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McKinsey Banking Practice

McKinsey Global Wealth Management Survey 2014

An attractive sector in transition

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Introduction and main themes

Wealth managers worldwide are considered to be among the most attractive business segments in the financial services industry.

The industry has consistently produced above-GDP revenue growth, attractive profitability with low capital requirements, and ample liquidity. In 2013, global asset pool growth was 11 percent, with market performance accounting for 8 percent and profitability converged around 20 to 25 basis points (bp) for most markets, representing a significant increase for Asia and India. Strong equity market performance, particularly in the US, helped many players in 2013. But regional differences in the wealth management sector are considerable and even within certain regions there is further variation by business model.[1], [2] Despite the specific market dynamics of each region, a set of global themes for wealth managers do prevail across geographies and different business models:

- **Profitability is converging globally.** Revenue margin is converging around 80 bp in all regions except the Middle East (110 bp), which still benefits from very high margins on deposits. Cost margin in Asia is at the same level as mature markets (about 60 bp), while Latin America and the Middle East still operate with significantly lower cost margins (about 40 bp) owing to the lower cost of back-office, IT, and support staff. As a result, profitability is converging around 20 to 25 bp (of assets) in almost every region. This earnings potential and the liquidity profile of the business makes wealth management attractive to new competitors.

- **Digitization is a game changer for wealth management.** Digitization amounts to a fundamental transformation of how advisors and clients interact; reducing the costs of the traditional multichannel models, adding value to clients in different ways (such as through investor communities), and enabling radically new ways to cater to more self-directed clients and guidance seekers. Currently about 70 percent of private banks support online transactional services, but only one in five (20 percent) offer online wealth planning solutions. We expect these numbers to rise considerably as incumbents roll out their digital offerings and attackers build or partner to overcome brand, reputation, or investment management competence gaps.

- **Sharpen the value add to avoid outflows.** There is an increasing need for wealth managers to clearly demonstrate how they add value. While wealth managers still gain share in the total HNW pool in emerging markets, this is no longer the case in developed markets, such as Europe or the US, where players only managed 1 to 2 percent net new flows on beginning assets in 2013. Fierce competition and more transparent product offers (particularly on prices) have empowered customers to compare offers from different firms. With an increasing number of new models, in particular targeting the self-directed segments, net inflows will remain under severe pressure. The subdued net inflows reflect deposits going to the retail units of

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1 Wealth management is defined as a relationship between an advisor and an individual or household. Wealth managers are broadly defined as financial institutions serving individuals with at least USD or EUR 1 million (EUR is calculated at USD 1.33) personal financial assets. Private banks (most players in Europe and some in the US) typically offer banking, investment, lending, and other financial services, while other wealth managers (mostly in the US) have a variety of different business models from the traditional investment-oriented firms to some credit-oriented private banks.

2 Many differences in the minimum wealth threshold exist. In the US, for example, many players also serve households with less than USD 1 million, while in Western Europe some private banks begin offering service to households with EUR 200,000 (USD 260,000). However, the services offered to these households differ considerably from what may be provided to wealthier clients.

universal banks, investments flowing to online platforms with transparent and low fee products (such as exchange traded funds) and continued investment in tangible assets, notably real estate.

- **Need to achieve scale through growth, outsourcing, or M&A.** With regulation and technological change pushing up costs and competition rising due to the intrinsic attractiveness of wealth management, the need for scale is clear. In the US, the decade-long consolidation trend is continuing. In other regions, notably Western Europe, consolidation is accelerating especially offshore. In Western Europe, banks with AUM of EUR 10 to 30 billion (USD 13.3 to 40 billion) face a 20 percent cost disadvantage compared to banks with over EUR 30 billion. This reaches 90 percent for banks with AUM below EUR 5 billion. Consequently, an increasing number of private banks are outsourcing operations and, in some cases, their entire IT infrastructure to shared international hubs or to external suppliers. Yet since outsourcing of IT and the back office offers only a 20 percent cost saving in these areas, it is important to get critical scale in the frontline in order to maximize access to product specialists and cross-selling opportunities. However, in emerging markets, the need for scale is less acute since most banks have a simple value proposition with a limited number of specialists and a basic investment offering. Often, they use retail bank infrastructure for IT and the back office as well as for some investment management functions.

- **Offshore banks must change.** Many players are opting to pull out of offshore services, leaving opportunities for those who recommit and invest. Offshore banks must act on tax evasion and compliance, but use a flexible service delivery model to keep options open. To handle growing complexity, wealth managers must be more selective regarding the location and client coverage offered by their booking centers, while investing in upgrading the skills of relationship managers (RMs) and product specialists. Finally, private banks that can make onshore and offshore work in harmony can boost inflows and profits. As the long-term business prospects are unclear, offshore private banks need to keep RMs engaged with clients on the ground and serve them outside of their domiciles.

Global wealth: growth slows amid rebalancing

- Despite slower global economic growth, the number of millionaires is expected to rise by 7.1 percent by 2018 to more than 18 million.
- By 2018, total HNW assets are expected to rise by 49 percent to USD 76 trillion. We expect Asia (excluding Japan) to create about USD 9 trillion in net new millionaire wealth.[1]
- Major shifts in HNW country ranking show China, India, and Saudi Arabia moving up the league table.
- Offshore wealth has stabilized at around USD 13 trillion with emerging market wealth compensating for a decline in offshore wealth from traditional Western European markets.
- Emerging markets are more skewed towards UHNW clients, enjoy higher asset growth, and have a larger offshore share than developed markets.

Millionaires prosper. Over the past five years, millionaire wealth has grown by 8.7 percent annually to around USD 51 trillion at the end of 2013. By 2018, we project that more than 18 million millionaires will control about USD 76 trillion in personal financial assets – 49 percent above current levels and more than double the postcrisis trough. Future growth will be particularly fueled by the UHNW clients with over USD 30 million. By 2018, we expect that emerging markets will represent roughly 42 percent of global millionaire wealth (Exhibit 1).

EXHIBIT 1

Emerging markets will represent 42% of global millionaire wealth[1] in 2018

Percent

	Share 2008	Growth 2008-13E, CAGR[2]	Growth 2013E-18F, CAGR[2]	Share 2018F
North America	32	10.8	7.1	33
Western Europe	26	2.8	4.0	16
Japan	13	4.3	4.8	9
Developed markets	**71**	**6.9**	**5.8**	**58**
Asia-Pacific (*excl. Japan*)	12	16.3	15.1	23
Middle East and Africa	9	10.4	9.5	11
Latin America	5	8.1	8.1	5
Central and Eastern Europe	3	10.2	8.1	3
Emerging markets	**29**	**12.7**	**12.1**	**42**
Global	***100***	***8.7***	***8.2***	***100***

1 Personal Financial Assets (PFA) of High Net Worth individuals (HNW) – on- and offshore excl. life insurance and pensions
2 Compound annual growth rate (CAGR) calculated in local currencies and therefore excl. currency impact
SOURCE: McKinsey Global Wealth Pools 2014

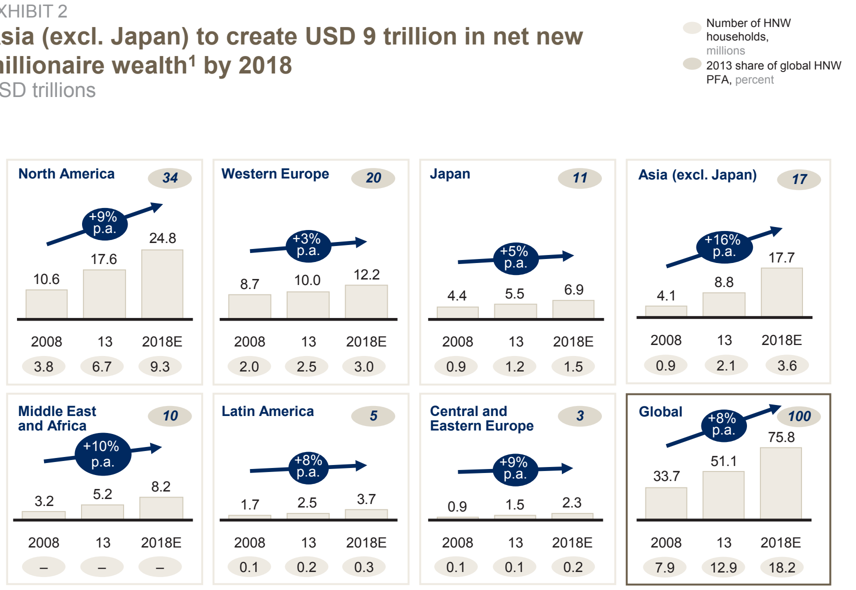
1 HNWI is defined as onshore liquid PFA (excluding life insurance, pension, and real estate) and offshore PFA held by households with more than USD 1 million.

Asia dominates wealth pool growth, but access to international players is limited. Over the next five years we expect Asia (excluding Japan) to create about USD 9 trillion in net new millionaire wealth, which is about 80 percent of the wealth created by the US, Europe, and Japan combined (Exhibit 2). China, India, South Korea, and Taiwan are the leading wealth generators in Asia. Despite the attractive market potential, international private banks with a traditional offshore focus struggle to significantly raise market share, as roughly three-quarters of the Asian wealth is generated onshore (something we expect to rise) and onshore markets are still dominated by local banks.

EXHIBIT 2

Asia (excl. Japan) to create USD 9 trillion in net new millionaire wealth[1] by 2018

USD trillions



1 HNW PFA (on- and offshore, excl. life insurance and pension) and converted using fixed EOY FX rate for USD against local currencies

SOURCE: McKinsey Global Wealth Pools 2014

HNW country rankings. In 2008, six Western European countries ranked among the top 12 HNW markets worldwide (Exhibit 3). In 2017, China is expected to overtake Japan in the global ranking and become the second-largest HNW market, trailing only the US. Furthermore, we expect Brazil and India (11th and 14th today) to move into the top 10 by 2018 with Saudi Arabia (currently ninth) also moving up the table. However, we expect Russia and Mexico to remain further down the table, but inside the top 20 HNW markets.

EXHIBIT 3

High Net Worth Pools: rankings by country 2008 – 2018

2008	2013	2018
US	US	US
Japan	Japan	China
Germany	China	Japan
UK	UK	UK
Italy	Germany	Germany
China	Canada	Canada
Canada	Italy	Italy
France	France	India
Switzerland	Saudi Arabia	Saudi Arabia
Brazil	**Switzerland**	Brazil
Spain	Brazil	France
Mexico	Russia	**Switzerland**
Hong Kong	HongKong	Russia
Saudi Arabia	India	HongKong
Russia	Mexico	Mexico
Belgium	Taiwan	Taiwan
Taiwan	UAE	UAE
UAE	Spain	Indonesia
Netherlands	Singapore	Singapore
Singapore	Belgium	Qatar

SOURCE: McKinsey Global Wealth Pools 2014

Western Europe: steady economics mask a fundamental transition

- AUM grew by 5 percent, primarily driven by equity market performance with modest net inflows of 2 percent.
- Industry profitability improved by 2 bp in 2013 to 25 bp, through a combination of flat revenue margins and tighter management of costs.
- European offshore economics were affected by affluent clients repatriating AUM with a 2 percent outflow from Luxembourg and a limited 1 percent inflow from Switzerland.
- Customers with less than EUR 1 million now account for only 13 percent of assets in offshore private banks (vs. 21 percent five years ago).
- European onshore boutiques with 3 percent net inflow keep pace with universal banks, but international entrants average just 1 percent net inflow and have lower average profitability of 10 bp.
- Minimum scale increasing to EUR 10 billion per booking center from EUR 5 billion, encouraging a new wave of outsourcing and consolidation.

