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Global Wealth Managers

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Special Report

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Out of the pit stop - into the fast lane

In 2018, Wealth Managers faced growing headwinds. Lower AuM growth, more volatile markets and continued fee compression led to declining Wealth Management business valuations. The revenue pressure felt by Wealth Managers in late 2018 highlights the continued vulnerability of operating models to market stress. The rebound in early 2019 brought short-term relief for some but further pressure is inevitable as the end of the cycle approaches. Wealth Managers must take action to capture growth opportunities in Emerging Markets while preparing their operating model for an eventual downturn.

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Messages for the C-suite

Wealth Managers faced growing headwinds through 2018. Global HNW wealth grew by 4% in 2018, far below levels seen in previous years.

Wealth Management business valuations decreased by more than 20% in 2018 on the back of lower AuM growth, volatile markets and continued fee compression. While valuations across banking also took a hit, the valuation gap between Wealth Management and other banking businesses continued to narrow.

Pressure on fee and transactional income increased due to market volatility, notably in H2 2018. The rebound in Q1 2019 brought short-term relief for some but further pressure is expected going forward as the end of the cycle approaches. Wealth Managers must take action to capture growth opportunities while preparing their operating model for an eventual downturn.

Consequently, in our fourth joint Deutsche Bank - Oliver Wyman Global Wealth Management Report we focus on the opportunities and challenges in Emerging Markets as well as the need to change the operating model. Achieving success along both dimensions will be the single most important factor in determining future winners and losers.

Priorities for the C-Suite

Rethink your footprint in Emerging Markets

To realise above-average growth, Wealth Managers need to rethink their positioning across Emerging Markets, which will constitute over half of global wealth growth compared to one third of stock today. APAC and LatAm are of particular relevance:

- APAC – Monitor shifts in relevance of offshore hubs and place call options on select onshore markets
 - Be alert to developments in offshore hubs Hong Kong and Singapore while the challenge to build scale is growing – prepare for potential shifts in relevance between hubs
 - Assess the China onshore opportunity now, given structural changes like easing regulation, the phase-down of guaranteed high-return products and the increasing complexity of Chinese HNW needs but accept this to be a 5+ year journey to profitability
 - Minimum AuM levels per country are quickly shifting to USD 10BN, so take concentrated positions to set up onshore advisory in select SEA markets to react to regulatory reforms, while considering various market entry models to optimise cost of entry

- LatAm – Integrate onshore and offshore offerings to gain competitive advantage
 - Focus on solving operational, technical and regulatory challenges to provide a seamless onshore and offshore experience for clients

- In light of lower interest rates, guide clients on their path towards more sophisticated investment strategies and better understanding of risk

Simplify the operating model

Wealth Managers need to improve the efficiency of their operating model and adjust their cost base while improving advisor productivity. The areas where most cost reduction potential exists are not new but the way to achieve results is. In working with industry leaders, we have proven a number of high impact use cases to reduce administrative tasks in the front office over the past 12-18 months, which eventually will have to be implemented across the industry more broadly:

- Onboarding & Profiling
 - Upgrade KYC process to improve RM efficiency – manual information collection of RMs can be enhanced through the integration of third-party databases to compile client data
 - Digitise the AML / transaction monitoring value chain to free up both first and second line capacity – machine learning techniques can be applied to identify potential false positives while more advanced analytics can also help identify trends in alerts
 - Reduce the client onboarding burden by combining increased digitisation of the onboarding process with holistic data management, allowing information to be shared easily across functions
- Advice & Implementation
 - Embed different service levels and greater automation in the investment engine – develop an industrialised, mass personalised offering that draws on uniform underlying processes for core HNW clients
 - Automate front-to-back credit processes for vanilla lending offering, reducing workload and generating volume growth from lower abandon rates

Allocated costs should be tackled by lowering group service consumption. Wealth Managers should focus on understanding and steering cost allocations as well as establishing a culture of cost ownership to get into the driver's seat for allocated costs.

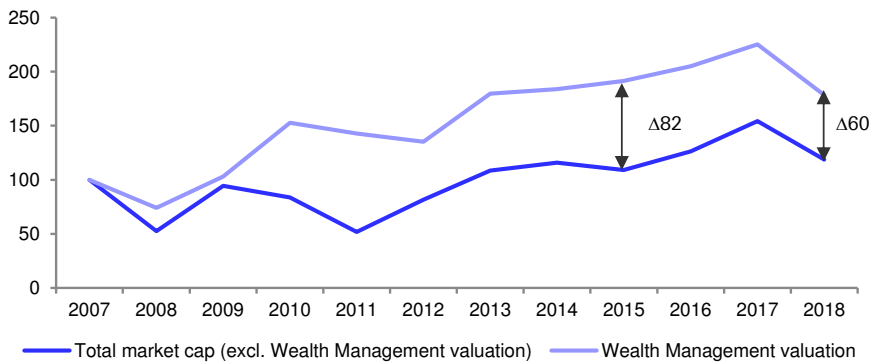
Joint Executive Summary

Persistent headwinds and resulting investor caution lead to a further narrowing of the valuation gap

Wealth Management business valuations decreased by more than 20% in 2018 on the back of lower Asset under Management (AuM) growth, more volatile markets and continued fee compression. Overall bank valuations also decreased, but at a slightly slower rate, further narrowing the “valuation gap” between Wealth Management and other banking businesses.

The gap has narrowed by a total of 22 percentage points (ppt) since its high in 2015, reflecting growing concerns about the industry’s business models. The gap emerged following the Global Financial Crisis as a reflection of comparatively low capital intensity, a primarily fee-based business model, and on the back of ongoing Net New Money (NNM) generation supporting revenue growth. To sustain or grow this gap again, Wealth Managers must show they can achieve earnings growth even in an adverse market environment and with increasing regulatory requirements.

Figure 1: Equity market value development of overall bank vs. Wealth Management business

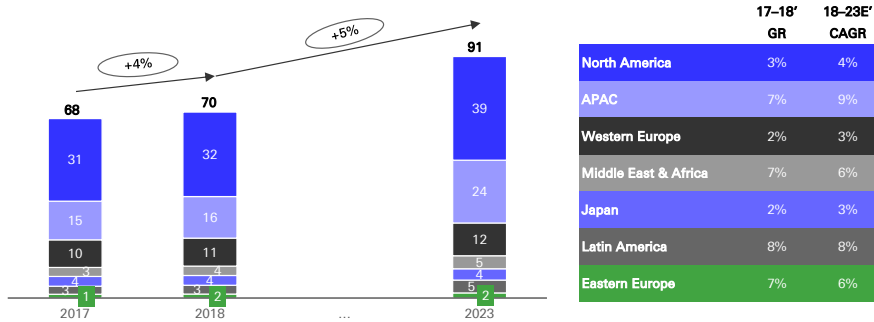


Source : Deutsche Bank Research, Oliver Wyman analysis

The end of the cycle is in sight – Emerging Markets to drive future growth

The wealth of high net worth individuals (HNWIs) grew to USD 70TN globally in 2018, albeit at a decelerated rate of 4% on the back of challenging equity markets. The strongest growth rates were observed in Emerging Markets at 7-8%, while Developed Markets trailed behind at 2-3%. We anticipate this growth divergence to continue over the coming years.

Figure 2: Global private (HNW) wealth by major region, in USD TN



Source : Oliver Wyman Wealth Management model

Note: HNW wealth is measured across households with financial assets greater or equal to USD 1 million. Financial assets include investable assets (deposits, equities, bonds, mutual funds and alternatives), excluding assets held in insurance policies, pensions and direct real estate or any other real assets. Numbers for all years were converted to USD at the year-end 2018 exchange rates to exclude the effect of currency fluctuations.

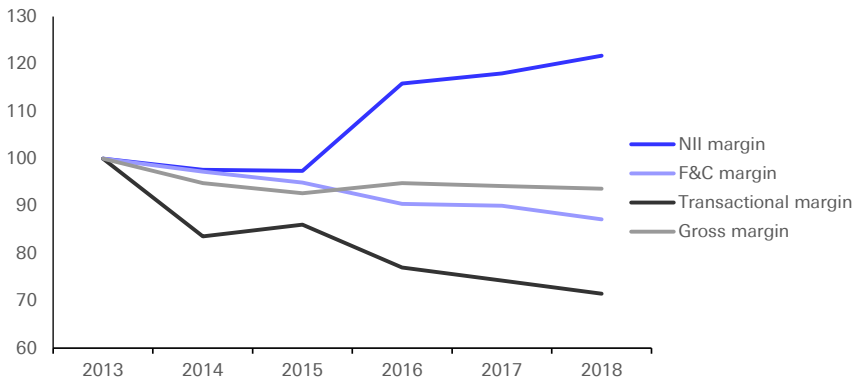
After two years of steady growth in asset prices, 2018 proved more challenging, particularly in the last 3 months of the year, with global equity markets down 9% (MSCI World Index). Markets have since rebounded in Q1 2019, buying Wealth Managers another period of relief before a major correction eventually hits.

Due to positive NNM, which contributes more than half of expected growth going forward, HNW wealth usually increases even in a market downturn. We expect HNW wealth to grow at a rate of 5% p.a. over the next five years – significantly lower than growth rates in more positive market environments – reaching USD 91TN in 2023. Emerging Markets will contribute over half of global wealth growth, despite representing “only” one third of total wealth today. Growth in Developed Markets will stabilise but will continue to be slower than in Emerging Markets.

Gross margins under pressure by increased volatility in 2018 and a halt on rate hikes

Gross margins of Wealth Managers based in Developed Markets decreased slightly in 2018. Increased market volatility drove risk aversion and impacted transactional income. Long-term drivers of fee and commission (F&C) margin compression also persisted – namely, the shift to passive products and the faster growth of quasi-institutional, lower margin ultra-high-net-worth business (UHNW). Increasing mandate penetration did not provide a large enough counterbalance. Net interest income (NII) continued to grow, supported by higher US rates, but was held back in Europe. Year-on-year (YoY) loan growth decreased due to deleveraging pressure in H2 2018. Reduced client activity in a more volatile market environment caused a notable drop in transactional income, which continues to decline as a percentage of total revenue. This exacerbates the slow but ongoing decline of transactional income, driven by the continued shift into mandates.

Figure 3: Margins for Developed Markets-based Wealth Managers, 2013-2018, indexed to 100 in 2013, margin as share of AuM, sample of leading Wealth Managers



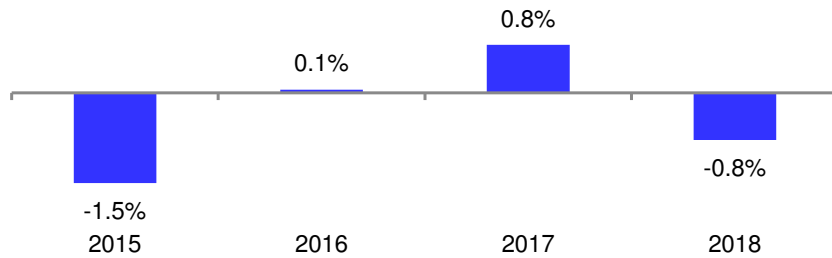
Source : Deutsche Bank Research, Oliver Wyman analysis
 Note: 'Developed Markets-based' refers to Wealth Managers who are based in North America or Europe

Wealth Management economics continue to rebound for some players as markets recovered in Q1 2019. Longer term, however, we expect gross margins to contract further. The 2018 dip in revenue margins gave Wealth Managers a glimpse of what can be expected from the next market downturn.

Wealth Managers remain unprepared for a looming downturn – high cost income ratios still persist

Industry-wide cost-income ratios (CIRs) persist in the mid to high 70s. Following positive operating jaws in 2017, revenue pressure outpaced timid cost cutting efforts. As a result, operating jaws turned negative again in 2018, illustrating the strong vulnerability of operating models to even moderate levels of market stress.

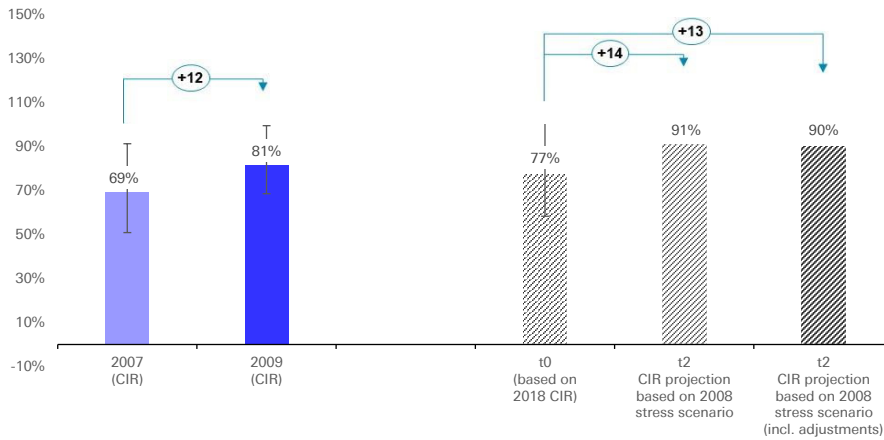
Figure 4: Operating jaws, 2015-2018, sample of leading Wealth Managers



Source : Deutsche Bank Research, Oliver Wyman analysis

If a shock of similar strength to the Global Financial Crisis were to occur today, our analysis suggests that the average CIR would rise to 91%. Adjusting CIR development for the current revenue composition (for example positive impact from increased mandate penetration) and operating models (for example negative impact from higher share of allocated costs and lower share of easily reduceable discretionary costs) yields a very similar picture with an average CIR of 90%. A third of leading Wealth Managers currently operating at CIRs of more than 80% would approach loss making territory quickly.

