit more wealth today (using the wealth from yesterday).



Our paper basically tests – using the Gaytan and Ranciere framework – whether (and how) wealth management helps transfer yesterday's affluence into today's wealth. We change their model to reflect three facts about wealth management and private banking. First, banks and broker-dealers do not offer such services without minimum account sizes. Figure 29b shows these account minimums as a relatively long part of the green line where today's affluence does not get transformed into tomorrow's wealth. Second, we postulate that wealth management services provide higher overall returns to clients (including returns related to estate, retirement and education planning). If these accounts failed to provide such higher returns in the long-run, clients would return to their economy-class bank accounts. We show these effects by the green line's relatively rapid climb. Third, we assume – drawing in part from our own experience – that wealth generated by high and ultra-high net worth individuals "spills over." These wealthy individual hire professionals (like lawyers) who become affluent in their own stead. Indeed, wealth management serves themselves have spill-over effects on less affluent customer classes. Wealth managers learn about new investments, fund managers, and ways of lowering costs which benefit retail segments as well. We show this effect by the bump-up the green line shows for higher levels of today's wealth. What is good for Bill Gates is good for the Covington & Burling LLP (one of Microsoft's law firms).



The simple additions to the basic model of financial intermediation have relatively farranging implications (which we test in our paper). We describe the model we use more fully in Appendix I. If wealth management does increase returns to investment, then we should observe a correlation between financial intermediation, particular characteristics of that intermediation, and levels of wealth across countries. If such spill-over effects exist, then we should observe – after controlling for other variables – an increase in the numbers of affluent adults as wealth (and wealth management service) increases. We test these two basic hypotheses in this paper.

We can not observe directly the extent to which wealth management and private banking impacts on wealth – and the numbers of affluent investors. We require the income statements and balance sheets of the major firms to conduct such an analysis. However, other models and evidence supports the view that wealth management has effects which differ from normal banking. Favilukis (2012) in particular (using simulation analysis) looks at the way that various variables might impact on banking clients' wealth. Favilukis wanted to know if share ownership led to increased inequality. However, the factors he identifies also apply to wealth management. Figure 30 shows the variables he considered in his analysis -- and the way that the major wealth management firms might develop their markets in light of his finding.

Figure 30: How Can Wealth Management Affect the Development of Wealth in a General Equilibrium Model?

Variable	Description
Main variables	
labour cohort	The naturally higher productivity of some workers leads to the generation of more
effects	resources for wealth managers. Wealth managers have a strong incentive to identify
	these higher productivity (and thus higher income-earning) investors.
labour's	Wealth managers need to protect their clients against these shocks before and after
productivity shocks	they occur.
wages	Provides income to investors – but decreases profits that business owners can place
_	with wealth managers.
desire to leave	Exogenous to the wealth advisor (who simply arranges to maximise the amount
bequests	transferred inter-generationally).
interest (cost of	Wealth advisor can help find lower cost capital (particularly for family businesses).
capital)	
adjustment costs	If wealth advisor provides advice to business, can reduce costs of adjusting to new
	business circumstances.
time value of	Very weakly endogenous to the wealth advisor (who determines true discount rate
money	by finding better investments).
love of the present	Exogenous to the wealth advisor (unless he also provides consumption
	opportunities like knowing a guy who sells bargain yachts and so forth).
risk aversion	Exogenous to the wealth advisor (except to extent he or she affects perceptions of
	risks). ¹⁰
Other factors	
firms' depreciation	Completely exogenous to the wealth advisor. Affects the amount of resources
	available for placing with wealth management firms.
longevity	Completely exogenous to the wealth advisor. Does not affect wealth management
	assets under management if death and transfer to beneficiaries relatively costless.
skill premium	Completely exogenous to the wealth advisor. Societies with higher skills premia
	will reward skills (and thus make more funds available for wealth managers).
persistence of	Affects the depth or height of market changes.
shocks	
learning about	The higher these costs are, the larger the potential market for wealth managers (by
investments	lowering the cost of learning about investments in an efficient market at least)
keeping investment	The higher these costs are, the larger the potential market for wealth managers (by
knowledge up-to-	lowering the cost of learning about investments in an efficient market at least).
date	
borrowing	Wealth managers should be able to reduce these borrowing constraints, making
constraint	more funds available at a lower cost.

Source: Favilukis (2012) with reinterpretation in a wealth management context by authors.