These apparently steady economics mask a more fundamental transformation on multiple fronts triggered by tighter cross-border and customer protection regulation, emerging digital innovation, and lingering lack of trust among HNW clients following the financial crisis. These trends are triggering significant shifts in the economics, especially for small booking centers below EUR 10 billion and offshore players with high affluent or tax-driven client exposure. This is accompanying changes in the advisory proposition as well as in the pricing and operating models, both onshore and offshore.

Wealth manager economics in the region: marginal profit improvements in a low-growth environment

Private bank assets grew by 5 percent (Exhibit 4), driven by a 2 percent net inflow and a 3 percent performance effect (interest, foreign-exchange, and capital-market gains). Clearly, net inflows have not rebounded to precrisis levels. The 2 percent net inflow is in line with the five-year average of 1.9 percent but significantly below the 6 to 8 percent prior to 2008.

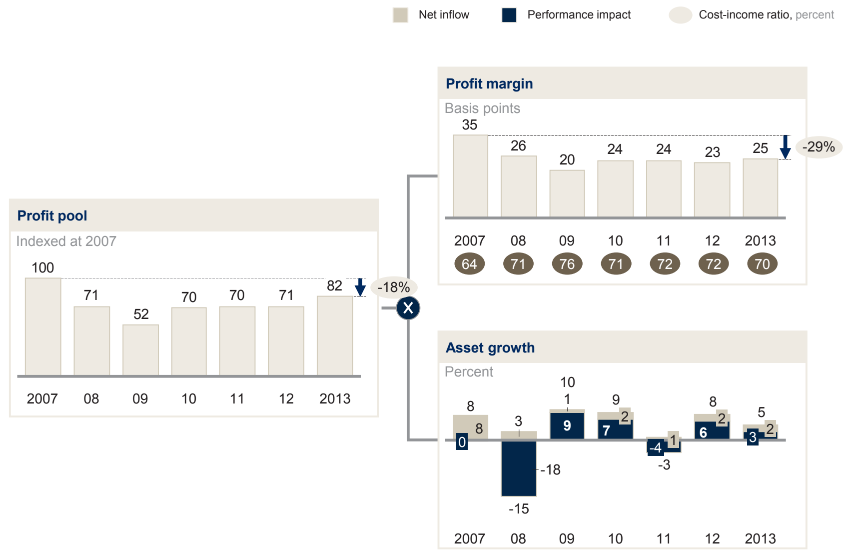
There are still significant differences between top-quartile banks, which captured a 12 percent net inflow while bottom-quartile ones faced an outflow of 7 percent, showing clearly that market share is on the move. The same pattern is repeated in each market. In Switzerland, for example, the average net inflow was 1 percent; yet, top-quartile private banks achieved an 8 percent net inflow while bottom-quartile peers saw a 10 percent outflow.

Profitability reached 25 bp in 2013 (Exhibit 5), its highest level since 2008, and well ahead of the low in 2009 of 20 bp. In 2013, top-quartile banks recorded a 49 bp profit margin while bottom-quartile ones operated at a loss of 2 bp.

Average cost margin is down 2 bp to 57 bp in 2013, falling below the 2004 level. The reduction came from a 0.3 percent decrease in the staff base and a 1 percentage point fall in the RM payout ratio to 13 percent, leading to a 1 bp drop in the sales and marketing

EXHIBIT 4

Western Europe: Assets up, but profit margin lags pre-crisis levels



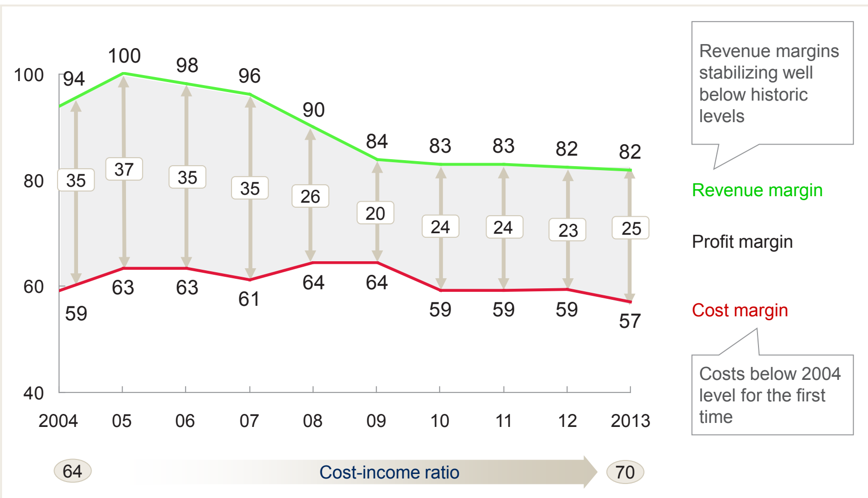
SOURCE: McKinsey Wealth Management Survey 2014

cost margin. Back-office, IT, and overhead costs also fell 1 bp. However, the absolute cost base increased by 3 percent. The aggregate figures hide the substantial differences between players, with less than half of banks (47 percent) actually cutting costs. In fact, one bank in seven remained loss making in 2013 (unchanged over the past two years)

EXHIBIT 5

Western Europe: Fall in cost margin drives partial rebound in profit margin

Basis points



SOURCE: McKinsey Wealth Management Survey 2014 while around one in three recorded outflows. Against this backdrop, we expect merger and acquisition activity to continue.

So far, cost reduction has focused more on support and back-office optimization. Banks with international footprints have tried to further streamline operations by centralizing functions. We see substantial potential to cut costs further through outsourcing, international sharing of IT and operations, full end-to-end optimization and digitization of operational and selected servicing processes, and legal-entity consolidation. Only 5 percent of our sample in this report have outsourced their back-office operations, but we expect this number to expand substantially in the coming years.

Revenue margin stayed stable in 2013 at 82 bp compared to 2012. The 1 percentage point increase in discretionary mandates to 23 percent and the 1 percentage point gain to 26 percent in the share of equities to total assets was offset by further pressure on deposit margin, which fell 4 bp to 43 bp in 2013.

Revenue margin stayed stable in 2013 at 82 bp compared to 2012

The likelihood of returning to a precrisis revenue margin of 96 bp is remote given the reduction in interest margins (6 bp), more conservative asset allocation (5 bp), and reduced portfolio activity (3 bp). In addition, the full rollout of MIFID and other national regulations, though not completely clear, will likely have a negative effect on revenue margins. We believe private banks must reinvent their advisory product offer and that pricing will need to become much more transparent.

The net effect will of course depend on the ultimate scope of these regulations and could easily be more than compensated for by slight increases in interest spreads or portfolio activity.

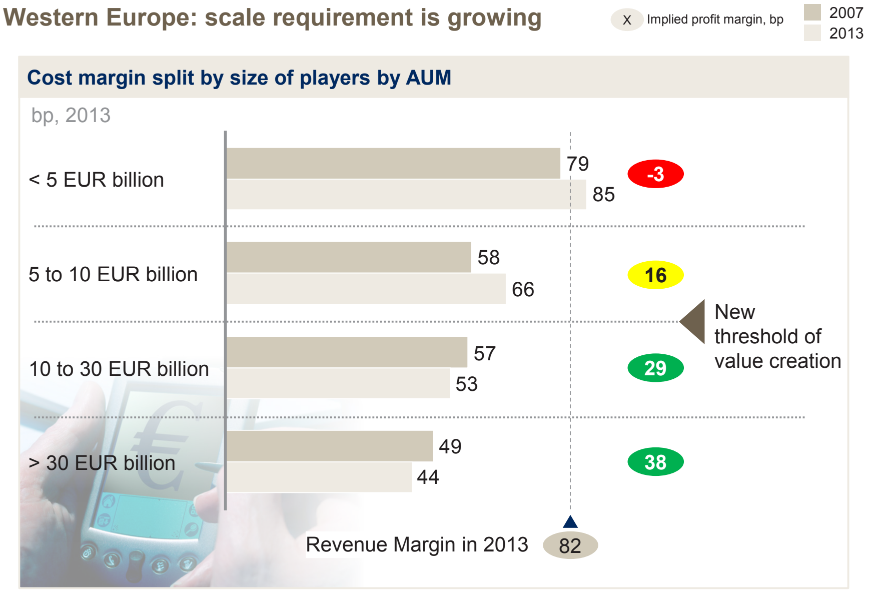
Regional trends: digitization to accelerate need for scale

We continue to see significant differences in growth and profitability among onshore boutiques, onshore universal banks, and foreign onshore players. Onshore boutiques captured the highest net inflow (3 percent) owing to, among other things, investors' perception of their greater independence. They also had the best investment performance (6 percent) due to their higher exposure to equities. Onshore universal banks still have the most attractive profit margin (36 bp), up 3 bp through cost containment. However, foreign onshore players continued to struggle in 2013, reporting inflows of just 1 percent and a lower profit margin (10 bp).

Meanwhile, the pressure is building on smaller integrated players. In the past, wealth managers with AUM of EUR 10 to 30 billion did not face a scale disadvantage on comparative costs with players having over EUR 30 billion. However, the cost of technology and regulation has changed this with the larger wealth managers (AUM over EUR 30 billion) for the first time recording much lower cost margins: 44 bp vs. 53 bp for their smaller peers (AUM of EUR 10 to 30 billion) (Exhibit 6). This is also reflected in the data showing that the size of an economically viable booking center is increasing to EUR 10 billion from EUR 5 billion.

EXHIBIT 6

Western Europe: scale requirement is growing



SOURCE: McKinsey Wealth Management Survey 2014

Consequently, many players are reviewing their geographical footprint, especially in very fragmented offshore markets. This is promoting M&A activity and operating model changes involving outsourcing and offshoring solutions.

Stricter cross-border and domestic regulation along with more competitive onshore markets has put pressure on offshore private banks (see Evolve or perish: offshore wealth managers in the spotlight, p. 37). In particular, recent agreements on double-taxation and tax information exchange have increased transparency and have begun shaping a new operating environment for offshore banks. In consequence, margin contraction among offshore private banks has fallen to 25 bp in 2013 (down from 36 bp in 2008), putting them in line with the profit margin earned by onshore players (25 bp). A rise in costs and flat net inflows to offshore banks meant that they trailed onshore banks that recorded 2 percent inflows.

In terms of client mix, an increasingly self-segmented customer base (execution-only clients still represent 60 percent of AUM) is becoming much better informed, and most private banks have no tailored proposition to this segment. Fee-based advisory clients (accounting for 17 percent of total private banking AUM in 2013) have made modest but increasing gains in the last four years by responding to client demand for a solution that lets them make the final investment decision. The revenue margin on advisory mandates is getting closer to discretionary mandate margins, but remains 11 bp less (93 bp vs. 104 bp in 2013). Yet our data show that over one in seven (15 percent) European private banks do not have an advisory offering.

Key implications for Western European wealth managers

Wealth managers in Western Europe must move quickly to reshape how they operate in a market characterized by increasing competition, regulatory change, and challenges of scale. The need for action on a number of fronts is clear.

- **Digitize or become marginal.** Though it may be late in the game compared to other consumer banking segments, wealth managers must offer digital alternatives for customer interactions and automate end-to-end processes. First, digitization is fast becoming the only way to profitably serve the growing segment of self-directed guidance seekers. Second, both advice seeking and delegating clients now demand full access to their wealth manager on an anywhere-anytime basis. Finally, applications like investment community tools and next-generation account aggregators are becoming important differentiators. Even if attackers are not currently grabbing market share due to weak branding or mediocre investment content, change is bound to happen rapidly. For this reason, it is crucial that incumbents act now to improve their digital offer.