Figure 5: CIR ratio pre and post crisis (mean, max and min in %, deltas in ppt calculated on average CIR levels), sample of leading Wealth Managers

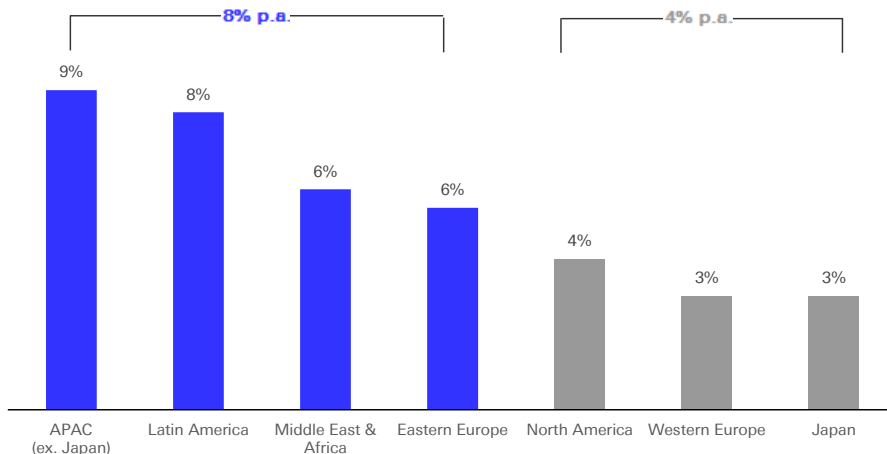


Source : Deutsche Bank Research, Oliver Wyman analysis

Emerging markets will outgrow Developed Markets by 4% p.a. until 2023 but a growing percentage of wealth can only be captured onshore

Emerging Markets HNW wealth will grow at a much higher rate than in Developed Markets (8% vs. 4% p.a.). APAC, Latin America (LatAm), Middle East & Africa and Eastern Europe are expected to account for over half of global wealth growth until 2023, compared to one third of stock today. These are the markets where Wealth Managers will have the greatest opportunities to expand their client base and significantly grow AuM over the coming years. APAC and LaAm show the highest expected growth rates and are therefore the focus of our analysis.

Figure 6: CAGR of global private HNW wealth by major region, 2018-2023



Source : Oliver Wyman Wealth Management model

APAC observation 1: Changing dynamics across APAC require Wealth Managers to review their offshore footprint across Hong Kong and Singapore

Hong Kong and Singapore, the two leading offshore hubs in APAC, are expected to continue to grow strongly but shifting dynamics within the region have the potential to affect their relative importance in the future.

Hong Kong's development as an offshore hub will be dependent on continued inflows from Chinese HNW clients. While these clients still favour Hong Kong due to a broader investment product offering and geographic proximity, they are concerned about the increasingly intrusive approach from Chinese authorities into Hong Kong. While this has potential to improve Singapore's position as offshore hub for Chinese HNW clients, Singapore faces challenges of its own. Changing regulations across SEA domestic markets, increasingly allowing onshore advisory for offshore assets (*see APAC observation 3*), put pressure on the Singapore-centric SEA operating models many Wealth Managers still have in place. This may lead to parts of the value chain migrating onshore, fragmenting footprints and increasing cost to serve.

As a result of these dynamics, Wealth Managers intending to cover the entire region still need strong presence in both hubs but the challenge to build or maintain scale in both is constantly growing.

APAC observation 2: Wealth Managers that want to benefit from future growth in onshore China need to assess the opportunity now

The Chinese onshore Wealth Management market is seeing significant structural changes; as a result, we recommend Wealth Managers assess the opportunity now.

Due to multiple entry barriers and operating challenges Wealth Managers have so far mostly focused their efforts on capturing Chinese offshore HNW wealth, despite about 80% of total financial assets being retained onshore. Easing ownership regulation for foreign Wealth Managers, the phase-down of guaranteed high-return products and the increasing complexity of Chinese HNW Wealth Management needs means we recommend Wealth Managers assess the China onshore opportunity now. In addition, HNW clients increasingly demand more sophisticated services (e.g. wealth and succession planning) which require deeper capabilities that so far only foreign players can fulfil.

Given these structural changes, domestic players are working hard to improve their Wealth Management offering. They are better placed to navigate local regulations but still struggle to meet evolving client needs. In contrast to the past, they are now increasingly open to partnerships with well-established foreign players. In the short-term, foreign Wealth Managers should consider these partnerships to rapidly acquire access to distribution channels and to accelerate their client acquisition.

Considering these obstacles to short-term success, Wealth Managers that choose to enter the Chinese onshore market will need to take a long-term view, accepting challenging economics and possible losses in the short to medium-term. We expect break even in onshore China will take foreign Wealth Managers a minimum of 5 years. Assessing the onshore opportunity requires them to make a trade-off decision between short-term shareholder demands and the long-term value a China call option by entering the market now provides.

APAC observation 3: Ongoing regulatory reforms will prompt Wealth Managers to take concentrated positions in select SEA onshore markets

In light of regulatory reforms in SEA and slowly maturing capital markets allowing for more sophisticated client offerings in domestic markets, Wealth Managers will increasingly need to consider their onshore footprint, in particular in Indonesia, Thailand and Malaysia.

As local regulation changes for onshore advisory on offshore assets and Government sponsored investments (e.g. savings bonds) are now increasingly encouraged, we expect parts of the Wealth Management value chain to migrate onshore. At the same time, a large proportion of assets are expected to remain offshore for better product access and as a continued political and currency hedge. We expect SEA clients with offshore assets to increasingly demand onshore advisory services and to no longer be content with advisory desks in offshore locations. The footprint required to serve offshore assets in SEA will thus become more fragmented, resulting in higher operating costs – for example, for domestic licensing, hiring and training of advisory staff and operations/infrastructure. Although the operating costs of a local advisory presence are far lower than those of a full booking centre, Wealth Managers will need to significantly increase their AuM originating from domestic SEA markets to justify these additional costs. We estimate minimum platform size to increase by USD 10BN for each onshore advisory presence. Based on our analysis only a handful of local players have achieved that AuM level so far. In Thailand, for example, we see no more than five domestic players, and none of the global firms, with assets in excess of USD 10BN of Thai HNW financial wealth.

In order to keep costs at a manageable level and to maintain an achievable minimum platform size, wealth managers will likely need to choose which domestic SEA markets are best to position themselves in. This requires a Wealth Managers to conduct an in-depth analysis of the respective SEA markets taking into account several market entry considerations to determine the most promising options.

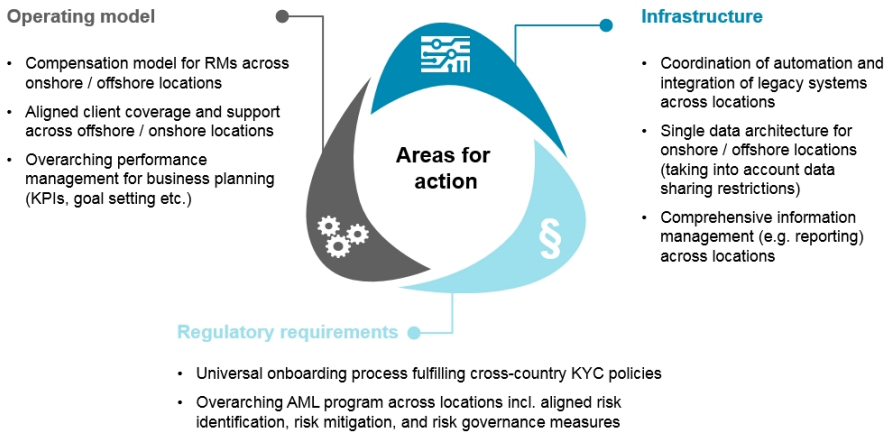
[Wealth Managers with an integrated onshore and offshore experience will gain a competitive edge in Latin America](#)

Latin America offers significant growth potential but requires a careful selection of target markets. Local market dynamics differ significantly across the region, as illustrated by Mexico and Brazil's market development following the respective elections. With offshore investments still being of great importance to HNW clients across LatAm, Wealth Managers who want to stand out should accelerate the development of an integrated on- and offshore offering and client experience.

While many Wealth Managers serving the domestic markets have an offshore offering in one or more of the preferred offshore locations, most lack integration. We see a strong separation of Wealth Managers' onshore and offshore offerings, often negatively impacting client experience. Many clients cite that their onshore and offshore relationship with the same bank often feels like banking with two different organisations. Hence today, clients often gain no benefit keeping their on- and offshore assets with the same Wealth Manager. While integration is not simple, given many regulatory and cross-border data sharing hurdles that need to be overcome, the rewards for those who manage to integrate the client experience can be significant and result into a real competitive edge.

In general Wealth Managers will need to overcome three key areas of roadblocks: Operating model, infrastructure and regulatory requirements.

Figure 7: Integrated onshore / offshore experience – areas for action (not exhaustive)



Source : Oliver Wyman analysis

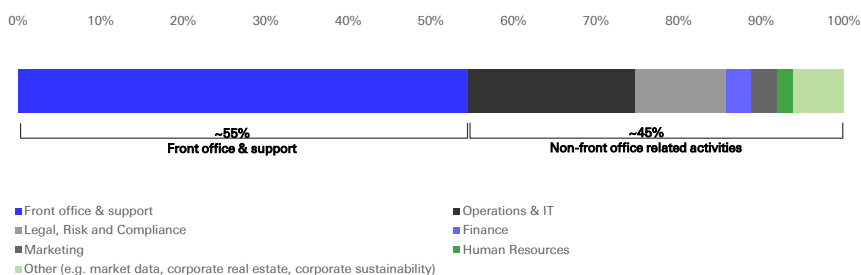
Due to the importance of US offshore locations to LatAm clients and increasing US resident ties of the next generation, those banks that can add US onshore Wealth Management to the mix will have an additional edge over competition.

In addition, the low interest rate environment across LatAm provides Wealth Managers with the opportunity to transition their clients from low-risk products, such as deposit linked investments, to more sophisticated products. Low-risk products are now no longer providing attractive returns. This is an inflection point for Wealth Managers, who can now provide more sophisticated services, such as financial planning and a much wider range of investment products to their clients. In order to benefit from this change in macro environment, HNW clients will need to be educated about broader investment offerings if they are to be convinced to reallocate their wealth. Wealth Managers need to support their clients along this journey.

Wealth Managers must use last reprieve to simplify their operating models before the approaching downturn

The Q1 2019 market rebound has given Wealth Managers what we think may be a last chance to simplify their operating models and adjust their cost base while improving advisor productivity before an eventual downturn. Cutting discretionary spending, delaying investments and trimming operating costs will not suffice – more substantial action is required.

Figure 8: Cost breakdown by function, indicative (% of total costs)



Source : Oliver Wyman analysis

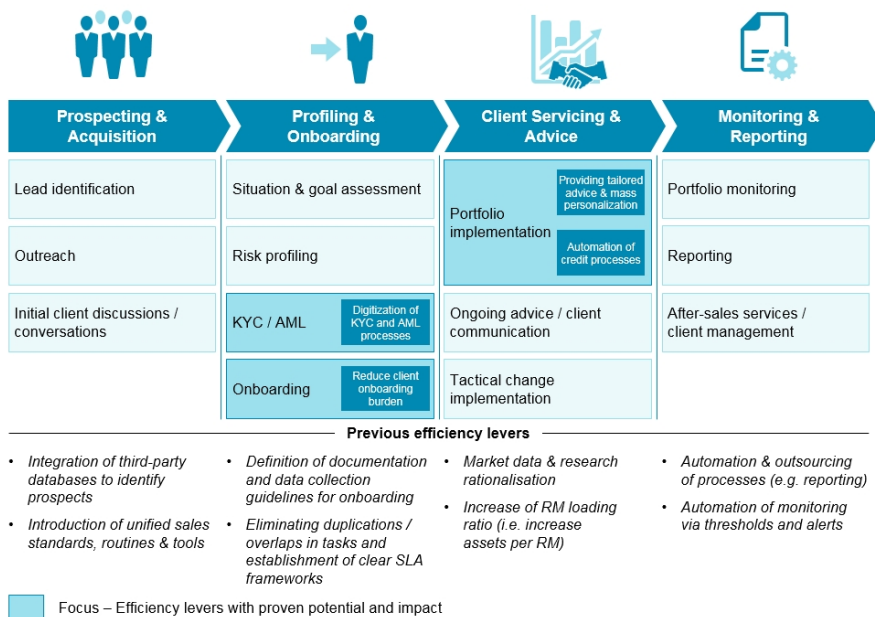
To increase efficiency in the front office, which accounts for more than 50% of costs, Wealth Managers must free up Relationship Manager (RM) capacity for revenue-generating activities by automating and digitising processes.

In the back office, allocated costs remain stubbornly high for Wealth Managers that are part of a broader group – more than 50% in some cases. Wealth Managers can take action to reduce the consumption of group services to ultimately lower cost allocations.