¹⁰ In theory as well as in practice, the wealth advisor has a very large unintentional and intentional role to play in affecting their clients' risk aversion. The amount of money an investor possesses may affect his willingness to take on risks, as well as the money risked in any particular venture. Wealth advisors help clients to understand the risks they take on – framing them – in ways can affect what economists call these investors' "absolute risk aversion" and "relative risk aversion." See Hackethal (2009) for evidence that financial advisors hurt performance and Kramer and Lensink (2012) for evidence that such advice helps.

These other factors – besides simply investing the wealthy's money in stocks and bonds – can greatly impact on wealth. In a recent set of papers, Piketty and Saez (2003) looked at trends in US wealth over the decade. Their data shows that wages tended to fall during the period for both the top 1% and 10% of wage earners (which in the US at the time basically translated into incomes for ultra-high net worth and high net worth individuals).¹¹ Wealth managers could do relatively little to help their clients' entrepreneurial spirit – and returns to entrepreneurship grew overall throughout the period. However, returns to capital – an area of intimate interest for wealth managers – showed decidedly mixed returns throughout the decade. Returns to capital for the top 1% rose. Such mixed results hint at a strong role for wealth managers. These data also beg the question as to why the richest investors' investments gained ground relative to their close peers.



Do financial institutions help the affluent and wealthy accumulate wealth? The models we reviewed suggest they help – but certainly do not play a critical role. We know that financial management – particularly the management of high net worth and ultra-high net worth individuals' wealth – can exacerbate wealth and income inequalities (even at the top of the wealth distribution). We also know that some aspects of wealth management can "spill over" to the broader financial sector – and to the economy in general. The amount of insurance investors buy, their appetite for risk, and even the educational decisions they made, all relate in some way to their financial planning (at the individual as well as aggregate or macro-level).

¹¹ As we mention elsewhere in the paper, the lowest incomes in the top 10% fell slightly below the \$1 million needed to qualify as a high net worth individual (HNWI). The lowest incomes for the top 1% also fell slightly short of the \$10 million needed to qualify as a ultra-high net worth individual (UHNWI). However, as the original data do not show enough detail to provide accurate data for HNWIs and UHNWIs, we use data ranked by decile (or centiles).

The Role of Wealth Management and Financial Planning – Domestic and Foreign

The micro-level evidence on wealth (at least in the upper-income countries) suggests that wealth results from planning. The complexity of the wealthy's portfolios clearly indicates that high net worth individuals – and/or their advisors – engage in wealth management. Figure 32 shows the allocation of resources across different types of assets for high and ultra high net worth US households.¹² In the US, roughly 7.2 million households (or 6% of them) have a net worth of \$1 million or more (qualifying as high net worth households). Roughly 462,000 of them (or 0.5% of them) have a net worth of \$10 million – qualifying as ultra-high net worth households. Their asset holdings clearly show signs of some form of financial planning and wealth management. Roughly 75% of these households possessed some form of trust instruments – financial instruments which the wealthy can not just purchase over the counter. More than half also held life insurance policies and pensions. These data clearly show a degree of investment diversity and depth which can only result from professional planning.



Reactions to the recent economic difficulties in the US also point to the important role of financial management – particularly for the wealthy. Figure 33 shows the effect of the financial crisis on wealth for various net worth deciles in the US from 2007 to 2009. In absolute terms, the wealthiest 10% of the US population lost the most – roughly \$5 million. However, as a proportion of their wealth, they lost less than 20% of their net worth. In comparison, the majority of Americans lost about 50% during the same period.

¹² A number of authors – like Davies and colleagues -- also provide estimates of major financial assets and liabilities held by households in the US and elsewhere. Like all our examples in this literature review, we use one example to illustrate the broader literature – rather than trying to provide complete coverage. We use Wolff as an illustration as he provides information on households with more than \$1 million and \$10 million in net worth. In contrast, many of the other authors only provide data for the top 10% and/or 1% of wealth holders and/or income earners.

Yet, even within the top 10% decile of net worth – financial losses varied rather largely. Relative loses amounted to only about 10% of net worth (for the 93^{rd} percentile group) to about 25% (for the 97^{th} and 99^{th} percentile group). These data beg the question whether these net worth groups have the same financial advisors? Or do losses in one wealth centile relate in some more complex way to gains (or losses) among other centiles in the top 10% of the US's wealthy households?