- **Operating models must be overhauled.** For a bank with EUR 5 billion in assets, a fully stand-alone IT and operations setup is not sustainable. Tailored outsourcing solutions to private-banking IT and operational needs now exist in most geographies, so offshoring and international sharing of platforms should be more fully embraced. Even though many private banks have struggled to share functions across multiple locations, selected players have achieved impressive results on specific parts of the value chain.

- **Advisory and pricing models need to shift.** Pricing transparency is increasing quickly and customers are becoming much more critical of the value wealth managers are adding or failing to add. Consequently, wealth managers need to improve discretionary and advisory service, and adapt their pricing models. In the UK and the Netherlands, for example, first movers have used innovative pricing schemes and offers that are differentiated by segment.

- **Offshore footprint and model needs to be rethought.** Shifts in the client mix, service proposition, AUM growth potential, and cross-border access rules means that players need to reassess the viability of offshore booking centers. In particular, they need to focus on select target markets to manage risk and upgrade capabilities to serve more demanding UHNW clients with propositions beyond tax. They also need to rethink the role of the offshore booking center and what it contributes to a broader wealth management network.

North America: equity market buoys wealth manager profit pool

- Wealth manager client AUM grew 13 percent in 2013, mostly driven by market performance as net inflows contributed only 2.3 percent.
- US private banks and multifamily offices (MFOs) trailed brokers with AUM growth of 10 percent.
- Full-service brokerage firms boosted operating profit margins to 18 percent, returning to pre-2008 levels.
- Client loading figures (relationships per client facing professional) rose by 3 percent overall, reflecting increased productivity among full-service brokers.
- With private banks, client loading fell slightly, but AUM per private bank RM rose 11 percent.

American investors have benefitted from two consecutive years of impressive domestic equity market performance following gains in the S&P 500 Index of nearly 30 percent in 2013 and over 13 percent in 2012. Unsurprisingly, the growth rate of different wealth management service providers tended to reflect the degree to which their clients had US equity exposure. Moreover, some of the best performance came from firms that cater to the mass affluent, affluent, and lower HNW segments.[1]

The North American wealth management industry includes different types of wealth managers in addition to private banks. Wirehouses, independent broker dealers (IBDs), independent advisors, and MFOs all compete to capture clients in the HNW and UHNW segments. For the first time, the McKinsey Global Wealth Management Survey 2014 includes all types of full-service wealth managers representing USD 9 trillion in client assets or roughly 65 percent of North American advised wealth. In the survey, we segment the market results into three categories of wealth managers: private banks and trust companies, UHNW MFOs, and full-service brokers (including those with employee and agent advisors).

Wealth manager economics in the region: asset gains, cost control, and increased client loading boost profit

US wealth managers built on the strong momentum of 2012 with the profit pool rising 26 percent (Exhibit 7). Two factors drove the increase in profit: average client assets grew by 13 percent in 2013 and costs fell by 3 bp per USD advised. The revenue margin fell about 1 bp. Lower client facing headcounts helped to contain costs and highlight increased advisor productivity for a second consecutive year. Brokers, in particular, showed higher load factors with the average number of clients handled per advisor increasing to 184 in 2013 (from 179).

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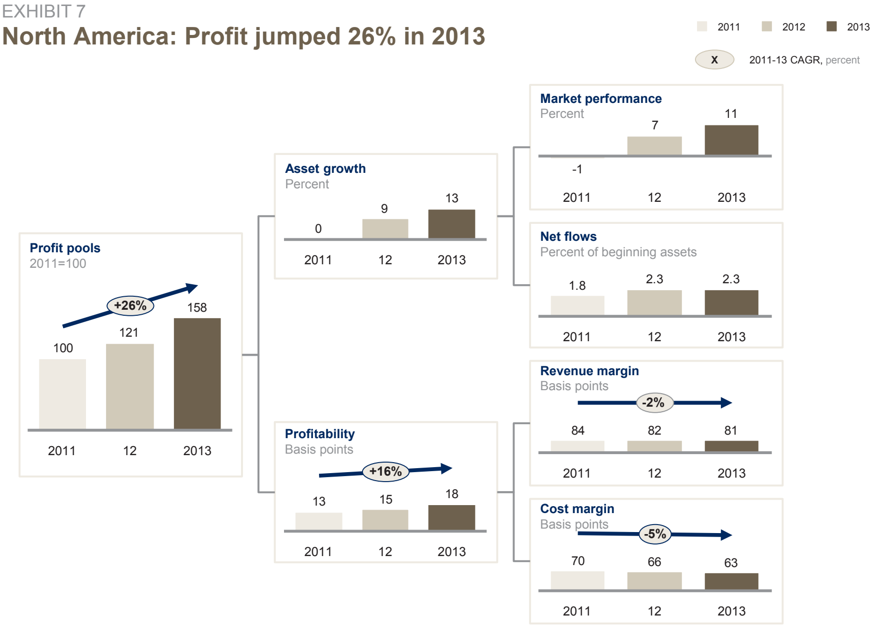
1 The definition of different groups of wealth management clients is based on the following household financial asset thresholds – mass market: USD 50,000 to 200,000; mass affluent: USD 200,000 to 1 million; affluent USD 1 to 5 million; HNW: USD 5 to 30 million; and UHNW over USD 30 million.

EXHIBIT 7

North America: Profit jumped 26% in 2013

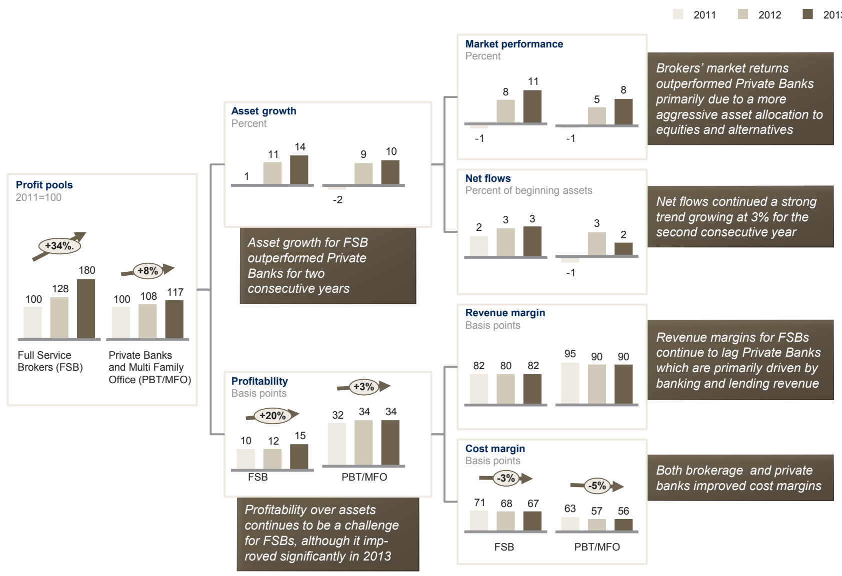


SOURCE: McKinsey Wealth Management Survey 2014

In another innovation, the 2014 survey looks at the economics of the main archetypes of wealth managers: full-service brokers, MFOs, and private banks (Exhibit 8). Full-service brokers may have been neck and neck with private banks and MFOs in profit pool growth shown in 2012. But in 2013, full-service brokers powered ahead, helped by stronger asset growth driven primarily by a more aggressive asset allocation to equities.

EXHIBIT 8

North America: Full Service Brokers lead profit pool growth



SOURCE: McKinsey Wealth Management Survey 2014

Although profitability among full-service brokers has increased by 50 percent to 15 bp from 2011 to 2013, this still trails the profitability in basis point terms earned by private banks and MFOs. A factor here is that revenue margins for full-service brokers continue to lag behind those of private banks, which were boosted by beneficial financing spreads and a larger share of revenue from other banking services.

More rapid asset growth occurred among wealth managers focusing on the affluent market, namely regional private banks and IBDs. Within the IBD channel, registered investment advisors (RIAs) with dual registration grew fastest. Traditional private banks and trust companies as well as MFOs tended to exhibit slower asset growth and lower net new flows. But private banks reported much higher profit margins, especially those with a lending-based offer.

Higher profitability is strongly correlated with the compensation model. Our full-service broker group, which employs payout grids based on revenue production for financial advisors, reported total compensation costs for full-time-equivalent (FTE) staff of 52 percent of operating revenue, nearly double the 27 percent level of private banks, which are more likely to use a salary-plus-bonus method.

Client loading grows but results vary widely

For participants reporting figures in both 2012 and 2013, the total number of client facing FTE in 2013 declined 0.3 percent to 44 relationships per client facing FTE from 2012 despite a 2.3 percent increase in client numbers. However, about half of the participating wealth management firms reported lower client loading. Private-bank client facing personnel each handled slightly fewer relationships, whereas full-service brokers and MFOs saw an increase in average client loading. Wealth managers are introducing better client management systems to facilitate higher client loading. Yet there is wide variation in the adoption of such technology and equally wide variation in client loading levels, both across and within the various wealth management business archetypes.

Unit costs fell 4.5 percentage points as a portion of average client assets in 2013 (although absolute costs in USD terms grew) after an already steep decline a year earlier. We saw a very sharp bifurcation in how costs moved. Private banks restrained compensation cost increases, whereas brokers, who work on a payout grid, saw compensation costs jump over 10 percent. Conversely, while brokers limited IT and other back-office cost growth to 2 percent, private banks invested 17 percent more in middle- and back-office functions than in 2012.

Wealth managers are introducing better client management systems to facilitate higher client loading

Revenue margins declined one basis point primarily driven by lower interest rate spreads, which fell by an average of 12 percent, from 125 bp to 109 bp. Spreads at private banks were significantly higher than at brokers. Asset management and trust revenues increased, aided by a shift in asset mix from fixed income and cash into higher yielding equity strategies.

North American wealth management performance

Exhibit 9 shows the key factors that drive wealth management performance. We believe that five factors had the highest impact in 2013.

EXHIBIT 9

North America: drivers of value in wealth management performance

SOURCE: McKinsey Wealth Management Survey 2014

- **Relative asset mix.** With 42 percent of client assets held in cash and fixed-income products, private-banking asset growth has been lower than that of brokerage firms, which tended to have higher allocations to equity products.

- **Change in RMs.** Wirehouses generally reported a fall in the number of financial advisors or RMs they engaged in 2013. The probable reasons for this are: a more aggressive weeding out of less productive advisors, losses to RIA start-ups, and also, potentially, greater difficulty in finding qualified advisors (to replace leavers). IBDs and regional brokers reported small increases in their advisory forces while changes in advisor numbers among private banks and MFOs were mixed.

- **Banking vs. investment mix.** To a large degree, the mix determines revenue margins. Private banks averaged 19 percent of client assets in deposits, down from 2012, but still far higher than the 9 percent reported by full-service brokers.

- **Banking spreads.** Private banks generated much higher spreads on banking products (151 bp vs. 81 bp for brokers), which largely explains their 14 bp advantage over brokerages in revenue generation per USD of client assets.

- **Wealth band mix.** The focus of MFOs on the UHNW client resulted in very low revenue margins of 38 bp in 2013, although this was a healthy increase of 4 bp from

2012. Similarly, IBDs and regional brokerage firms that serve the USD 100,000 to 5 million segment had weighted-average revenue margins of 88 bp.