Utilise proven efficiency levers to reduce the >50% of RM time allocated to low-value-adding administrative activities

Today, average RMs still spend ~50% of their time on low-value adding administrative activities. Improving the time allocations of RMs can have a significant impact on their performance and holds material potential. Across the industry, we observe that often only 20% of Relationship Managers are responsible for 80% of NNM generation. Past strategies of replacing low performing Relationship Managers with external hires often proved unsuccessful. Instead, Wealth Managers need to make their current front-office operations more efficient, particularly by reducing the time burden for administrative tasks. In working with industry leaders, we have proven a number of high impact use cases over the last 12-18 months, which eventually have to be implemented across the industry more broadly, complementing efficiency levers that have already been recently implemented by many players.

Figure 9: Opportunities for efficiency increases along the client journey



Source : Oliver Wyman analysis

Efficiency lever 1: Know Your Customer (KYC)

KYC processes need to be upgraded in light of greater external data availability and ready third-party solutions. RMs (and compliance officers) need to draw on an array of external databases to compile client data, rather than relying on time-consuming manual information collection and reconciliation. Incorporating advanced information aggregation and analytics tools offered by third party providers or built in-house, sourcing and reconciling data from hundreds of data bases, Wealth Managers can access and process client data in unprecedented ways, whilst ensuring

regulatory compliance in terms of data protection. Such tools also offer substantial benefits for periodic client reviews, as these can now be largely automated and conducted on an ongoing basis.

Efficiency level 2: Anti Money Laundering (AML) – Transaction monitoring

Monitoring transactions is still a resource-heavy process for Wealth Managers at present. Whilst transaction monitoring tools (TMT) are screening and flagging transactions, following up on alerts is still a highly manual process. The algorithms used by the tools are often crude, creating a high number of false alerts. AML represents another area for improving efficiency and effectiveness in the short-term based on enhanced use of data, analytics, and technology.

During alert generation, automated data aggregation of transaction data and data processing to group alerts can be employed. Before launching a time-consuming investigation, statistical and machine learning techniques can be applied to identify potential false positives while more advanced analytics can also help identify trends in alerts. The manual collection of relevant documents can be replaced by automated data collection. Data visualisation makes data more intuitively accessible to employees.

Efficiency level 3: Reduce client onboarding burden

A number of challengers have shown that increased automation and digitisation of the onboarding process (beyond KYC), combined with holistic data management is achievable.

Centralised and consolidated data storage eliminates a duplication of tasks and allows information to be shared across functions. Increased digitisation and automation of processes reduces manual work, provides a uniform view of workflows and data, and simplifies client interaction with fewer touchpoints. Centralized data management also enables more sophisticated data analytics to identify revenue opportunities and the digitisation of client servicing activities, for which the lack of a uniform data architecture remains a key hurdle (see last year's report "Dare to be different").

Efficiency level 4: Providing tailored advice and mass personalisation

Wealth Managers must better align their offering to the varied needs of their client base. Differentiating RM service levels has been in focus in the recent past, but embedding different service levels and greater automation in the investment engine is still a largely underutilised efficiency lever. For example, HNW clients with assets below the typical entry threshold of USD 5 MM must be served at a lower cost point without compromising on quality.

In an industrialised offering, Wealth Managers create standardised, basic mandate offerings that are matched to clients based on their risk profile. Base offerings can subsequently be "mass personalized" with a handful of standardised opt-in modules. These allow a degree of customisation from the client perspective on top of largely uniform underlying investment processes. Mandates of the same type are managed collectively and back office activities, such as risk management and reporting, can be standardised. A more industrialised mandate offering should benefit clients and reduce conduct risk by standardising outcomes across portfolios.

Efficiency level 5: Automation of credit processes

Lending will remain a key income growth lever for Wealth Managers. At the same time, lending – particularly Lombard lending – is well suited to front-to-back auto-

mation. FTE costs can be reduced by 10-40% through reduced manual intervention along the value chain. For example, automated pricing and profitability tools can support origination and structuring. Automated fraud detection and pre-approvals shorten the time required for credit applications and reviews. Real-time monitoring and automated margin calls increase efficiencies in the ongoing monitoring of credit.

A simplified credit application process also generates volume growth by reducing abandon rates. The time to apply is reduced to minutes and approvals on plain-vanilla requests can be provided in seconds.

Wealth Managers must review group service consumption to help lower allocated costs

Allocated costs make up a significant share of Wealth Managers' costs. Cost allocation methodologies, the implementation of robust cost tools at group level and the reduction of group service costs are outside their direct scope of influence. Wealth Managers must focus on understanding and steering cost allocations as well as embedding a culture of cost management.

Cost allocation management

Cost allocation mechanisms are often so opaque that business unit management cannot anticipate their allocation with accuracy, but they can gain an element of control. The first step is to understand the cost allocation mechanisms and the underlying drivers. Elasticity of allocated costs is a key metric to understand when trying to reduce the cost allocated to the Wealth Management business unit.

For example, automation and digitisation of the AML/transaction monitoring value chain standardises processes in alert generation and investigation. This creates a more uniform, higher quality information base for final case decisions in the compliance department, reducing workload and thus eventually allocated costs.

Cost management culture

Wealth Managers need to move from a governance model, where no one owns the allocated costs, to a system with named owners who are responsible for understanding them front-to-back, negotiating them, and taking action to reduce the allocation. This includes treating shared service divisions like a third-party supplier at arms-length and compare their value-for-money with external providers. This may, for example, be applicable for processes such as transaction processing, payments and billing, as well as reporting. While this leads to stranded costs for the group in the short-term, it is the only way to discipline internal suppliers and, ultimately, to increase the efficiency of the overall group.

Reducing costs and not merely reallocating them will require real collaboration across the business and corporate centre. In our cost work, we found that "studio design" sessions can make a real difference.

1. The end of the cycle is in sight

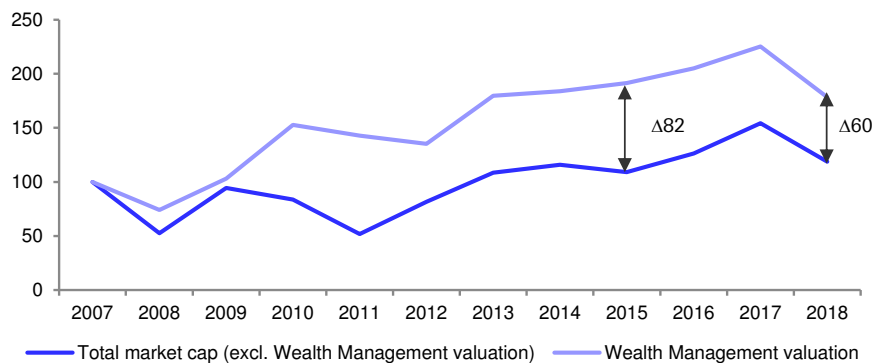
Persistent headwinds and resulting investor caution lead to a further narrowing of the valuation gap

The structural headwinds identified in last year’s report “Dare to be different” were clearly evident in 2018. Wealth Management business valuations decreased by more than 20% in 2018 on the back of lower Asset under Management (AuM) growth, more volatile markets, and continued fee compression. Overall bank valuations also decreased, but at a slightly slower rate, further narrowing the “valuation gap” between Wealth Management and other banking businesses.

Over recent years, the strong performance of Wealth Managers has been driven by robust asset growth supported by quantitative easing and wealth growth. Wealth Managers’ valuations have materially profited from the comparably high market sensitivity of the business model. In addition, investors have been attracted by Wealth Managers’ capital-light models. For example, Wealth Managers acting as “fiduciaries” were significantly less affected by regulatory capital requirements than other banking businesses, such as investment banking. As market volatility increases, high market sensitivity adversely impacts valuations. Additionally, there are increasing signs that regulatory tightening across capital-intense banking models has peaked. Regulators have increasingly shifted their focus towards compliance, Know Your Customer (KYC)/Anti Money Laundering (AML) and data protection, which also heavily affects Wealth Managers, therefore losing their relative advantage towards other banking businesses in the eyes of investors.

The valuation gap has narrowed by a total of 22 percentage points (ppt) since its high in 2015, reflecting growing concerns about the industry’s business models. The gap emerged following the Global Financial Crisis as a reflection of comparatively low capital intensity, a primarily fee-based business model, and on the back of ongoing Net New Money (NNM) generation supporting revenue growth.

Figure 10: Equity market value development of overall bank vs. Wealth Management business



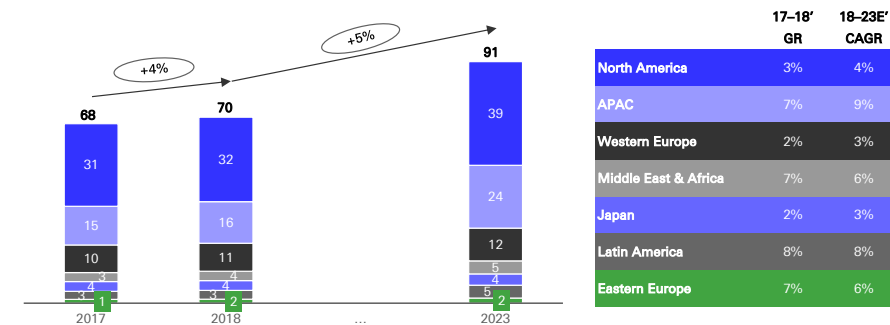
Source : Deutsche Bank Research, Oliver Wyman analysis

To sustain or grow this gap again, Wealth Managers must show they can achieve earnings growth even in adverse market environments and with increasing regulatory requirements. As we observe investors shifting their focus from risk to growth, idiosyncratic growth success stories are becoming more relevant across the industry.

The end of the cycle is in sight – Emerging Markets to drive future growth

The wealth of high net worth individuals (HNWIs) grew to USD 70TN globally in 2018, albeit at a decelerated rate of 4% on the back of challenging equity markets. The strongest growth rates were observed in Emerging Markets at 7-8%, while Developed Markets trailed behind at 2-3%. We anticipate this growth divergence to continue over the coming years. Wealth Managers looking to achieve above average growth rates must take a look at their Emerging Markets footprint and strategy to best position themselves to capture this growth.

Figure 11: Global private (HNW) wealth by major region, in USD TN



Source : Oliver Wyman Wealth Management model

Note: HNW wealth is measured across households with financial assets greater or equal to USD 1 million. Financial assets include investable assets (deposits, equities, bonds, mutual funds and alternatives), excluding assets held in insurance policies, pensions and direct real estate or any other real assets. Numbers for all years were converted to USD at the year-end 2018 exchange rates to exclude the effect of currency fluctuations.

North American markets held up slightly better than European markets in 2018, with the strong US Dollar cushioning some of the negative market effects due to protectionist US politics and trade tensions.

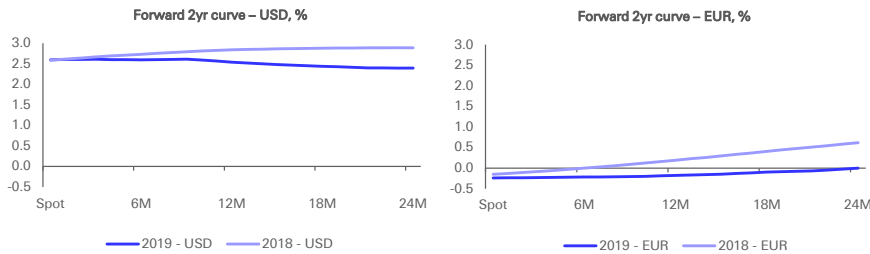
European markets experienced continued strain from political uncertainty, including Brexit, Italian elections, protests in France, and the approaching end of the Merkel era in Germany. Monetary tightening raised concerns of an economic slowdown. The Euro remained weak compared to other currencies, exacerbating negative market effects.

Economic growth rates in APAC and, especially, in China (2018 GDP growth: 6.6%) are slowing to more sustainable levels, although still markedly higher than Europe (EU: 1.8%) and North America (US: 2.9%). Deleveraging took priority over economic stimulus in China, which also suffered from US trade tariff tensions.

Equity markets have since rebounded in Q1 2019 on the back of investors' improved views of geopolitical risks, China stimulus and lower probability of a near-term economic downturn. Recent communications by the ECB and Fed also indicate a change of gears in quantitative tightening and rate hikes. EUR forward curves indicate a significantly lower increase in rates than was expected a year ago and USD forward curves even point towards possible cuts. This may buy Wealth Managers

a last period of relief before a major correction eventually hits.

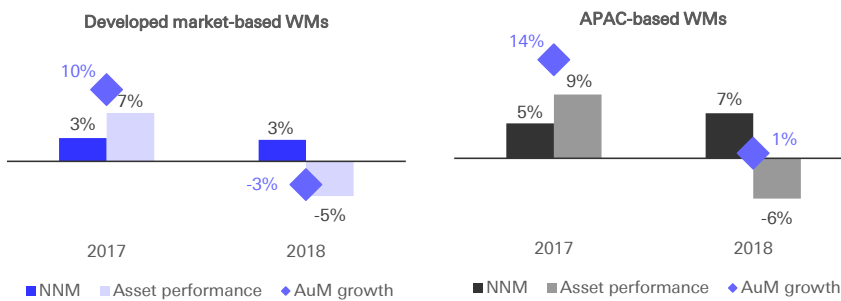
Figure 12: Forward 2yr curves - USD and EUR



Source : Thomson Reuters, Oliver Wyman analysis

Leading Wealth Managers headquartered in Developed Markets, i.e. Europe and North America, saw slight declines in AuM during 2018, driven by negative asset returns. Net new money (NNM) remained positive but did not make up for market losses. APAC-based players saw a small increase in AuM, driven by continued strong NNM.