Successful domestic wealth management practices should lead (and have led) bulge bracket wirehouses to expand their books of business into the developing world. As shown in the first figure we presented in this paper (Figure 1), signing up accounts equivalent to even 10% of the value of this wealth could increase assets under management by \$30 trillion. Theory points to several reasons why foreign wealth managers and private banks might have a competitive advantage over their domestic rivals in developing markets. Figure 34 shows several of these factors – most of which readers will already know. Some of these factors include better access to international capital markets (and thus investments for clients), economies of scale in servicing clients (like mass mailings about new retirement products), and most importantly the capitalisation to deal with market fluctuations that reduce the firm's ability to repay clients' funds.¹³

¹³ Despite the many reasons why the large international broker-dealers may want to enter foreign markets, the literature points to a number of reasons why they may wish to exercise caution. Some of these reasons include limited general development and barriers which can hinder the effectiveness of foreign banks (Garcia-Herrero and Martinez Peria, 2005; Demirguc-Kunt, Laeven and Levine, 2004)m as well as cultural and other factors (Claessens and Van Horen, 2011).

Figure 34: Factors Encouraging Foreign Wirehouses to Enter Wealth Management Markets in Developing Countries

Factor and authors	Description from literature	Wealth management angle
Access to capital	Lower costs of intermediation and	Competitive advantage consists of
(Claessens, Demirguc-	gains from breaking up oligopolistic	providing access to funds to local
Kunt, and Huizinga,	markets.	segments that local banks can not serve
2001		as profitably.
Investment know-how	Foreign banks have lower losses and	Clients want more skilled advice and
(Martinez-Peria and	default rates, suggesting more skilled	bankers – thus prefer foreign banking
Mody, 2004).	financial analysis.	options.
Safety	Large foreign banks may provide	HNWIs feel more confident to place
-	financial support to local affiliates and	funds with a safer bank – encouraging
	subsidiaries.	entry.
Cheery-picking clients	Foreign banks may pick lowest risk	Desire for cherry-picking may
(Detragiache, Gupta, and	clients, thereby constraining credit.	encourage foreign market entry rather
Tressel, 2008)		than domestic market deepening.
Militate for better	Foreign banks likely pressure	Can engage in policy entrepeneurship
policies	governments to improve regulation and	to gain first entry and attendant profits.
(Levine 1996, Dobson,	supervision, increase transparency, and	
2005, and Mishkin,	more generally catalyze domestic	
2006)	reform	
Economies of scale	Only largest banks can profitable serve	Only largest wirehouses can consider
required	certain developing markets.	entering some markets.
(Claessens and Lee,		
2003)		

Source: Claessens and van Horen (2008). online.

The evidence seems to suggest that foreign financial institution entry promotes economic growth – and thus the creation of wealth. No data yet exist about the effect that foreign bank entry has on the distribution of wealth. However, we do know something about the way that foreign bank entry affects firm revenues and assets. Figure 35 shows the number of models in which one prominent study of foreign bank lending resulted in increases in revenues, assets and increased borrowing. The effect about stock market returns signals an effect every wealthy client knows – wealth managers can extent credit and offer better returns in bull markets. Increases in bank concentration also correlate with higher firm revenues and assets – suggesting an important role for scale. These results apply to firms. However, as many high net worth and particularly ultra-high net worth individuals have roughly the same range of assets as those companies Giannetti and Onegena analysed, these results are instructive.
	Revenues	Assets	Debts/ Assets	Debt burden (i/D)
Foreign lending	4/4	1/1	1/1	1/1 (neg)
Financial development	3/3	1/1	1/1	1/1
Creditor rights	3/3	1/1	1/1	1/1
Firm size	4/4	1/1	1/1	0/1
Stock market returns	4/4	1/1	1/1	1/1
FDI	4/4 (neg)	1/1 (neg)	1/1	1/1
Concentration (H-H Index)	4/4	1/1	1/1	1/1

Figure 35: Foreign Entry Suggests More Wealth (for Firms at Least)

The data in the graph show the number of models which each variable is significant at the 95% level or better. We do not report on interaction effects. Source: Giannetti and Onegena (2009)

We can deduce from the extant studies that foreign wirehouse entry into many of these markets would significantly increase wealth - through increases in the effectiveness of wealth management services. Claessens and van Horen (2008) provide one of the few studies showing why foreign wirehouses would (or would not) enter a market – because these foreign markets have similar cultures, laws and needs as the bank's own home market. Specifically, they look at the extent to which political voice and accountability, political instability and violence, government effectiveness, regulatory quality, rule of law and control of corruption affect a bank's decision to enter a market. The initial data do not show any kind of relationship between the bank's own institutions and those of the foreign markets a wirehouse may wish to prospect in. Figure 36 shows a scatter-gram of their results. If wealth managers like Axa, Deutche Bank and HSBC wanted to compete in markets similar to their own, we would expect to see a strong correlation in these data. However, the randomly dispersed cloud of dots shown in the figure suggest other factors may be at play. We can not say that national institutions drive a broker-dealer to locate in certain markets - something else must be involved. That "something else" must - of course – represent the profit motive.