Regional trends: attractive but fiercely competitive

Wealth management is the crown jewel of the North American financial services industry thanks to its capital-light, liquidity generating characteristics. The industry's relatively steady economic returns have led insurers, retail banks, investment banks, investment managers, and online attackers to try to grab a piece of the market. Each competitor tends to have its own distinctive mix of product focus, service model, and target clients. As a result, competition, particularly for the affluent and HNW household, is intense. Over 10,000 financial institutions compete for assets (and loans), ranging from the one-person RIA to the global universal banks. Fragmentation is thus the rule. However, at the same time a "super league" of players managing over USD 1 trillion of client assets has emerged either through acquisition or organic growth.

The digital revolution is relatively far advanced in North America with online firms serving an increasing number of households ranging from mass affluent through to affluent, HNW, and UHNW. The next generation of digital attackers is already here, with a host of innovative digital wealth managers competing for the affluent wallet, although the greatest threat to the traditional incumbents may come from established firms that have launched proprietary, ultra-low-cost "robo-advisor" offerings to make recommendations to clients. But for truly HNW clients, the digital approach remains unproven in coping with the complexities of trusts, wealth structuring, and alternative investing that the wealthiest require.

In such a crowded market it is increasingly difficult, but increasingly vital, to be able to demonstrate a clear and distinctive value proposition. Canada, debatably, may be the exception to the rule as the big banks continue to dominate the market and have not hesitated in buying promising independent wealth management firms to maintain that dominance. Their main competitors are each other.

In such a crowded market it is increasingly difficult, but increasingly vital, to be able to demonstrate a clear and distinctive value proposition

In the US, however, change and innovation have been greater. Many large private banks and wirehouse brokers have experienced a gradual erosion in market share since 2008. This has come as smaller RIAs, regional brokerages, and independent brokerage networks have attracted customers with the promise of a more personal relationship for households without several million dollars to invest. At the same time, online/direct brokers continued to attract a large segment of the mass market and mass affluent customers through a combination of online planning tools, very low trading costs, no-transaction-fee fund supermarkets, and on-call financial advisors. Much of the online players' business has come from efficient and administratively simple rollovers of assets from customers' defined-contribution pension plans. They have also occasionally attracted assets from customers who were "orphaned" when their old broker or private bank moved up market. As these online providers have grown larger, they increasingly compete on price and technology. They have also been adding online advice and advisors working in real time to better serve affluent and HNW households focused on investing rather than trading.

Thanks to service provider innovation, smaller wealth managers have been able to compete with at-scale wealth managers. Turnkey asset management programs, RIA service agents, third-party marketers, and specialist software providers have helped to level the playing field. It means that the 50-client RIA in Omaha is able to provide a client experience not too dissimilar from what is offered by the wealth management behemoths that have emerged through consolidation in the US over the past decade.

Key implications for North American wealth managers

Wealth managers in North America have different challenges and opportunities depending on their business model and the market segment where they are looking to compete. Private banks, for example, will seek growth while looking to maintain their margins. Brokers will seek to boost profitability by increasing their bank service offering and raising productivity while MFOs will continue to search for a viable business model.

- **For most private banks, growth is the priority.** The overriding need for private banks is to find new ways to capture and retain a new generation of wealthy clients who are offered anytime-anywhere wealth management by competing online and full-service brokers. The challenge will be to capture these clients while maintaining high service standards and adding sufficient value to be able to continue charging premium prices compared to broker dealers. The economics of the traditional private-bank business model are under pressure in the core millionaire segment (USD 1 to 10 million) and it is here that new value propositions need to be identified to drive growth.

- **FSBs and wirehouses need to rethink advisor models and develop new products.** The advisor compensation structure is a significant barrier to improving the profitability of FSBs. Compensation schemes need to be reconfigured to reward and retain top advisors without ceding an overly large share of earnings. Innovation is also needed in order to boost advisor loads while maintaining (or preferably improving) the quality of client service. Brokers no doubt look on with envy at how private banks earn healthy profits through specialty lending. Although brokers are increasing their share of bank products and building credit capabilities, this will take several years.

- **MFOs need a new client service model to become profitable.** With MFOs, the opportunity of serving the very wealthiest households is matched with a propensity to offer large discounts on scheduled rates. Moreover, MFOs usually lack both bank products and proprietary investments, but operate an expensive service model, in which an RM serves just a few client households. MFOs need to step up the scale of their operations and develop a professional client service model (including minimizing discounts and providing tailored services) to become profitable.

Asia: economics improving as millionaire wealth builds

- Asia (excluding Japan) is forecast to double net new millionaire wealth to USD 17.7 trillion over the next five years through 2018.
- In 2013, offshore centers in Asia recorded AUM growth of 15 percent with 7 percent from net inflows and 8 percent from performance.
- The profit margin increased to 20 bp in 2013 on a 1 bp revenue margin rise and a 2 bp cost margin reduction.
- Entrepreneurs are still the most attractive segment, but banks need to be flexible to meet this challenge.
- Offshore is the existing opportunity, but onshore[1] will be the future and digitization will change the way banks compete.

With Asia (excluding Japan) forecast to double net millionaire wealth to USD 17.7 trillion by 2018, the region will account for around 23 percent of millionaire wealth by that year – trailing only North America. The 15 percent growth rate in the region's offshore AUM in 2013 tailed off from the previous year (17 percent) but is expected to grow by an annual mid-teen percentage rate through 2018.

China is expected to contribute over 50 percent of the growth in HNW personal financial assets in Asia (excluding Japan). Currently, private-banking penetration in these HNW assets in China is estimated at only 15 to 25 percent – suggesting significant room for growth.

Wealth manager economics in the region: improving but lagging precrisis levels

The 18 percent increase in the profit margin to 20 bp comes on the back of a 1 bp rise to 83 bp in the revenue margin accompanied by a 2 bp fall in the cost margin to 63 bp. The slight increase in revenue margin (growth in lending penetration and fund share) and cost margin gains from efficiency programs, including process streamlining, drove the improvement. As the region matures, we expect the shift in AUM to more profitable advisory and discretionary mandates to accelerate beyond the current level of just over 40 percent.

The 7 percent growth in net inflows matched 2012 but trailed the five-year average. However, the profit margin in offshore centers rose 3 bp to 20 bp in 2013 (Exhibit 10).

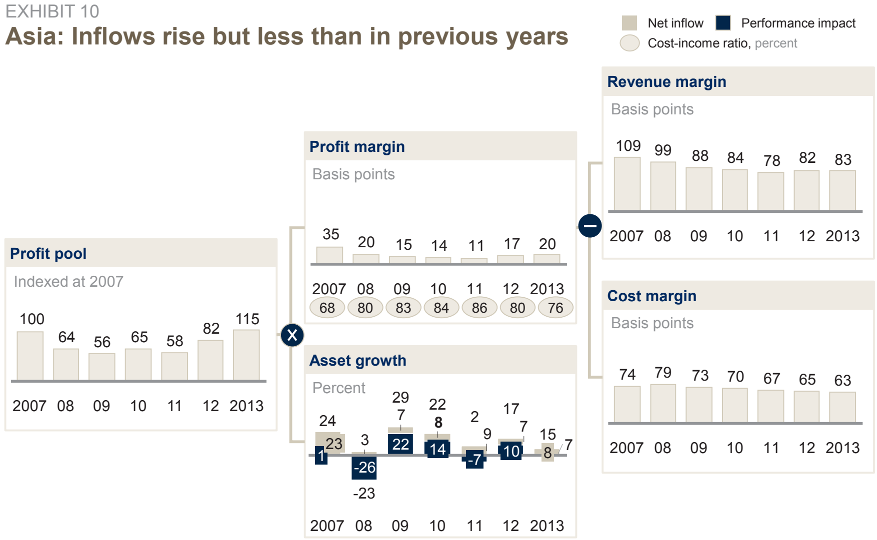
Our latest HNW survey in China and India highlights that the entrepreneur segment represents the largest opportunity and also has the highest proportion of UHNW wealth. For instance, in China, entrepreneurs represent over 40 percent of total HNW with 5 percent of them being UHNW.

By segment, however, preferences differ. For entrepreneurs, investment banking services, such as coinvestment or direct deals, corporate finance, and restructuring, continue to be in demand. But needs also vary by life stage. Young entrepreneurs, for example, prefer capital growth while older clients focus more on capital preservation.

1 Offshore defined as assets parked by residents in the country where they are not domiciled. Onshore defined as assets parked by residents in the country where they are domiciled.

EXHIBIT 10

Asia: Inflows rise but less than in previous years



SOURCE: McKinsey Wealth Management Survey 2014

For retirees, services including discretionary mandates are more popular. We also see increasing demand for nonfinancial advice in areas like philanthropy and art, particularly in China. Although entrepreneurs are the most attractive segment, serving them continues to be challenging, given the overlapping demand exerted on private-bank, corporate, and investment-bank service teams. The organizations that have fared best have used both “hard” rules (such as referral incentives) and “softer” attitudinal guidelines that reflect the bank’s culture.

Asian HNWs have a relatively strong risk appetite for alternative assets and for offshore assets as shown by the surge in cross-border real-estate investments from wealthy Chinese. They also prefer more frequent updates from their advisor and have a higher preference for digital communication. At the same time, however, they would rather consult with several expert advisors or banks rather than depend on a single source of advice.

Most private banks have broadened their product offering to cater to the specific needs of Asian clients. However, not all banks have been able to reap the benefits of this investment. Clients have tended to prefer institutions with a strongly established private-banking platform rather than those with a somewhat smaller private-bank setup. This has led to noticeable polarization among players as well as a large variance in margin and productivity performance among different private banks. In most Asian offshore centers, the revenue margin, for example, varies from 101 bp to 60 bp between top and bottom performers (Exhibit 11).

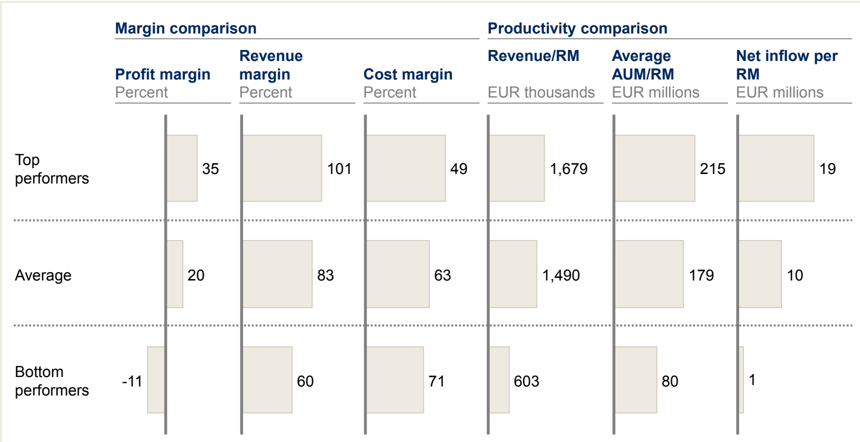
The cost margin varies substantially as well, with top performers at 49 bp and bottom performers at 71 bp. With an increasingly complex regulatory environment, costs, particularly for compliance, are expected to increase. Scale can serve to partially mitigate such cost increases and helps to explain M&A activity in the region.

Frontline productivity varies widely, with top performers’ revenue per RM amounting to three times that of bottom performers (EUR 1.7 million per RM vs. EUR 600,000 per RM).

EXHIBIT 11

Asia: Margins vary with relationship manager productivity

2013



SOURCE: McKinsey Wealth Management Survey 2014

Many are even starting to build in-house RM training universities as a way of addressing the region's talent shortage.

Regional trends: slow consolidation, rise of Chinese onshore and digitization

Asia is extremely fragmented, combining traditional offshore centers and different-sized onshore markets. Profitability among players varies widely. A number of larger M&A transactions have taken place with local players snapping up assets in the region to secure growth outside of their home market.