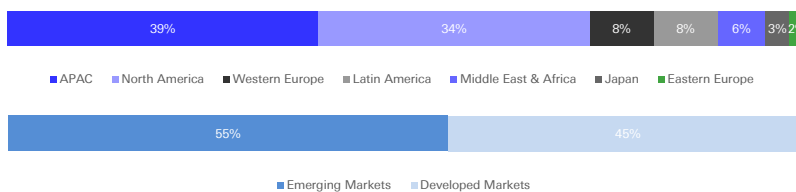
Figure 13: Asset performance vs. NNM (in % of AuM)



Source : Deutsche Bank Research, Oliver Wyman analysis

Due to positive NNM, which contributes more than half of expected growth going forward, HNW wealth usually increases even in a market downturn. We expect HNW wealth to grow at a rate of 5% p.a. over the next five years – significantly lower than growth rates in more positive market environments – reaching USD 91 TN in 2023. Emerging Markets will contribute 55% of growth with above average growth rates of 6-9%. Growth in Developed Markets will stabilise but will continue to be much slower than in Emerging Markets.

Figure 14: Share of total HNW wealth growth 2018-2023, by region (in %)



Source : Oliver Wyman analysis

We anticipate HNW wealth to continue growing through a likely near-term economic downturn supported by new wealth creation. At the same time, asset returns across the HNW population tend to be less sensitive to market stress scenarios, due to greater diversification and flexibility, and better access to investment advice and services. As a result, HNW wealth has historically rebounded quickly from previous downturns.

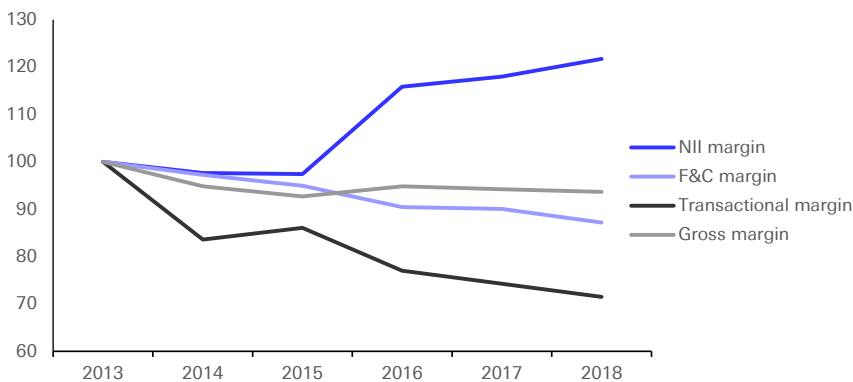
Gross margins under pressure by increased volatility in 2018 and a halt on rate hikes

Gross margins of Wealth Managers based in Developed Markets decreased slightly in 2018. Increased market volatility drove risk aversion and impacted transactional income. Long-term drivers of F&C margin compression also persisted – namely, the shift to passive products and the faster growth of quasi-institutional, lower margin ultra-high-net-worth business (UHNW). Increasing mandate penetration did not provide a large enough counterbalance.

Net interest income (NII) continued to grow, supported by higher US rates, but was held back in Europe. Year-on-year (YoY) loan growth decreased due to deleveraging pressure in H2 2018.

Reduced client activity in a more volatile market environment caused a notable drop in transactional income, which continues to decline as a percentage of total revenue. This exacerbates the slow but ongoing decline of transactional income, driven by the long-term shift into mandates.

Figure 15: Margins for Developed Markets-based Wealth Managers, 2013-2018, indexed to 100 in 2013, margin as share of AuM, sample of leading Wealth Managers



Source : Deutsche Bank Research, Oliver Wyman analysis
Note: 'Developed Markets-based' refers to Wealth Managers who are based in North America or Europe

Wealth Management economics continue to rebound for some players as markets recovered in Q1 2019. Revenues and profits are growing, albeit mostly still below Q1 2018 levels. Transactional income is growing again as markets stabilise and investor confidence returns. AuM growth is recovering as asset performance improves, stabilising F&C revenues. Longer term, however, we expect gross margins to contract further.

NII margins are growing but at a decelerated speed as rate increases are on hold

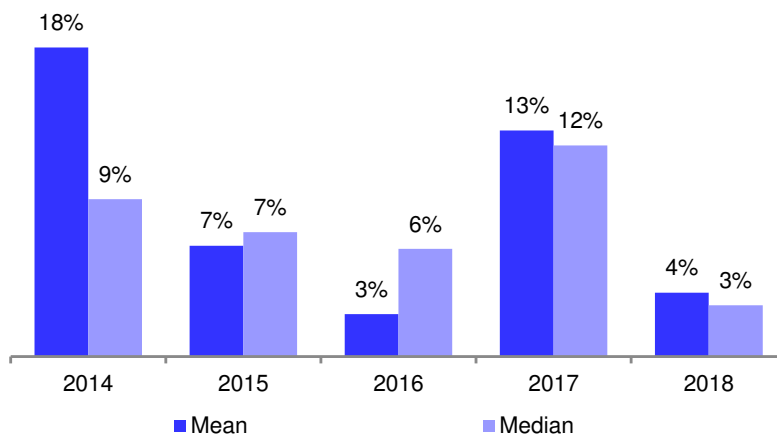
NII margins continued to grow for Wealth Managers but at a slower rate as the Fed rate cycle comes to an end. NII pressure will intensify going forward. As a result, we expect gross margins to contract.

North America-based Wealth Managers' NII margins have continued to benefit from Fed rate hikes in 2018. Further hikes have been declared unlikely by the Fed in the short-term and cuts even seem possible if inflation or growth falters. This trend, combined with increased deposit betas, will put pressure on NII margins in the near future.

The ECB has not raised interest rates from their historically low levels. This has left NII margin growth of Europe-based Wealth Managers trailing their North America-peers since 2016. ECB rate hikes, previously anticipated for 2019, are now expected to be delayed further. This is reflected in EONIA (Euro Overnight Index Average) forward rates, which have declined over the past six months.

Loan growth remained positive in 2018, contributing to NII margin growth, but decelerated notably from 2017 due to market stress and deleveraging pressures. AuM-weighted loan penetration increased slightly due to weakness in AuM growth.

Figure 16: YoY loan growth, 2014-2018, in %, sample of leading Wealth Managers



Source : Deutsche Bank Research, Oliver Wyman analysis

With AuM growth below expectations, F&C income is under pressure, despite increasing mandate penetration

Market stress in 2018 led to low AuM growth (or even declines in some markets), restricting the baseline for F&C income.

F&C margins remain under pressure. Developed Markets overall saw a slight decline in F&C margins, driven by ongoing structural pressures. Europe-based Wealth Managers faced greater market volatility than their North America-based peers and, as a result, suffered a 5% (2bps) reduction of F&C margins while North American F&C margins rose marginally by 2% (1bps). North America-based Wealth Managers continue to benefit from lighter regulation than their European counterparts, who are subject to MiFID II requirements. The Department of Labour (DOL)

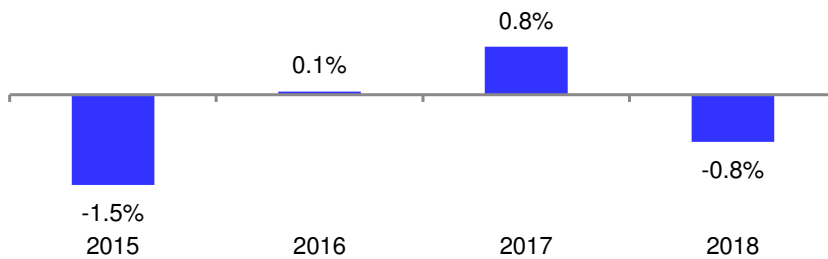
Fiduciary rule has been abandoned and the U.S. Securities and Exchange Commission's (SEC) proposed Regulation Best Interest remains under debate. As implementation of the latter becomes more likely, however, we expect the regulatory burden of North America-based Wealth Managers to increase.

Beyond regulation, F&C margins face several opposing trends: Continued margin pressure from the commoditization of advisory services and the increasing share of comparably lower margin UHNW business is cushioned by continuously increasing mandate penetration. Slight regional differences, for example from regulatory pressure, may likely be the difference between constant or decreasing F&C margins.

Wealth Managers remain unprepared for a looming downturn – high cost income ratios still persist

Industry-wide cost-income-ratios (CIRs) persist in the mid to high 70s. Wealth Managers remain unprepared for a looming downturn and must take additional actions to make their business model more efficient. Following positive operating jaws in 2017, revenue pressure outpaced timid cost cutting efforts. As a result, operating jaws turned negative again in 2018, illustrating the vulnerability of operating models to market volatility.

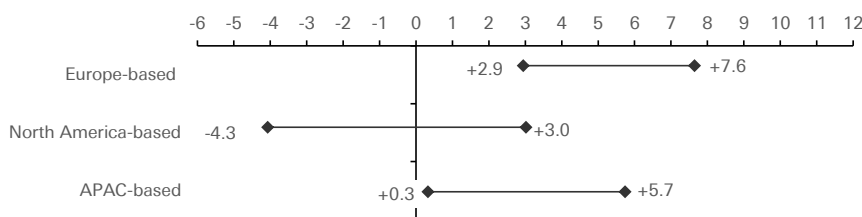
Figure 17: Operating jaws, 2015-2018, sample of leading Wealth Managers



Source : Deutsche Bank Research, Oliver Wyman analysis

Comparing CIRs of H1 2018 and H2 2018 shows the vulnerability of CIRs to even low levels of market stress. The CIRs of more than two thirds of leading Wealth Managers increased between H1 2018 and H2 2018. As expected, the variable-cost-heavy structure (~40%) of North America-based Wealth Managers showed greater adaptability to volatile markets than the more fixed-cost-heavy structure of Europe-based peers.

Figure 18: Range of CIR change of Wealth Managers, H1 2018 vs. H2 2018 (in ppt)

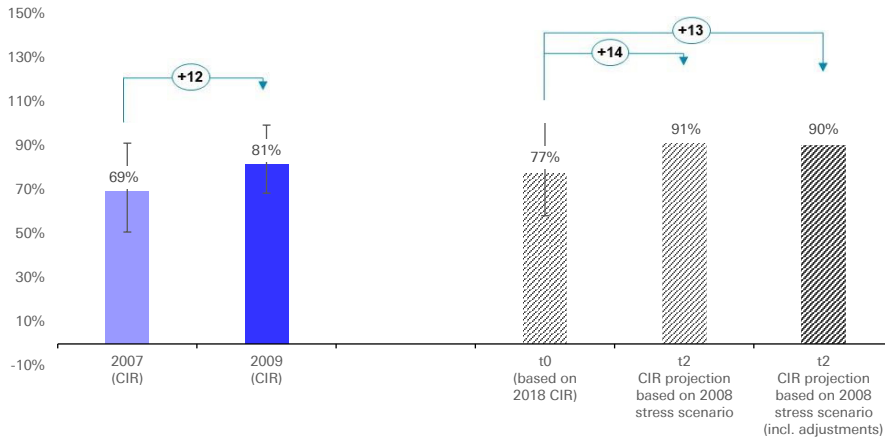


Source : Deutsche Bank Research, Oliver Wyman analysis

The need for Wealth Managers to reduce their CIRs is even more apparent when looking at cost-income-ratio developments during the Global Financial Crisis. Between 2007 and 2009, the average CIR for leading Wealth Managers that still exist today increased by about 12 ppt. CIRs have declined since 2009 but not returned to pre-crisis levels.

If a shock of similar strength to the Global Financial Crisis were to occur today, our analysis suggests that the average CIR would rise to 91%. Adjusting for the current revenue composition (for example positive impact from increased mandate penetration) and operating models (for example negative impact from higher share of allocated costs and lower share of easily reduceable discretionary costs) yields a very similar picture with an average CIR of 90%. A third of leading Wealth Managers, currently operating at CIRs of more than 80%, would approach loss making territory quickly.

Figure 19: CIR ratio pre and post crisis (mean, max and min in %, deltas in ppt calculated on average CIR levels), sample of leading Wealth Managers



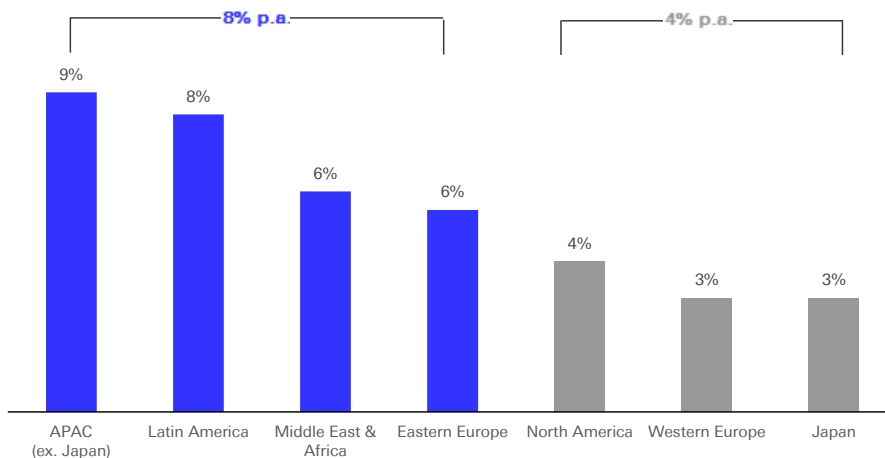
Source : Deutsche Bank Research, Oliver Wyman analysis

The need to cut costs creates a dilemma for Wealth Managers as fulfilling their growth targets without further investments will be near impossible. Growth outlooks need to reflect the reality of revenue pressure and required action on costs. Wealth Managers need to brace themselves for negative markets while maintaining their commitment to selected high-priority growth opportunities.

2. Emerging Markets will outgrow Developed Markets by 4% p.a. until 2023 but a growing percentage of wealth can only be captured onshore

Emerging Markets HNW wealth will grow at a much higher rate than in Developed Markets (8% vs. 4% p.a.). APAC, Latin America (LatAm), Middle East & Africa and Eastern Europe are expected to account for over half of global wealth growth until 2023, compared to one third of stock today. These are the markets where Wealth Managers will have the greatest opportunities to expand their customer base and can significantly grow AuM over the coming years. APAC and Latin America show the highest expected growth rates and are therefore the focus of our analysis.

Figure 20: CAGR of global private HNW wealth by major region, 2018-2023



Source : Oliver Wyman Wealth Management model

Regulatory reforms in local markets increase the relevance of onshore presence across APAC

Global Wealth Managers in APAC have, for the most part, served HNW clients in the region from offshore hubs Hong Kong and Singapore. However, significant growth of onshore wealth and a gradual opening and increasing maturity of select onshore markets require Wealth Managers to reevaluate their largely offshore driven approach.

We see three main areas of action for Wealth Managers to reposition their business in APAC. First, closely observe developments in the offshore hubs Hong Kong and Singapore to be well prepared for any shifts in relevance. Second, assess the Chinese onshore opportunity now. And third, take select concentrated positions in

South East Asia.

[Changing dynamics across APAC require Wealth Managers to review their offshore footprint across Hong Kong and Singapore](#)

Hong Kong and Singapore, the two leading offshore hubs in APAC, are expected to continue to grow strongly but shifting dynamics within the region have the potential to affect their relative importance in the future.

Rapidly growing wealth in APAC, combined with limited product offerings in domestic markets and limited property rights, have made Hong Kong and Singapore leading offshore hubs over the past decades. Both have all the prerequisites in place to effectively serve HNW clients: access to global financial markets and investment opportunities, strong domestic financial markets, respected financial market regulators, stable economic and monetary governance, advanced infrastructure and transparent legal frameworks based on English Common Law – respectively, ranked 3rd and 4th in the Global Financial Centre Index. The ranking serves as a strong indicator for the strength of the overall financial ecosystem – a crucial condition for successfully attracting HNW offshore wealth.

Hong Kong's growth continues to be fuelled by inflows from mainland China. With its stock connect programmes to Shanghai and Shenzhen stock exchanges, Hong Kong offers valuable China access opportunities to non-Chinese investors and remains the primary market for Chinese IPOs. Singapore will remain the preferred offshore destination for SEA-based HNW clients, who benefit from its geographic proximity, advanced infrastructure and pro-business political environment. Across both markets, residency opportunities for HNW investors add to the appeal.

Despite continued strong growth in both hubs, we expect Hong Kong and Singapore to be increasingly affected by changing dynamics within the markets from which their offshore assets originate. Hong Kong's development as an offshore hub will be dependent on continued inflows from Chinese HNW clients. While these clients still favour Hong Kong due to a broader investment product offering and geographic proximity, they are concerned about the increasingly intrusive approach from Chinese authorities into Hong Kong. While full Hong Kong and Mainland integration is still a long way off we expect Mainland HNW clients to increasingly consider offshore alternatives to Hong Kong as a way of mitigating the perceived increasing political risk.

While this has the potential to improve Singapore's position as an offshore hub for Chinese HNW clients, Singapore faces challenges of its own. Changing regulations across SEA domestic markets, increasingly allowing onshore advisory for offshore assets, put pressure on the Singapore centric SEA operating models many Wealth Managers still have in place. This may lead to parts of the value chain migrating onshore, fragmenting footprints and increasing cost to serve (see chapter on SEA). The development of SEA onshore markets could threaten Singapore's mid-term growth outlook.

As a result of these dynamics, Wealth Managers with the ambition to cover the entire region still need strong presence in both hubs but the challenge to build or maintain scale in both is constantly growing.

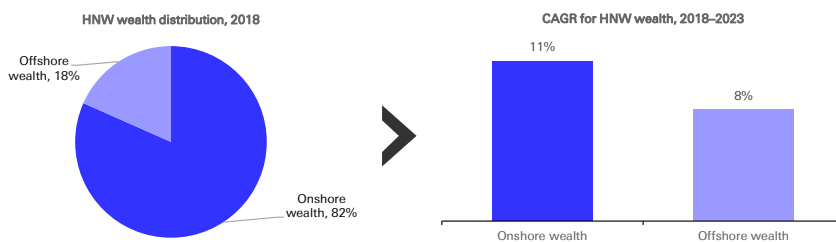
[Wealth Managers that want to benefit from future growth in onshore China need to assess the opportunity now](#)

The Chinese onshore Wealth Management market is seeing significant structural

changes, leaving Wealth Managers with the question whether to enter the market, and we recommend Wealth Managers to assess the opportunity now. Those deciding to enter need to take a mid- to long-term view and accept challenging economics and possible losses in the short-term for a chance to benefit from access to the immense Chinese onshore wealth in the future. Wealth Managers should be open to partnership models with local players to accelerate access to the market and limit financial exposure.

The Wealth Management market in China is one of the fastest growing in the world. HNW financial wealth is expected to grow 10% p.a. between 2018 and 2023. Despite significant Chinese offshore asset growth, about 80% of total financial assets remain onshore.

Figure 21: China HNW wealth comparison – onshore vs. offshore



Source : Oliver Wyman Wealth Management model

The Chinese onshore market is undergoing significant structural changes. Easing ownership regulation for foreign Wealth Managers, the phase-down of guaranteed high-return products and the increasing complexity of Chinese HNW Wealth Management needs lead us to recommend Wealth Managers to assess the China onshore opportunity now.

Regulations for foreign Wealth Managers are easing

Chinese-owned Wealth Managers have benefited in the onshore market from capital controls and restrictions on foreign ownership. Many of the foreign firms that entered the market in the past have soon exited, and none of those that remained have gained meaningful scale. Capital controls remain, but regulations on foreign ownership are easing. Foreign firms are allowed majority ownership in joint ventures with Chinese firms and, from 2021, 100% foreign ownership will be permitted. We also observe a gradual expansion of outbound investments driven by extensions of regulated schemes and quotas (e.g. QDLP and QDII). Combined, these regulatory changes will allow foreign Wealth Managers to provide outbound investment products to HNW clients who they advise domestically.

Product demands are evolving

Growing restrictions on the shadow banking industry and the phase-down of guaranteed high-return products, which foreign players have largely avoided to offer due to their often lower risk appetite vs. Chinese domestic players, lead to declining attractiveness of local player's investment products. Suppressed investment returns for underlying assets are likely to trigger HNW clients' needs for more efficient portfolio allocation. According to our proprietary HNW client survey conducted in early 2019, more than 40% of HNW clients in China still expect investment returns of more than 8% p.a. over the next 5 years. As a result, advancing capital market offerings and emerging financial instruments (for example index options) will be of increasing relevance for HNW clients. Foreign wealth managers have the

qualifications required to serve these shifting demands given their superior investment offering expertise.

Wealth Management needs are shifting

The Wealth Management needs of HNW clients in China are becoming more open and complex, making extensive wealth planning capabilities of foreign players more attractive. For example, the demand for inheritance planning is increasing as wealth is passed to the second generation of HNWIs. Our HNW survey reveals that for the majority of HNW clients in China access to succession planning services is one of the top three requested services of a Wealth Manager. However, the vast majority of the clients also state that their Wealth Manager currently does not provide these services. We expect changes in wealth-related policies and tax regulation to become more mature and complex (e.g. much speculated estate tax). This will only increase the demand for sophisticated estate planning and more internationally diversified portfolios. These developments provide foreign Wealth Managers with an opportunity to bring their more advanced capabilities to bear and out-compete the local players.

China remains a difficult market for foreign Wealth Managers

While recent developments offer great potential for international Wealth Managers, the strong market position of domestic players and still existing entry barriers will preclude them from scaling-up independently and bringing their full strengths to bear in the near-term. As long as domestic players still dominate distribution, going alone will often not lead to the desired success for international Wealth Managers. At the same time, we see a great opportunity for international Wealth Managers to pursue collaborative approaches with local players to gain accelerated access to the market in the short-term.

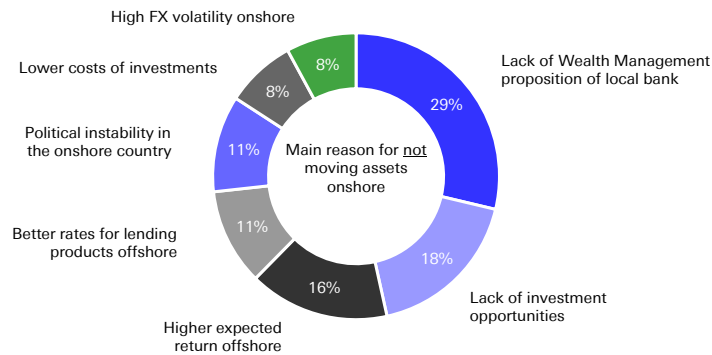
The Chinese onshore market is still dominated by domestic players who control distribution. Their history and scale give them major advantages over international players. Given the structural changes mentioned above, domestic players are also working hard to increase the sophistication of their Wealth Management offering. Domestic banks already own a large number of retail banking clients, many of whom could be upgraded to wealth management in the future as incomes and savings continue to grow. They also have access to scarce, "localised" products that often exceed the risk appetite of foreign players.

Despite easing regulation, foreign Wealth Managers still face regulatory barriers to entry. Wealth Managers that want to offer their full range of services require multiple licenses that can be obtained only through complex and often opaque administrative processes. This prevents international players from capitalising on their relative strengths in financial planning and product manufacturing and from scaling-up their business when entering the onshore market independently. In addition, the "separate operations" regulatory scheme requiring banks to separate banking and securities businesses, is another barrier for entering the market independently with full force. For example, when opting for the banking business only, global players would not be allowed to provide offerings like securities trading or margin financing. For an independent full-scale offering however, international Wealth Managers would need to operate and maintain two different and separate entities.

Such obstacles also create an opportunity for foreign Wealth Managers. Local players are better placed to navigate local regulations, but often struggle to develop a Wealth Management offering meeting the evolving HNW client needs. Our HNW survey reveals, that the main driver for not moving more assets onshore is the lack

of wealth management propositions of domestic players. As a result, domestic players are also increasingly open to partnerships with well-established international Wealth Managers. A partnership can also include sharing parts of the value chain, for example providing infrastructure and product capabilities to domestic players.

Figure 22: Main reasons of investors for not moving more assets onshore (in % of respondents)



Source : HNW client survey, Oliver Wyman analysis

Our survey further indicates that ~60% of HNW clients found their primary Wealth Manager through a recommendation by their domestic bank. As a result, foreign players should see a partnership approach as a chance in the short-term to benefit from important market insights of domestic players, to rapidly acquire access to distribution channels and to accelerate their customer acquisition. In addition, such partnerships create optionality to expand in the future once market presence and know-how is established.

Considering these obstacles to short-term success, Wealth Managers that choose to enter the Chinese onshore market will need to take a long-term view, accepting challenging economics and possible losses in the short to medium-term. We expect break even in onshore China will take foreign Wealth Managers a minimum of 5 years. Assessing the onshore opportunity requires international Wealth Managers to make a trade-off decision between short-term shareholder demands and the long-term value of a China call option by entering the market now.

Ongoing regulatory reforms will prompt Wealth Managers to take concentrated positions in select SEA onshore markets

In light of regulatory reforms in SEA and slowly maturing capital markets allowing for more sophisticated Wealth Management offerings in domestic markets, Wealth Managers will increasingly need to consider their onshore footprint, in particular in Thailand, Malaysia and Indonesia. Minimum platform size across the region will increase by USD 10BN per onshore presence and Wealth Managers will need to carefully weigh the additional costs of going onshore with the need to protect their offshore business by following their clients onshore and getting early access as these markets continue to mature.

SEA HNW clients have been historically served by Wealth Managers offshore, predominantly from Singapore. Wealth protection and product access were the main reasons for moving wealth offshore with no credible domestic market alternative.

While local regulation would largely prohibit onshore advisory on offshore assets, clients seeking access to advice and a full Wealth Management offering would have to travel to Singapore.

[Advisory services will migrate to onshore markets](#)

As local regulation changes for onshore advisory on offshore assets and Government sponsored investments are now increasingly encouraged, we expect parts of the Wealth Management value chain to migrate onshore. At the same time, a large proportion of assets are expected to remain offshore for better product access as local markets are still maturing and as a continued political and currency hedge.

Recent regulatory changes in SEA countries are gradually opening domestic markets. For example, in Thailand regulations previously required investments into offshore assets to be wrapped in investment structures sponsored by domestic financial institutions (e.g. master feeder scheme). Investors can now directly invest into offshore assets through local brokers or banks. If the Indonesian government continues its regulatory reforms, onshore advisory services on offshore assets become increasingly accessible.