The rise of a Chinese onshore market is expected to account for over half of all growth in Asia excluding Japan. China is still largely a product-driven market with investors chasing returns. This is being fuelled by the proliferation of bank wealth management products, some of which are in the shadow banking[2] area. The onshore opportunity is limited to local providers, primarily the large banks, but with increasing competition from other nonbanking players, including securities firms, trust companies, and leading independent financial advisors. Offshore assets (estimated to account for 15 to 20 percent of regional AUM) continue to flow to foreign private banks. Thus, many onshore players in China are still looking at how to serve the cross-border segment. One viable option to do this is partnerships.

The average Asian investor uses digitization for everyday contact points. However, Asia does not yet have an at-scale digital wealth management provider, though many players (both incumbents and attackers) are considering building such a platform. Such a move would look sensible as the region is dominated by self-directed investors where product accessibility (vs. advisory) is the key factor in client decision making.

2 Shadow banking defined as credit intermediation involving entities and activities outside the regular banking system.

China is likely to be at the forefront of innovation in digital wealth management, something which may include e-commerce players obtaining bank licenses. For attackers, digitization may be an effective way to penetrate onshore markets that are difficult to crack owing to regulation or intense competition. For incumbents, a successful homegrown digital product may offer a replicable model to be rolled out elsewhere.

Key implications for Asian wealth managers

- **Get ready to do battle to win offshore business.** Offshore hubs in Asia will continue to see growing inflows amid increased competition from both rival centers in the region as well as Europe and the US. The best way to compete is to build hubs that attract flows from a variety of client segments in different domiciles.
- **Success in China requires a local affiliate.** Onshore is where most of the future growth will occur, given the expected strong economic expansion of the region's economies, particularly China. However, onshore regulatory restrictions, especially in China, will continue to constrain both access and profitability. For global players, a long-term plan to tap into China involving M&A transactions and partnerships may be attractive. These onshore franchises in China or in other regional markets can then be used to develop local relationships that can be deepened offshore. It is clear that both challengers and existing players need to innovate beyond the traditional offshore offering to win clients.
- **Digitization is a potent weapon, but new value propositions are needed.** Digitization can enhance core businesses and facilitate the development of go-to-market models. Yet, most private banks are using digitization to enhance current value propositions (for example, equipping RMs with easy-to-use, client-presentable iPads and streamlining middle- and back-office processes). However, few have considered how to use digitization to create new value propositions to target underserved, digitally savvy investors, many of whom are "core millionaires." Using this digital model means going beyond an "app" and carefully considering target customer value propositions.
- **Serving entrepreneurs requires a special focus.** Entrepreneurs remain by far the most important HNW segment in Asia as the region continues to be characterized by first-generation wealth creation. However, serving entrepreneurs can be a challenge and organizations should encourage the use of both "hard" rules, such as referral incentives, and "softer" attitudinal guidelines that reflect the bank's culture to work across organizational silos. Within the entrepreneurial segment, providing credit and liquidity is crucial.
- **Develop offers for different subsegments.** A few banks have already created separate offers for different subsegments. In Asia, emerging HNW "core millionaires" with about USD 1 to 10 million in personal financial assets is one of the fastest-growing subsegments, but it requires a different model. This segment is highly profitable, with lower service requirements.

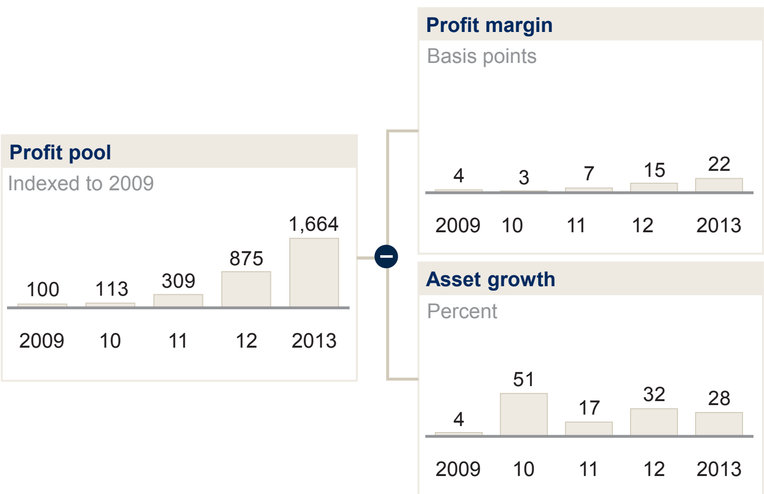
India: rapid development from a low base

- Indian private-bank AUM increased by 28 percent (vs. 32 percent a year earlier) with net inflows driving growth.
- Profit margins improved by 7 bp to 22 bp in 2013 (from just 3 bp in 2010) helped by players attaining operational scale and by increasing RM productivity.
- The UHNW segment accounts for 48 percent of private-bank AUM; about two-thirds of total AUM is concentrated in Mumbai and Delhi.
- Banking-led players and others with AUM over USD 1 billion exhibit much better margins compared with pure advisory and smaller operators.

Private banking is undergoing rapid development in the Indian banking sector. Existing affluent segment offers are being expanded into private-banking services by many banks.

With 28 percent AUM growth in 2013 (Exhibit 12), Indian private banks are growing quickly, but coming from a low base. Since 2010, India has been one of the world's fastest-growing private-banking markets. In 2013, this growth combined very strong net inflows (23 percent) and positive market performance (5 percent). We expect net inflows to continue to show strong growth.

EXHIBIT 12
India: Profit pools nearly double in 2013



SOURCE: McKinsey Wealth Management Survey 2014

Wealth manager economics in the region: profitability approaching EU levels

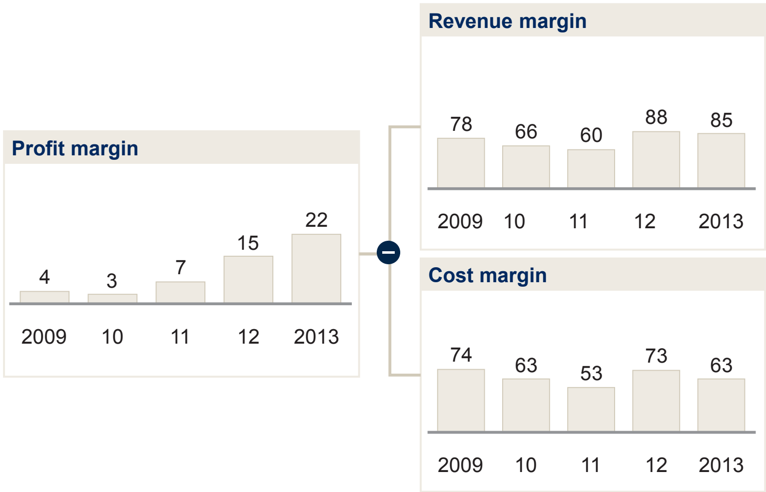
The Indian private-banking industry is showing profitability approaching Western European levels with profit margins having tripled since 2011 to 22 bp in 2013 (Exhibit 13). This came on the back of a 41 percent increase in the revenue margin (to 85 bp in

2013 from 60 bp in 2011) and a lower 19 percent rise in cost margins (to 63 bp in 2013 from 53 bp in 2011). The key factors in this are players developing operational scale and increasing RM productivity.

EXHIBIT 13

India: Lower cost margin drives profit growth

Basis points



SOURCE: McKinsey Wealth Management Survey 2014

Banking-led players are the most profitable owing to significantly better cost margins than pure play advisors who do not have a banking license. Indeed, the profitability of Indian private banks (with a margin of 39 bp) is often better than that of European peers. Unsurprisingly, scale has a significant impact on profitability. Firms with AUM of USD 1 billion or more show higher profitability (at 28 bp) due to better revenue and cost margins.

The industry also witnessed a slight shift in the revenue mix with a higher share of revenue coming from standard banking pools and recurring revenue, and a slightly lower share from brokerage revenue.

Regional trends: UHNW is the prime opportunity, but other segments are growing

The UHNW segment (assets in excess of USD 30 million or INR 2 billion) remains the prime opportunity in India and accounts for nearly half (48 percent) of private-bank AUM. However, the HNW and other affluent segments are experiencing higher growth rates and becoming a bigger portion of private-bank AUM share. Mumbai, Delhi, and other metropolitan areas, such as Bangalore and Kolkata, are leading the growth in private-bank assets. However, data shows that private banks are expanding beyond the top four cities and that this broader coverage of the country is fueling part of the industry's growth.

Indian HNW customers, particularly self-directed professionals, are very receptive to using digital channels as shown by the fact that most requests for product information are coming from the Internet and mobile platforms. But despite some early steps, none of the Indian private banks have a full-scale digital wealth management offering.

Key implications for Indian wealth managers

- **Better coordination of commercial and private-bank units needed.** Entrepreneurs may be the biggest opportunity in the Indian private-bank market, but they also pose specific challenges. Both established and new players need to improve coordination and cooperation between commercial and private-banking units to capture the full opportunity spanning the personal and business needs of entrepreneurs. An alternative is to create specialized units, perhaps aligning private-bank RMs more closely with commercial-bank account managers.

- **Renewed economic growth poses a creative challenge.** A revival in growth in the Indian economy means that the SME and mid-corporate markets outside of the top four cities present a small, but fast-growing, private-banking opportunity. Putting resources in new locations, maybe in conjunction with retail and commercial bank services, offers a way to serve these clients profitably, while ushering in the next wave of growth.

- **Increasing RM productivity must be a top priority.** As the Indian economy picks up speed, private banks must shift from reducing the number of RMs to increasing their productivity and reaching out to new customers. Building capabilities, notably through technology enablement and by using tablets to propose solutions to clients, is one useful step in making RMs more productive. Another is deploying analytics to feed RMs with trigger-based leads to deepen existing relationships and to reach new clients.

Middle East: continued expansion spurs innovation in service models

- Private-bank AUM grew 12 percent in 2013, driven mainly by rising net inflows.
- World-leading profit margins were unchanged at 68 bp after a 2 bp rise in the revenue margin to 110 bp was offset by a similar increase to 72 bp in the cost margin amid investment in middle-office capabilities.
- Cash and equivalent fell as a proportion of the overall asset allocation to 52 percent, but is still high in comparison to other regions.
- Middle East and Africa are forecast to see 9.5 percent average annual growth in millionaire wealth through 2018, trailing only Asia (excluding Japan).

The private-bank market in the region continues to be one of the world's fastest growing with AUM growth driven mainly by rising net inflows rather than investment performance. Incremental changes in asset allocation and lending volumes gave a 2 bp boost in the revenue margin to 110 bp. That was offset by an equivalent rise in the cost margin owing to investment in middle-office capabilities among leading regional private banks.

The level of investment in cash and equivalents declined again, but still remains considerably higher than in any other region. Equities and alternatives each account for 5 percent of AUM, trailing fixed income on 16 percent and other/ balanced on 21 percent.

Private banks are under competitive pressure to improve wealth management and advisor services to entice clients to move beyond execution-only mandates. Despite progress, regional players still trail international competitors in what they offer in both areas although modest improvements have occurred in financial advisory and platform product offers.

Wealth manager economics in the region: high growth drives profitability

The Middle East region is the second-fastest-growing private-banking market. The positive outlook for Gulf Cooperation Council (GCC) countries is expected to translate into a near 70 percent increase in wealth growth through 2015 as personal financial assets in the biggest GCC countries rise to around USD 2.7 trillion (Exhibit 14). This should continue to keep profit margins healthy.