In line with these changes, we expect SEA clients with offshore assets to increasingly demand onshore advisory services and to no longer be content with advisory desks in offshore locations. The footprint required to serve offshore assets in SEA will thus become more fragmented.

[Minimum platform size increases by USD 10BN per onshore presence – Wealth Managers need to consider partnership strategies to control costs](#)

The more fragmented footprint will result in significantly higher operating costs – for example, for domestic licensing, hiring and training of advisory staff and operations/infrastructure. Although the operating costs of a local advisory presence are far lower than those of a full booking centre, Wealth Managers will need to significantly increase their AuM originating from domestic SEA markets to justify these additional costs.

As outlined in our previous report “Time to Advance and Defend”, AuM of around USD 30BN are required to operate a booking centre profitably. We estimate USD 10BN are required for each onshore advisory presence. Based on our analysis only a handful of local players have achieved that AuM level so far. In Thailand, for example, we see no more than five domestic players, and none of the global firms, with assets in excess of USD 10BN of Thai HNW financial wealth.

However, the required AuM increase to offset the market entry costs may be reduced if Wealth Managers enter onshore markets through partnerships or can leverage existing local group presence.

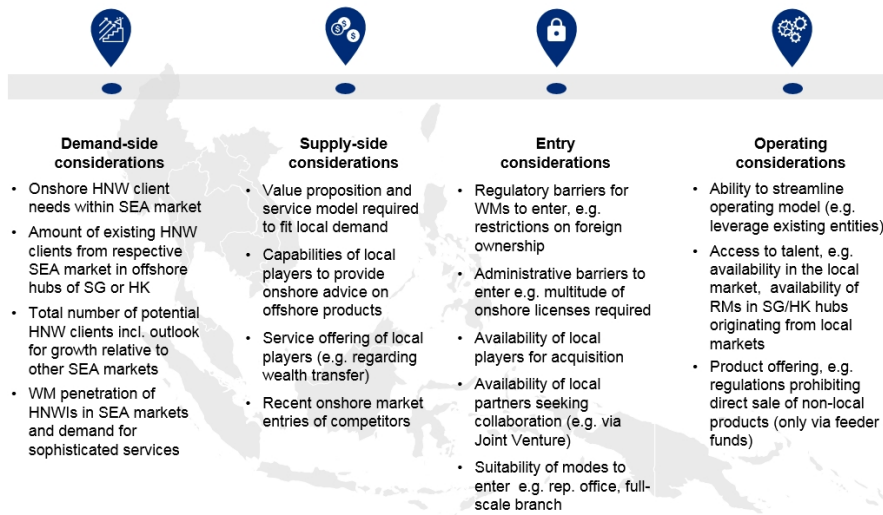
Figure 23: Market entry models for onshore advisory presences



Source : Oliver Wyman analysis

In order to keep costs at a manageable level and to maintain an achievable minimum platform size, wealth managers will likely need to choose which domestic SEA markets are best to position themselves in. This requires Wealth Managers to conduct an in-depth analysis of the respective SEA markets, taking into account several market-specific entry considerations to determine most promising options.

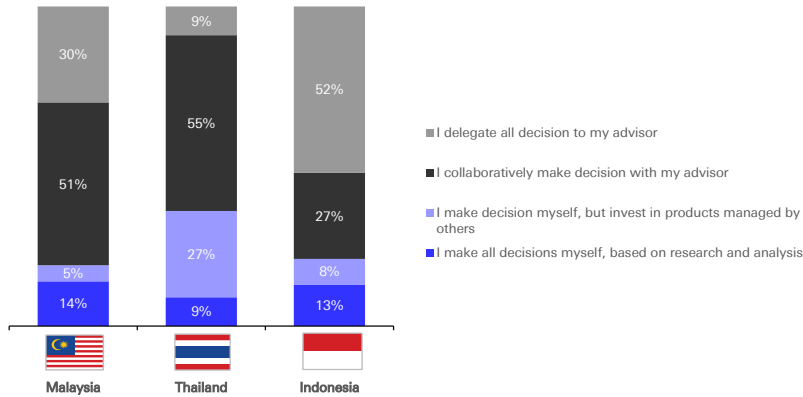
Figure 24: Strategic considerations when assessing market entry



Source : Oliver Wyman analysis

For example, Wealth Managers need to consider the different investing styles across SEA markets to identify a promising value proposition. Indonesian HNW clients are likely to delegate all investment decisions to their advisor while Thai HNW clients pursue a more collaborative investing approach with their advisor.

Figure 25: Investing styles across SEA

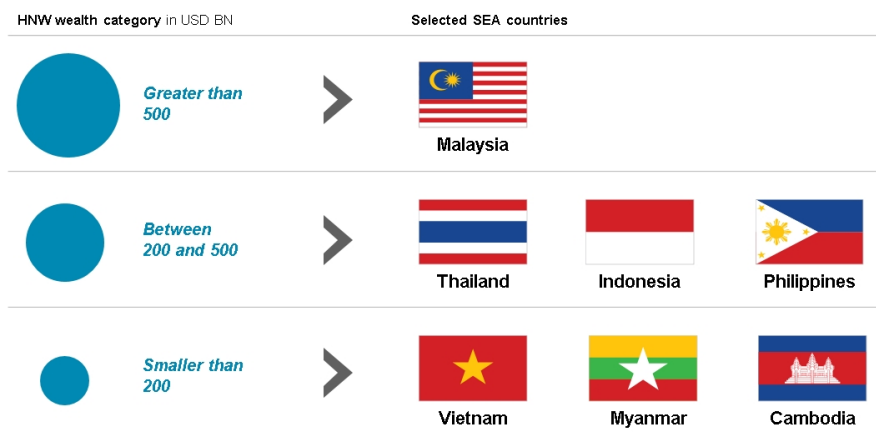


Source : HNW client survey, Oliver Wyman analysis

In addition, Wealth Managers need to better understand their exposure to each market across all booking centres to come to a full risk/reward assessment of following clients onshore. With respect to entry mode the analysis must include an evaluation of entry barriers to the specific market (e.g. restriction of foreign ownership).

When making the decision on whether to go onshore, domestic market development also needs to be considered. Individual markets in SEA have experienced high growth in onshore financial wealth which is expected to continue over the next years. Malaysia offers the largest potential in terms of financial wealth followed by Thailand and Indonesia. Our proprietary HNW survey reveals that more than 70% of HNW clients from these countries have moved more of their assets onshore over the last three years. Primary drivers for this shift were an improving access to investment opportunities onshore and tax amnesty programs implemented by SEA governments.

Figure 26: Private HNW wealth by country, 2018



Source : Oliver Wyman Wealth Management model

Establishing an advisory presence can be seen as a call option to potentially expand into a full onshore offering at a later stage as local wealth pools are broadening and financial markets keep maturing.

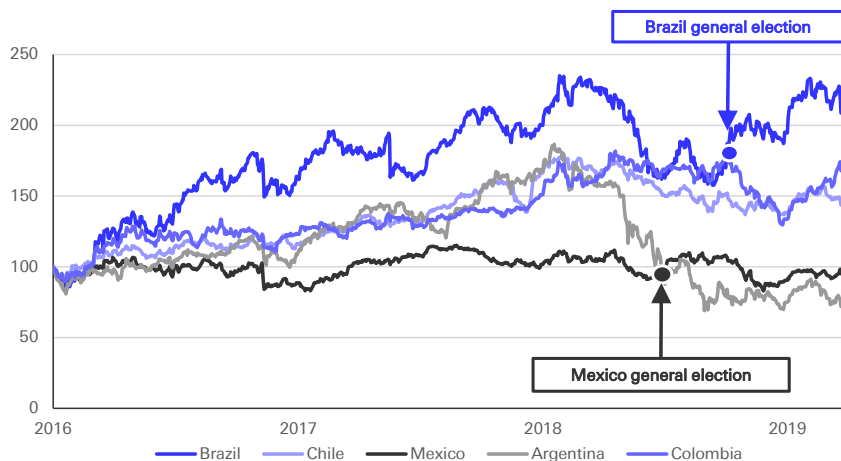
Wealth Managers with an integrated onshore and offshore experience will gain a competitive edge in Latin America

Latin America offers significant growth potential for Wealth Managers but requires a careful selection of target markets as local market dynamics can differ significantly across the region, as illustrated by Mexico and Brazil's market development following their respective elections. With offshore investments still being of great importance to HNWI clients across LatAm, Wealth Managers who want to stand out should accelerate the development of an integrated on- and offshore offering and client experience. In addition, the low interest rate environment no longer provides HNWI clients with low-risk high return on deposit linked products and sovereign bonds. Wealth Managers now have the chance to expand their investment offering unlocking potential new revenue sources.

The financial wealth of Latin America HNWIs has grown at consistently high rates over recent years. At 8% the 2017-18 headline growth rate in HNWI wealth in Latin America is comparable to APAC. But in contrast to APAC, where most markets flourished, growth in Latin America is unevenly distributed across countries, often as a result of political events.

In Brazil, the election of a right-wing government resulted in a rallying stock market, strengthening of the Real and a moderately improved economic confidence and outlook. In contrast, a new left-wing government in Mexico has seen volatile markets immediately following the election on the back of challenging economic confidence, with investors fearing a deteriorating business environment. These sentiments are reflected in the market indices. While Brazil's market index has increased by more than 10% since the election, Mexico's has stagnated. Such disparity is mirrored in the next tier LatAm economies, such as Chile, Argentina and Colombia.

Figure 27: Market Return Index, indexed to 2015



Source: Thomson Reuters, Oliver Wyman analysis

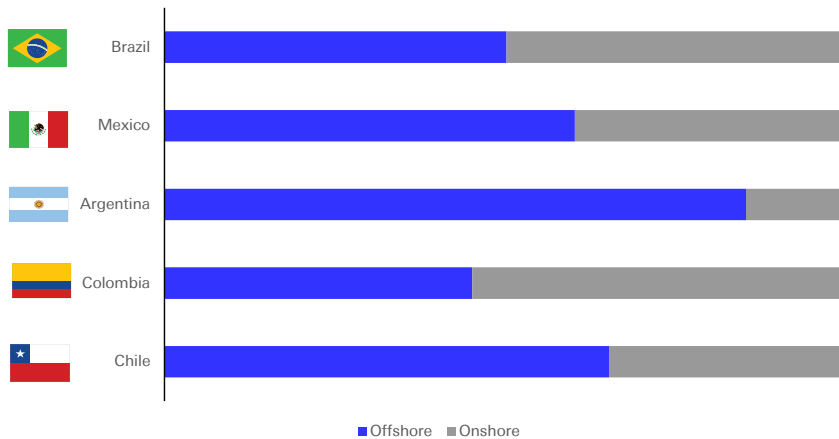
Latin America provides great growth prospects for Wealth Managers, but they need to think carefully about the best approach to serve HNWI clients within individual

markets. Considering that Brazil and Mexico account for more than 80% of total financial wealth across Latin America, these two markets should be of highest priority for Wealth Managers.

Integrated onshore / offshore offering

HNW clients in most Latin American countries invest large proportions of their total financial wealth offshore (up to 85%).

Figure 28: HNW wealth distribution across largest Latin American economies, 2018



Source : Oliver Wyman analysis

The Caribbean and Miami / New York have emerged as the most attractive offshore hubs for Latin American clients. Unlike Switzerland, which used to be primary hub for wealthy individuals from LatAm, Miami and the Caribbean are geographically close, have the same time zone and dozens of daily flight connections from Latin American capitals. With the increasing movement of wealthy individuals from Latin America to the US, particularly the younger generations, we expect the US to soon become the primary offshore location of choice. As an example, the percentage of US private schools' students coming from Latin America has increased over the last 20 years, from 8% to 11%.

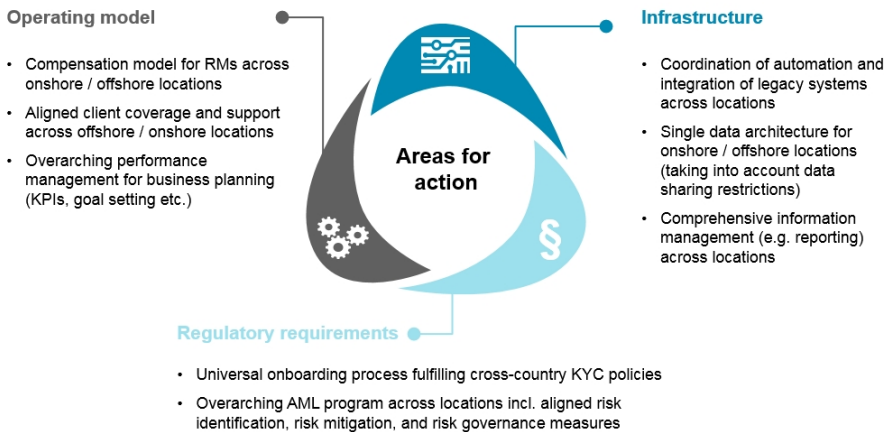
While many Wealth Managers serving the domestic markets have an offshore offering in one or more of these locations, most lack integration. Across the industry, we see a strong separation of Wealth Managers' onshore and offshore offerings, often negatively impacting client experience. Many clients cite, that their onshore and offshore relationship with the same bank often feels like banking with two different organisations. Hence today, clients often gain no benefit keeping their on- and offshore assets with the same Wealth Manager. While integration is not simple, given many regulatory and cross-border data sharing hurdles that need to be overcome, the rewards for those who manage to integrate the client experience can be significant and result into a real competitive edge.

In general, Wealth Managers will need to overcome three key areas of roadblocks: Operating model, infrastructure and regulatory requirements.

As part of an integrated Operating Model, Wealth Managers must design performance and reward systems for their Relationship Managers that allow them to make booking centre agnostic decisions for their clients without negatively impacting

their own performance assessment. On the infrastructure side, Wealth Managers must ensure that the client front end is integrated across locations, providing clients a single account view and functionality across their on- and offshore assets. This is particularly challenging considering different tax regulations and disclosure requirements across locations. On the regulatory side, Wealth Managers should strive for a unified onboarding process that allows for a simple cross-border onboarding without onerous re-papering requirements.

Figure 29: Integrated onshore / offshore experience – areas for action (not exhaustive)



Source : Oliver Wyman analysis

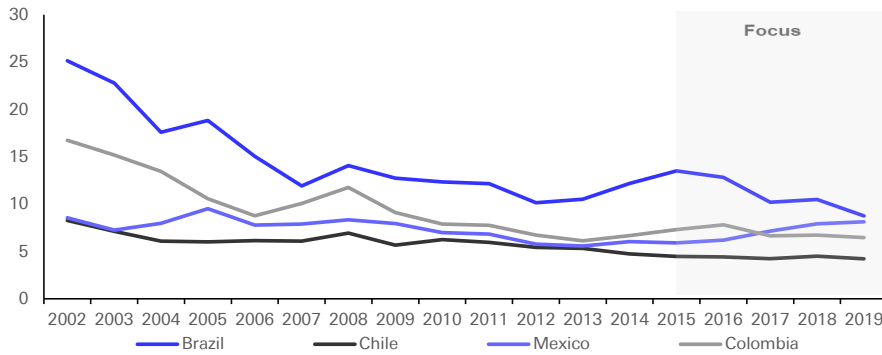
Due to the importance of US offshore locations to LatAm clients and increasing US resident ties of the next generation, those banks that can add US onshore Wealth Management to the mix will have an additional edge over competition.

Education of clients to take risks

Given the low interest rate environment across LatAm at the moment, this provides a great opportunity for Wealth Managers to transition their clients from low-risk products, such as deposit linked investments, to more sophisticated products as low-risk products are now no longer providing attractive returns.

To stimulate economic activity, Brazil's central bank has repeatedly lowered interest rates over recent years, with large effects on returns of multiple asset classes, such as sovereign bonds. HNW clients, who were used to achieving double-digit returns on investments guaranteed by the government must now invest in different products to maintain the high returns to which they have become accustomed. This is an inflection point for Wealth Managers, who can now provide more sophisticated services, such as financial planning and a much wider range of investments products to their clients. In order to benefit from this change in macro environment, HNW clients will need to be educated about broader investment offerings if they are to be convinced to reallocate their wealth. Wealth Managers need to support their clients along this journey.

Figure 30: 10Y Government Bond Yield, 2002-2019



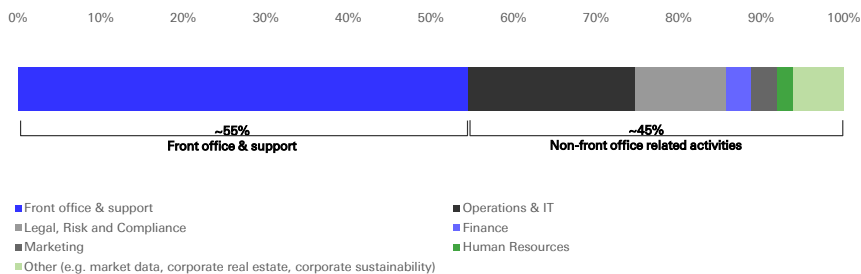
Source : Oliver Wyman analysis

We expect political and economic uncertainty to remain a key theme in Latin America, with persistent effects on the Wealth Management sector in the individual markets. Changing macroeconomics will require HNW clients, especially in Brazil, to become less risk-averse and to diversify across a greater number of investments. Only Wealth Managers that can lead HNW clients on this journey, teaching them how to take risks, will profit from this structural change of local investment behaviour.

3. Wealth Managers must use last reprieve to simplify their operating model for an eventual downturn

The Q1 2019 market rebound has given Wealth Managers what we think may be a last chance to simplify their operating models and adjust their cost base while improving advisor productivity before an eventual downturn. Cutting discretionary spending, delaying investments, and trimming operating costs (e.g. market data and index costs or reduction of research budgets) will not suffice – more substantial action is required.

Figure 31: Cost breakdown by function, indicative (% of total costs)



Source : Oliver Wyman analysis

To increase efficiency of the front office, which accounts for more than 50% of costs, Wealth Managers must free up Relationship Manager capacity for revenue-generating activities by automating and digitising processes. In working with industry leaders, we have proven a number of high impact use cases, which can be implemented across the industry more broadly.

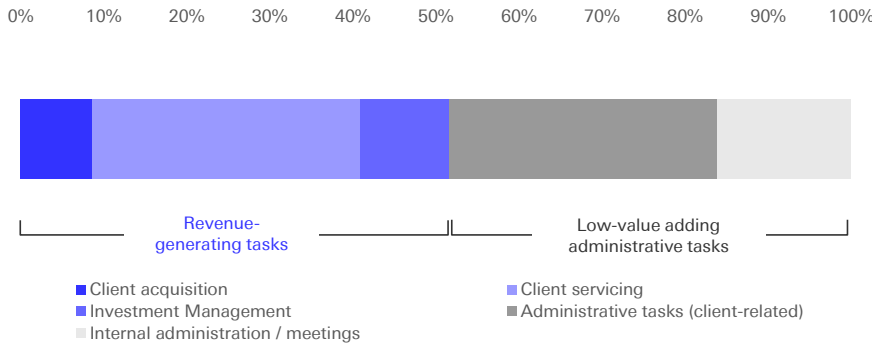
In the back office, allocated costs remain stubbornly high for Wealth Managers that are part of a broader group. Many levers to reduce allocated costs remain in the power of the group centre, but Wealth Managers can take action to lower the consumption of group services to ultimately decrease cost allocations.

Utilise proven efficiency levers to reduce the >50% of RM time allocated to low-value-adding administrative activities

Today, average RMs still spend ~50% of their time on low-value adding administrative activities. Improving the time allocations of RMs can have a significant impact on their performance and holds material potential. Across the industry, we observe that often only 20% of Relationship Managers are responsible for 80% of NNM generation.. Past strategies of replacing low performing Relationship Managers with external hires with the promise of moving their books often proved unsuccessful. The total costs of replacing a Relationship Manager quickly add up to six figures and integrating new hires frequently fails. Following the prominent 2017 exits from the protocol for broker recruiting, this approach is even less attractive in the US. Instead, Wealth Managers need to make their current front-office operations more

efficient, freeing up RM time for client facing activities.

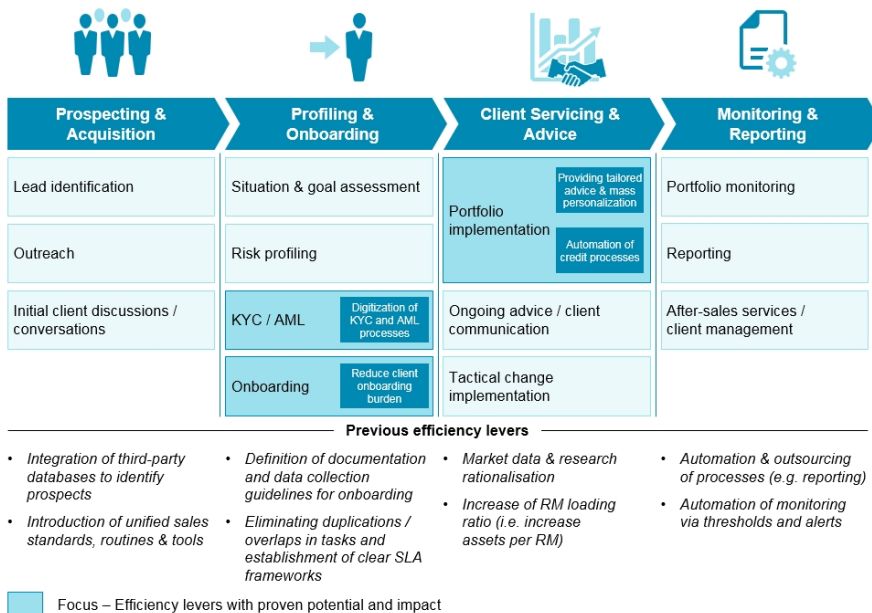
Figure 32: Activity profile of a Relationship Manager, indicative (in %)



Source : Oliver Wyman analysis

RMs currently spend about half of their time on non-revenue generating tasks, such as compliance or managing onboarding processes. Administrative processes owned by RMs need to be made more efficient to free up their time for revenue generating activities.

Figure 33: Opportunities for efficiency increases along the client journey



Source : Oliver Wyman analysis

In working with industry leaders, we have identified and implemented measures to improve efficiency along the client journey. A few levers, formerly considered theoretical or experimental ideas, have over the last 12-18 months emerged as effective tools with high impact and a proven business case. These should be implemented more broadly across the industry, complementing previous efficiency levers that have already been recently implemented by many players.

Profiling & Onboarding Digitization of KYC and AML processes

Following a significant increase in risk & compliance resources over the past years, driven by tighter regulation and remediation needs, Wealth Managers now have the opportunity to realise first and second line efficiencies while maintaining and improving quality. Rapid changes in regulation over recent years required Wealth Managers to quickly build up their KYC and AML compliance processes. As regulatory and market expectations are now stabilising, Wealth Managers can simplify these complex and resource intense processes to free up resources front-to-back, including RM time, whilst improving customer experience and overall robustness.

Know Your Customer (KYC)

KYC processes (such as collecting and reviewing basic reference data, background information, etc) need to be upgraded in light of greater external data availability and ready third-party solutions. RMs (and compliance officers) need to draw on an array of external databases to compile client data, rather than relying on time-consuming manual information collection and reconciliation. Leading providers compile information on several hundred million individuals globally.

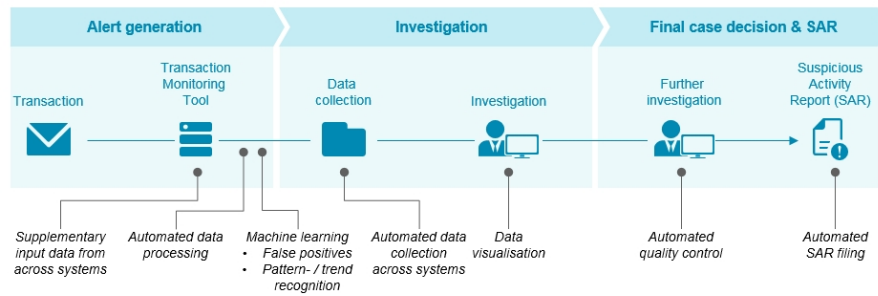
Oliver Wyman's access to the FinTech community suggests that by incorporating advanced information aggregation and analytics tools offered by third party providers or built in-house (building on advances made by firms like leading technology firms), sourcing and reconciling data from hundreds of data bases, Wealth Managers can access and process client data in unprecedented ways, whilst ensuring regulatory compliance in terms of data protection. This has the potential to fundamentally transform how the industry is conducting KYC.

With less resources, a more comprehensive KYC check is performed, whilst also enhancing the customer experience. This also offers substantial benefits for periodic client reviews, as these can now be largely automated and conducted on an ongoing basis. Automated alerts highlight relevant cases to RMs for investigation and follow up.

Anti Money Laundering (AML) – Transaction monitoring

Monitoring transactions – for example, due to suspicions of tax evasion or dealings with embargoed countries – currently is a resource-heavy process for Wealth Managers. Whilst transaction monitoring tools (TMT) are screening and flagging transactions, following up on alerts is still a highly manual process for RMs, support resources and compliance officers. The algorithms used by the tools are often crude, creating a high number of false alerts. AML represents another short-term area for improving efficiency and effectiveness in the short-term based on enhanced use of data, analytics, and technology.

Figure 34: Optimisation levers along the transaction monitoring value chain



Source : Oliver Wyman analysis

At the time of alert generation, data aggregation can be used to enhance transaction data ahead of the analysis, for example by providing supplementary information on the transaction. Automated data processing groups multiple alerts on the same transaction into one case, reducing duplicative work downstream.

Before launching a time-consuming investigation, statistical and machine learning techniques can be applied to identify potential false positives based on experience and suggest the closure of such cases. Over time, robust patterns can be incorporated directly into the algorithms and filters of the transaction monitoring tools, improving the power of prediction both on the positive and negative side. Advanced analytics can also help to identify trends in alerts, informing employees about the newest developments and helping to continuously improve the transaction monitoring process. The previously resource intense process of manually collecting relevant documents across systems can be replaced by automated data collection through robotic process automation (RPA), that accesses the various systems and tools via Application Programming Interfaces (APIs). This automates the search for transaction histories and client information across systems and data formats. Data visualisation, replacing the traditional system of rigorously structured databases, can make data more intuitively accessible to employees.

During final decision making, automated quality controls help to maintain high, uniform standards. Initially only checking for completeness, the system's capabilities can be extended to actual quality checks using machine learning. Automated filing of suspicious activity reports (SARs) and triggering of the subsequent internal reporting facilitate timely recording and reactions.