The Middle East region is the second-fastest-growing private-banking market

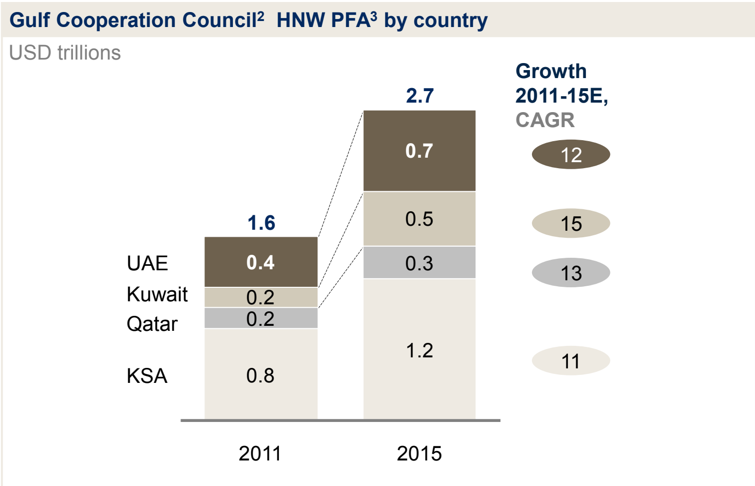
Regional markets (beyond the GCC and including Turkey, Egypt, and the Middle East and North Africa more broadly) have seen strong nominal GDP growth, particularly in oil-rich states, with the S&P GCC Composite Index up over 24 percent in 2013. This has boosted investor confidence and encouraged financially sophisticated HNW clients to actively manage their investment portfolio. In turn, local private banks have enhanced their advisory offer and access to product platforms, but local investor appetite for stocks remains limited. Moreover, execution-only mandates account for around 75 percent of AUM.

Real estate remains a very important asset class for HNW and UHNW clients. Property valuations in Dubai (perceived as a relative "safe haven" by Middle East and North African investors) have soared up to 40 percent over the 18 months to mid-2014. Beyond direct investment in property, HNW and UHNW clients are investing in more complex real-

EXHIBIT 14

Middle East: Saudi Arabia and UAE drive wealth growth[1]

Percent



1 Includes both onshore and offshore and life insurance/pension volumes but does not include certain markets (rest of the world)
2 Selected countries, excludes Bahrain and Oman
3 Includes onshore and offshore but not life insurance/pension volumes because they are negligible in value for GCC region
SOURCE: McKinsey Global Wealth Management Survey 2014

estate structures in the region and beyond to hedge against inflation. Private banks with a range of innovative real-estate investment products, including proprietary "club" deals in Europe, have collected large commitments. Growth has also occurred in regional private-equity investment products.

Regional-bank lending also continues to grow strongly. Our sample shows lending penetration grew to 20 percent of AUM from 18 percent during 2013. There has been active promotion of finance for income-generating real-estate assets as well as of the use of a Lombard credit to enhance yields.

Growing AUM among many of the regional private banks has enhanced economies of scale despite rising overhead costs for regulatory compliance. Consolidation of a number of international private banking franchises provided an opportunity for local private banks to hire talent, notably investment professionals and portfolio managers.

Regional trends: international players investing in local capacity

Despite healthy AUM growth and profitability, the gap between regional and international private banks in the provision of fully-fledged wealth management and financial advisory services remains. Nevertheless, we believe the market has reached a stage of development where on-the-ground competition from international private banks is growing as clients increasingly seek more sophisticated investment solutions.

In turn, this marks a fundamental change in the operating models used by private banks in the Middle East. Traditionally, local and regional private banks have had significant onshore operations, whereas international private banks have used a "fly in, fly out" approach, shuttling their private bankers to the Middle East from hubs in Switzerland and London. Typically, it was the international banks that captured the lion's share of the private banking assets.

Over the past 18 months, however, we have witnessed how a number of international private banks have made the Middle East a priority market. These players are now effectively "doubling down" and investing in locally domiciled physical infrastructure with private bankers, investment advisors, and product specialists increasingly located in the Middle East. While Dubai remains a hub for most international private banks, this new breed of player is expanding to other GCC cities in an effort to get closer to clients and compete more effectively with the regional leaders. Many of these banks have set up offices in Saudi Arabia, for example.

At the same time, several of the leading regional banks have begun to position themselves to capture the offshore portion of client wealth. They have done so by strengthening their value proposition (notably advisory and investment products) for HNW clients and setting up offshore in the traditional booking centers of London and Switzerland, but also, increasingly, in Singapore and even Hong Kong. However, they still rely on superior service and client relationships (often defined by proximity) as the core pillars of their value proposition, and struggle to compete with international private banks to deliver a fully-fledged wealth management proposition. Execution-only mandates (including custody) still account for over 75 percent of AUM.

Key implications for Middle East wealth managers

- **Local private banks must invest in capabilities and products.** Continued strong economic growth and the high margins enjoyed by Middle East private banks means that new entrants are going to continue targeting the region. Local players have an advantage in their deep knowledge of the local client base, but that may not account for much if regional private banks cannot match their international rivals on capabilities, notably advisory skill, and in the range of investment products on most platforms. Local private banks must use their healthy profitability to improve the quality of their franchise offer as well as providing more of the best investment products to clients.

- **Mergers and partnerships can provide needed scale.** Local private banks have carved out a lucrative niche with a clientele that has traditionally used simple cash products to preserve wealth. The future will be about expanding the client offer, particularly through the innovative use of digitization. Some players will be able to fund this investment, but others will be well advised to build local scale through mergers in the regions. In some cases, local firms may be well advised to use their superior access and client knowledge to build partnerships with international wealth managers.

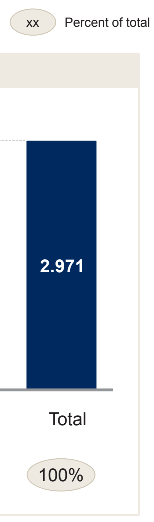
Latin America: attractive market even as Brazil slows

- AUM grew by 17 percent in 2013, even as regional leader Brazil saw growth halve to just below 10 percent.
- The profit margin is 33 bp, reflecting a tight cost margin of 44 bp, well below levels in most other regions.
- Brazil and Mexico account for two-thirds of the private-banking market, with more than one-third invested offshore.
- Brazilian and Mexican private banking clients still favor fixed income instruments, but diversification is expanding.

The region's private-banking market has AUM of roughly USD 3 trillion (Exhibit 15). Its 4.6 percent global share has increased by a fraction since last year.

In an expansion of our survey, new data demonstrates the profitability of the Latin American wealth management sector. Although the 77 bp revenue margin is the lowest among global regions, the low cost margin (44 bp) means that the 33 bp profit margin is higher than anywhere else, except for the Middle East.

EXHIBIT 15
Latin America: Brazil and Mexico account for two-thirds of AUM



1 Regarding individuals with more than USD 1 million in investable assets
SOURCE: McKinsey analysis

Wealth manager economics in the region: challenging year in Brazil

Economic growth, associated wealth creation, developing capital markets, increasing interest among foreign investors, and high interest rates have helped the development of the region's private-banking market.

Growth in Brazil's private-banking market was lukewarm with AUM up 9.5 percent – less than half the annual rate in each of the three previous years. Returns from high interest rates created most of the AUM growth while net inflows accounted for about a quarter of the gains. As the Brazilian economy decelerated, equity markets slid with the iBovespa down 15.5 percent in 2013.

The waning of investor optimism meant that the private-banking market in Brazil and the region experienced one of its most difficult years, exacerbated by stiffer competition. Yet expectations for the future are bullish. The number of millionaires in Brazil, Mexico, and across the region is forecast to continue growing. Furthermore, with private-banking players already adjusting business models to the new market dynamics, their profitability should grow. What is more, independent boutiques and family offices are catering to increased demand for advice and financial education.

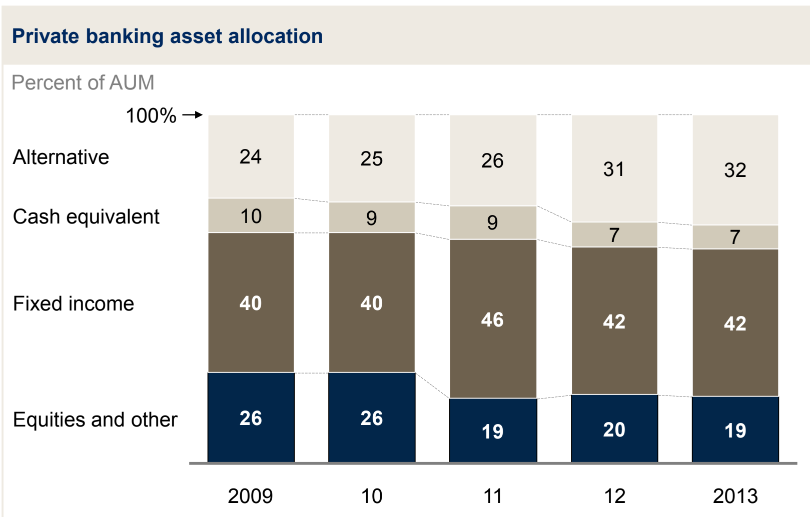
Regional trends: adjusting to new market dynamics

The new market environment in Brazil is characterized by dampened economic prospects, lower interest rates than what has historically prevailed, and more market volatility. Clients, too, have evolved, showing greater investment sophistication, more interest in offshore vehicles, and a propensity to consult with multiple advisors.

With the decrease in nominal interest rates and relatively high inflation rates, investors are worried about real investment returns. Private-banking clients accustomed to 6 to 8 percent real returns are now getting 1 to 2 percent annually. Although investors are still highly concentrated in fixed-income products, alternative investment products have made moderate gains in allocations (Exhibit 16).

EXHIBIT 16

Brazil: Alternative investments gain share from equities



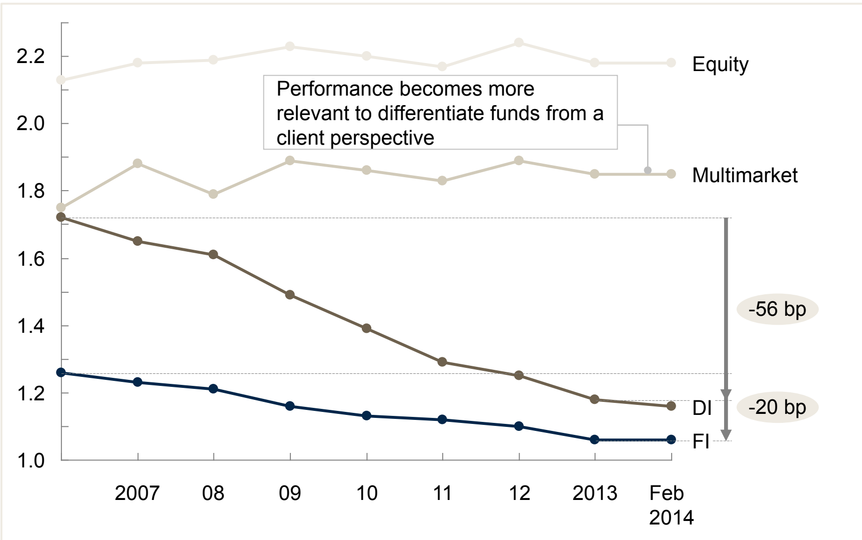
SOURCE: McKinsey Wealth Management Survey 2014; McKinsey analysis

Hedge funds, private equity, and asset-backed securities have grown substantially over the past five years as a result of this drive for real returns. The growth has increased pressure for lower management fees on fixed-income and money market funds (Exhibit 17). Another effect is that investors are demanding true open architecture from their banks in order to have access to the best products in the market.