Beyond improving the predictive power of the algorithm and facilitating resource intense and often dull tasks for the RM, these techniques introduce additional control – Manually reviewing a large number of mostly false alerts can lead to reduced attentiveness, potentially missing true alerts.

As such, we see transaction monitoring as another area enabling break-throughs in reforming the operating models of Wealth Managers.

Reduce client onboarding burden

RMs devote significant time to administrative tasks related to onboarding. Duplication of processes and a continued reliance on paper documents have prevented true progress across large parts of the industry so far. A number of challengers have shown that increased automation and digitisation of the onboarding process (beyond KYC), combined with holistic data management, is achievable and significantly increases client satisfaction.

Figure 35: Efficiency levers in client onboarding (not exhaustive)

	Description	Examples
Data management 	<ul style="list-style-type: none"> • Digital creation and transmission of data; employing digital customer interaction channels to capture data • Centralized data storage and management, connected via API • Cross-function sharing of information • ... 	<ul style="list-style-type: none"> • Digital Passport (unique client identifier) • Digital forms (eForms) and digital submission • Pre-filled forms, based in existing data • ...
Digitalisation & automation 	<ul style="list-style-type: none"> • Integration of digital customer interaction channels • Workstreams shared across functions, enabling one uniform view on status, open steps etc. • AI-enhanced customer interface • ... 	<ul style="list-style-type: none"> • Instant Messaging & Video Conferencing (omnichannel communication) • Video authentication • E-signatures • Real-time status updates • Digital document exchange • ...

Source : Oliver Wyman analysis

Centralised and consolidated data storage eliminates a duplication of tasks and allows information to be shared across functions. Increased digitisation and automation of processes reduces manual work, provides a uniform view of workflows and data, and simplifies client interaction with fewer touchpoints. Centralised data management also enables more sophisticated data analytics to identify revenue opportunities and the digitisation of client servicing activities, for which the lack of a uniform data architecture remains a key hurdle (see last year’s report “Dare to be different”).

Various third-party providers readily offer such digital, integrated onboarding solutions via API plug-in. Alternatively, Wealth Managers can drive in-house development of these capabilities.

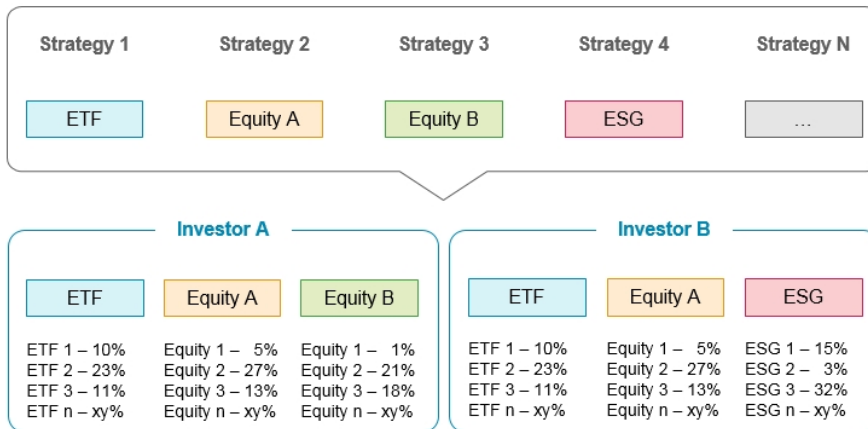
However, Wealth Managers should be careful not to rush into digitising their onboarding process without defining their target architecture. Patching together a series of mismatching or overlapping technologies will create frustration for clients and RMs alike. The key to a truly efficient onboarding process will be the careful creation of a digitally supported, easy to navigate technology suite with a centralised, shared client database at its heart.

Client Servicing & Advice Providing tailored advice and mass personalisation

Wealth Managers must better align their offering to the varied needs of their client base. Not all clients require or justify the cost-intensive, high-touch “white glove” service model still employed across most of the industry today. While differentiating RM service levels has been in focus of change initiatives in the recent past, embedding different service levels and greater automation in the investment engine is still a largely underutilised efficiency lever.

The vast majority of leading Wealth Managers maintain entry thresholds for discretionary portfolios below USD 5 MM. Wealth Managers aiming to reduce costs in the front office must ensure that comparably low AuM HNW clients with assets below USD 5 MM are served at a lower cost point without compromising on quality.

Figure 36: Industrialized module-based client service model



Source : Oliver Wyman analysis

Wealth Managers should look to the Asset Management industry when developing an industrialised but “mass personalised” model that allows for “customised” portfolio implementation while keeping costs at a minimum. This is time critical for Wealth Managers as some Asset Managers are starting to push into the B2C market with similar “mass personalised” offers. To avoid losing clients, Wealth Managers must close this gap.

In this industrialised offering, Wealth Managers create standardised, basic mandate offerings that are matched to clients based on their risk profile. Base offerings can subsequently be “mass personalised” with a handful of standardised opt-in modules. These allow a degree of customisation from the client perspective on top of largely uniform underlying investment processes. Mandates of the same type are managed collectively and back office activities, such as risk management and reporting, can be standardised.

A more industrialised mandate offering should benefit clients and reduce conduct risk by standardising outcomes across portfolios. In the current world of regularly individualised mandates, clients with similar risk profiles will often see divergent outcomes. Mass personalisation eliminates this to a large degree, ensuring clients with similar risk capacity and investment horizons can expect the same outcomes.

Automation of credit processes

Lending will remain a key income growth lever for Wealth Managers. At the same time, lending – particularly Lombard lending – is well suited to front-to-back automation. FTE costs can be reduced by 10-40% through reduced manual intervention based on our experience, depending on the starting point.

Efficiencies in the credit process can be realised along the entire credit value chain. For example, automated pricing and profitability tools can support credit origination and structuring. Data capture tools and automated fraud detection materially shorten the time required to create credit applications. Review- and decision making times can be significantly reduced, for example through automated haircut calculations and automated (pre)approvals for plain vanilla requests.

Real-time monitoring tools and automated margin calls increase efficiencies in ongoing credit monitoring. This also improves credit risk management, especially for Lombard lending based on liquid collateral.

Figure 37: Automation potential along the credit value chain (not exhaustive)

	Activity with automatization potential	Sample automatization tools
Origination and structuring	<ul style="list-style-type: none"> • Pricing & Limit offering 	<ul style="list-style-type: none"> • Automated pricing & profitability tool
Application	<ul style="list-style-type: none"> • Data gathering • Data review 	<ul style="list-style-type: none"> • Data aggregation tools / data capture • Automated fraud detection
Review	<ul style="list-style-type: none"> • Collateral evaluation • Lending value estimation • Automated pre-approval 	<ul style="list-style-type: none"> • Automated haircut calculations • Automated pre-approval based on shadow limits
Decision/ approval	<ul style="list-style-type: none"> • Review of lending value • Decision making 	<ul style="list-style-type: none"> • Auto-approvals • Automated client offers
Administration	<ul style="list-style-type: none"> • Documentation • Booking • Client confirmation 	<ul style="list-style-type: none"> • Automated connection from application to admin system • Automated data validation and data quality checks
Monitoring/ reporting	<ul style="list-style-type: none"> • Exposure/Collateral/Limit monitoring • Margin/ warning calls 	<ul style="list-style-type: none"> • Automated real-time monitoring • Automation of margin calls

Source : Oliver Wyman analysis

Beyond RM efficiencies, a simplified credit application process also generates volume growth by reducing abandon rates. Digital application processes and end-to-end standardisation of the credit process reduce the time it takes to apply to minutes, and auto-approvals for plain vanilla requests can be provided in seconds.

Cross-provider client data aggregation allows to unlock new revenue opportunities

First use cases show that similar concepts to Open Banking in the UK (which is now followed by Open Pensions) that allows for the aggregation of client positions across providers can also work in a Wealth Management context. While providers are naturally reluctant to support this trend to take a hold in the industry, first applications in particular in APAC show the great benefits to Wealth Managers with access to consolidated client information and their clients alike.

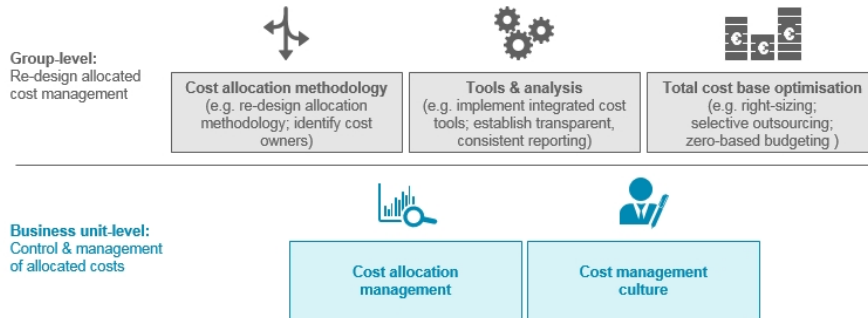
Data aggregation of client accounts across institutions (“cross-banking provider transparency”) can provide Wealth Managers with in-depth knowledge of their clients’ overall holdings. This allows them to better tailor their offering to their client’s needs, improving asset allocation and outcomes for the client. Wealth Managers having this access can outcompete other providers, positioning themselves as a superior provider to their clients and increase their share of wallet.

Data processing still poses a challenge. Sharing data between providers in a mutually reconcilable, real-time format that is easy to process requires a robust data architecture on all sides, cross-provider coordination and advanced data processing capabilities. A number of third-party providers have already produced workable solutions to overcome this challenge already though and we see this as only a starting point to much broader developments going forward.

Wealth Managers must review group service consumption to help lower allocated costs

Allocated costs make up a significant share of Wealth Managers' costs. They account in some case for more than 50% and can be considered as "holy grail" of cost management.

Figure 38: Management of allocated costs on group- and business unit level



Source : Oliver Wyman analysis

Cost allocation methodologies are decided at the group level and are thus beyond the direct control of business units. Similarly, the day-to-day and strategic management and optimisation of these costs are group functions. The implementation of integrated, robust cost tools at group level, transparent reporting, and central data availability requires group-wide initiatives. Working with what is given to them, business units, including Wealth Managers, must act within their sphere of control to reduce the amount of cost allocated to them. They must focus on understanding and steering cost allocations and embedding a culture of cost management.

Cost allocation management

Cost allocation mechanisms are often so opaque that business unit management cannot anticipate their allocation with accuracy. Management sometimes feel that the allocation introduces an arbitrary element to the measurement of their performance, driven by political considerations rather than true financial contribution. Some frustration about cost allocation may be inevitable in large organisations with many different units making use of shared resources. But business unit managers can gain an element of control over their cost allocations.

The first step is to understand the cost allocation mechanisms and the underlying drivers. For example, automation and digitisation of the AML / transaction monitoring value chain standardises processes in alert generation and investigation. This creates a more uniform, higher quality information base for final case decision in the compliance department, reducing workload and thus eventually allocated costs. Another example is increased efficiency in the onboarding process. Digitisation of data collection and centralisation of data management during onboarding facilitates the transmission of data between departments and simplifies onboarding-related activities in the back office with easy data availability (internal account creation, billing, etc).

More generally, elasticity of allocated cost is a key metric to understand when trying to reduce the cost allocated to the Wealth Management business unit. Initiating a dialogue with other cost owners across the group can facilitate this understanding. By identifying the drivers of processes that are heavy in allocated costs and optimising the drivers appropriately, Wealth Management units can reduce their share in allocated costs.

Cost management culture

After understanding the cost allocation mechanism and their own influence on it, Wealth Management units must establish a culture of ongoing cost management: front-to-back dialogue, continuous challenge, and robust cost management. Wealth Managers need to move from the common governance model in which no one owns the allocated costs, where they just happen to the unit. Instead, allocated costs must have named owners who are responsible for understanding them front-to-back, negotiating them, and taking action to reduce the allocation.

This includes treating shared service divisions like a third-party supplier at arms-length. If they cannot provide the same value-for-money as an external provider, business units should look externally for alternatives. This may, for example, be applicable for processes such as transaction processing, payments and billing, as well as reporting. While this leads to stranded costs for the group in the short-term, it is the only way to discipline internal suppliers and, ultimately, to increase the efficiency of the overall group.

Reducing costs and not merely reallocating them will require real collaboration across the business and corporate centres. In our cost work, we found that “studio design” sessions can make a real difference.



Appendix 1

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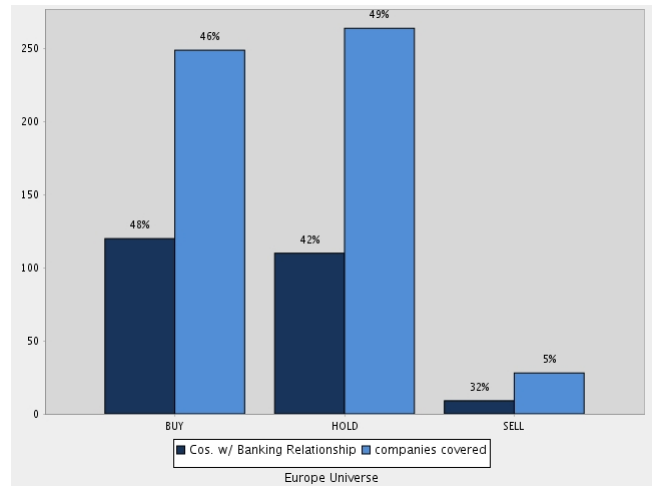
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