EXHIBIT 17

Brazil: Profitability shifting to more sophisticated products

Management fee as percent of AUM



SOURCE: ANBIMA administration fee report

Even though private banks are offering a broader mix of investment options, they are still limited by the depth and breadth of the Brazilian capital markets. With the uncertain domestic outlook and the recovery of developed markets, notably the US, Brazilian investors are increasingly looking for offshore opportunities.

As portfolios become more diversified, private-banking clients are demanding greater advice. As such, private banks are investing in dedicated advisory structures. In the last four years, Brazilian private banks grew their noncommercial-focused teams (mostly advisory and fund of funds) by 11 percent while banker numbers have expanded by only 6 percent. Additionally, banks are investing heavily in training, with almost half of the bankers being certified financial planners.

As portfolios become more diversified, private-banking clients are demanding greater advice

This trend favors the growth of boutique private banks, whose value proposition is focused on independence, personalization, and quality of advice. MFOs have gained importance in the UHNW segment. To further differentiate their service, MFOs have expanded into nonfinancial services such as art advisory. The increased importance of MFOs has led some private banks to build their own MFO offering.

Finally, as competition increases and puts pressure on costs, we are seeing an increased digital offering, including online tools. However, most private banking clients are still resistant to this change. Age and a focus on confidentiality and security are the main barriers. As young professionals and entrepreneurs generate wealth and succession occurs in established wealthy families, the digital offering is likely to be in greater demand.

Key implications for Latin American wealth managers

- **Get ready for increased competition.** With half of the region's HNW clients in Mexico City and Sao Paolo it is clear where new competitors are most likely to focus. Though digital attackers don't seem to pose much threat now, the emergence of young entrepreneurial wealth and of a new generation with inherited wealth is likely to bring sudden change. With this shift, banks will need to tailor their service to the needs of a new generation – clients who not only are digitally savvy, more sophisticated, and less risk averse, but who also have a broader range of interests.

- **Move to an advice and asset allocation model.** An approach focused on products is being replaced by an advice and asset allocation model. With increasing demand for advice and investment products becoming more sophisticated, open architecture is the future. For private banks it is necessary to redefine the value proposition and develop a more holistic view of what clients require. Thus, to serve the growing base of UHNW clients, private banks will need to provide a full spectrum of services – from fiscal advice to art counseling – in order to compete with the MFOs. It is still unclear, however, how much clients will pay for this advice.

- **Strengthen international product and offshore offering.** With Latin American economic growth forecast to be lower than in recent years, international investments will likely become more attractive. Private banks should thus strengthen their international product offer. The considerable scale and continued growth of offshore business underscores why private banks should also invest in servicing this client base. Overall, the winners will be players combining onshore franchises offering increasingly diverse international products along with a capable offshore operation for clients requiring that flexibility.

Offshore wealth managers face complex transformation issues

A shakeout is coming to offshore banking markets. The wealth managers that survive will be the ones able to undertake a fundamental transformation.

The death of secrecy means offshore private banking has come under mainly US and European regulatory pressure to enforce full tax compliance. In the US, following the FATCA regulation, offshore assets are now fully transparent while in Europe wide-ranging regulatory change is having a significant impact on wealth manager economics. Meanwhile, in Asia, the established offshore hubs in Singapore and Hong Kong are facing increasing competition from growing local onshore markets; pressure to enforce tax compliance may eventually have an impact, although the timing remains uncertain.

Yet despite these significant challenges, offshore markets can offer a residual valuable proposition to clients, but wealth managers need to fundamentally change their operating model to provide it. Transformation, not incremental change, is needed.

The traditional value proposition of offshore private banks combined two broad offerings. One offering – that of secrecy and preferential tax law provided in a climate of regulatory predictability – is being dismantled. The second offering – where a private bank delivers value through an ecosystem of skills and capabilities catering to specific cross-border private-banking client needs in an environment of financial stability – remains valid. But to exploit it private banks need to reshape how they operate. This is needed to help navigate a new regulatory environment which is applying increased transparency to double taxation agreements and tax information exchange.

The real drain on offshore markets is the disappearance of the traditional tax rationale

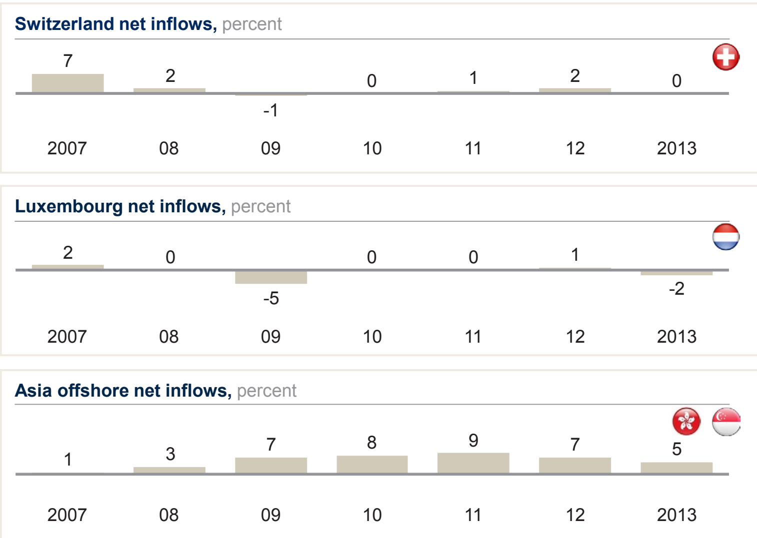
But European offshore hubs have wallowed in flat inflows since 2008 (Exhibit 18) – well before the latest regulatory onslaught. Switzerland and Luxembourg continue to attract just enough capital to compensate for the departure of money to onshore regimes. Switzerland still offers attractive diversification benefits to emerging-market clients while Luxembourg retains its appeal for UHNW clients in Europe. The real drain on these offshore markets is the disappearance of the traditional tax rationale. Customers with less than EUR 1 million of invested assets continue to return onshore, and now account for only 13 percent of assets in offshore private banks compared with 21 percent for onshore private banks.

In Singapore and Hong Kong, the offshore story remains one of significant net inflows. Yet even though Asian offshore wealth managers have made steady gains with inflows of 5 percent in 2013, this marks a decline in the rate of growth since 2008 (Exhibit 18). The upshot is that Asian onshore wealth is growing more rapidly, making it difficult for offshore regimes to grow at rates observed in the past.

The acute international pressure on European offshore regimes to accelerate disclosure is having an impact. UK-dependent or associated territories and Luxembourg are adopting provisions for the automatic exchange of information. Switzerland and Singapore have also announced their participation in a wide-ranging standard on automatic exchange of information (with Swiss implementation scheduled for 2017). We expect pressure on flows to offshore wealth managers to remain acute as regulatory provisions become tighter.

EXHIBIT 18

Offshore: Asia gains AUM as Europe wallows in flat inflows



SOURCE: McKinsey Wealth Management Survey 2014

Profitability remains under pressure

The new regulatory environment for offshore booking centers has changed the economics of the offshore wealth management business. Historically, wealth managers in offshore centers have been able to charge international clients a premium for the unique value they delivered compared with local onshore banks.

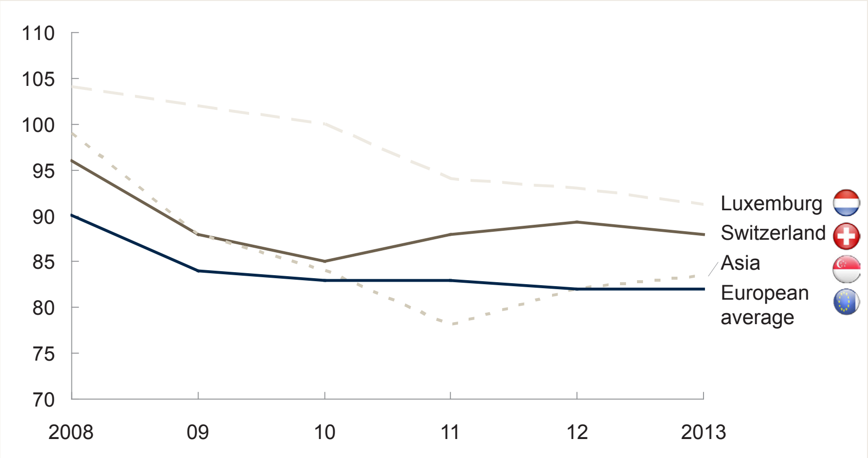
Over time the traditional value proposition of offshore private banks became rooted in secrecy, preferential tax regimes, and an ecosystem of investment capabilities. However, with the core proposition of secrecy being overturned, wealth managers are witnessing attacks on both volumes and margins. Although there are significant differences among major offshore centers, the clear negative trend for revenue margins is expected to continue in the new environment (Exhibit 19).

- **Switzerland.** Over the past five years revenue margin contraction and rising costs saw the profit margin contract by one-third or 11 bp to 22 bp in 2013. An increase in UHNW clients failed to offset a fall in affluent share, leading to an 8 bp revenue margin decrease to 88 bp in 2013. The cost margin grew by 3 bp to 66 bp in 2013 owing to the increased cost of compliance and implementation of new regulations like FATCA. Inflows from emerging markets broadly offset smaller European clients withdrawing funds.

- **Luxembourg.** During the five years to 2013 the profit margin fell by 12 bp to 34 bp mostly driven by revenue margin contraction (which fell 13 bp over the period to 91 bp). A changing client mix was a key factor in this. Lower margin clients (clients with more than EUR 10 million in investible assets invested with one institution) rose to 43 percent of AUM in 2013 from 33 percent in 2008. In tandem, higher-margin affluent clients only accounted for 29 percent of AUM in 2013 vs. 40 percent five years earlier.

EXHIBIT 19

Offshore: Revenue margins fall sharply on regulatory changes



Source: McKinsey Wealth Management Survey 2014

Moving to an automatic exchange of information by January 2015 has accelerated the outflow of assets from Luxembourg affluent clients with an overall net outflow of 2 percent of AUM in 2013. The result is an increased competition among wealth managers in the wealthier client segments, which could put further pressure on profit margins.

- **Singapore and Hong Kong.** The profit margin (20 bp) is back to the 2008 level but is still far below the 35 bp recorded in 2007. In the last four years, revenue margins decreased by 16 bp to 83 bp in 2013, reflecting an increased share of UHNW clients. The cost margin also fell by 16 bp as increasing RM loadings and scale optimization served to maintain overall profitability among Asia's offshore wealth managers.

The economics for wealth managers in offshore markets will continue to face challenges. Changes in MIFID II, for example, will see each EU member state settle on new cross-border market access provisions for financial services providers to begin by 2017. Offshore wealth managers need to remain attentive.

In the meantime, wealth managers need to redefine the value proposition for each offshore location in which they operate. Luxembourg, for example, has an advantage over onshore markets through its expertise in structures and tax planning as well as in credit. With Switzerland, the combination of stability, independence, and holistic wealth management service should remain appealing to wealthy clients looking to diversify.

A transformation agenda

Offshore wealth managers face challenges from the narrowing of differences with onshore regimes. But as we have shown there is clear evidence that offshore wealth managers can continue to offer a residual value proposition. But this requires embracing radical decisions to transform operating models. Private banks, in our view, need to act decisively on several fronts.

- **Commit or pull out.** A number of large international banks in all the main jurisdictions – from Switzerland to Asia to Monaco and Luxembourg – are opting to pull out of offering offshore services. The reasons are varied. They range from a lack of scale to poor earnings and growing risk to the broader organization from increasing operational complexity. Additionally, many private banks lack the knowledge and skills to serve an UNHWI base since, until recently, secrecy was the client's chief reason for allocating funds. Yet for wealth managers that recommit to offshore service consolidation and invest in improving capabilities opportunities are likely to beckon.

- **Take action on tax evasion.** Offshore and international private banks need to take radical action on tax evasion and related compliance. This applies to both existing accounts and to new clients. Private banks must also comply with the new regulatory rules even if big differences in the interpretation of rules (such as on client acquisition, mandates, and products that can be offered to clients from countries where private banks are not allowed to travel) as well as the service delivery model mean that players should look to keep options open.

- **Target with precision.** Wealth managers can no longer serve all clients with a single approach. Existing clients have faced reviews and retrospective action on existing portfolios, whereas new ones are subject to even stronger compliance provisions. To handle the growing complexity, wealth managers need to be more selective on the locations of their booking centers, especially the number of client domiciles to serve and the priority client segments to cover, such as European entrepreneurs or the emerging-market wealthy. Many large private banks have cut the number of countries served by their offshore centers from over 100 to 40.

- **Upgrade capabilities.** Offshore private banks need to be much more competitive in how they target specific geographic markets and customer segments. This involves a big culture shift for many offshore banks. The evolution towards more wealthy clients means that frontline personnel, including RMs and product specialists, need to upgrade their skills in order to cater for the specific needs of UHNW customers. For some offshore banks this will require more active client acquisition models as well as developing streamlined client onboarding to help maintain profitability with lower-margin affluent customers.

- **Leverage group.** Increasingly fierce competition means that the traditional split between onshore and offshore operations in the same private-banking group is no longer sensible. Private banks that are able to promote an offshore value proposition across their broader network will win referrals, boosting inflows and profits. Similarly, private banks should look to better coordinate communication and training across both offshore and onshore operations. Affluent clients that opt to go onshore should be given assistance to stay in the broader group.

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A few players are well advanced in making these changes while many others are still defining priorities. We are seeing how the new regulatory and commercial realities are forcing private banks and wealth managers to reinvent how they operate. Yet the uncertainty about where all of this will end up makes it vital for a firm to act with agility and make choices that conserve its options.

Embrace the digital revolution: a global call for wealth managers

Wealth managers face a wake-up call on digital. Reputation, brand recognition, and investment competence can buy time for established players. But to win market share from traditional rivals and battle the new digital attackers, wealth managers must become digital themselves – both in how they operate and how they interact with clients. The digital imperative is a product of the service requirements of a new generation of clients and the evolving demand of traditional clients for more remote interaction. It spans traditional everyday banking activities as well as more advanced products and services.

The urgency to act is growing. Compared with other industries, banks have lagged in the adoption of digital innovation to complement or provide an alternative to traditional processes and services. Private banking is no exception. Some clients are becoming increasingly self-directed in making investment decisions; they are seeking better online service, including a broader choice in digital wealth management products. Coupled with rising customer demand for a smoother online interface is the continuing pressure on the profitability of most wealth managers. For the vast majority of wealth management firms the best strategy is to speed cost reduction efforts in order to fund digital investment and maintain profits. We believe this will put wealth managers in a strong position to manage digital change as it begins to accelerate.

Imperatives for wealth managers

To make digitization work efficiently wealth managers have to deliver on several things simultaneously. This makes digitization a significant challenge for most players.

Getting the cross-channel approach right is a significant opportunity

On the most basic level, wealth managers need to provide a robust, coordinated and client-friendly multichannel experience. More wealth management direct products and services will be required, including – among others – transactional banking, account integration, portfolio management as well as access to research and client-to-client social media connectivity. There will also be more sophisticated “advice light” offerings in the fast-growing digital guidance-only segment. Yet personal contact to build lasting relationships with private bank advisors will remain indispensable for the majority of wealthy individuals, even if remote, digital interaction increasingly complements and deepens the connection.

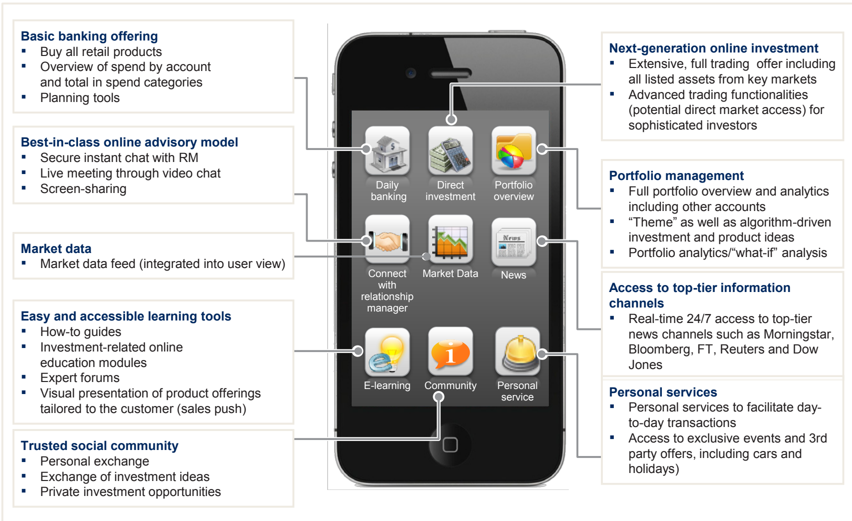
Fully mastering how to offer a multichannel experience also provides an opportunity for most private banks to drive down the cost of conducting business with customers. Here the key building blocks are the digitization of traditional banking processes (for example, account opening and onboarding) where automation can make a big impact on efficiency. A major part of this lies in empowering clients to directly handle more tasks and activities through digital channels (including qualification and risk profiling, and using easily accessible learning tools).

Getting the cross-channel approach right is a significant opportunity. Winning players will be able to shift a large proportion of low-value-add interaction to online channels, freeing up valuable commercial time, and reducing manual back- and middle-office work, and with it overall operational risk. This is particularly true for affluent and low-end HNW customers.

For the HNW segment, digital offers a dual opportunity. First, with traditional HNWs embracing online service, aggressive wealth managers with innovative digital offers have an opportunity to attract new clients by differentiating themselves from laggards. Indeed, the range of evolving products and services is very powerful (Exhibit 20). Second, digital offers the chance to boost the satisfaction of existing and new clients with smoother customer journeys, less subject to the glitches and boilerplate explanation pages that plague most service offerings.

EXHIBIT 20

The digital products and services wealth managers can offer



SOURCE: McKinsey Digital Wealth Management Service Line

But first each wealth manager must decide which digital models suit it best and avoid a "one size fits all" approach. We think wealth managers need to focus on how best to handle quickly evolving and widely differing client expectations, while integrating self-directed models with all the other channels to make the overall client relationship more consistent.

How to succeed in digital wealth management

Wealth managers have been relative laggards in digitization. That may, however, be an advantage since there are no clear winners and arguably no winning strategy is yet apparent.

A variety of mostly online-only attackers have targeted the wealth management sector with offers focusing mostly on nifty and modern designs, but with no clear step change in the client experience. They lack brand legitimacy and a sufficiently compelling product proposition. Moreover, the bricks-and-mortar presence offering the "human touch" most clients still look for in a wealth manager is also absent.

Among incumbents, meanwhile, we see mainly a patchwork of initiatives. Investment is happening in what might be best described as random functions with limited coordination. However, a number of private banks are shifting up a gear and moving towards a more optimized client experience. This is particularly true with some universal banks leveraging their retail banking know-how.

Our experience suggests that being successful in digital requires a number of qualities. Having the right strategy is important, but implementation is likely to be a complicated task. In particular, a high level of cross-bank coordination is required to link prioritization (particularly of customer journeys), resource allocation, collaboration, and execution. For many wealth managers, capabilities will need to be strengthened in order to drive and execute a digital strategy.

Above all, digitization requires an adaptive culture that embraces trialing and continual rapid modification. The focus needs to go well beyond just protecting sources of value for the wealth manager, but instead concentrate on creating value for customers and RMs. In addition, we think that inculcating a “start-up” culture can go a long way towards preparing wealth managers for future shifts in the market.

The dynamic nature of the digital organization is reflected in rapid technology development and agile delivery. Speed and agility are more important than absolute precision. The rapid test-and-learn delivery model in a digital operation is radically different from what typically happens in private banks. To succeed in digital transformation, top management must combine stewardship with sustainability, while promoting an aptitude for risk taking and tolerance of failure.

The implications for each functional team – from the back office through to the front – will be substantial. But the outcome in terms of efficiency and flexibility can be highly positive, in particular, for RMs. They will become more oriented to high quality advice, and thus be able to deliver even more value to clients and their firm.

EdgE: End-to-end rapid process digitization

Digitization is no longer something nice to have but an imperative. Yet for institutions with legacy infrastructure and limited digital experience, the burden of meeting these expectations is enormous. Moreover, existing methodologies for transforming operations too often fall short with digitization.

We seek to combine the strengths of each approach, blending a rigorous, end-to-end perspective on key client journeys and processes; advanced IT concepts such as agile software development; and a co-located, cross-functional team structure that quickly builds an organization's digital capabilities. The result is a methodology of end-to-end rapid process digitization ("EdgE") offering a zero-based designed, simple, digital, automated process connected to back-end systems that can be rolled out in just a few months, and that end customers can access on a self-service basis.

Step change benefits come from:

- Customer experience and sales where the creation of customer interfaces makes the product offering available anywhere, anytime.

- Efficiency where significant FTE capacity is freed up through radical redesign, standardization, and digitization of the process.

In addition, EdgE allows a wealth manager to act more flexibly. This is due to a much faster approach to product development and higher process compliance, thanks to the use of best-in-class, simplified and standardized processes, as well as of automation.

The core element of an EdgE transformation is the creation of a multidisciplinary (including frontline personnel), co-located, SWAT team. Its role is to rapidly conduct end-to-end design, testing and delivery of digitized processes.

The results can be dramatic: at one European bank, the time required for opening an account fell from as long as five days to less than fifteen minutes. Processing times for mortgages fell by as much as 90 percent, while the cost per mortgage fell by 60 to 70 percent.

Methodology

McKinsey & Company's annual Wealth Management Survey, first launched in 2002, seeks to provide comprehensive information on the wealth management industry. Thanks to its worldwide coverage the survey represents a global effort comprising all relevant markets: Western Europe, Central and Eastern Europe, the Middle East, Asia, India, Latin America and North America. The total number of banks participating in the survey has increased to more than 170 this year.

This document provides an overview of the latest survey's key findings for all the markets analyzed. The issues it raises are discussed in more detail in other McKinsey publications and at regular events held by McKinsey's Wealth Management Practice.

The participating banks cover a range of sizes and business models, with all geographies well represented. Some 83 percent are private-banking units of universal banks, whereas the other 17 percent are specialist players. Approximately 72 percent operate "onshore," with the remaining 28 percent based in offshore centers. The banks provided detailed economic data based on their 2013 results.

Players allocate revenues and costs within their wealth management operations and between their wealth management activities and parent companies in different ways. But while these differences have been clarified as much as possible through interviews with the participants, some variations may nevertheless remain and may distort the final results. The increased number of participants this year may induce a slight sample bias on occasion, affecting the comparability of this year's results with those of previous years. Sample comparisons have been made where appropriate.

Survey participants are entitled to customized benchmarking and feedback sessions and have access to more detailed information than that presented here, but within the bounds of confidentiality governing the data supplied by individual participants. McKinsey would like to thank everyone who has participated in the 2014 survey for their valuable contributions, which will help us gain a better understanding of the economics surrounding the wealth management industry. The survey will run again in 2015.

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